

Case note, Monday 18 May 2009

A director's duty to exercise care, skill and diligence – *ASIC v Macdonald (No 11) [2009] NSWSC 287*

Commercial & corporate Litigation & dispute resolution

The recent decision of *ASIC v Macdonald (No 11) [2009] NSWSC 287* in the Supreme Court of NSW (Hardie) has caused widespread alarm within the business community. Indeed, some in the media have gone so far as to label the decision “a blow against good corporate governance”, which will distract directors from their primary function of guiding a company's strategy.

Despite this reaction, Hardie does not extend the scope of directors' duties. The decision does, however, clarify that the duty to exercise care, skill and diligence is a strict one, which requires that, amongst other things, directors be familiar with relevant documents and participate actively in matters discussed at board meetings. The decision also provides useful guidance as to what is expected of directors in approving the content of public announcements.

Background

ASIC's central allegation against the directors related to the alleged approval by the board of James Hardie Industries Limited (JHIL) of a draft ASX announcement (Announcement) that dealt with the establishment of an independent foundation (Foundation) to compensate future asbestos claimants.

ASIC alleged that the Announcement was deceptive, false or misleading as it contained statements to the effect that the Foundation would have sufficient funds to meet all legitimate asbestos claims, was 'fully funded' and would provide certainty for claimants.

In giving judgment, Gzell J found that both the executive and non-executive directors breached their duty to exercise care and diligence in relation to their approval of the Announcement. In addition, Gzell J found that the executive directors (the CEO, General Counsel and CFO) had each failed in his duty to inform the board that the ability of the Foundation to fund future asbestos claims was expressed in the Announcement in overly emphatic terms.

Key points

The key messages for directors from the Hardie decision are:

- a director's duty to act with care and diligence is interpreted and applied strictly by the courts;
- at least in respect of announcements of strategically and/or critically important company decisions, a director should not simply rely on the opinion of a co-director, company management or external advisor. Rather, each director must independently scrutinise the accuracy of the contents of the announcements;
- a director attending a board meeting by telephone or video conferencing facilities must request that they be provided with a copy of documents being discussed and must familiarise themselves with the terms of those documents, or otherwise abstain from voting;

- caution should be exercised when using emphatic or unequivocal language in company announcements;
- when external advisors are involved, directors need to turn their attention to any key assumptions, qualifications or limitations that underpin the advice; and
- minutes of board meetings that do not strictly comply with the requirements of the *Corporations Act 2001 (Cth) (Act)* will not be presumed to be conclusive evidence of what occurred at that meeting.

The duty of care, skill and diligence

Courts have traditionally used an objective test to determine whether or not a director has exercised reasonable care and diligence, namely – has the director performed their duties to the standard expected of a 'reasonable person' in the corporation's and that director's particular circumstances? The Hardie decision applies that test.

Gzell J stated a number of circumstances should be considered, such as the experience or skills of the particular director and the particular function the director is performing, when determining whether these duties have been carried out in an appropriate and sufficient manner.

When is reliance by directors reasonable?

An important aspect of the case was the extent to which a director can rely on the opinion of other directors, management or external advisors. Contrary to some opinions expressed in the media, the case does not stand for the proposition that directors should not ever rely on the opinion of others in performing their duties.

Gzell J reaffirmed the general principle that although non-executive directors are not required to have a direct involvement in operational matters, they are nevertheless required to take reasonable steps to place themselves in a position to guide and monitor the management of the company.

As such, Gzell J found that a director may rely on the opinions of management or another company officer if the reliance is appropriate (in other words, reasonable) in the circumstances. Such reliance will be unreasonable where a director knows, or by the exercise of ordinary care should have known, that those opinions are not correct or accurate, or that such reliance is inappropriate or suspect.

What was required of the non-executive directors in this case?

While the Court found that the executive directors failed to properly inform the board about the limitations of the expert reports, the Court also found the non-executive directors breached their duties by failing to amend the Announcement to include appropriate reference to the limitations and qualifications contained in the expert reports, on which the Announcement was purportedly based.



It was apparent that the importance of the Announcement to the future of the company was a crucial factor in determining the extent to which the directors could rely on others. Gzell J noted that the Announcement was a “key statement in relation to a highly significant restructure of the James Hardie group” and contained “potentially explosive” material. Given the importance of the Announcement, it was thus incumbent upon each director to satisfy themselves that, to the best of their knowledge, the contents of the Announcement were true, accurate and not misleading.

The emphatic language used in the Announcement was also found to be contrary to the information put before the board at and prior to the meeting, and it must therefore have been obvious to the non-executive directors (so Gzell J held) that the Announcement was misleading and deceptive.

Gzell J did not see this as a case that involved specialist skill or knowledge of which the directors could reasonably rely upon management, a co-director or an expert advisor “more concerned with communications strategy”. On this point Gzell J was clear – scrutiny of the Announcement involved “no more than an understanding of the plain English used”. As a consequence, Gzell J felt that it was appropriate for the directors to take the necessary steps to verify the accuracy of the information in the Announcement.

Furthermore, even if a director does not have a complete copy of all the board materials, it is the director’s responsibility to obtain the materials or otherwise abstain from voting. Gzell J also found that in circumstances where directors have not seen the contents of board materials until the board meeting, or where an announcement is a “last minute affair”, there is “all the more reason” for a detailed consideration of its content.

Continuous disclosure

The CEO and Company Secretary (also acting as General Counsel) were also found to have breached their duties by not advising the board of the obligation to disclose certain documents under the ASX continuous disclosure rules. In particular, Gzell J highlighted that the CEO and Company Secretary should have sought advice in relation to the company’s disclosure obligations and should also have advised the Chairman as to the material documents that needed to be disclosed to the ASX.

Approving public announcements

It is the board that is ultimately responsible for ensuring that public announcements are true and accurate. In particular, it is critical for directors to exercise great caution when making unequivocal or unqualified statements in public announcements. Although actuarial reports and other types of forecasting models can be used, it is important that they are fairly represented by clearly stating any assumptions and qualifications.

What do board minutes prove?

ASIC submitted that, under s251A(6) of the Act, there was a statutory presumption that the minutes of the board meeting at which the Announcement was allegedly considered were conclusive evidence of what occurred at the meeting, unless the defence could prove otherwise.

Gzell J held that board minutes will only be given that special evidentiary status if they are recorded strictly in accordance with the requirements of s.251A. Because the board minutes failed that test (on the basis that they were not recorded in a minute book within one month of the meeting), Gzell J found that they should not be given any special evidentiary status.

Conclusion

This case serves as an opportunity for boards to assess any improvements that can or should be made to their decision-making processes and the way their decisions are conveyed to the market.

Rather than being a “blow against good corporate governance”, the case simply reaffirms that directors must actively participate in and scrutinise matters discussed at board meetings. In particular, at least in respect of announcements of importance to the company and to the public, directors should not simply rely on the opinion of others and should independently scrutinise the contents of announcements to satisfy themselves of the accuracy of their contents.

Finally, it should be noted that exoneration provisions within the *Corporations Act* give the court the power to relieve a director from liability when they have acted honestly and in good faith. These provisions have not yet been considered in this case, with submissions required from the parties in response to the Hardie decision.

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