

ASIC FAILS TO CHOP DOWN FORREST

Fortescue Metals Group Ltd v ASIC and Forrest v ASIC [2012] HCA 39

Introduction

The High Court has handed down its decision in the proceedings brought by the Australian Securities and Investments Commission (**ASIC**) against Fortescue Metals Group (**FMG**) and Andrew Forrest. The decision turned on whether the description of a set of agreements as 'binding contracts' in market announcements by FMG was misleading and deceptive. In a unanimous outcome, the High Court overturned the Full Federal Court's decision and found that the announcements were not misleading or deceptive and consequently there was no breach of the continuous disclosure obligation by FMG and no breach of duty by Mr Forrest.

Although the decision ultimately turned on its own particular facts so that the High Court did not, and did not need to, provide any guidance on continuous disclosure obligations in general, it provides a useful insight into how two small words can be interpreted very differently and how careful consideration needs to be given to the terms of any public company announcements.

Facts

Andrew Forrest was the chairman, chief executive officer and a major shareholder of FMG.

In early 2004 FMG entered into negotiations with three state-owned Chinese companies (**Chinese Contractors**) to build, finance and transfer the mine, port and railway for a proposed mine in the Pilbara. Between August 2004 and October 2004 FMG and the Chinese Contractors executed three agreements referred to as 'framework agreements'.

Subsequent to executing the framework agreements, FMG released information to the Australian Stock Exchange in the form of letters and media releases which stated that FMG had entered into binding contracts with the Chinese Contractors. The share price in FMG rose significantly over the period of the announcements (from \$0.59 to \$5.05).

In March 2005 an article published in the Australian Financial Review asserted the framework agreements did not impose any legally binding obligations on the Chinese Contractors. Whilst the share price in FMG dipped, it did eventually recover and return to the rate prior to the publication of the article.

In 2006 ASIC brought proceedings against FMG and Mr Forrest alleging:

- FMG engaged in misleading and deceptive conduct under s.1041H of the *Corporations Act* by falsely representing¹ to the investing public that the framework agreements were enforceable agreements. ASIC sought a declaration only that FMG had contravened s.1041H of the *Corporations Act*;
- FMG had contravened its continuous disclosure obligations under s.674(2) of the *Corporations Act* by failing to disclose the terms or true meaning of the framework agreements or, alternatively, by making an inaccurate disclosure or by failing to correct its earlier misstatements. ASIC sought declarations and pecuniary penalties against FMG;
- Mr Forrest was involved in FMG's contraventions above because he authorised or approved the letters and media releases and, accordingly, he contravened his duty of care and diligence to FMG under s.180 of the *Corporations Act* by exposing FMG to

¹ ASIC relied upon 13 different communications but the allegations about each were substantially the same.

penalties. ASIC sought pecuniary penalties against Mr Forrest and an order disqualifying him from managing a corporation.

ASIC's case was based on the view that the framework agreements were binding but only as agreements to agree on a future contract. ASIC assured the framework agreements did not contain an enforceable obligation on the Chinese Contractors to build, finance and transfer the mine, port and railway for a proposed mine in the Pilbara – only an obligation to agree to a contract in the future to do so.

At first instance²

The evidence before the court consisted primarily of documents and expert evidence. There was no evidence led by the directors of FMG or Mr Forrest

The trial judge, Gilmour J, dismissed ASIC's claim against FMG and, as a result, the case against Mr Forrest also failed.

The cause of action under s.1041H was dismissed on the basis the public statements by FMG were expressions of opinion of the legal effect of the framework agreements and those expressions of opinion were honestly and reasonably held by FMG's directors and Mr Forrest. The cause of action under s.674 failed for the same reason.

ASIC asserted that FMG and Mr Forrest did not have an honest and reasonable basis for the opinion reflected in the public statements because there was no evidence FMG obtained any legal advice concerning the framework agreements. If it had, it would have been aware of the legal effect of the framework agreements. The trial judge disagreed (and was critical of ASIC's pursuit of a case of deliberate dishonesty in circumstances where, in his view, there was no evidence to support the allegations).

Whilst ASIC's case of breach of s.674 included FMG's failure to disclose the terms of the agreement as well as their actual effect, the trial judge did not reach a concluded view as to the true effect of the framework agreements.

Appeal to Full Federal Court³

ASIC appealed on three bases, namely that the trial judge:

- erred in treating FMG's public statements as statements of opinion because the judge failed to consider the effect or likely effect of the statements on the minds of the ordinary and reasonable members of the class of persons to whom it was addressed; and
- failed to appreciate that FMG's public statements were misleading by describing the framework agreements as binding when they did not contain the essential terms of price, subject matter or scheduling. Rather, the framework agreements were only agreements to agree to further negotiations and therefore were not enforceable in any substantial sense; and
- erred in concluding that the opinion which he ascribed to FMG and Mr Forrest was genuinely and reasonably held by them since the terms of the framework agreements themselves were substantially different to the public statements.

The Court found the trial judge erred in failing to conclude FMG's public statements would have been understood as statements of fact by ordinary and reasonable members of the investing public for the following reasons:

- It is the effect of a statement upon the person 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;

² *Australian Securities and Investments Commission v Fortescue Metals Group Ltd* [2009] FCA 406

³ *Australian Securities and Investments Commission v Fortescue Metals Group Ltd* [2011] FCAFC 19

- Statements of the kind made by FMG would ordinarily and reasonably be understood as statements to be accepted at face value rather than as assertions of a contestable opinion, which may or may not be accurate, depending on the view taken by the court;
- To determine whether the statement is of fact or opinion, one must consider the precise terms of the representation, all the circumstances known to the representee including the form in which the statement is made and personal knowledge or likely personal knowledge of the representor. 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;
- The approach adopted by the trial judge artificially limited the protection afforded to the investing public which was not permitted by the legislation, not warranted on the facts and not supported by case law. If the trial judge's views were upheld, the responsibility for the statement could be avoided by the representor on reliance of reservations not apparent to the persons to whom the statement was published;
- The requirements of s.1041H could have easily have been met by FMG publishing copies of the framework agreements to the market and the media at the outset.

As to whether the representations made by FMG were accurate (ie were the framework agreements binding agreements), the Court found:

- an agreement to agree is not legally enforceable;
- whatever may have been the subjective intention of the parties to enter a binding agreement, whether the framework agreements were binding must be answered by taking an objective view of the agreements;
- where parties have not agreed upon the essential terms and have not agreed upon the application of an objective standard to measure their obligations or to provide a mechanism to fix the content of essential terms, no agreement can be upheld and the framework agreements were not legally enforceable contracts.

The conclusion that the framework agreements were not enforceable contracts meant that ASIC's case under s.674 must also succeed. Once misleading statements had been made by FMG, it was required to take steps to correct them.

As to the case against Mr Forrest, the Court found Mr Forrest knowingly participated in the relevant events leading to FMG's contravention of s.1041H and also contravened s.674(2A) as person involved in FMG's contravention of s.674(2)(c). The onus was on Mr Forrest to show that he took all steps reasonable in the circumstances to ensure that FMG complied with its obligations and, after doing so, believed on reasonable grounds that FMG had complied. Mr Forrest was unable to point to any steps he had taken.

The Court found that the claim under s.180 was made out. Mr Forrest was unable to deploy the business judgment rule in his defence in the absence of any evidence from Mr Forrest himself. Further, a decision not to disclose the true effect of the agreements could not be described as 'business judgment', rather it is a decision related to compliance.

High Court

Both Mr Forrest and FMG appealed to the High Court. The Court unanimously overturned the decision of the Full Court. They found that the market announcements were not misleading or deceptive or likely to mislead or deceive. Consequently there was no breach of the continuous disclosure obligation by FMG and no breach of director's duty by Mr Forrest.

In the majority judgment (French CJ, Gummow, Hayne and Kiefel JJ), the court found:

- the cause of action based on fraud, despite being pleaded without precision and mixed with a cause of action for misleading and deceptive conduct, failed on the basis that ASIC did not establish that FMG did not believe that the framework agreements were binding (ASIC expressly accepted at trial the parties intended to be bound by the framework agreements);
- the representation that the parties had entered a 'binding contract' was accurate and was not misleading or deceptive. In reaching this view, the majority found that the impugned statements did not express any relevant opinion. They found that the

statements conveyed to the intended audience of investors the fact that the parties had made agreements that they said were binding and nothing more. The Full Court had erroneously assumed that 'binding' necessarily conveyed a message about enforceability in an Australian court when:

- investors to whom the representations were made would have understood the representation as a statement of what the parties to the framework agreements intended would happen in the future; and
- there was no representation made that the framework agreements were not open to legal challenge in an Australian court nor that they would be determined by reference to Australian domestic law;
- Given the above, the balance of the allegations including the allegations against Mr Forrest fall away.

The majority of the Court was at pains to point out that their conclusions did not 'artificially limit the protection afforded to the investing public' because:

- their findings turned on the precise facts of this case and that their judgment does not establish a general proposition that can be applied to every public statement that Company A has made a contract with Company B. The court refers to the James Hardie⁴ decision which also turned on its own specific facts;
- if a party makes a representation about the content of a document knowing that what is conveyed by the statement is false, that party is guilty of deceit. But if a party makes a public statement about the content of a document that is alleged to be misleading and deceptive, the critical question is what the representation conveyed to the intended audience, not what the party concerned says what it was intended to convey.

The majority was critical of ASIC's pleading for the following reasons:

- the pleading was inconsistent and embarrassing in pleading the terms of the framework agreements;
- the pleading confused and mixed allegations of fraud with allegations of misleading and deceptive conduct which resulted in the allegation of fraud being pleaded without precision;
- the body of ASIC's pleading was 108 pages long containing hundreds and possibly thousands of alternative and cumulative combinations of allegations.

The result was that the pleading did not, as it should have, identify ASIC's case clearly and distinctly but instead distracted from and did not aid the comprehension of the issues in dispute.

Heydon J reached the same conclusion albeit for different reasons. He found that the market announcement correctly represented the effect of the agreement, leaving aside the question of its contractual force. Unlike the majority, he characterised the statement about the contract being binding as one of opinion and found that ASIC must fail because it did not establish that FMG did not genuinely and reasonably hold that opinion.

Observations

Whilst this case turned largely on the unique facts, there are some useful lessons that can be taken away.

Any company proposing to make a disclosure to the market about an agreement or any other matter, it may be appropriate and prudent to:

- refrain from commenting on the legal effect of a document unless it is necessary to do so;
- consider whether the document itself should also be disclosed in the announcement. The Full Court referred to this possibility. Although the majority in the High Court did not deal with it and Heydon J specifically rejected any legal obligation to release the

⁴ *Australian Securities and Investments Commission v Hellicar* [2012] HCA 17

agreements, in some cases releasing the actual agreement may avoid any issue arising. Documents that are lengthy, highly technical or commercially sensitive should obviously not be disclosed;

- obtain legal advice on the wording of the announcement before releasing it.

The court's criticism of the pleading is also instructive, and consistent with statements made in other appellate judgments. The High Court emphasised the fundamental requirement for a party to litigation to identify the case it seeks to make and do that clearly and distinctly. The task of the pleader 'does not extend to planting a forest of forensic contingencies and waiting until final address or perhaps even an appeal hearing to map a path through it'.

This article was prepared by Kathryn Rigney, Julia Turner and Jonathan Shakenovsky.

For further assistance with corporate and governance matters, please contact Kathryn Rigney, Director (t: 9231 7027, e: krigney@ypol.com.au) or Julia Turner (t: 9231 7059, e: jturner@ypol.com.au)

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LEVEL 2, 39 MARTIN PLACE
SYDNEY NSW 2000

DX 162 SYDNEY

T: +61 2 9231 7000
F: +61 2 9231 7005
WWW.YPOL.COM.AU

YPOL PTY LTD TRADING AS
YELDHAM PRICE O'BRIEN LUSK
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