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HIGH COURT RULES

James Hardie Directors Approved Misleading ASX Release

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Introduction

The High Court has held that 7 former non-executive James Hardie directors approved a misleadng ASX announcement regarding the James Hardie Group's restructure in 2001 which separated its asbestos liabilities from its trading companies. The High Court also held that James Hardie's general counsel and company secretary (Mr Shafron) was acting as an *"officer"* when he failed to give adequate advice in relation to the misleading ASX announcement and limitations of an actuarial report.

In upholding the appeal of the Australian Securities and Investments Commission **(ASIC)** in ***ASIC v Hellicar & Ors*** [2012] HCA 17 (3 May 2012) and dismissing Mr Shafron's appeal in ***Shafron v ASIC*** [2012] HCA 18 (3 May 2012) the High Court has:

+ reinforced the requirement for non-executive directors to take a diligent and intelligent interest in their independent assessment of information put to them, rather than merely relying on management;
+ highlighted the probative value of approved board minutes;
+ given guidance on ASIC's duties to conduct litigation fairly; and
+ held that a person acting as a company secretary and general counsel acts as an officer.

Facts

In 2001 the James Hardie Group restructured its business to *"ring fence"* its asbestos liabilities. Two subsidiaries with the greatest exposure to asbestos claims were separated from the Group and the Medical Research and Compensation Foundation **(MRCF)** established to fund compensation to asbestos claimants.

At a James Hardie Board meeting on 15 February 2001 **(the Board Meeting)** the separation proposal was approved. The minutes of the Board Meeting **(the Minutes)** record that the Board also approved a draft announcement to the ASX **(draft ASX announcement)** outlining the separation proposal which importantly provided that the MRCF would have sufficient funds to meet all legitimate asbestos claims and was therefore *"fully funded"*. The next day a finalised ASX announcement was made (in similar form to the draft ASX announcement, including the reference to *"fully funded"*) which was ultimately shown to be incorrect as there were not sufficient funds to meet all claims.

Supreme Court of NSW Decision

The Supreme Court of NSW originally ruled that the directors had approved the misleading ASX announcement by reason of their approval of the draft ASX announcement (see the Wotton + Kearney Case Note "James Hardie: Directors Under ASIC Scrutiny).

Justice Gzell held that:

+ the draft ASX announcement was approved at the Board Meeting;
+ the draft ASX announcement was false and misleading because of the reference to the MRCF having sufficient funds to meet all legitimate asbestos claims and being fully funded;
+ Mr Shafron failed to advise the Board about the limitations of the economic model supporting the funding of the MRCF and also failed to consider whether JHIL was required to disclose to the ASX a deed of covenant and indemnity between JHIL and its 2 subsidiaries **(DOCI)**; and
+ the 9 directors and one officer had breached s180(1) of the **Corporations Act 2001 (Cth)**.

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The 7 non-executive directors argued that at the Board Meeting they did not approve, and would not have approved, the draft ASX announcement, however Gzell J found that the draft ASX announcement was discussed and approved at that meeting because the Minutes referred to that as having occurred and the Minutes were subsequently approved by all of the directors.

Court of Appeal Decision

The Court of Appeal overturned J Gzell's findings against 7 non-executive directors on the basis that ASIC had failed to discharge its onus of proof and establish that the draft ASX announcement had been approved at the Board Meeting. The Court of Appeal relied on:

+ no witnesses having been called who could specifically recall the approval of the draft ASX statement;

+ ASIC failing to call JHIL's principal legal adviser, Mr Robb, who was present at the Board Meeting; and

+ mistakes in the Minutes which indicated that they may not be a reliable record of what had occurred.

However, the Court of Appeal upheld the finding that Mr Shafron had failed to advise the Board about both the limitations in the economic models projecting future asbestos liabilities and of the Board's duty to disclose the DOCI.

High Court Decision

ASIC v Hellicar & Ors

It was not disputed that the draft ASX statement was false and misleading or that, if it had been approved by the directors as alleged by ASIC, that would have amounted to a breach of the directors' duties. Accordingly, the issues before the High Court were:

+ was the Court of Appeal correct in determining that the directors did **not** approve the draft ASX statement at the Board Meeting; and

+ should ASIC have called Mr Robb to give evidence as part of its duty to conduct litigation fairly and, if it should have done so, what was the effect of that failure?

In relation to the first point, the High Court held that the ultimate issue was *"... having regard to the nature of ASIC's claims and the respondents' defences, the nature of the subject matter of the proceeding and the gravity of the matters which ASIC alleged, did ASIC establish, on the balance of probabilities, that (as the minutes recorded) the* [draft ASX announcement] *was tabled and approved by the board ..."*.

In rejecting the directors' argument that they did not approve the draft ASX statement, the High Court relied heavily on the Minutes which were a formal and near contemporaneous business record and which importantly had been approved by each director as being correct. Along with the evidence of Mr Baxter about his taking the draft ASX announcement to the Board Meeting, the force of the Minutes was that the draft had been approved. Accordingly, without evidence to the contrary, ASIC had proved its case by tendering the Minutes. In addition, all the directors maintained that they would not have approved the draft ASX announcement if it had been put before them. However, each director had ultimately been provided with a copy of the finalised ASX announcement (which referred to *"fully funded"*) and not one of them had objected to its content.

The directors advanced 3 specific arguments which they maintained inferred that the draft ASX announcement was not approved. Firstly, the fact that the draft ASX announcement was amended after the Board Meeting implied that it had not been tabled or approved by the Board at the Meeting. The High Court disagreed, noting that the amendments were textual rather than substantive and that both versions of the announcement conveyed identical misrepresentations regarding adequacy of funding.

Secondly, the Minutes were an unreliable record because they were demonstrably inaccurate in some respects. As none of the inaccuracies related to the separation proposal or the draft ASX statement, the High Court ruled that merely because some parts of the Minutes were inaccurate did not necessarily imply that other parts were also inaccurate.

Thirdly, because ASIC did not call Mr Robb to give evidence the Court of Appeal was correct to conclude that ASIC had not proved its case. The High Court agreed that ASIC was under a duty to conduct litigation fairly, however the relevant issue was the nature of the evidence Mr Robb was likely to have given, rather than the evidence he might theoretically have given. Further the High Court considered the notion of unfairness required either the denial of an advantage to the directors or subjecting them to a disadvantage. The former had not been identified and the latter had not been established.

In addition, the effect of any unfairness to call a relevant witness could only ever raise the issue of a possible miscarriage of justice which required a new trial. It could not, as the Court of Appeal had found, justify discounting the cogency of other evidence ASIC had led at trial. In any event, the High Court concluded that there had been no unfairness in not calling Mr Robb because there was no basis for inferring Mr Robb would have given evidence favourable to the directors.

Shafron v ASIC

Mr Shafron argued that he was acting in his capacity as a general counsel, rather than as a company secretary (and therefore not acting as an officer), when advising the Board in relation to the restructure and the draft ASX announcement. The High Court rejected his submissions and held that as Mr Shafron's job description was both company secretary and general counsel, all tasks were performed in that joint role and it was not possible to divide his duties and responsibilities. Further, s180(1) requires an officer to discharge **all** of his duties with due care and diligence, not only statutory duties, so that it was irrelevant if some of Mr Shafron's duties to advise JHIL arose from his position as general counsel.

In any event, the High Court ruled that Mr Shafron was also acting as an officer because he participated in making decisions affecting the whole, or a substantial part of, the business of the corporation so as to fall within the definition of *"officer"* under s9 of the Corporations Act. The High Court provided useful guidance on the statutory criteria of an *"officer"*, notably it did not matter that Mr Shafron was not involved in making the ultimate decision, as he had still participated in the decision making process sufficient to be classified as an officer.

Summary and Effect

The important principles of the High Court's decision are:

+ Although the High Court did not state this expressly, its endorsement of J Gzell's findings reinforces the importance of non-executive directors' duties to independently and properly assess information put before them, particularly regarding critical strategic announcements. They cannot blindly rely on advice from management which was also a central theme of the ASIC prosecution of the Centro directors (see Wotton + Kearney Case Note on that decision, June 2011).

+ It highlights that, unless there is something more than inferential evidence to the contrary, approved board minutes will have substantial probative value as a business record of events occurring at that board meeting. As such, prior to approving minutes, directors have to ensure that they accurately reflect and record events, which may necessitate directors taking their own notes or at some stage requesting that board meetings be recorded so as to resolve any disputes.

+ The High Court has given guidance on ASIC's duties in bringing civil penalty proceedings by confirming that the failure to call a witness is not necessarily unfair per se and, in any event, does not impeach other evidence led at trial. However, it may be a ground for a miscarriage of justice depending on the facts.

+ A joint company secretary and general counsel will often be acting as an officer in giving legal advice to the company. Perhaps more significant is the High Court's finding that, by preparing draft documents for board approval, a general counsel may be participating in making decisions that affect the whole or a substantial part of the business of a corporation and therefore acting as an officer for the purposes of s180(1) of the Corporations Act. This aspect of the decision has no doubt unsettled many in-house counsel and could also extend to any executive undertaking equivalent preparatory tasks utilised in board decisions. This could significantly expand the number of people who may be deemed to be 'officers' of a company and thereby subject to the obligations and duties, including punitive provisions, of the Corporations Act.

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