Recent Developments in Corporations Law – CLERP 9 and the Whistleblower Protection Reforms

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1 Introduction

The *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004* (Cth) ("CLERP 9 Act") was passed by Parliament on 25 June 2004 and proclaimed on 30 June 2004. The CLERP 9 Act came into effect on 1 July 2004, with amendments relating to reporting applying to financial years commencing on or after that date.

The CLERP 9 Act is largely a legacy of recent disastrous high profile corporate collapses (think HIH, OneTel) with some of the reforms reflecting recommendations of the HIH Royal Commission Report and the Ramsay Report on Auditor Independence. Those recommendations were aimed at restoring public confidence in corporate Australia by, *inter alia*, improving disclosure and enhancing auditor independence.

The CLERP 9 reforms are groundbreaking in many respects. One area of reform is the amendment of the *Corporations Act*, 2001 ("the Act") to insert a new Part 9.4AAA entitled "Protection for Whistleblowers." As the name suggests, the new part establishes a framework designed to encourage employees, officers and subcontractors engaged by a company to report suspected breaches of the corporations legislation to either ASIC or through internal company channels.

The purpose of this paper is to provide a summary of the whistleblower provisions introduced by CLERP 9 and to discuss the background to the new provisions. As well, the paper briefly examines some of the perceived deficiencies of the new provisions.

2 Overview of the Reforms

The CLERP 9 Act introduced reforms to a number of areas. Reforms were made in the following areas, *inter alia*:

- Executive Remuneration;
- Financial Reporting;
- Increased Shareholder Participation;
- Disclosure;
- Audit Reform;
- The revision of some criminal penalties;
- Management of conflicts of interest by financial services licensees.

3 Background to the Whistleblowing provisions

Since the early 1990s there has been increasing recognition in Australia of the importance of an effective whistleblowing regime in exposing wrongdoing and encouraging desirable conduct. It has now become widely accepted that individuals who make disclosures serve the public interest by assisting in the elimination of fraud, impropriety and waste. As evidence of acceptance of this view, one need only look to the various whistleblower legislation enacted by state governments in Australia in the past decade.[1]

Up until now however, whistleblower legislation has been directed only towards the public sector. Because of its applicability to the private sector, the whistleblowing provisions of CLERP 9 are in many ways groundbreaking.

4 Why a corporate whistleblower regime?

Further impetus for the introduction of a whistleblower regime in the corporate sphere was provided by the most recent spate of corporate collapses. These latest corporate failure have highlighted, yet again, the problems created

[1] All states apart from the Northern Territory have enacted whistleblower legislation. Federal legislation has not yet been passed despite the *Public Interest Disclosure Bill 2001 [2002]*. That Bill was never passed by the Senate. For an overview various legislation see Appendix 5 to Finance and Administration Legislation Committee, *Public Interest Disclosure Bill 2001 [2002]*, September 2002.

by a culture of corporate silence which allows wrongdoing to go undetected.[2] As the Treasurer and Parliamentary Secretary to the Treasurer said in September 2002 whilst announcing CLERP 9:

> "There have been a number of instances of unacceptable corporate behaviour in Australia and overseas and it is important that those who choose to circumvent effective ethical practice and legislative standards are deterred and appropriately dealt with."

In the United States, one of the corner-stones of the Sarbanes-Oxley Act 2002 (which has been quite influential on corporate regulation in Australia) is its reliance on a whistleblowing regime as a new means of combating corporate crime. That Act protects public company employees in circumstances where they lawfully disclose information about corporate fraud or assist criminal investigators in detecting fraud.

5 Early Days – Treasury Policy Proposal Paper

In September 2002, Treasury issued a policy proposal paper in which it outlined the framework for the whistleblower scheme in broad terms. After referring to the Sarbanes-Oxley Act, the paper went on to describe proposal number 35 in the following terms:

> "The Government will amend the law to provide qualified privilege and protection against retaliation in employment for any company employee reporting to ASIC, in good faith on reasonable grounds, a suspected breach of the law."

As can be seen, Treasury's intention was quite specific in that the proposed legislation would be drafted so as to facilitate employees assisting ASIC with its enforcement activities. This narrow scope for reporting however was thought overly restrictive by many (including ASIC). ASIC for example suggested that employees needed to have the confidence of raising matters with directors and auditors of the company.[3]

Curiously, the expression "whistleblower" was not used in the policy proposal paper.

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[2] Parliamentary Joint Committee on Corporations and Financial Services, *CLERP (Audit Reform and Corporate Disclosure) Bill 2003*, June 2004 at paragraph 2.5.

[3] ASIC, *Submissions on CLERP 9*, November 2002 at paragraph 5.19.

6 The Whistleblower Regime

CLERP 9 amends the Act by introducing a new "Part 9.4AAA Protection for Whisltleblowers." The Part has five substantive sections:

- Section 1317AA – Disclosures qualifying for protection;
- Section 1317AB – Disclosure that qualifies for protection not actionable;
- Section 1317AC – Victimisation Prohibited;
- Section 1317AD – Right to Compensation;
- Section 1317AE – Confidentiality requirements for company, company officers and employees and auditors.

7 Section 1317AA – Disclosures qualifying for protection;

To qualify for protection a disclosure of information must satisfy the following conditions.

The "discloser" must be either:

- An officer of a company;
- An employee of a company;
- A person who has a contract for the supply of services or goods to a company; or
- An employee of a person who has a contract for the supply of services or goods to a company.

The "disclosure" is made to:

- ASIC;
- The company's auditor or a member of an audit team conducting an audit of the company;
- A director, secretary or senior manager of the company; or
- A person authorised by the company to receive disclosure of that kind.

The following additional conditions also need to be satisfied:

- The discloser informs the person to whom the disclosure is made of the discloser's name before making the disclosure; and
- The discloser has reasonable grounds to suspect that the information indicates that the company has, or may have, contravened a provision of the Corporations legislation or an officer or employee of the company has, or may have, contravened a provision of the Corporations legislation; and
- The disclosure makes the disclosure in good faith.

7.1 Commentary

The expression "company" is not defined in Part 9.4AAA so presumably the Part applies to both public and proprietary limited companies. This is in contrast to Sarbanes-Oxley where the whistleblower provisions apply only to public companies.

Protection is only afforded to a limited class of persons. It remains to be seen whether this class of persons is overly restrictive and may prevent other persons who do not fit within the class from disclosing information. For example, one can imagine officers and employees of company subsidiaries acquiring information of corporate wrongdoing. Under the current provisions disclosure of information by such persons if they are not an employee, director or officer of the company to whom the information relates would not be protected.

Only contraventions of the Corporations legislation will attract protection. "Corporations legislation" is defined in section 9 of the Act to mean the Act, the ASIC Act and certain rules of Court. This restriction has been criticised as unrealistic by the Parliamentary Joint Committee[4] given that a company has a whole host of other legislative requirements to comply with.

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[4] See footnote 2.

The "reasonable grounds" standard is presumably an objective one determined on the basis of a reasonable person in the circumstances with the complainant's experience and training.[5] It will be interesting to see how the Courts construe and apply the reasonable grounds test particularly in cases where subsequent investigation reveals a complainant was wrong.[6]

The expression "good faith" is not defined - what constitutes "in good faith" of course is open to interpretation and potentially problematic. The purpose of the good faith requirement is to deter spurious disclosure. According to the commentary on the exposure draft of CLERP 9 released by Treasury on 8 October 2003:

> "The use of 'good faith' is intended to raise the threshold for obtaining qualified privilege. This is considered appropriate given the need to discourage malicious or unfounded disclosures being made to ASIC. Where a person has a malicious or secondary purpose in making a disclosure, it is considered that the good faith requirement would not be met."

From the above it is clear that the *motivation* of the discloser will be a relevant factor in determining whether or not the person has made the disclosure in good faith. Prior to the enactment of CLERP 9 the good faith test was widely criticised as undermining the effectiveness of the legislation. Many commentators thought that motivation and intention of the discloser was irrelevant and what mattered was the veracity of the allegations.[7] The Parliamentary Joint Committee went so far as to recommend that the good

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[5] As was the case in the United States decision of *Minard v Nerco Delamar Co.,* 92-SWD-1, Sec'y (Jan. 25, 1994).

[6] In the United States it has been held that a belief activity was illegal may be reasonable even when it was later revealed that the complainant was wrong. For example, cases under the Surface Transportation Assistance Act (US) have held that a complainant's opposition to an employer's acts that the complainant reasonably believes violate the law is protected, even if investigation reveals the employer did not breach the law. This is so even where the employer never did what the employee complained about or where the employer's actions were legal: *Clean Harbors Environmental Services v Herman*, 146 F.3d 12, (1st Cir. 1998).

[7] Dr Longstaff's comments of the St James Ethics Centre were indicative of the attitude of many commentators: "… there are facts about things that occur, which can be checked and validated and. Therefore, determined as being true, and that their truth does not depend on what the intention of the person who spoke the truth happened to be. In that sense, it is reasonable to make that sensible distinction between the two."

faith test be removed and be replaced with an "honest and reasonable belief test."[8]

In contrast to Sarbanes-Oxley, disclosures cannot be made anonymously – the discloser must disclose his or her name before making a disclosure. This is so notwithstanding the very strong recommendation from the Parliamentary Joint Committee to allow for anonymous whistleblowers.[9]

8 Section 1317AB – Disclosure that qualifies for protection not actionable

Upon satisfying the conditions set out in section 1317AA, a person (the discloser) will be subject to the protections outlined in section 1317AB. The protections are as follows:

- The person is not subject to any civil or criminal liability for making the disclosure;
- No contractual or other remedy may be enforced, and no contractual or other right may be exercised, against the person on the basis of the disclosure;
- The person has qualified privilege in respect of the disclosure;
- A contract to which the person is a party may not be terminated on the basis that the disclosure constitutes a breach of contract.

An employee also has the added protection of being reinstated into their previous position if that employee makes a disclosure that qualifies for protection under Part 9.4AAA. In certain circumstances a Court may order that the employee be reinstated in their former position or at a position at a comparable level.

8.1 Commentary

The following brief points can be noted in relation to section 1317AB:

- Section 1317AB(1) does not protect a person from liability for any illegal act or wrongdoing in which they have been involved;

[8] At paragraph 2.64.

[9] Paragraph 2.78.

- There are no specific sanctions for a person who makes a false disclosure. However, a person who knowingly provides false or misleading information to ASIC may be guilty of an offence under Division 137 of the *Criminal Code Act* 1995. Also, any malicious or unfounded disclosure would unlikely be protected because the good faith requirement would not be met;
- The expression "comparable level" is not defined and will obviously be subject to interpretation.

9 Section 1317AC – Victimisation Prohibited

Section 1317AC provides civil and criminal sanctions against persons who actually cause detriment to a "discloser" or threaten to cause detriment to a discloser.

A person (the first person) contravenes subsection 1317AC(1) if:

- The first person engages in conduct; and
- The first person's conduct causes any detriment to another person (the second person); and
- The first person intends that his or her conduct cause detriment to the second person; and
- the first person engages in his or her conduct because the second person or a third person made a disclosure that qualifies for protection under this Part.

A person contravenes subsection 1317AC(2) if:

- the first person makes to another person (the second person) a threat to cause any detriment to the second person or to a third person; and
- the first person intends the second person to fear that the threat will be carried out or is reckless as to causing the second person to fear that the threat will be carried out; and
- the first person makes the threat because a person makes a disclosure that qualifies for protection under this Part or may

make a disclosure that would qualify for protection under this Part.

A threat may be express or implied or conditional or unconditional. Officers and employees involved in the contravention are also guilty of an offence: subsection 1317AC(3). In a prosecution for an offence against subsection (2), it is not necessary to prove that the person threatened actually feared that the threat would be carried out: subsection 1317AC(5).

Where a person contravenes subsection 1317AC(1), (2) or (3) they will commit an offence and may be subject to a penalty of up to 25 penalty units and/or 6 months imprisonment.

9.1 Commentary

The expression "detriment" or "threat to cause to any detriment"[10] is not defined however the Explanatory Memorandum to the CLERP 9 Bill states that the detriment contemplated includes[11] the termination of employment, a reduction in a person's terms and conditions of employment, demotion, or unfair or unequal treatment in the workplace.[12]

It remains to be seen whether cases decided under other whistleblower legislation will be relied upon to assist in the interpretation of "detriment" and indeed the entirety of Part 9.4AAA.

It is likely that in most cases brought under this section, there will be little or no direct evidence of a person's motivation in engaging in conduct that causes

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[10] In *Berry v Ryan*, [2001] ACTSC 11 Crispin J in interpreting a similar provision under the *Public Interest Disclosure Act*, 1994 (ACT) said that "… a threat normally consists of a declaration of an intention to punish or to hurt someone and I think that … conduct that "threatens to cause detriment" must mean conduct that reflects an intention.

[11] Query whether "detriment" extends to personal injury and if so, whether a plaintiff would need to satisfy the requirements of any worker's compensation legislation: see for example *Reeves-Board v Queensland University of Technology* [2002] 2 Qd R 85.

[12] Under the *Queensland Whistleblowers Act*, 1994 for example detriment is defined as including personal injury or prejudice to safety, property damage or loss, intimidation or harassment, adverse discrimination, disadvantage or adverse treatment about career, profession, employment, trade or business, threats of detriment and financial loss from detriment. See also section 20 of the New South Wales *Protected Disclosure Act*, 1994.

detriment to a whistleblower. In the United States, one factor to consider when addressing a plaintiff's allegation of victimisation, is the temporal proximity of the subsequent detriment to the time the company learned of the protected disclosure.[13]

Section 1317AC raises a number of other issues, inter alia:

- The expression "engage in conduct" is not defined;
- Who is to actually enforce protection? The section is unclear as to whether ASIC (or any other person receiving the information) has any role to play in preventing victimisation;
- The penalty imposed for a contravention of the subsection is relatively light. For example, Sarbanes-Oxley imposes penalties of up to ten years imprisonment.

10 Section 1317AD – Right to Compensation

Compensation is available to a victim who suffers damage as a result of a person contravening either subsection 1317AC(1), (2), or (3). No guidance however is given as to how a Court should quantify such compensation.[14] In addition to section 1317AC, victims would also be entitled to injunctive relief (including mandatory injunctions) under section 1324 of the Act.

In the United States, some jurisdictions have recognised that compensatory damages for such harm as impairment of reputation, humiliation and mental anguish may be appropriate.[15]

11 Section 1317AE – Confidentiality requirements for company, company officers and employees and auditors.

Section 1317AE imposes confidentiality obligations on company officers and the company when receiving information subject to protection. A person ("the

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[13] *Jackson v Ketchikan Pulp Co.,* 93-WPC-7 and 8 (Sec'y Mar. 4, 1996). Findings on causation based upon temporal proximity have ranged from two days (*Lederhaus v Donald Paschen & Midwest Inspection Service, Ltd.,* 91-ERA-13 (Sec'y Oct. 26, 1996) to about one year (*Thomas v Arizona Public Service Co.,* 89-ERA-19 (Sec'y Sept. 17, 1993).

[14] Under some state government whistleblower legislation, damages are recoverable in an action as for a tort, for example in the ACT and Queensland.

[15] *Smith v Esicorp*, ARB Case No. 97-065, ALJ Case No. 93-ERA-16 ARB Dec. (August 27, 1998).

offender”) is guilty of an offence under this section if they disclose information provided by a whistleblower in certain circumstances.

Only the following persons may be an “offender” under this subsection:

- The company’s auditor or a member of an audit team conducting an audit of the company;
- A director, secretary or senior manager of the company;
- A person authorised by the company to receive disclosures of the kind referred to in Part 9.4AAA;
- The company;
- Any officer or employee of the company.

The offender must also be either to whom the qualifying disclosure is made or a person to whom the confidential information is disclosed in contravention of section 1317AE and the offender knows that the disclosure of the of the confidential information to the offender was unlawful or made in breach of confidence.

The “confidential information” subject to the prohibition is any of the following:

- The information disclosed in the qualifying disclosure;
- The identity of the discloser;
- Information that is likely to lead to the identification of the discloser.

The confidential information may be disclosed however to ASIC, APRA or a member of the Australian Federal Police.

12 The whistle is blown – what next?

The new provisions are to be welcomed for conferring protection on whistleblowers and for creating an offence for a person causing or threatening to cause detriment to a whistleblower. Unfortunately, part 9.4AAA says

nothing about what procedures are to be adopted when a party receives a disclosure of information.[16]

In particular, the new part does not impose any obligation on a company to put in place systems, processes and procedures for dealing with a report. As the Parliamentary Joint Committee noted:

> "The … legislation is silent on the obligation on companies to put in place a reporting system. It leaves open the question about whether companies should be required to establish a reporting regime that sets in place procedures to facilitate the disclosure of information and to deal with the disclosure as soon as practicable. There is no mention of how a company or indeed whether a company is required to assist and provide information to a person contemplating making a report."

The release of Australian Standard 8004-2003 may provide at least some guidance in relation to the above issue. The standard contains practical steps and suggestions on establishing a whistleblower protection program.

It is unclear as to why Parliament chose not to impose obligations to put in place appropriate procedures. This is in stark contrast to the Sarbanes-Oxley Act (upon which the whistleblower reforms seem to have been inspired). Under Sarbanes-Oxley, (public) companies must have the following processes and procedures in place:

- Companies are required to have a venue in place to receive the reports of anonymous whistle-blowers: Section 302 of Sarbanes-Oxley for example provides: "Each audit committee shall establish procedures for the confidential, anonymous submission by employees of the issuer of concerns regarding questionable accounting or auditing matters."
- After receiving a report, any investigation conducted must comply with section 806: "no publicly traded company, or any officer, employee, contractor, subcontractor, or agent of such company may discharge, demote, suspend, threaten, harass, or in any other manner discriminate

[16] Information provided to ASIC in confidence is generally subject to the confidentiality provisions contained in section 127 of the *Australian Securities and Investments Commission Act*, 2001. See also ASIC Policy Statement 103 "Confidentiality and Release of Information."

against an employee in the terms and conditions of employment because of any lawful act done by the employee."

It is also unclear as to whether any regulations will be enacted to resolve this issue or whether ASIC will issue any policy guidance in relation to Part 9.4AAA.[17]

13 A sign of things to come? Sarbane-Oxley Whistleblower decisions in the United States

The Sarbanes-Oxley Act was enacted on 30 July 2002 and to date the whistleblower provisions of that Act have been the subject of a significant amount of litigation.

13.1 *Welch v Cardinal Bankshares*

One of the first cases involving the whistleblower provisions of Sarbanes-Oxley was the decision of *Welch v Cardinal Bankshares Corp.*, 2003-SOX-15 (ALJ January 28, 2004).

In *Cardinal Bankshares*, the complainant, Mr Welch, was employed as the company's chief financial officer. For a period of about six weeks Welch reported to the CEO and other senior personnel a number of concerns regarding the company's financial statements and procedures (including suspected insider trading). Welch refused to certify company financial reports because of his concerns. The company requested Welch meet with an audit committee but insisted on him not being legally represented. Welch refused and the company fired him.

Welch filed his complaint with an administrative body (as the administrative procedure of the Act's regulation require). To succeed in a Sarbanes-Oxley whistleblower complaint a complainant must establish on the balance of probabilities that:

1) the employee engaged in "protected activity" as defined by the Act;

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[17] As at the date of this paper, ASIC has released an Information Sheet dated 11 January 2005.

2) the employer was aware of the protected activity;

3) the employee suffered an adverse employment action; and

4) circumstances exist that are sufficient to raise an inference that the protected activity was likely a "contributing factor" in the unfavourable action.

The administrative body declined to rule in Welch's favour. Welch appealed to the United States Department of Labor, Office of Administrative Law Judges ("the ALJ"). The company adduced evidence to the effect that it terminated Welch's employment solely because of Welch's insubordination in refusing to meet with the audit committee without a lawyer and not for his whistleblowing. The company also argued that Welch's activities did not constitute "protected activity" because Welch could not have reasonably believed that his allegations of wrongdoing by the company were true.

Judge Stephen Purcell held that for the alleged retaliatory conduct to be actionable under Sarbanes-Oxley, Welch need not show that the company actually contravened the law but only that Welch had "reasonably believed" the company had contravened the law and that his employment was terminated because he had engaged in activity in support of that belief.

In determining that Welch's protected activity was likely a contributing factor in his termination, Judge Purcell relied almost exclusively on the proximity in time between Welch's first complaint and his termination (about two months). The Court found that the company's requirement that Welch attend the meeting without legal representation was "arbitrary" and that it was "clearly imposed for the purpose of using Welch's anticipated refusal to comply as a pretext for firing him." The Court accordingly ordered that:

- Welch be reinstated as CFO;
- His personnel file be purged of all references to his engaging in protected activity;
- The company be required to pay to Welch backpay.

13.2 *Jayaraj v Pro-Pharmaceuticals*

In *Jayaraj v Pro-Pharmaceuticals*, 2003-SOX-00032, (ALJ 11 February 2005) the applicant (Jayaraj) sued her former employer, a small publicly traded start-up biotechnology firm for breaches of the whistleblowing provisions. Mrs Jayaraj who was primarily responsible for directing and managing the company's fund raising efforts, alleged that the company was using a Mr Mottel as an unregistered broker to bring in investors for a commission in breach of Federal securities laws. After becoming aware of the suspected contraventions, Ms Jayaraj directed the Chief Operating Officer to turn Mr Mottel's file over to the company's auditors which the COF failed to do. Ms Jayaraj also refused to attend a meeting with Mr Mottel's referrals. Ten days later Ms Jayaraj was fired.

Ms Jayaraj was successful in her claim against Pro-Pharmaceuticals for breach of the whistleblower provisions of Sarbanes-Oxley. Pan-Pharmaceutical were ordered to pay Ms Jayaraj's legal costs and also ordered Pan-Pharmaceutical:

- To remove any and all reference to Ms Jayaraj's termination from its records;
- To report that Ms Jayaraj's performance was satisfactory in response to inquiries regarding Ms Jayaraj's employment.

14 Conclusion

Part 9.4AAA is a much needed step in corporate regulation in Australia. The new provisions will no doubt encourage some people to "blow the whistle" on corporate wrongdoing where previously they may have been reluctant to do so for fear of reprisal. It is the writer's view however that there are a number of deficiencies in the legislation that may hinder the efficacy of the new provisions. There is also some uncertainty as to precisely how the provisions are to operate. It is suggested that to overcome some of the uncertainties surrounding the interpretation and application of Part 9.4AAA Corporations regulations be introduced and ASIC issue appropriate policy.