Directors & Officers – be careful what is recorded in the minutes

On 3 May 2012 the High Court handed down its long anticipated judgment in proceedings brought by the Australian Securities & Investments Commission (**ASIC**) against the non-executive directors of James Hardie Industries Limited and against the company secretary and general counsel of the company. In two separate decisions, the High Court held that the non-executive directors had breached their duties as a director of the company by approving the company's release of a misleading announcement to the Australian Stock Exchange (**ASX**) and that the Company Secretary/General Counsel had failed to discharge his duties as an officer of the company with the degree of care and diligence that a reasonable person in his position would have exercised. This article considers the decision in relation to the directors[1], a separate article considers the decision in relation to the Company Secretary/General Counsel.

Background

The proceedings arose out of a restructure of the James Hardie Group of companies in 2001. James Hardie Industries Limited (**JHIL**) was the ultimate holding company of the group and was a public company with its shares listed on the ASX. Two wholly owned subsidiaries had manufactured and sold products containing asbestos. Each of the subsidiaries was subject to claims for damages for personal injury, and further claims were expected. The board of JHIL decided to restructure the group by 'separating' the two subsidiaries from the rest. This was to be done by establishing a foundation (the Medical Research and Compensation Foundation (**MRCF**)) to manage and pay out asbestos claims against the two companies. JHIL's shares in the two subsidiaries would be cancelled. A new company would be incorporated in the Netherlands and that company would become the ultimate holding company of the James Hardie Group.

On 15 February 2001 the board of JHIL agreed to the separation proposal. The making of that decision, and the terms on which the separation was to be effected, were matters that had to be announced to the ASX and an announcement was duly made to the ASX the following day. The announcement was misleading because it described the Foundation as 'fully funded' and as having 'sufficient funds to meet all future claims', when that was not in fact the case.

A draft announcement to the ASX had been taken to the board meeting by JHIL's Senior Vice-President of Corporate Affairs. The draft was not in exactly the same terms as the announcement in fact made the next day but was also misleading. The minutes of the February meeting recorded the directors' approval of the draft announcement. The minutes were approved at a subsequent meeting in April as an accurate record of what was decided at the February meeting.

ASIC brings civil penalty proceedings

In February 2007, ASIC brought civil penalty proceedings in the Supreme Court of New South Wales against all of the directors of JHIL, the General Counsel/Company Secretary and the Chief Financial Officer for breach of their duties under section 180(1) of the *Corporations Act* 2001 (Cth). That section (set out in full in the next article) provides that 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 were a director or officer of a corporation in the corporation's circumstances and occupied the office held by, and had the same responsibilities within the corporation as, the particular director or officer. ASIC

[1] *Australian Securities & Investment Commission v Hellicar & Ors* [2012] HCA 17

alleged that the directors breached that duty by approving a draft of the announcement to the ASX at the meeting on 15 February 2001.

In their defence, the non-executive directors disputed that the minutes were accurate and disputed that the draft announcement had been tabled or approved at the meeting. Not all of the non-executive directors gave evidence, but those that did did not accept that they had approved a draft ASX announcement and said either that they did not read the draft minutes or that they did not read them with any care.

The trial judge found that the directors had in fact voted in favor of the resolution approving the draft announcement and so that they breached their statutory duties of care and diligence.

The Court of Appeal

The non-executive directors appealed to the Court of Appeal. The managing director (Mr Macdonald) did not appeal.

The Court of Appeal concluded that ASIC had not discharged its burden of proof and had not established that the draft announcement was tabled at the February board meeting, or that the non-executive directors had approved that draft announcement. In reaching this conclusion, the Court of Appeal took into account the failure of ASIC to call Mr Robb, a partner of the external law firm that was advising James Hardie about the restructuring, to give evidence as to the events at the February board meeting. The Court of Appeal held that ASIC owed a 'duty of fairness' analogous to that owed by a Crown Prosecutor which it had breached by not calling Mr Robb. It ordered that ASIC's proceedings against the non-executive directors be dismissed. ASIC appealed to the High Court.

The High Court

The High Court allowed ASIC's appeal unanimously, handing down two separate judgments – a joint judgment of Gummow, Hayne, Heydon, Crennan, Keifel and Bell JJ and a separate judgment from Heydon J.

The majority refer to what they call the 'central conundrum' in the directors' assertion that they had not approved any draft announcement. As they state in their joint judgment:

> 'The directors knew that their approval of the proposal had to be announced to the ASX. Did they, as they now say, leave to the decision of management the way in which the decision would be announced and leave to the decision of management what would be said about a proposal that all directors knew could be very controversial? Or did they, as their minutes recorded, approve what was to be said to the market?'

As the court points out, the issue was, having regard to the nature of ASIC's claims and the respondent's 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 the draft announcement was tabled and approved by the board?

The minutes of the board meetings of February and April were admissible as business records and were evidence of the truth of the matters that they represented, so that, absent evidence to the contrary, ASIC proved its case by tendering the minutes. However other matters supported this conclusion.

In coming to his conclusion that the board had approved the draft announcement at its February board meeting, the primary judge had taken into account the complete absence of any evidence of protest after the event, by any member of the board, about the announcement that JHIL in fact made to the ASX. This absence of protest also influenced the High Court. As the majority point out:

> 'Underpinning much of the argument advanced on behalf of the respondents at trial, on appeal to the Court of Appeal and in this court, was a proposition which, though never expressed in these terms, amounted to saying that, if asked, the directors would never have approved the 7.24 draft announcement because the announcement was evidently misleading. If that were right, why would the directors not have challenged management about what was said in the final ASX announcement.'

The majority also point out that if the directors' arguments that the February and April minutes were false were to be accepted, those arguments may go so far as to demonstrate that the directors had failed to take reasonable steps to ensure that the company's minute

books were not false or misleading, in potential of other statutory provisions of the Corporations Law.

The court rejected an argument from the directors that management could not make any alterations to an announcement approved by the board and so, as the announcement was altered therefore it cannot have been approved by the board. The court found that approval by the board does not mean 'set in stone':

> 'Whether a deed that is later executed or an announcement that is later published is the document which the board approve must be determined by more than a literal comparison between texts. Slips and error can be corrected. In at least some cases better (but different) wording can be adopted.
>
> ….
>
> The bare fact that alterations were later made does not demonstrate that the document was not approved by the board.'

Although the final announcement was not in exactly the same terms as the draft, the court found that, taken as a whole, the amendments made to the draft announcement were properly described as textual rather than substantive, so that the announcement as made was not materially different to the draft announcement approved.

In his separate judgment, Heydon J refers to the group of legal obligations relating to the minutes of directors meetings and statutory obligations to ensure that the records of the company are not false or misleading. He states:

> 'Provisions of this kind correspond with a strong feeling that accurate minutes should be kept of general meetings and committee meetings in organisations of all kinds. They include businesses; educational and medical institutions; social and sporting clubs; cultural and religious groups; professional and trade associations; trade unions; community bodies and political parties. The members of these organisations, humble as they often are, see it as important that minutes accurately record what took place. How much greater is the importance of accurate minutes in the case of directors running a large multi-national public company listed on stock exchanges, in which thousands of people had invested on the faith of a belief that its affairs were efficiently conducted?
>
> ….
>
> To find that the minutes of a company listed on the ASX were false in so important a respect was a serious matter legally and commercially. It is fundamental to the running of so large and important an organisation as the James Hardie group that the records of its central decision making organ be correct, lest the foundations on which its future affairs rested be left to the vagaries of corporate memory and changing personnel.'

The High Court rejected the Court of Appeal's finding that ASIC was under a duty in this litigation to call Mr Robb. They accepted that courts and litigants rightly expect that ASIC will conduct any litigation in which it is engaged fairly, although they did not make a formal finding to that effect and did not need to because they found that there was no basis for inferring that the lawyer may have given evidence favorable to the directors, so that ASIC's failure to call him caused no unfairness to the directors. Noting that ASIC had called two witnesses to give evidence about the board meeting but each was not able reliably to recall events, the court found that it was far more likely that Mr Robb would have given evidence either to the effect that what was said and done at the meeting accorded with the minutes or that he had no independent recollection of what had transpired or some combination of the two than that he would say (contrary to his own interests and the interests of the firm of which he was a member at the relevant time) that he positively remembered that what was recorded in the minutes was untrue.

The appeal was allowed and the matters have been remitted to the Court of Appeal to consider the directors claims to be excused from liability under section 1318 of the Corporations Law and, if those claims are not accepted, penalty and disqualification. (At first instance in 2009 the non-executive directors had each been ordered to pay pecuniary penalties of $30,000 and disqualified from managing corporations for a period of five years.)

The implications

The decision emphasises the importance of reading proposed minutes and ensuring that they accurately reflect what happened at the relevant meeting. This should not be regarded as an obligation that is unduly onerous. As Heydon J points out, the February 2001 meeting may

have been the most significant in the company's history. The directors knew that there was no legal capacity to resolve that there should be separation without announcing that fact to the ASX and that there was no commercial point in any announcement unless an assurance of sufficient funding for asbestos claims was given. However, going forward, boards may wish to consider their practice as to when minutes are circulated. It may be appropriate for minutes to be prepared immediately after the meeting, perhaps cleared through the CEO and the chairman, and then sent to the directors within a week – not with the next board papers. This will allow directors the opportunity to consider the minutes at a time when the meeting's details are still fresh in their minds.

To the extent that it requires directors to consider the matters before them and to exercise independent judgment (in this case, about announcements to the ASX and draft minutes) the decision is consistent with the decision of the Federal Court in the *Centro* case[2] that directors are required to exercise independent judgment and are required to read, understand and focus upon financial reports before they approve them.

In this case it was not disputed that the announcement to the ASX was misleading. The extent to which directors have an obligation to make sure that announcements to the ASX are accurate is currently being considered by the High Court in *ASIC v Forrest and Fortescue Metals Group*, which was heard at the end of March 2012. In that matter, ASIC alleges that announcements to the ASX by the mining group concerning three agreements with Chinese owned state entities were false and misleading. At issue is whether it is the effect of statements in such announcements on the persons to whom they are published that determines whether they are misleading or deceptive or the mental state of the publisher. The judgment is awaited with interest.

May 2012

This article was prepared by Kathryn Rigney, Director. Kathryn Rigney can be contacted on 9231 7027 or at krigney@ypol.com.au

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
ACN 109 710 698

LIABILITY LIMITED BY A SCHEME APPROVED UNDER PROFESSIONAL STANDARDS LEGISLATION. LEGAL PRACTITIONERS EMPLOYED BY YPOL PTY LIMITED ARE MEMBERS OF THE SCHEME

[2] *Australian Securities & Investments Commission v Healey* [2011] FCA 717