



More responsibility for directors and in-house counsel?

ASIC commenced proceedings¹ against James Hardie Industries Limited (JHIL), James Hardie Industries NV (JHINV) and seven former directors and 3 former executives of JHIL.

For a summary of the consequences of this decision for general counsels go to the comments section on page three below.

ASIC alleged that various public statements made by JHIL and JHINV about the establishment and funding of the Medical Research and Compensation Foundation, established to pay asbestos claims against the James Hardie Group, were false and misleading, or misleading or deceptive, and that the directors and executives had breached various provisions of the Corporations Act in the preparation and approval of those statements.

The decision demonstrates how the Courts will look at the role of directors and advisers (such as general counsel) and assess the way that they perform their duties.

The New South Wales Supreme Court decided in favour of ASIC's civil claim that a number of statements in the Draft ASX Announcement by James Hardie to the effect that the Foundation would have sufficient funds to meet all legitimate asbestos claims, that it was fully funded and provided certainty for people with legitimate asbestos claims were false or misleading and that the directors were in breach of Section 180(1) of the Corporations Act.

Section 180(1) states:

¹ Australian Securities and Investments Commission v Macdonald (No 11) [2009] NSWSC 287

Care and diligence--civil obligation only

Care and diligence--directors and other officers

(1) 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.

The judge made the following main findings:

- A. In relation to a draft ASX Announcement prepared by JHIL on 15 February 2001 which contained statements to the effect that the Foundation was fully funded and provided certainty for claimants:
 - that all seven former directors of JHIL had breached s180(1) by failing to exercise their powers and discharge their duties with the necessary degree of care and diligence when approving a draft of that announcement;
 - that the CEO and general counsel had also breached s180(1) by failing to advise the Board appropriately.
- B. In relation to information concerning a deed of covenant and indemnity executed in February 2001:
 - that JHIL negligently failed to disclose that information, and
 - that the CEO and general counsel breached s180(1) by failing to advise the board appropriately in relation to the disclosure of that information.

C. In relation to the final ASX Announcement released on 16 February 2001, containing statements to the effect that the Foundation was fully funded and provided certainty for claimants, and statements to similar effect made at a press conference on that day, that the Announcement and statements were false and misleading, and

- that the CEO breached s180(1) by approving the Announcement and in making similar statements at the press conference
- that JHIL breached various provisions of the Corporations Act by releasing the Announcement and making the statements at the press conference.

D. In relation to ASX announcements made by JHIL on 23 February and 21 March 2001, concerning sufficiency of funding for asbestos claims:

- that the CEO breached s180(1) by approving the Announcement and in making similar statements at the press conference;
- that JHIL breached various provisions of the Corporations Act by releasing the Announcement and making the statements at the press conference;
- that the directors and the general counsel had breached Section 180(1) by failing to advise the board of JHIL that the reviews of the Cashflow Model by PwC and Access Economics (upon which the ASX announcements were based) were limited to reporting on its logical

soundness and technical correctness;

- the directors and the general counsel did not disclose that they had not verified, and had been specifically instructed not to consider, the key assumptions adopted by the Cashflow Model, being fixed investment earnings rates, litigation and management costs and future claim costs; and
 - that a director breached Section 180(1) in approving for release the Final ASX Announcement, or in failing to advise that the Final ASX Announcement not be released, or that it be amended before being released to remove the matters that were false or misleading.
- E. In relation to investor roadshow presentations and slides lodged with ASX in June 2002, containing statements concerning sufficiency of funding for asbestos claims:
- that the CEO breached s180(1) by approving the Announcement and in making similar statements at the press conference; and
 - that JHINV breached s1041E and s 1041H of the Corporations Act by releasing the Announcement.

The court found that ASIC had failed to establish a basis for all other allegations made against the James Hardie companies, the directors and the executives.

The failed allegations included allegations that the CEO breached s181 of the Corporations Act (the good faith obligations), and also various allegations with respect to a draft JHIL information memorandum for a scheme of arrangement in July 2001.

It should also be noted that the court has requested and is yet to hear submissions as to whether the various defendants should be exonerated for these contraventions, or whether some form of penalty or other sanction should be imposed.

Comments:

The court has found that in circumstances where the company is implementing a major transaction or corporate action, and the company is to make public statements concerning the matter, directors are not entitled to abdicate responsibility for approving and releasing public statements by delegating responsibility to other directors, to management or to advisers who may have greater expertise in the substance of the matter, or to the communications department.

Further, senior management have an obligation to bring to the notice of the board relevant material information upon which proposed public statements are based.

Consequences for General Counsel

For persons who hold the position of general counsel, this decision confirms that their level of corporate responsibility and liability has expanded, as they will be considered as officers of the company. Their obligations include:

- as well as providing legal advice, and assisting the board with legal issues, they will also need to warn the board of any risks associated with actions taken by the board, and protect the company against risk with care and diligence; and
- this duty extends possible damage to the company's reputation.

This decision will be the subject of intense scrutiny and debate. It will have an effect on

governance practices for the preparation and approval of statements made by listed entities concerning significant transactions, not just in ASX releases but also in prospectuses and other disclosure documents.

ASIC notes that a future hearing will consider penalties and submissions by the defendants relating to penalties.

ASIC has released a table analysing proved contraventions and dismissed allegations against each defendant.

The law is current as at May 2009.

Please note that this paper is a summary of the law only and is not a substitute for legal advice. Holley Nethercote is able to assist companies in meeting their obligations in this area by providing practical and prompt legal advice. Licensing, training and creation of compliance programs are also available via an associated business, Compact- Compliance and Corporate Training – www.compliance-training.com.au.

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