

D&O – WHO IS AN OFFICER OF A COMPANY?

On 3 May 2012, the High Court delivered its much anticipated judgments concerning the breaches of duty by the directors and company secretary/general counsel of James Hardie Industries Ltd (**JHIL**). This article deals with the judgment concerning the company secretary/general counsel (**Mr Shafron**)¹ and should be read in conjunction with the previous article on the judgment in relation to the directors (*Directors & Officers – Be careful what is recorded in the minutes*).

The *Corporations Act* 2001 (Cth) (**Act**) defines 'officer' of a corporation in section 9 as follows:

- '(a) a director or secretary of the corporation; or
- (b) a person:
 - (i) who makes, or participates in making, decisions that affect the whole, or a substantial part, of the business of the corporation; or
 - (ii) who has the capacity to affect significantly the corporation's financial standing; or
 - (iii) in accordance with whose instructions or wishes the directors of the corporation are accustomed to act (excluding advice given by the person in the proper performance of functions attaching to the person's professional capacity or their business relationship with the directors or the corporation); or
- (c) a receiver, or receiver and manager, of the property of the corporation; or
- (d) an administrator of the corporation; or
- (e) an administrator of a deed of company arrangement executed by the corporation; or
- (f) a liquidator of the corporation; or
- (g) a trustee or other person administering a compromise or arrangement made between the corporation and someone else.' (emphasis added)

The duty of directors and officers is codified in section 180(1) of the Act as follows:

'A director or other officer of a corporation must exercise their powers and discharge their duties with the degree of care and diligence that a reasonable person would exercise if they:

- (a) were a director or officer of a corporation in the corporation's circumstances; and
- (b) occupied the office held by, and had the same responsibilities within the corporation as, the director or officer.'

Was Mr Shafron an 'officer'?

At the time of the relevant breaches of duty by Mr Shafron, he was employed as 'general counsel and company secretary' of JHIL. He held the position of company secretary jointly with another employee.

Mr Shafron argued that his obligations under section 180(1) of the Act were limited to his role as company secretary and did not extend to his role as general counsel. In essence, Mr Shafron argued that:

- none of his relevant conduct involved his role as company secretary (he accepted this position was an 'officer') and as such he was not acting as an officer of the company for the purposes of section 180(1) of the Act;
- the references in section 9(b)(i) of the Act to 'an officer' being a person who 'participates in making' decisions was confined to persons who have a role in actually making the

¹ *Peter James Shafron v Australian Securities and Investments Commission* [2012] HCA 18

decisions rather than a person (like him as general counsel) who provided information and advice to the board to assist in its decision making, even if that person could be said to make a real contribution to the decision.

The primary judge² and the New South Wales Court of Appeal³ rejected Mr Shafron's arguments and found that all of his relevant conduct were performed in his capacity as an officer of the company.

Recognising that the question of the role of any officer of the company will be a question of fact, the majority of the High Court (French CJ, Gummow, Hayne, Crennan, Kiefel and Bell JJ) held that a fundamental difficulty with this aspect of Mr Shafron's submissions was that there was no evidence demonstrating or suggesting that Mr Shafron performed certain tasks in one 'capacity' and 'other tasks in another' and noted that Mr Shafron did not give evidence.⁴ The majority went on to hold at [16]:

'All of the tasks Mr Shafron performed were undertaken in fulfilment of his responsibilities as general counsel and company secretary. More particularly, because of his qualifications and the position in which he was employed, his responsibilities as general counsel and company secretary extended to proffering advice about how duties of disclosure should be met. And when he procured advice of others and put that advice before the board for its use, his responsibilities could, and in this case did, extend to identifying the limits of the advice that the third party gave.'

Heydon J (in a separate judgment) held at [41]:

'It is not possible to sever Mr Shafron's responsibilities into watertight compartments, one marked "Company Secretary" and the other marked "General Counsel". The expression "company secretary" is not a term of art. The responsibilities of company secretaries can vary from company to company, within companies, and over time. They have tended gradually to wax over many decades. From Mr Shafron's behaviour in practice, it may be inferred that his responsibilities were much more than mere administrative duties. He advised the board on substantive matters, particularly in respect of James Hardie Industries Ltd's exposure to asbestos litigation. He was one of its three most senior executives. He had assisted in devising proposals for separating its subsidiaries exposed to asbestos claims from the rest of the group.'

Whilst these conclusions were sufficient to dispose of this aspect of Mr Shafron's appeal, the majority went on to make a number of important observations about what constitutes 'participation in making decisions' for the purposes of the definition of 'officer' under section 9(b)(i) of the Act. Those observations can be summarised as follows:

- it is necessary to inquire what role the person plays in the corporation and the inquiry should not be confined to the role the person played in the issue the subject of the alleged breach of duty;
- in a case like this where the alleged breach concerned omissions to provide advice, in considering how a reasonable person occupying a same office and having the same responsibilities would have acted, it may be useful to consider how the officer in question acted on other occasions;
- the category of persons identified by section 9(b)(i) are not necessarily persons who hold a named office in or in relation to the company and must not necessarily be 'in substantially the same position as directors' or 'those to whom the management and direction of the business of the company is usually ... given';
- the use of the word 'participation' in section 9(b)(i) is important because it 'directs attention to the role that a person has in the ultimate act of making a decision, even if that final act is undertaken by some other person or persons';
- participation in any decision of the company does not make the person an officer unless the decisions in which the person participates have the requisite significance for the business of the company.

² *Australian Securities and Investments Commission v Macdonald (No 11)* [2009] NSWSC 287; (2009) 274 ALR 199

³ *Morley & Ors v Australian Securities and Investments Commission* [2010] NSWCA 331; (2010) 274 ALR 205

⁴ See paragraph [14]

With these observations in mind, the majority held [at 31] that:

'Mr Shafron was one of three executives who shaped and developed the proposal through its successive variants; he was one of the executives who presented successive proposals to the board; he was, as the Court of Appeal found, part of the 'promotion of the separation proposal to the board', a board that did not itself decide what elements would go to make up any of the several proposals it considered and was, as ASIC submitted, 'reactive' rather than 'proactive' in the formulation of the proposals.'

Breach of duty

There were two essential breaches of section 180(1) by Mr Shafron as found by the primary judge and the Court of Appeal:

- a failure to advise the Chief Executive Officer and the Board of JHIL that they needed to consider whether certain information about the terms of the separation proposal needed to be disclosed or failing to advise them that they should obtain external advice on that issue;
- a failure to disclose to the Board that the actuarial figures provided did not allow for superimposed inflation and prudence warranted the making of that allowance.

Mr Shafron argued that if he was an officer, neither of these omissions constituted a breach by him because he was entitled to assume that the company's external legal advisors (who were actively involved) would have advised him if further or different disclosure were necessary and he was not required to bring to bear any expert actuarial knowledge to discharge his duties to the board in relation to superimposed inflation. In rejecting these arguments and upholding the findings of the Court of Appeal, the High Court reaffirmed that the test as to breach of duty is measured by what a reasonable person would have done in the office and with the responsibilities of Mr Shafron. Having regard to the particular circumstances, the Court found that both breaches were made out.

Observations

The following observations can be made about the judgment:

- the Court has confirmed that the reach of the statutory duty extends beyond the makers of the decisions (ie the board) to persons who significantly participate in the making of decisions;
- the particular facts of this case were such as to bring the general counsel within the role of an 'officer' for the purpose of the statutory duty. This was because he played a significant role in shaping and developing the proposal that lead to the relevant decisions;
- the extent to which employees of a company (such as general counsel) may have a liability under the statutory duty will depend upon not only the nature of their role in the company as a whole but also the significance of their participation in the relevant decisions. Whilst the question will be one of fact and degree, this judgment demonstrates the capacity for the statutory duty to be applied to such persons even though traditionally they may not have been regarded as officers;
- the Court has not squarely dealt with the question of whether or not external advisors to a company could fall within the definition of 'officer' depending on their participation in the making of decisions. Whilst the particular facts of this case did not call for a determination of that question, the tenor of the findings suggests that the officer will be an employee. On this issue, the finding of the majority at paragraph [30] is noteworthy:

'The fact that Mr Shafron was an employee of the company, and not an external adviser, is important. What he did was not confined to proffering advice and information in response to particular requirements made by the company. And what he did went well beyond his proffering advice and information to the board of the company.

He played a large and active part in formulating the proposal that he and others chose to put to the board as one that should be approved. It was the board that ultimately had to decide whether to adopt the proposal but what Mr Shafron did, as a senior executive employee of the company, was properly described as his participating in the decision to adopt the separation proposal that he had helped to devise.'

- the findings of breach of duty in this case demonstrate that an officer with particular knowledge and skills (such as general counsel) cannot necessarily solely rely upon assumptions about the advice received from external legal advisors and experts and has an obligation to exercise an independent assessment.

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