DIRECTORS AND OFFICERS: PERFORMANCE OF DUTIES IN THE CONTEXT OF CONTINUOUS DISCLOSURE

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1. INTRODUCTION
   (a) Performance by directors and officers of their statutory duties in the context of company compliance with continuous disclosure obligations has been the subject of scrutiny by the Courts recently at the instigation of the Australian Securities and Investments Commission (ASIC).

   (b) The Courts have been asked to determine whether company directors and officers conduct has satisfied the statutory duties imposed on them in relation to releases provided to the Australian Stock Exchange (ASX) which have been asserted to be misleading and deceptive, or likely to mislead or deceive.

   (c) This paper reviews the statutory framework of primary legal obligations owed by directors and officers and then examines the decisions made by the Courts in the ASIC v Fortescue Metals Group Ltd, James Hardie Industries NV v ASIC, Morley v ASIC and Morley v ASIC (No.2) / Shafron v ASIC (No.2) in respect to performance of directors and officers in those respective companies.5

   (d) No attempt has been made to comment on every issue raised in these cases. Specific observations made by the Courts relating to director and officer conduct which provide guidance as to how directors and officers can be seen to perform, or fail to perform, their duties is the focus of this paper.

2. LEGAL OBLIGATIONS ON DIRECTORS

2.1 Directors Duties
   (a) The statutory duties imposed on directors and officers under the Corporations Act 2001 (Cth) (Corporations Act) have been canvassed in depth elsewhere and it is not proposed to review this area in any detail in this paper.

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3 [2010] NSWCA 331.
4 [2011] NSWCA 110
5 The author takes responsibility for the content of this paper but notes that this paper is general discussion only on specific issues arising from the respective cases. No advice is provided. Consideration of the application of these cases to other specific factual circumstances should be undertaken with care and reference to the full judgements. The author would also like to thank Jessica Patrick, Katrina Mawer and Owen Wadley for their assistance with this paper.
(b) The principal duties can be found in sections 180 to 184 inclusive of the Corporations Act being duties to:

(i) exercise care and diligence in the exercise of their powers and discharge of their duties;  
(ii) exercise their powers and discharge their duties in good faith in the best interests of the company and for a proper purpose;  
(iii) not improperly use their position to gain an advantage for themselves or someone else or cause detriment to the company;  
(iv) not improperly use the information obtained because they are a director or officer to gain an advantage for themselves or someone else or cause detriment to the company;  
(v) act recklessly or intentionally dishonestly to fail to act in good faith in the best interests of the company or for a proper purpose to discharge their powers and duties;  
(vi) act dishonestly with the intention to gain an advantage for themselves or someone else or cause detriment to the company;  
(vii) obtain information dishonestly with the intention to gain an advantage for themselves or someone else or cause detriment to the company.

(c) These duties set the framework for directors and officers in the performance of their respective roles.

2.2 Continuous Disclosure

(a) Continuous disclosure requirements apply to both listed and unlisted entities pursuant to sections 111AP, 674 and 675 of the Corporations Act.
(b) A listed disclosing entity is required to disclose information that has a substantial effect on the value or price of the entity’s “enhanced disclosure securities”, otherwise known as “ED securities”, or more generically “securities”.

(c) A listed disclosing entity is defined as a disclosing entity whose ED securities are “quoted”.\(^{15}\)

(d) The listed entity falls under the disclosure requirement if the "listing rules"\(^{16}\) of a "listing market"\(^{17}\) require the entity to "notify the market operator of information about specified events or matters as they arise for the purpose of the market operator making the information available to participants in the market".\(^{18}\)

(e) The obligation imposed on entities is to adhere to the provisions of the listing rules by notifying the listing market of information which meets the following two conditions:

   (i) the information is not "generally available".\(^{19}\) Information is described as "generally available" if it contains readily observable matter and is made known in a reasonable time by a means that would likely bring it to the attention of parties who may commonly invest in securities of a kind whose value or price may be affected this information or if it consists of "deductions, conclusions or inferences" made from these types of information mentioned here.\(^{20}\)

   (ii) a “reasonable person” would expect his information to have an effect on the value or price of the entity’s ED securities.\(^{21}\)

(f) The obligations of continuous disclosure presume a contravention of a primary listing rule.\(^{22}\)

(g) ASX Listing Rule 3.1 provides that a listed entity must notify ASX of information concerning the entity and which a reasonable person believes would have an effect

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\(^{14}\) Dr D. Morrison, Continuous disclosure requirements apply to listed and unlisted disclosing entities. (The Laws of Australia, Australia: 2007).

\(^{15}\) ss 111AE, 111AL(1), 111AM Corporations Act.

\(^{16}\) s 9 Corporations Act (definition “listing rules”).

\(^{17}\) s 111AE(1), (1A) Corporations Act.

\(^{18}\) s 674(1) Corporations Act. Where the listing rules of a particular market do not contain these provisions. s 674(1) Corporations Act, the entity is still bound by the unlisted disclosing entity requirements. s 675(1) Corporations Act

\(^{19}\) s 674(2)(c)(i) Corporations Act

\(^{20}\) s 676(2), (3) Corporations Act

\(^{21}\) s 674(2)(c)(ii) Corporations Act. s 1042A Corporations Act (definition of “information”). It should also be noted that the fault elements under the Criminal Code (Cth) apply and are not present in the Corporations Act. Corporations Act 2001 (Cth), ss 678, 1311, Criminal Code (Cth), Ch 2. These provisions draw on the insider trading provisions, however are narrower, such as the definition of “information”.

\(^{22}\) ASX Listing Rules r 3.1.
on the value or price of the company’s securities; however exceptions do apply such as when the information is confidential.  

(h) In regards to unlisted disclosing entities, defined as those which are unlisted disclosure requirements still apply again regarding any information that may have an effect on the value or price of the entity’s “ED securities”.

(i) The obligations set out that as soon as practical an unlisted entity must disclose information that is not “generally available” to ASIC.

(j) The purpose of these obligations are to ensure the efficiency and integrity of the securities market as all participants are entitled to be informed about market trading.

2.3 Misleading and Deceptive Conduct

(a) Obligations in relation to misleading and deceptive conduct are imposed on directors by sections including, 1041H of the Corporations Act, and section 12DA of the Australian Securities and Investments Commission Act 2001 (Cth) (ASIC Act).

(b) Section 1041H of the Corporations Act prohibits conduct that is in relation to financial products or services, that is misleading or deceptive or is likely, to mislead or deceive.

(c) A ‘financial product’ is defined as a facility through which a person makes a financial investment, manages a financial risk or makes a non-cash payment. In addition, certain items are specifically identified as financial products in the Corporations Act. These include securities, derivatives, superannuation...
interests\textsuperscript{34} and debentures, stocks or bonds issued, or proposed to be issued, by the Government.\textsuperscript{35}

(d) ‘Financial services’ include, but are not limited to, functions that provide financial product advice,\textsuperscript{36} deal in a financial product\textsuperscript{37} or make a market for a financial product.\textsuperscript{38}

(e) Section 12DA of the ASIC Act operates alongside section 1041H of the Corporations Act. It states that:

\begin{quote}
‘a person must not, in trade and commerce, engage in conduct that in relation to financial services that is misleading or deceptive, or is likely to mislead or deceive’.\textsuperscript{39}
\end{quote}

(f) The purpose of these pieces of legislation is to protect the public from statements by directors that mislead or deceive, or are likely to mislead and deceive or misstate a situation.

(g) The following cases are examined in light of the respective Court findings on the performance of the directors and officers of their statutory duties and obligations.

3. **ASIC v FORTESCUE METALS GROUP LTD**

3.1 **Facts**

(a) Fortescue Metals Group (FMG) is a minerals exploration group based in Western Australia, led by Mr Andrew Forrest (Forrest) in his capacity as chairman and CEO.

(b) This case arose from events surrounding a mining project known as the Pilbara Infrastructure Project (Project) in 2004 and 2005.

(c) The Project was to consist of a mine in the Pilbara region, a port at Port Hedland, and a railway to connect the mine to the port.

(d) In early 2004, negotiations were entered into with three Chinese companies, China Metallurgical Construction Group Corporation (CMCC), China Harbour Engineering...
Company (CHEC) and China Railway Engineering Corporation (CREC) (collectively the Chinese companies), in relation to construction of the three parts of the Project.

(e) Subsequent to those negotiations, separate agreements were entered into with each of the Chinese companies that were known as ‘Framework Agreements’. Each of the Framework Agreements in its recitals stated in terms similar to the CREC agreement:

“CREC has represented that it has the necessary skills, personnel and equipment to successfully carry out and complete the Build and Transfer of the railway (the “Works”) for the Pilbara Iron Ore and Infrastructure Project (the “Project”) and the FMG is relying on the CREC’s representation.

CREC, having closely examined all the proposed documents, has submitted an offer to execute the Works and the FMG has accepted the CREC’s offer and the parties now wish to evidence their agreement.”

(f) The operative parts of each of the Framework Agreements however stated that the parties “would jointly develop and agree” on amongst other things, general conditions of contract, scope of works, and the value of the works.

(g) Following the signing of the first agreement on 6 August 2004, FMG requested a trading halt of its shares on the ASX and then released information about the Project to the ASX. These releases and subsequent media comment by Forrest, stated:

“Fortescue Metals Group Ltd (FMG) is pleased to announce that it has entered into a binding contract with China Railway Engineering Corporation (CREC) to build and finance the railway component of the Pilbara Iron Ore and Infrastructure Project.

The “Build and Transfer” (BT) contract covers the railway from the Company’s iron ore tenements in the Chichester ranges to the export hub at Port Hedland. The contract covers all earthworks, culverts, bridges, rail, sleeper and rolling stock

40 At [17].
41 At [17].
requirements, with the exception of locomotives which will continue to be sourced internationally and may form an addition to this agreement”. 

(h) Similar requests and releases were made following the execution of the remaining two framework agreements in November 2004.

(i) Sizeable variations to FMG’s share price occurred in the periods immediately following the releases by FMG to the ASX.

(j) In March 2005, an article was published by the Australian Financial Review (AFR Article) which asserted that the Framework Agreements with each of the Chinese companies were not legally binding. As a result, the share price in FMG fell, however, at the time of this hearing the share price had recovered and was higher than it had been before the release of the AFR Article.

(k) ASIC initiated proceedings against both FMG and Forrest in March 2006. ASIC alleged that:

(i) FMG had engaged in misleading and deceptive conduct under section 1041H of the Corporations Act and under section 52 of the Trade Practices Act 1974 (Cth) (TPA), and had breached section 674(2) of the Corporations Act; and

(ii) Forrest had breached sections 180 and 674(2A) of the Corporations Act by allowing FMG to breach legal requirements and be exposed to penalties, thereby breaching his duty of care and diligence to the company.

(l) At first instance, ASIC’s case was rejected by the trial judge, which led to the appeal before the Full Court of the Federal Court of Australia.

3.2 Issues

(a) ASIC in its appeal raised the following points:

(i) that the trial judge erred in treating FMG public statements as statements of opinion as opposed to fact; \(^{43}\)

(ii) that the trial judge erred in his failure to appreciate FMG’s public statements about the framework agreements were misleading in describing them as

\(^{42}\) At [23].

\(^{43}\) At [15].
binding contracts for the construction of mine, railway and port when they did not contain agreed terms as price, subject matter or scheduling but provided only for further negotiations with a view to agreement; and

(iii) that the trial judge erred in concluding the opinion which he ascribed to FMG and Forrest was ‘reasonably’ held by them.

3.3 Parties’ Arguments

(a) ASIC’s case rested on assertions that:

(i) 16 public statements made by FMG with respect to the CREC, CHEC, and CMCC framework agreements were misleading in contravention of section 1041H of the Corporations Act.

(ii) the directors of FMG, were in possession of each of the framework agreement, in possession of information, being the terms of those agreements, or ought reasonably have come into possession of information being the effect of those agreements.

(iii) a reasonable person would expect the information in the possession of FMG to have a material effect on the price of value of FMG’s shares because it would influence persons who commonly invest in securities in deciding whether to acquire or dispose of their shares in FMG. On that basis ASIC alleged the statements made were misleading and deceptive in breach of section 674 of the Corporations Act.

(iv) Forrest, as a director of FMG, contravened section 180 of the Corporations Act by allowing FMG to provide the misleading statements to the public, in breach of section 674, thus exposing FMG to pecuniary penalties.

(b) The arguments made by FMG were that:

(i) the framework agreements were binding agreements to build, finance and transfer the infrastructure. Therefore, there was no breach of FMG’s

44 At [86].
45 At [15].
46 At [15].
47 At [10].
48 At [13] and 46.
obligation not to mislead or deceive the investing public and no breach by FMG of its disclosure obligation under s 674 of the Corporations Act;\(^{49}\)

(ii) the statements in the announcements were statements of opinion only and not fact, on the likely effect of the framework agreements and as such were reasonably held as each of the Chinese companies, FMG and Forrest believed the framework agreements were binding;\(^{50}\)

(c) The arguments made by Forrest were:

(i) he was not ‘aware’ of any information that was required to be disclosed under section 674 of the Corporations Act.\(^{51}\)

(ii) he had honest and reasonable grounds for approving or permitting FMG to make the disclosure complained of by ASIC;

(iii) he claimed the benefit of the ‘business judgment rule’ and that his judgment in allowing FMG to make the disclosures complained of by ASIC was based in good faith and was for a proper purpose.\(^{52}\)

3.4 Court Findings and Reasoning

(a) The Court found that:

(i) it is the effect of a statement upon the persons to whom it is published, rather than the mental state of the publisher, which determines whether the statement is misleading or deceptive, or likely to mislead or deceive;\(^{53}\)

(ii) statements of the kind made would ordinarily and reasonably be understood as statements to be accepted at face value rather than assertions of a contestable opinion, which may or may not be accurate, depending on the view taken by a court;\(^{54}\)

(iii) citing the decision of *Middleton v Aon Risk Services Australia Ltd* [2008] WASCA 239:

\(^{49}\) At [93].
\(^{50}\) At [214].
\(^{51}\) At [94]. And [97].
\(^{53}\) At [98].
\(^{54}\) At [106].
“Thus, an unqualified assertion by a person who has, or is reasonably expected to have, personal knowledge of a matter may be a statement of fact not opinion;\textsuperscript{55}

(iv) where parties reserve a question as to essential matters such as subject matter or price for further agreement between them, a concluded contract has not been made. \textsuperscript{56} An agreement to agree would not be enforceable;\textsuperscript{57}

(v) it was unable to accept the framework agreements expressed a common intention that the Chinese Contractors were bound to build the infrastructure for the Project without an agreed description of the works that formed the subject matter of the contract.\textsuperscript{58}

(vi) Therefore it did not view the framework agreements as enforceable agreements which obliged the Chinese Contractors to construct the infrastructure referred to in general terms in the statements.\textsuperscript{59}

(b) The Court found that FMG had breached the provisions of section 1041 of the Corporations Act as a result of its public statements.

(c) Further once the misleading statements had been made FMG section 674 of the Corporations Act required that they be corrected.\textsuperscript{60} The Court stated that it rejected FMG’s argument that it is only if the actual notifications made by FMG had a material positive effect on the price of shares in FMG that corrective disclosure was required. The Court said that the circumstances that FMG’s management had misstated the terms of the agreements was a circumstance necessarily apt to affect the confidence of investors in the management of the enterprise – and hence influence them to acquire or dispose of FMG shares.\textsuperscript{61}

(d) The Court emphasised that it was not suggesting that section 674(2) imposed an obligation to correct information already provided on the ASX. However it was of the view that corrective information was necessary because in the circumstances...
that information was information which would or be likely to influence investors to acquire or dispose of shares.\footnote{At [184].}

(e) Pursuant to section 79(c) of the Corporations Act, Forrest was found to be knowingly involved in FMG’s contravention of section 1041 and section 674 of the Corporations Act as he knew of the terms of the framework agreements and the disparity between them and FMG’s representations about them.\footnote{At [191].}

(f) If Forrest could convince the Court that he had established the defence section 674(2B) of the Corporations Act he would not be found to be in contravention.\footnote{At [193].} However Forrest:

(i) was not to the Court’s view able to point to any steps he took to ensure that the framework agreements were binding agreements. The Court discounted the late reference by Forrest to his in-house counsel on the issue as the public statements had already been made at that point;\footnote{At [193].} and

(ii) had in his own communications demonstrated inconsistency with the belief that there was a binding agreement in place for the construction of the infrastructure o the project\footnote{At [194].}. Email evidence was provided in which Forrest was found to have acted in a manner which indicated he did not consider the agreements to be fully binding on the parties to the extent that had been represented to the public.

(g) As a result the Court did not find that Forrest had discharged the onus he bore when attempting to rely on the defence in section 674(2B).

(h) The Court also made express mention that a decision not to disclose the true effects of the agreements cannot be described as a ‘business judgement’. A decision not to make accurate disclosure of the terms of a major contract is not a decision related to the business operations of the company.\footnote{At [194].} Rather it is a decision related to compliance with the requirements of the Corporations Act. Therefore there is an inability to utilise the business judgement rule as a defence to contraventions of continuous disclosure obligations under the Corporations Act.\footnote{At [199].}
The Court found that Forrest was in breach of section 180 and 674(2A) of the Corporations Act in light of his involvement and the failure to avail himself of any of the defences available.

4. JAMES HARDIE INDUSTRIES NV V ASIC

4.1 Facts

(a) The James Hardie Group was historically involved in the manufacture and distribution of asbestos products.

(b) The holding company of the James Hardie Group was originally James Hardie Industries Limited (JHIL) which had been involved with asbestos since 1937.

(c) Two companies within the James Hardie Group had the most significant exposure to liability, James Hardie & Co Pty Ltd (later renamed Amaca Pty Ltd) and Jeskarb Pty Ltd (later renamed Amaba Pty Ltd) (operating companies). In order to isolate themselves from asbestos claims and to improve their tax position JHIL considered and then restructured the group over a period from 1998 to 2001.

(d) In particular on 15 February 2001 the board of JHIL:

(i) vested 100,000 partly paid shares worth $1.96 billion in James Hardie Industries NV (JH NV) (a company incorporated in the Netherlands by JHIL) so that JHIL became a wholly owned subsidiary of JHNV. The issue of these shares sought to ensure sufficient funding was available to meet future liabilities, including those arising from asbestos claims.

(ii) established the Medical Research and Compensation Foundation (MRCF) in the effort to isolate themselves from the claims, transferring $3 million and the shares in the operating companies with primary liability for the claims to MRCF. The purpose of the Foundation was to manage and pay out asbestos claims in relation to any members of the James Hardie Group.

(iii) Discussed the need to make an announcement to the market about the creation and provisioning of funds to MRCF to enable it to meet future liabilities.

(iv) entered into a deed of covenant and indemnity with the operating companies to pay them a substantial sum over 50 years. In return the
operating companies provided covenants not to sue JHIL in relation to asbestos products, sale of such products and asbestos claims made against it.

(e) During 2002 the CEO gave presentations to potential investors in Edinburgh and London which included a slide show.

(f) The fourth slide in the show included statements:

(i) “future claims separates and fully funded”;

(ii) “no future liability – no provision required”.

(g) The thirty-fourth slide in the slide show included:

This presentation contains forward-looking statements...Forward –looking statements involve inherent risks and uncertainties. We caution you that a number of important factors could cause actual results to differ materially...These factors are discussed in our periodic reports filed with the Securities and Exchange Commission...”

(h) Evidence was also lead from witnesses that oral statements were made to the same effect in the Edinburg and London presentations. These slides were later lodged with the ASX in June 2002.

(i) JHIL had commissioned a series of reports commencing from 2000 from Trowbridge (a firm of actuaries) on the extent of its asbestos liability. At the time that the slides were lodged JHNV knew that anticipated future asbestos liability claims were likely to exceed substantially the actuarial estimate provided in February 2001.

(j) In March 2003, JHIL (then renamed ABN 60 Pty Ltd) cancelled the partly paid shares issued to JH NV and transferred ownership to a second foundation, ABN 60, which was independent of JH NV. A further deed of covenant and indemnity was executed under which ABN 60 Pty Ltd indemnified JH NV for asbestos claims (DOCI). This was completed by 14 April 2003.

(k) JH NV was of the view that announcing the transaction would neither affect its share price nor any decision by persons who commonly invest whether or not to buy them.
(l) JH NV had originally received advice from external lawyers that the separation agreements should be disclosed. A second advice from the external lawyers requested after provision of further information and opinion from the company secretary and general counsel, Shafron, stated that “if the company’s view was correct then disclosure was not required”.

(m) On 15 May 2003, JH NV disclosed that it no longer owned shares in JHIL now ABN 60 Pty Ltd, however no reference was made to the indemnity obligation under the DOCI. The complete separation agreements were not disclosed until the release of JH NV’s annual report on 30 June 2003.

(n) ASIC commenced proceedings and the trial judge found contraventions by JH NV of section:

(i) 1041E and 1041H of the Corporations Act by virtue of the information on the fourth slide in the slideshow lodged with ASIC; and

(ii) 674 of the Corporations Act by failing to notify the market of information relating to its separation from JHIL.

(o) Gzell J rejected JH NV’s case that the contraventions should be excused pursuant to section 1317S of the Corporations Act and imposed a $80,000 pecuniary penalty.

4.2 Issues

(a) The key issues on appeal were:

(i) whether the trial judge had erred in finding that the statements made by JH NV in the slide presentation:

(A) were misleading and deceptive or likely to mislead and deceive by way of inducing people to buy or sells shares. That is JH NV had contravened section 1041E of the Corporations Act;

(B) were misleading and deceptive or likely to mislead and deceive in relation to a financial product or financial service. That is JH NV had contravened section 1041H of the Corporations Act;
whether the trial judge had erred in finding that a failure to disclose the full separation to the market operator, the ASX, was a breach of section 674 of the Corporations Act;

whether the trial judge had erred in determining that JH NV was unable to seek relief from liability for contravention of a civil penalty provision under section 1317S of the Corporations Act.

4.3 Parties’ Arguments

(a) ASIC alleged that:

(i) the ASX announcement made by JH NV by provision of the slides which contained statements that were false or misleading breached the Corporations Act (Cth) because:

(A) there was not reasonable grounds for making the statement that there would be sufficient funds to meet asbestos liabilities either itself or the operating companies,

(B) the material available did not provide a reasonable basis to say that there would be sufficient funds;

(C) the James Hardie Group had not received legal advice supporting the statement that the Group had no asbestos liabilities.69

(ii) JH NV failed in its duty to disclose information not generally available that would have a material effect on the price of JH NV’s securities.

(b) JH NV denied contravention of the issues raised above by ASIC amongst others.

4.4 Court Findings and Reasoning

(a) The Court of Appeal found among other items that:

(i) The meaning of the statements in slide 4 is the meaning that they would bear to an ordinary reasonable member of the notional class to which the statements were directed.70 The class to whom representations were

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69 At [36].
70 At [78].
directed was wide and included “sophisticated and unsophisticated” persons who were interested in the market for JH NV shares.\textsuperscript{71}

(ii) Direct evidence of being misled was not of much assistance, at least where the representation was made to a large and diverse group. This was because evidence of some members of the large group might be unrepresentative.\textsuperscript{72} Nor was opinion evidence of assistance for the same reasons.\textsuperscript{73}

(iii) The statements in the slide would be likely to convey to the reasonable member of the notional class that there was a proper and supportable basis for making the statements. There was no doubt about the misleading nature of those statements and contravention of 1041E and 1040H of the Corporations Act.\textsuperscript{74}

(iv) To place an unqualified statement on a regulators website without qualifying the statement to reflect changes of circumstances was misleading.\textsuperscript{75} At the times that the slides were lodged with the ASX, JH NV knew that the anticipated future asbestos related claims were estimated to exceed, in a substantial amount, the actuarial estimate given in February 2001 that had been the basis upon which the MCRF was funded.\textsuperscript{76} Further there was nothing in the cover letter to the ASX which identified the nature, time, or circumstances in which the slides were used so as to operate as a qualification of the statements contained in the slides.\textsuperscript{77}

(v) The general disclaimer in the presentation was insufficient to put people on notice of those fourth slide statements requiring further qualification.\textsuperscript{78} Where information in the slide was unqualified, it was concluded that the reasonable member of the class to whom the slides were directed would not have sought out other publicly available information and in particular, the information in the form 20-F, which was the only publicly available information at the times that the slides were released to the public.\textsuperscript{79} If persons were meant to have access to other information in the market, JH

\textsuperscript{71} At [79].
\textsuperscript{72} At [93].
\textsuperscript{73} At [93] citing approvingly commentary in other decided cases.
\textsuperscript{74} At [123-124], [173-174].
\textsuperscript{75} At [119].
\textsuperscript{76} At [118].
\textsuperscript{77} At [130].
\textsuperscript{78} At [125].
\textsuperscript{79} At [165].
NV should have directed attention to that information or to the existence of that information;\(^{80}\)

(vi) The statutory obligation to disclose involves an objective test.\(^{81}\) It is necessary to determine if the information is not generally available and then if it would have a material effect on price.\(^{82}\) The views of the company senior management or its directors cannot determine whether disclosure of any given information is required, though they may be relevant. Even if there is no other evidence other than the company’s own deliberations, it remains for the trial judge to evaluate whether information is material so as to require disclosure;\(^{83}\)

(vii) Any matter that affects a company’s borrowing ability will invariably have an effect on the company’s share price;\(^{84}\)

(viii) The effect of the transfer of JHIL (ABN 60 Pty Ltd) out of the James Hardie Group was to dispose completely of liability for no cost. There was significant evidence to support the trial judge’s finding that JH NV’s connection with asbestos had created difficulties in securing funding and that the creation of the foundation could make it easier to secure future funding. Accordingly, information about the separation agreements was likely to have a material effect on the price or value of JH NV’s securities;\(^{85}\) and

(ix) The burden of proving that JH NV’s decision not to disclose was honestly made in order to excuse its contravention fell on JH NV. No relevant evidence of JH NV’s honesty was provided. It was thus open to the trial judge to find that the decision not to disclose was a well thought out commercial decision made in the face of legal advice to the contrary and to refuse to infer that the decision was an honest mistake and thus reject the request for relief.\(^{86}\) There was no question that JH NV and its management were aware about the market’s sensitivity to the asbestos issue. Contrary to

\(^{80}\) At [191].
\(^{81}\) At [189].
\(^{82}\) At [356].
\(^{83}\) At [349], [454], and [527].
\(^{84}\) At [493], [497], [503], [530].
\(^{85}\) At [539-540], [547-548].
\(^{86}\) At [566-700].
this being an error of judgement, JH NV’s strategy in not disclosing the separation agreement in total was well thought through.\textsuperscript{87}

5. **MORLEY V ASIC**

5.1 **Facts**

(a) The case of *Morley v ASIC* also involves the James Hardie Group of companies arising out of the same events that are related in *James Hardie NV v ASIC*.

(b) At first instance, Gzell J found that ASIC had established contraventions of section 180(1) of the Corporations Law.

(c) It was held that the non-executive directors, the joint company secretary, and general counsel, Mr Shafron, the CFO, Mr Morley, and the CEO, Mr MacDonald, had breached their statutory duties and, as such, they were ordered to pay pecuniary penalties and disqualified from managing corporations.

(d) This decision was appealed by all non-executive directors and officers, except the CEO, Mr MacDonald resulting in this case.

(e) The additional facts relevant to this appeal include.

(i) the non executive directors and officers were alleged to have voted in favour of a resolution to make an draft announcement (allegedly put before the board at its meeting in February 2001) of the establishment of MRCF which contained statements alleged to be misleading;

(ii) provision of an announcement to the ASX which allegedly misleadingly conveyed that the MRCF would be “fully funded” and would provide “certainty” to all future asbestos claimants; and

(iii) a failure to disclose the DOCI to the ASX for several months after it came into existence and the original release was provided.

5.2 **Issues**

(a) There were two primary issues before the Court being:

(i) whether the non-executive directors and officers had breached their statutory duties under section 180(1) of the Corporations Law;\textsuperscript{88} or

\textsuperscript{87} At [575]

\textsuperscript{88} At [576]
(ii) whether the non-executive directors and officers had breached their statutory duties under section 180(1) of the Corporations Act.\textsuperscript{89}

(b) Both of these issues related to provisions concerning the exercise of care and diligence by a director or officer of a corporation and were civil penalty provisions.

5.3 Parties’ Arguments

(a) ASIC had successfully contended at first instance that:

(i) the non-executive directors voted in favour of a resolution to approve a draft announcement and supported the decision by Gzell J which imposed penalty and banning orders.\textsuperscript{90}

(ii) Peter Shafron, the company secretary/general counsel, had breached his duty of care to advise the board and CEO:

(A) that the draft announcement was too robust with statements regarding the adequacy of Foundation funding

(B) the reviews of the cash flow model performed by PwC and Access Economics were limited.

(C) that they should consider whether disclosure of the DOCI to the market was required by the parent company.

(D) that the estimate regarding exposure to asbestos claims did not take into account superimposed inflation.

(iii) Philip Morley, the chief financial officer had breached his duty of care by not advising the board that the reviews by PwC and Access Economics only had regard to the “logical soundness and technical correctness” of the cash flow model and not the earning rates, litigation costs, management costs and future claims costs.

(iv) the parent entity, JH NV, had breached section 1041E of the Corporations Act by releasing slides of a road show presentation to the ASX market and when the CEO gave seminars in London and Edinburgh. ASIC alleged these activities were also a breach of section 1041H amounting to

\textsuperscript{88} As carried into effect by section 1401 of the Corporations Act.
\textsuperscript{89} Other appeals of findings made by the trial judge also occurred but are not all canvassed in this paper due to length constraints.
\textsuperscript{90} At [
misleading conduct and the company had breached its continuous disclosure obligation by failing to reveal the restructuring.

5.4 Court Findings and Reasoning

(a) The Court of Appeal held that ASIC had failed to prove its allegation against the non-executive directors that a draft of the 16 February market announcement had been tabled and approved at a board meeting on 15 February 2001.\(^91\)

(b) This finding by the Court of Appeal resulted in the findings against the non-executive directors' by Gzell J which included penalty and banning orders being set aside.

(c) However the Court went further to say that had ASIC been able to prove that the draft announcement was voted on at the board meeting then:

(i) non-executive directors physically present at the meeting would have breached their duty to act with due care and skill due to the wording of the draft announcement.\(^94\)

(ii) the submission by the non-executive directors was not sustained that they were entitled to proceed on the basis that:

(A) management and advisers reviewed the draft ASX announcement and that it was correct and not misleading, as they had no indication that the usual procedures had not been followed; and

(B) that directors with doubts about unqualified assumptions were entitled to proceed on the assumptions that experts in the fields of communications, public relations and corporations law had determined that no further qualification was necessary.\(^95\)

(iii) the Court in response said that it did not think this was an occasion of reasonable reliance on management or others especially as the board had

\(^{91}\) The CA commented adversely on ASIC's failure to call key witnesses affected the cogency of its case and that ASIC may have breached its obligation to act fairly. At [673-678], [728], [731-732], [741-742], [756], [766], and [775-777]. This was a result of the drafting of the pleadings which meant that ASIC had to show the exact form of draft announcement was what the board approved at the meeting in February 2001. At [297].

\(^{92}\) It was not enough for ASIC to show that the directors were provided with a copy of the draft announcement and in discussion of satisfaction that a message of sufficiency of funding could be put on the market. Approval of the news release as an ASX announcement and of its sending to ASX was required. At [278].

\(^{93}\) At [789-796].

\(^{94}\) At [809-810], [821], [823-826], [828-831].

\(^{95}\) At [812].

\(^{96}\) At [817].
long been considering separation, and the directors were well aware of the importance of sufficiency of funding and its communication to stakeholders in relation to the separation proposal.\(^97\)

(iv) non-executive directors attending by teleconference would have also breached their duty to act with care and diligence due by remaining silent and not abstaining from the voting, where they held concern about the ‘forward looking statements’ which they had expressed when giving evidence, as this means they would have participated in the decision making;\(^98\)

(v) the Court said that non-executive directors with their expertise would understand the need to familiarise themselves with what was being proposed, even when his or her participation was over the telephone.\(^99\)

(d) Shafron, the Company Secretary /General Counsel was found to have participated in the decisions and was therefore deemed to be an officer of JHIL within the meaning of section 9 of the Corporations Act. He was:

(i) found to be part of the Project Green team (the team put together to explore separation of subsidiaries with asbestos liabilities) and of its promotion of the separation proposal to the board;\(^100\)

(ii) frequently reporting on asbestos litigation and risk management and occasions such as authority to finalise the terms of an agreement with JH NV and authority to negotiate and execute and underwriting agreement in conjunction with Project Chelsea;\(^101\)

(iii) acting in his capacity as company secretary and his role as general counsel did not detract from his being an officer of JHIL.\(^102\)

(e) The Court thought that what Shafron did was well beyond administrative arrangements, and well beyond providing advice and information as required, and

\(^97\) At [820].
\(^98\) At [855-857], [863-868].
\(^99\) At [867].
\(^100\) At 894]
\(^101\) At [894].
\(^102\) At [894-898], [928-929].
is correctly described as participation in decisions affecting the whole or a substantial part of JHIL’s business.  

(f) As the draft market announcement was found not to be before the board meeting, Shafron, was held to have not breached his duty of care in relation to participating in the decision making in respect to that resolution.

(g) However the Court went further to say that had ASIC been able to prove that the draft announcement was voted on at the board meeting then Shafron would have been found to have breached his duty of care and diligence.

(h) Shafron was also found not to have breached his duty of care and diligence to advise the board of the limited reviews of the cash flow model performed by PwC and Access Economics which was of critical concern and had been for some time to the board. The evidence did not show he knew these reviews were limited in nature and it was outside the area of his expertise. This original finding of contravention was set aside.

(i) However Mr Shafron was found to have breached his duty of care and diligence as an officer by not:

1. seeking legal advice on the issue of disclosure of the DOCI;

2. providing advice on the issue of whether the DOCI should be disclosed;

and

3. advising the board that the best estimate regarding exposure to asbestos claims did not take into account superimposed inflation, which was crucial to assessing adequate funding for MRCF and of which he was aware.

(j) The chief financial officer, Morley, was also found to be an officer of JHIL and participated in its decisions. He, in addition to being the CFO, was involved in the

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103 At [895].
104 Ibid.
105 At [[940-942].
106 At [963-970].
107 The Court specifically commented that Shafron could not rely on specific directed legal advice or proffer general advice on so multifaceted a subject to discharge his duties. At [1015]. There was no direct evidence of a retainer to advise on all legal matters with respect to these events. At [1022].
108 The Court specifically commented that it would be expected that a company secretary with a legal background would raise issues such as potential misleading statements. At [926] and at [1031-1035].
109 At [952].
110 At [1068-1069], [1071], [1073-1074], [1144].
111 At [1085-1086], [1090].
restructuring proposals from which came the separation proposal. He had presented papers and reports on separation aspects.\textsuperscript{112}

\textbf{(k)} Morley was found to have breached his duty of care as an officer by not advising the board that the reviews of the cash flow model by PwC and Access Economics only had regard to the “logical soundness and technical correctness” of the cash flow model and conveyed the impression that unlimited reviews had taken place when they had not\textsuperscript{113}.

\textbf{(l)} Due to the results of the appeal further time was given to the parties to consider what further evidence or submissions they may wish to make which is recorded below in the No. 2 decisions of the Court of Appeal.

6. MORLEY V ASIC (NO.2) / SHAFRON V ASIC (NO.2)

\textbf{6.1 Facts}

\textbf{(a)} These decisions were handed down by the New South Wales Court of Appeal on 6 May 2011 on the penalties to be imposed on Mr Morley, the CFO of James Hardie and Mr Shafron, the General Counsel of James Hardie, arising from the earlier decision in the appeal judgement discussed above.\textsuperscript{114}

\textbf{(b)} No further evidence was put on by the parties. Further written submissions however were provided, with no further oral hearing occurring.\textsuperscript{115}

\textbf{6.2 Issues}

\textbf{(a)} In light of decision made in the appeal judgment\textsuperscript{116} the issues the Court of Appeal was asked to consider were:

\textbf{(i)} should either Mr Morley or Mr Shafron be relieved from the liability imposed by the trial judge;

\textbf{(ii)} should the disqualification orders made by the trial judge against Mr Morley and Mr Shafron stand;

\textsuperscript{112} At [1085].
\textsuperscript{113} The reviews did not confirm assumptions about earning rates, litigation costs, management costs and future claims costs. At [1120-1121] and [1144].
\textsuperscript{114} Morley v ASIC [2010] NSWCA 331.
\textsuperscript{115} At [4].
\textsuperscript{116} Ibid.
(iii) should the pecuniary penalties made by the trial judge against Mr Morley and Mr Shafron stand;

(iv) should the costs orders made by the trial judge be altered in light of the appeal judgment.

### 6.3 Court Findings and Reasoning

(a) The Court ordered that:

(i) neither Mr Morley or Mr Shafron be relieved from the liability imposed by the trial judge;

(ii) Mr Shafron should remain disqualified for 7 years as ordered by the trial judge, however Mr Morley’s disqualification should be reduced from 5 to 2 years from the date of the trial judge’s judgment;

(iii) Mr Shafron’s pecuniary penalty of $70,000 be reduced to $50,000 and Mr Morley’s pecuniary penalty of $35,000 be reduced to $20,000; and

(iv) the costs orders made were also varied.\(^\text{117}\)

(b) The Court affirmed the principles in section 1318 of the Corporations Act that to be relieved from liability it must appear to a court that the person has acted honestly and also that the person ought fairly to be excused for the contravention, or the negligence, default or breach. The Court further noted that “all circumstances of the case needed to be considered”.\(^\text{118}\)

(c) Only Mr Morley appealed against the trial judge’s finding that no relief from liability should be granted. The Court found that Mr Morley:

(i) knew that verification of the cash flow model had been suggested;

(ii) had described the cash flow model as logically sound and technically correct in the course of his presentation to the board;

(iii) was aware that the confirmation of the cash flow model was central to James Hardie’s communication strategy;

\(^{117}\) At [5]/

\(^{118}\) At [8].
was aware that there was intended to be public reference to external parties as having reviewed and verified the legitimacy of the modelling;

(v) failed to advise the board of the limited nature of the reviews undertaken by the external parties;

(vi) acknowledged that he did not appreciate that the directors may be acting under a misapprehension that the external parties had verified the assumptions or conducted unlimited reviews.

(d) The Court indicated that it was prepared to find that Mr Morley had acted honestly as it is found in sections 1317 and 1318 of the Corporations Act.

(e) However the Court said that a person acted honestly does not mean that he ought to be excused.\(^{119}\) Relevant considerations include: the degree to which the persons conduct fell short of the statutory standard of care, the seriousness of the contravention and its potential or actual consequences; impropriety such as deceptiveness or personal gain and contrition.

(f) Mr Morley was found to have been a senior executive in James Hardie, a major public company. Through his conduct he was viewed as having made a high degree of departure from the care and diligence required by section 180 of the Corporations Act, which had serious consequences for James Hardie.\(^{120}\)

(g) The Court found that:

"proper corporate governance and business activity depend upon business leaders adhering to standards not only of honesty but also of care and diligence, and a failure of the nature and seriousness of that of Mr Morley is no tin our view one that can properly be excused."\(^{121}\)

(h) The Court therefore declined to relieve Mr Morley from liability.

(i) With respect to the disqualification orders the court considered the success of part of the appeal of Mr Shafron and the contraventions that remained subsequent to the appeal.

\(^{119}\) At [49].

\(^{120}\) At [52] and [51].

\(^{121}\) At [52].
(j) The Court after examining each of the trial judge’s findings and reasoning on sentencing addressed itself to the remaining contraventions Mr Shafron was found to have contravened. It said that Mr Shafron:

(i) was a senior executive with responsibilities to ensure compliance with regulation requirements such as Listing Rule 3.1 and did in fact give advice on those issues from time to time;¹²²

(ii) was aware of the requirements for continuous disclosure and of the fact that if James Hardie did not comply with the Listing Rule 3.1 it would be harmful to James Hardie and contravention of the Corporations Act and damaging to James Hardie’s reputation;¹²³

(iii) had within his scope of responsibilities as company secretary disclosure in accordance with ASX listing requirements;¹²⁴

(iv) was not to be distinguished from the Chief Executive, Mr MacDonald in relation to attention to disclosure of the DOCI information to the ASX;¹²⁵

(v) had failed to advise Mr MacDonald concerning the disclosure of the DOCI information to the ASX or to obtain advice for Mr MacDonald or the board;¹²⁶

(vi) had less than full concern for compliance with disclosure obligations through based on an email sent from him to James Hardie’s external legal advisers saying “he would prefer to find a way not to mention it in the JHNV Sale Agt. The context of the US disclosure is different, given it will only be submitted in the final filing”;¹²⁷

(vii) had a serious failure in his duty, in an important area of ensuring an informed market being diverted by a desire that the put option not be disclosed¹²⁸.

(k) The Court ordered the disqualification order to stand in the circumstances surrounding the maintained contravention against Mr Shafron.

(l) Applying consideration to Mr Morley’s appeal the court stated that:

¹²² At [72] and [99].
¹²³ At [72].
¹²⁴ At [72].
¹²⁵ At [79].
¹²⁶ At [72].
¹²⁷ At [84].
¹²⁸ At [99].
“Accepting that the need for personal deterrence is low, nonetheless general deterrence is in our view an important consideration given the nature and significance of the cash flow analysis contravention. As well, it is necessary that relief be granted appropriate to mark the significant failure in performance of duties of a senior executive of a large public corporation and to maintain public confidence in the law’s upholding of corporate standards”. 129

(m) Accordingly on the basis of consideration of personal references as to character and conduct, early contrition expressed in the course of litigation of the case, the Court reduced Mr Morley’s disqualification period to 2 years.

(n) The circumstances regarding the pecuniary penalty reductions made by the Court reflected the measures of success of the appeal and reduction of contraventions found against each of Mr Shafron and Mr Morley with reductions to both from the original trial judge’s orders.

(o) A similar recalibration occurred with respect to the costs orders made.

7. POINTS OF NOTE FROM JUDGMENTS

(a) Key points of note for directors and officers arising from the judgments discussed include:

(i) when complying with the continuous disclosure regime, ensure that all releases are complete, factually accurate and if providing an opinion rather than reciting a fact expressly note that the comments made are opinion;

(ii) where assertions of legal conclusions are being made ensure, where the maker of the statement has no legal qualifications themselves, that advice as to the accuracy of the statement is obtained;

(iii) where assertions of legal conclusions are being made and the maker of the statement has legal qualifications themselves, ensure that an opinion has been formed and is held to that effect by the maker of the statement;

(iv) where circumstances change between preparation of a statement to be released to the market or a historical presentation being made and its release, ensure notification of relevant changes are incorporated into the

129 At [125].
release or qualifications are made so as to not mislead or deceive or be likely to mislead or deceive;

(v) as a matter of practice if submitting powerpoint presentations to the ASX ensure details of the date, time and context of the presentation are included so as to avoid allegations of misleading or deceptive conduct;

(vi) reliance on general disclaimers is fraught with danger. Although these should be included, the drafting and use of terminology on each document should be carefully considered in the context of the impression it creates to an uninformed reader;

(vii) if wanting to incorporate or refer to some other material extrinsic to the release itself, this should be done in a prominent way and suitable language be used to identify and caveats as to reference only to the one release and not other material to which readers are referred;

(viii) records such as board minutes, board papers and the like should be carefully maintained and scrutinised for accuracy in the event need to refer to these in proceedings arises in future;

(ix) participation or non-participation in the form of absence or abstention from a vote can be critical in demonstrating exercise of care and diligence in performance of directors and officers duties;

(x) on issues critical to the company directors and officers may not be able to reasonably rely on management to satisfy performance of their duties;

(xi) where relevant knowledge is held by a director or officer that is not “generally known” to other directors and officers then there is a need to provide that information to assist with decision making;

(xii) if there is a risk of misapprehension of information presented clarification or seeking confirmation of understanding and whether further clarification is required may be necessary.

(b) In addition to these recent examinations by the Courts of director and officer conduct in the context of compliance with the continuous disclosure regime, the ASX on 4 March 2011 also released a revised guidance not on trading halts.
(c) This will also provide further insight into measures required for compliance with duties and legislative requirements.

8. CONCLUSION

(a) As is evident through the examination of each of these cases it is critical for directors and officers to ensure that they:

(i) understand the scope of their roles and expected duties that attach to it;

(ii) are adequately performing their duties by complying with the legislative continuous disclosure regimes and avoiding misleading and deceptive conduct amongst others;

(b) A failure to do so runs the risk of serious sanctions if found to be in breach of these duties.\(^{130}\)

(c) By addressing the points specifically noted in the judgments directors and officers can reduce the risk of being found to have contravened their duties.

\(^{130}\) Note further appeals have been flagged with respect to the James Hardie cases at the time of writing.