CASE NOTE

AUSTRALIAN SECURITIES AND INVESTMENTS COMMISSION v MACDONALD [NO 11]*

CORPORATE GOVERNANCE LESSONS FROM JAMES HARDIE

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*[*Australian Securities and Investments Commission v Macdonald [No 11] *required the New South Wales Supreme Court to determine whether company directors and officers of James Hardie Industries Ltd had breached their duties, in particular the statutory duty of care and diligence in s 180(1) of the* Corporations Act 2001 *(Cth) in the context of the board approving and releasing to the Australian Securities Exchange a defective media statement that commented on the effects of a corporate restructure and the company's ability to meet future asbestos liabilities. Significantly, in affirming liability in respect of some of the civil penalty charges laid by the Australian Securities and Investments Commission, Gzell J held that 10 former directors and officers of James Hardie Industries Ltd breached their duties of care by approving and releasing a media statement that was false, or misleading and deceptive, and capable of having an adverse effect on the company and the market. In holding that the company also breached its statutory obligations under the continuous disclosure provisions,* Macdonald *highlights the responsibilities of the board, chief executive officer and general counsel of listed companies to ensure compliance with the law. This case note analyses the reasons underpinning the outcome in* Macdonald*, with a focus on the modern scope and content of officers' and directors' duties. It considers the extent to which reliance can be placed by a non-executive director on other directors, management and external advisers and discusses the potential implications of the case and the lessons that need to be implemented for sound boardroom governance.]*

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I INTRODUCTION

Corporate governance embraces, inter alia, 'how risk is monitored and assessed' and provides 'accountability and control systems commensurate with the risks involved.'[1] Corporate governance measures, in particular directors' duties, are but one of the many control devices relied upon to reduce the agency costs associated with shareholder monitoring.[2] The Berle–Means paradigm — which views the separation of ownership and control as being ownership dispersed among shareholders and control vested in directors[3] — has been highly influential in the development of corporate law norms in Anglo-American jurisdictions. To bridge the gap between shareholder and manager interests, a consequence of an 'agency problem' arising from divergent interests,[4] the board of directors has a duty to monitor management performance and to align managers' incentives with the shareholders' profit-maximising goal.

As a general rule, a company is to be managed by or under the direction of its board of directors.[5] The board's monitoring functions 'are the heart of what the agency cost model of the firm identifies as the central role for the board'.[6] The movement to take boards seriously, according to a leading commentator, has

1 ASX Corporate Governance Council, *Corporate Governance Principles and Recommendations* (2nd ed, 2007) 3, from which this definition is adapted for purposes of this case note.

2 See generally Michael C Jensen and William H Meckling, 'Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure' (1976) 3 *Journal of Financial Economics* 305. The agency costs consist of, inter alia, expenses associated with monitoring activities by and on behalf of the shareholders in order to limit the non-wealth-maximising activities of managers: at 308.

3 Adolf A Berle Jr and Gardiner C Means, *The Modern Corporation and Private Property* (1932) 3–7.

4 Ibid 6–7.

5 *Corporations Act 2001* (Cth) s 198A.

6 Donald C Langevoort, 'The Human Nature of Corporate Boards: Law, Norms, and the Unintended Consequences of Independence and Accountability' (2001) 89 *Georgetown Law Journal* 797, 802.

identified monitoring management decisions as a primary governance role of the board of directors.[7]

For the purpose of accountability and to minimise the risk of self-dealing and shirking by management, the law imposes both fiduciary duties and the duty to exercise care, skill and diligence upon officers and directors.[8] As fiduciaries, directors have an obligation to favour corporate interests over personal interests.[9] As monitors of management performance, boards of directors are accountable for decisions and conduct in office through the duty to exercise care, skill and diligence. Directors are expected to discharge their duties in a careful and competent manner. There is no place for underperformance or shirking of directors' duties, particularly when the board is entrusted with a specific task, as illustrated by the decision in *Australian Securities and Investments Commission v Macdonald [No 11]* ('*Macdonald*'), where eight former directors (seven non-executive and one executive) and two officers of James Hardie Industries Ltd ('JHIL') were found culpable of dereliction of duty.

The facts and decision in *Macdonald* underscore the failure of the JHIL board to discharge its dual role as adviser and supervisor.[10] The aim of this case note is to examine the decision and reasoning of the Supreme Court of New South Wales in *Macdonald* and to discuss the potential impact of the case on Australian corporate governance practices. However, first it is appropriate to discuss the antecedent and complex events leading to the relevant legal issues raised in *Macdonald*, which attracted great, and legitimate, public interest following the company's manifest intention at the outset to create a limited fund to compensate asbestos claims and thereafter to divest itself of future liabilities upon depletion of the fund.

II CONTEXT: SPECIAL COMMISSION OF INQUIRY

Macdonald came before the Supreme Court in the wake of the findings of a Special Commission of Inquiry established by the NSW government to examine, inter alia, the circumstances in which the Medical Research and Compensation Foundation Ltd ('Foundation') was created and separated from the James Hardie group and whether this may have impacted on the sufficiency of assets to meet its future asbestos-related liabilities.[11]

Before identifying the principal conclusions of the Special Commission of Inquiry, it is necessary to canvass the background to the events leading to the

7 Jill E Fisch, 'Taking Boards Seriously' (1997) 19 *Cardozo Law Review* 265, 268–70.

8 For discussion on the rationale and development of directors' statutory duties in Australia, see Jason Harris, Anil Hargovan and Janet Austin, 'Shareholder Primacy Revisited: Does the Public Interest Have Any Role in Statutory Duties?' (2008) 26 *Company and Securities Law Journal* 355.

9 See generally R P Austin and I M Ramsay, *Ford's Principles of Corporations Law* (14th ed, 2010) 363–4.

10 For discussion on the balance between the two roles, see Tamar Frankel, 'Corporate Boards of Directors: Advisors or Supervisors?' (2008) 77 *University of Cincinnati Law Review* 501.

11 Department of Premier and Cabinet (NSW), *Report of the Special Commission of Inquiry into the Medical Research and Compensation Foundation* (2004) ('*Jackson Report*').

contentious corporate reconstruction of James Hardie and the facts leading to the commencement of civil proceedings in *Macdonald* by the corporate regulator for, inter alia, breach of directors' and officers' duties.

A *James Hardie's Activities*

Companies in the James Hardie group were major participants in the manufacture of asbestos products in the 1920s, which were used extensively in Australia during the major part of the last century, particularly in building products and insulation materials. James Hardie had been responsible for 70 per cent of Australian asbestos consumption.[12] Asbestos is injurious to health and its fibres can give rise to asbestosis, lung cancer and mesothelioma, which are often fatal. These diseases may not manifest themselves immediately, and it is not uncommon for a severe medical condition to arise some decades after exposure to the asbestos fibre. Asbestosis was common in the 1920s, but the insidious effect of asbestos and its link to mesothelioma were only established in 1960.[13]

JHIL (now 'ABN 60 Pty Ltd') manufactured asbestos products until 1937, whereupon this activity was taken over by its subsidiary, James Hardie & Coy Pty Ltd (now 'Amaca Pty Ltd'), which became a substantial producer until it ceased this business activity in the 1980s.[14] Another business arm of the corporate group, Jsekarb Pty Ltd (now 'Amaba Pty Ltd'), manufactured brake lining products until its sale to an independent party in 1987.[15] These three companies in the James Hardie group were the main participants in the manufacture and distribution of asbestos products. These companies, together with Mr Macdonald as JHIL's chief executive officer, Mr Shafron as the company secretary and general counsel, and Mr Morley as the chief financial officer, were to form the dramatis personae in the corporate reconstruction of James Hardie.[16]

B *Impetus for Corporate Restructure*

A switch in business focus to the United States and the development of new non-asbestos products in the 1980s proved successful for the James Hardie group and provided the impetus to separate the accruing asbestos liabilities in Australia from the group's core business in the United States.[17] This impetus to divest itself of its asbestos liabilities also came from the desire of the group to remove what it perceived as an obstacle to its aspirations to access the capital market in the United States. An aborted attempt to issue 15 per cent of the shares of a related Dutch company, James Hardie Industries NV ('JHINV'), on the New

[12] Ibid vol 1, 59 (citations omitted).
[13] Ibid vol 1, 18 fn 4.
[14] Ibid vol 1, 17–18.
[15] Ibid vol 1, 18.
[16] There have been many changes in the identity and names of the James Hardie companies over the years. This case note, however, will refer to the three companies relevant for purposes of this discussion as 'James Hardie Industries Ltd' (or 'JHIL'), 'Amaca' and 'Amaba'.
[17] *Jackson Report*, above n 11, vol 1, 18–19.

York Stock Exchange added to the impetus for a corporate restructure to 'fully realise the value of JHIL, and for its growth prospects to be realised', by adopting the United States as the group's base.[18] Without separation of the asbestos-related liabilities on its balance sheet, it was thought that 'listing in the United States was "commercially unrealistic"'.[19]

Three other influential factors contributed to the momentum towards the group's corporate reconstruction and its timing. The first factor was the desire to avoid the impact of a proposed new Australian Accounting Standard,[20] due to come into force in October 2001, which would have required disclosure of the group's estimated total of its asbestos liabilities.[21] The second factor was the desire to capitalise on the timing of the announcement of the group's third quarter results to the market on 16 February 2001.[22] It was envisaged that the simultaneous announcement of the group's profits together with the corporate restructure plan would deflect attention from a controversial issue which might otherwise attract undesirable publicity. The third factor related to the effluxion of time and the new stewardship of the business.[23] Within this context, the James Hardie group's asbestos liabilities were treated as 'non-core issues', a source of 'management distraction' and regarded as 'legacy issues' which formed 'part of the rump'.[24]

Against this backdrop of corporate aspiration and apparent indifference to the fact that the James Hardie group remained accountable for negligence in the manufacture and distribution of asbestos products over the last century (notwithstanding cessation of that business), the group marched forward with a separation plan that was poorly executed, as illustrated below in Part III.

C *Key Features of the Separation Plan*

From the year 2000 until 15 February 2001, the management of JHIL worked on a plan (known as 'Project Green') to divest the group of its asbestos liabilities through the use of a trust structure in the following way. Amaca and Amaba 'would remain responsible to claimants in respect of asbestos-related liabilities, to the extent of their existing assets, but ownership [of both these companies] would pass from JHIL to a new company unrelated to JHIL' known as the Medical Research and Compensation Foundation Ltd, which would operate as a trust.[25]

The Foundation, a company limited by guarantee, became the trustee of the Foundation trust. New directors were appointed to the trust and to Amaca and

18 Ibid vol 1, 23–4 (citations omitted).
19 Ibid vol 1, 340 (citations omitted).
20 See Australian Accounting Standards Board, *Provisions and Contingencies*, Exposure Draft No 88, December 1997.
21 *Jackson Report*, above n 11, vol 1, 25–6.
22 Ibid vol 1, 26.
23 Ibid vol 1, 19.
24 Ibid (citations omitted).
25 Ibid vol 1, 25.

Amaba. The structure adopted sought to exploit the benefits of the separate legal entity rule and limited liability,[26] benefits ordinarily conferred on companies by the corporate veil and extended to corporate groups.[27]

Furthermore, as part of the concerted effort to quarantine JHIL from its asbestos liabilities, the following arrangements were put in place. 'In return for payments to be made over time by JHIL to each of [Amaca and Amaba], JHIL was to be indemnified by [both these companies] against any asbestos-related liabilities which JHIL might have'.[28] Moreover, both these companies agreed to forego any claims against JHIL arising from any past dealings with it, including in relation to the payment of dividends or management fees. Recovery of such intra-group payments was barred by a deed of covenant and indemnity ('DOCI') entered into by the contracting parties.[29]

The Australian Securities and Investments Commission ('ASIC') alleged that JHIL breached its obligation to disclose the DOCI information to the Australian Securities Exchange ('ASX') as required under ASX *Listing Rules* (at 1 July 2000) r 3.1 ('*Listing Rules*') and the *Corporations Law*.[30] ASIC also alleged that the failure of the chief executive officer (Mr Macdonald) to advise the chair of the board of the need to make disclosure was a breach of the duty of care and diligence under s 180(1) of the *Corporations Act 2001* (Cth) ('*Corporations Act*').[31] Similarly, ASIC alleged that failure by the company's general counsel (Mr Shafron) to provide his own advice on the need for disclosure was a breach of s 180(1).[32] ASIC further alleged that the failure of the chief financial officer (Mr Morley) to negotiate additional funds during the execution of the DOCI was a breach of s 180(1).[33]

26 See generally *Salomon v Salomon & Co Ltd* [1897] AC 22.

27 See *Walker v Wimborne* (1976) 137 CLR 1, 6–7 (Mason J); *Industrial Equity Ltd v Blackburn* (1977) 137 CLR 567, 575–7 (Mason J). The question whether existing laws concerning the operation of limited liability or the corporate veil within corporate groups require reform falls outside the scope of this case note. There is, however, a wealth of literature that explores this relevant question highlighted by the James Hardie experience: see generally Frank H Easterbrook and Daniel R Fischel, 'Limited Liability and the Corporation' (1985) 52 *University of Chicago Law Review* 89; Phillip I Blumberg, 'Limited Liability and Corporate Groups' (1986) 11 *Journal of Corporation Law* 573; Phillip I Blumberg, 'The Transformation of Modern Corporation Law: The Law of Corporate Groups' (2005) 37 *Connecticut Law Review* 605; Kurt A Strasser, 'Piercing the Veil in Corporate Groups' (2005) 37 *Connecticut Law Review* 637; Anil Hargovan and Jason Harris, 'Piercing the Corporate Veil in Canada: A Comparative Analysis' (2007) 28 *Company Lawyer* 58; Peter Prince, Jerome Davidson and Susan Dudley, 'In the Shadow of the Corporate Veil: James Hardie and Asbestos Compensation' (Research Note No 12, Parliamentary Library, Parliament of Australia, 2004). The deficiencies in Australian corporate law concerning the operation of limited liability within corporate groups were noted in the *Jackson Report*, above n 11, vol 1, 571–3.

28 *Jackson Report*, above n 11, vol 1, 28.

29 Ibid vol 1, 28, 329–31.

30 *Corporations Act 1989* (Cth) s 82 ('*Corporations Law*'). See *Macdonald* (2009) 256 ALR 199, 207–8 (Gzell J).

31 *Macdonald* (2009) 256 ALR 199, 208 (Gzell J).

32 Ibid.

33 Ibid 209.

D *Public Announcement of the Separation*

The events surrounding the public announcement of the separation are germane to the litigation in *Macdonald*. The draft ASX announcement that ASIC alleged was before the board on 15 February 2001,[34] and which was subsequently released to the public on 16 February 2001, was an integral part of the public relations planning in relation to the separation. The theme of certainty of sufficient funding pervaded this, and future, media statements which became the focus of attention in *Macdonald*. The final ASX announcement included, inter alia, the following statements which ASIC alleged to be false or misleading and the basis of the directors' breaches of the statutory duty of care and diligence in s 180(1):

> The Foundation has sufficient funds to meet all legitimate compensation claims … Mr Peter Macdonald said that the establishment of a fully-funded Foundation provided certainty for both claimants and shareholders. … In establishing the Foundation, James Hardie sought expert advice … 'James Hardie is satisfied that the Foundation has sufficient funds to meet anticipated future claims' …[35]

ASIC also alleged that press conference statements and representations made at JHINV's roadshows in Edinburgh and London in 2001 by Mr Macdonald, in terms similar to the document above, were false and misleading and constituted breaches of s 180(1).[36] Furthermore, ASIC alleged that through Mr Macdonald's conduct in making such statements JHIL engaged in misleading and deceptive conduct in breach of the *Corporations Law* and the *Corporations Act*.[37] ASIC had a substantial degree of success in its claims on these issues for reasons discussed below in Part III.

E *Scheme of Arrangement and Relocation to the Netherlands*

After the establishment of the Foundation in February 2001, steps were implemented in October 2001 pursuant to a scheme of arrangement[38] to substitute a new Dutch company (JHINV) for JHIL as the holding company of the group — with JHIL becoming a wholly-owned subsidiary of JHINV. The impetus for the move to the Netherlands centred on the prospect of further international growth for the group, as well as being in the best interests of the shareholders as a whole due to the improvement in the after-tax returns to shareholders.[39]

34 This point was contested, unsuccessfully, by the 10 former directors and officers who claimed that they had no recollection of this document being tabled at the board meeting: ibid 239; see also at 240–5.

35 ASX, 'James Hardie Resolves Its Asbestos Liability Favourably for Claimants and Shareholders' (Media Release No 228763, 16 February 2001), quoted in ibid 229.

36 *Macdonald* (2009) 256 ALR 199, 212–13 (Gzell J).

37 Ibid 213.

38 *Corporations Act* s 411.

39 *Jackson Report*, above n 11, vol 1, 32–3. James Hardie, ironically, has offered a similar reason for its plan, subject to approval at a meeting of shareholders anticipated in early 2010, to move

A brief overview of the mechanics of the scheme is relevant for the legal issues subsequently raised in *Macdonald*. One of the main features of the scheme involved JHINV subscribing for partly paid shares in JHIL. Consequently, JHIL could call on its holding company to pay any or all of the remainder of the issue price of those shares at any time in the future. Significantly, the amount callable under the partly paid shares would be equal to the market value of the James Hardie group less the subscription monies already paid up. This sum was considerable and was likely to be in the region of $1.9 billion.[40] The significance of this feature of the scheme was underscored when JHIL assured Santow J — during the application for approval of the scheme in the NSW Supreme Court in October 2001 — that JHIL had the ability to satisfy any asbestos-related liabilities by calling upon the partly paid shares.[41]

The cancellation of the partly paid shares and the formation of a new foundation in March 2003 to acquire the shares in JHIL ensured the complete removal of JHIL from the James Hardie group. The subsequent failure to inform the public of this development immediately also became the focus of attention in *Macdonald*.

ASIC alleged that, in approving the information memorandum ('IM') sent to members of JHIL, which failed to include the plan to cancel the partly paid shares, five of the non-executive directors present at the board meeting on 23 July 2001 breached s 180(1).[42] Similarly, ASIC alleged that, by issuing the IM to its members, JHIL breached s 995 of the *Corporations Act* due to misleading and deceptive conduct.[43] For the same reasons, ASIC alleged that Messrs Macdonald and Shafron, in failing to discharge their duties in advising the board that the IM was false or misleading, acted in breach of s 180(1).[44]

It is this background of the very large discrepancy between the initial funding of the Foundation and the actuarial assessments of its liabilities which gave rise to controversy and the appointment of the Special Commission of Inquiry. Concerns about the ability of the Foundation to meet its liabilities were also underscored by its application to court to seek relief that would permit payments

its corporate domicile from the Netherlands to Ireland following approval by the Commonwealth Treasurer: see 'James Hardie Cleared for Ireland Move', *The Sydney Morning Herald* (online), 22 September 2009.

40 See *Jackson Report*, above n 11, vol 1, 34.

41 *Macdonald* (2009) 256 ALR 199, 211–12 (Gzell J). Management of JHIL did not alert the Court to the Foundation's concerns over the inadequacy of the initial funding and the Foundation's fears of being unable to meet the claims of all asbestos victims, which were expressed by the Foundation in a director's letter dated 24 September 2001: ibid vol 1, 34–5. Santow J approved the scheme under these circumstances: see *Re James Hardie Industries Ltd* (2001) 39 ACSR 552.

42 *Macdonald* (2009) 256 ALR 199, 211 (Gzell J). The five non-executive directors present were Mr Brown, Mr Gillfillan, Ms Hellicar, Mr Koffel and Mr Willcox.

43 Ibid 212.

44 Ibid.

to claimants in full[45] notwithstanding statutory provisions that prohibit insolvent trading.[46]

F *The* Jackson Report *and Its Significance*

In a wide-ranging inquiry into the financial position of the Foundation, the likelihood that it could meet its future asbestos-related liabilities and the circumstances of the corporate reconstruction of James Hardie, David Jackson QC came to the following conclusions that are relevant for purposes of this case note:

1 As at 30 June 2004, liabilities of the Foundation were estimated at not less than $1.5 billion. Against that, the value of the total assets acquired by the Foundation was $293 million.[47]

2 There was 'no prospect [of the Foundation] meeting the liabilities of Amaca and Amaba in either the medium or long term' due to the rapid depletion of the funds used in the payment of current claims,[48] and the life of the Foundation was about three years or a little less.[49]

3 The actuarial report produced by Trowbridge in February 2001 'provided no satisfactory basis for an assertion that the Foundation would have sufficient funds to meet all future claims.'[50]

4 'The evidence demonstrated that the February 2001 estimates of future liabilities were far too low and that the results of the financial modelling were wildly optimistic.'[51]

5 'The public announcements made by JHIL at the time of separation [16 February 2001] emphasised that JHIL had provided for a Foundation which had sufficient funds to satisfy all future legitimate asbestos-related claims.'[52]

6 The media release sent to the ASX, conveying the idea of 'certainty' with respect to the Foundation's funding, was 'seriously misleading' and also conveyed the misleading impression that the funding amount JHIL arrived at was checked by independent experts.[53]

45 It was argued that, at the time of the application, the Foundation was insolvent in a 'practical and commercial sense' because it was likely to not be able to meet future asbestos-related liabilities: *Edwards v A-G (NSW)* (2004) 60 NSWLR 667, 682 (Young CJ in Eq).

46 See, eg, *Corporations Act* s 588G.

47 *Jackson Report*, above n 11, vol 1, 8.

48 Ibid vol 1, 7.

49 Ibid vol 1, 63.

50 Ibid vol 1, 9.

51 Ibid vol 1, 12.

52 Ibid vol 1, 8.

53 Ibid vol 1, 10. The Commissioner remarked incredulously:

> I find it difficult to accept that management could really have believed that the funds of the Foundation would have been sufficient … [y]et that was the message that JHIL propounded, … the day after separation, to the [ASX], to government, the media, its shareholders, unions, plaintiffs' solicitors, asbestos victims and anybody else it felt the need to convince.

7 Contrary to the claims in the media release sent to the ASX, the Foundation was not 'fully-funded'. 'It was massively under-funded.'[54]

8 '[T]he JHIL board meeting of 15 February 2001 approved the ASX announcement to be made by JHIL.'[55] This view, however, was unsuccessfully challenged by the board in *Macdonald* despite the absence of direct evidence of board approval.

The Commissioner's report, released in September 2004, had a direct bearing on ASIC's decision to launch civil penalty proceedings in February 2007 against James Hardie, its directors and its officers. The report was used as a springboard to launch further investigations into the activities of the James Hardie group.

ASIC investigated the conduct of JHIL and that of both executive and non-executive directors and sought court declarations that a range of directors and officers had breached their duties owed to JHIL.[56] The practical application of the scope and content of directors' and officers' duties, particularly the statutory duty of care and diligence, was one of the essential tasks requiring judicial determination, as addressed below.

III *Australian Securities and Investments Commission v Macdonald [No 11]*

A *Legal Issues*

Based on the facts discussed above, ASIC alleged in Supreme Court hearings in September 2008 that JHIL, its officers and the board had engaged in multiple breaches of the *Corporations Law* and the *Corporations Act* which attracted civil penalties.[57] In particular, ASIC argued that:

1 The draft ASX announcement approved at the board meeting on 15 February 2001 was false or misleading. The approval by the non-executive directors,[58] the chief executive officer (Mr Macdonald), the company secretary and general counsel (Mr Shafron) and the chief financial officer (Mr Morley) was in breach of the duty of care in s 180(1).[59]

54 Ibid vol 1, 356.

55 Ibid vol 1, 351.

56 The investigation 'spanned three countries (the United States, the United Kingdom and Australia) and … involved about 348 billion documents, 72 examinations and the issuing of 284 notices to obtain evidence': ASIC, 'ASIC Commences Proceedings Relating to James Hardie' (Media Release No 07-35, 15 February 2007).

57 In relation to non-executive directors, 'ASIC concluded that the evidence was not of a nature sufficient to refer any matter' to the Commonwealth Director of Public Prosecutions ('CDPP') for criminal prosecution: ASIC, 'James Hardie Group Civil Action' (Media Release No 08-201, 5 September 2008). ASIC did, however, refer briefs to the CDPP 'in respect of certain individuals' but agreed with the CDPP's 'conclusion that there was an insufficient basis to commence any criminal proceedings.'

58 *Macdonald* (2009) 256 ALR 199, 206 (Gzell J). The non-executive directors were Mr Brown, Ms Hellicar, Mr Gillfillan, Mr Koffel, Mr O' Brien, Mr Terry, and Mr Willcox.

59 Ibid 206–7.

2 JHIL's failure to disclose information to the ASX in relation to the DOCI was in breach of s 1001A(2).[60]

3 Failure by the chief executive officer and the company secretary and general counsel to advise the board that the DOCI information should be disclosed to the ASX was in breach of s 180(1).[61]

4 The chief executive officer had breached s 180(1) for failure to advise that the final ASX announcement on 16 February 2001 should not be released or that it should be amended to cure the defect.[62]

5 Statements made by the chief executive officer at a press conference concerning the adequacy of funding for asbestos claims were false or misleading and involved a breach of s 180(1).[63]

6 A release to the ASX on 23 February 2001 by the chief executive officer, which contained false or misleading statements, was in breach of s 180(1).[64]

7 The approval by the same officer of an announcement released to the ASX on 21 March 2001 containing false or misleading statements was in breach of s 180(1) and the good faith provisions in s 181(1).[65]

8 The publication of the final ASX announcement, the press conference statements and the further ASX announcements, referred to in point 6 above, by JHIL contravened ss 995(2)[66] and 999[67] of the *Corporations Law*.

9 The representations made by the chief executive officer with respect to JHINV at roadshows in Edinburgh and London and in slides for these presentations, which were lodged with the ASX, were false and misleading and in breach of ss 180(1) and 181.[68] On the same facts, it was argued that

60 Ibid 207. Section 1001A(2) of the *Corporations Law*, carried over into *Corporations Act* s 1001A(2) until its repeal in 2002 (by *Financial Services Reform Act 2001* (Cth) sch 1 item 1), dealt with breach of continuous disclosure obligation.

61 *Macdonald* (2009) 256 ALR 199, 208 (Gzell J).

62 Ibid 209.

63 Ibid.

64 Ibid.

65 Ibid 210. Section 181 of the *Corporations Law* (now s 181 of the *Corporations Act*) requires directors and officers of a corporation to exercise their powers and discharge their duties 'in good faith in the best interests of the corporation' and 'for a proper purpose'.

66 *Macdonald* (2009) 256 ALR 199, 210 (Gzell J). Section 995(2) of the *Corporations Law*, carried over into *Corporations Act* s 995(2) until its repeal in 2002 (by *Financial Services Reform Act 2001* (Cth) sch 1 item 1), was modelled on s 52 of the *Trade Practices Act 1974* (Cth) and prohibited misleading or deceptive conduct in connection with securities. A similar provision to *Corporations Law* s 995(2) exists in *Corporations Act* s 1041H(1).

67 *Macdonald* (2009) 256 ALR 199, 210 (Gzell J). Section 999 of the *Corporations Law*, carried over into *Corporations Act* s 999 until its repeal in 2002 (by *Financial Services Reform Act 2001* (Cth) sch 1 item 1), prohibited making statements or disseminating information in relation to securities that was false or misleading.

68 *Macdonald* (2009) 256 ALR 199, 212–13 (Gzell J).

JHINV was in breach of s 1041E[69] and, in making the ASX representations, breached s 1041H.[70]

10 JHINV failed to notify the ASX of JHIL information in accordance with *Listing Rules* r 3.1, and thereby contravened disclosure obligations in s 674(2).[71]

B *The Supreme Court Decision*

In a judgment delivered by Gzell J, his Honour upheld a number, but not all, of ASIC's claims identified above. His Honour had no difficulty in finding that the content of the draft ASX announcement satisfied the test used for a breach of s 52 of the *Trade Practices Act 1974* (Cth).[72] Noting that in this case the notional representative class member impacted by the announcement was broad, including financial market analysts, investors and other stakeholders, his Honour held:

> To the unsophisticated sufferer of an asbestos related disease or other stakeholder the message on a fair reading … was that it was certain that the foundation had sufficient funds to pay all legitimate asbestos claims. That was the plain English meaning … [I]t was [re-]enforced … by the statement attributed to Mr Macdonald that the foundation was fully funded. … People with legitimate asbestos claims could be certain that there were sufficient funds to pay their claims. To read [that statement] as conveying that the establishment of the foundation provided certainty but not certainty that legitimate claims would be paid is a tortuous reading of the document.[73]

Significantly from a corporate governance perspective, his Honour held that the 10 directors and officers of JHIL breached their statutory duty of care and diligence under s 180(1) by approving the false or misleading and deceptive public announcement.[74] In arriving at this conclusion, his Honour focused attention onto the legal responsibilities of the non-executive directors when requested by management to consider this strategic public announcement surrounding the separation plan.[75] The judicial spotlight, thereafter, was turned on the standard of performance expected of the chief executive officer, general counsel and the chief financial officer of JHIL.[76]

[69] Ibid 213. Section 1041E of the *Corporations Act* prohibits false or misleading statements which induce persons to, inter alia, apply for or dispose of financial products.

[70] *Macdonald* (2009) 256 ALR 199, 213 (Gzell J). Section 1041H of the *Corporations Act* prohibits misleading or deceptive conduct in relation to a financial product.

[71] *Macdonald* (2009) 256 ALR 199, 214–15 (Gzell J). Section 674(2) of the *Corporations Act* deals with a listed disclosing entity's continuous disclosure obligations.

[72] *Macdonald* (2009) 256 ALR 199, 258–60 (Gzell J). See also *National Exchange Pty Ltd v Australian Securities and Investments Commission* (2004) 49 ACSR 369, 373–4 (Dowsett J); *Ingot Capital Investments Pty Ltd v Macquarie Equity Capital Markets Ltd* (2008) 252 ALR 659, 667 (Giles JA).

[73] *Macdonald* (2009) 256 ALR 199, 258–9.

[74] Ibid 260–3.

[75] See ibid 260–2.

[76] See ibid 262–79.

Although all of the directors and officers denied considering the draft ASX announcement at the relevant board meeting despite its mention in the minute book, Gzell J relied on inferential evidence and did 'not accept the chorus of denial of recollection to be genuine.'[77] However, his Honour did not rely on the special evidentiary status of the minutes, conferred by s 251A(6) of the *Corporations Act*, due to the company's noncompliance with the strict formalities for the entry of minutes within one month of the meeting.[78]

C *Non-Executive Directors' Breach of Duty of Care and Diligence*

The directors' statutory duty of care and diligence, which is akin to that at common law[79] and occupied centre stage in this case, is expressed in the following terms in s 180(1) of the *Corporations Act*:

> 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.

In assessing whether the 10 directors and officers breached s 180(1) in approving the draft ASX statement considered at the 15 February 2001 board meeting, Gzell J adopted[80] the legal principles considered by Brereton J in *Australian Securities and Investments Commission v Maxwell* ('*Maxwell*'),[81] which accepted, inter alia, the following propositions of law:

1 'In determining whether a director has exercised reasonable care and diligence … the circumstances of the particular corporation concerned are relevant to the content of the duty. These circumstances include [inter alia] the type of company, … the size and nature of the company's business, the composition of the board, the director's position and responsibilities within the company, the particular function the director is performing, the experience or skills of the particular director … and the circumstances of the specific case'.[82]

2 The statutory duty of care and diligence can be contravened 'even if there was no actual damage, [so long as] it was reasonably foreseeable that the relevant conduct might harm the interests of the company'. Furthermore, to

[77] Ibid 377.

[78] Ibid 218.

[79] Ibid 245, quoting *Australian Securities and Investments Commission v Maxwell* (2006) 59 ACSR 373, 397–8 (Brereton J). See also *Vines v Australian Securities and Investments Commission* (2007) 62 ACSR 1, 34–5 (Spigelman CJ) ('*Vines*').

[80] *Macdonald* (2009) 256 ALR 199, 245–7.

[81] (2006) 59 ACSR 373.

[82] Ibid 397 (citations omitted). See also *Daniels v Anderson* (1995) 37 NSWLR 438, 602 (Powell JA); *Australian Securities and Investments Commission v Adler* (2002) 168 FLR 253, 347 (Santow J) ('*Adler*').

> establish breach 'the foreseeable risk of harm must be balanced against the potential benefits which could reasonably be expected to accrue to the company from that conduct'.[83]

Within this general review of legal principles, Gzell J paid particular attention to the question whether the law differentiated between the standard of performance expected of executive and that expected of non-executive directors.[84]

His Honour referred to the divergent judicial views expressed by Rogers CJ Comm D in *AWA Ltd v Daniels*, who appeared to show readiness to accept a lower standard of care for non-executive directors,[85] and the NSW Court of Appeal in *Daniels v Anderson*, wherein Clarke and Sheller JJA held that the approach of Rogers CJ Comm D on this issue did not represent modern company law[86] and that all directors are required to 'take reasonable steps … to guide and monitor the management of the company.'[87]

After reviewing case law on this issue,[88] Gzell J reiterated the analysis of Santow J in *Australian Securities and Investments Commission v Adler* ('*Adler*')[89] (drawn from earlier authorities) and held that a director should become familiar with the fundamentals of the company's business and is under a continuing obligation to keep informed about the company's activities.[90] Gzell J observed, significantly, that the NSW Court of Appeal in *Adler* did not consider Santow J's analysis of the modern legal principles applicable to the directors' duty of care and diligence 'to be deficient'.[91]

Satisfied that the same standards of care are imposed on all directors, Gzell J focused on the test to determine breach of s 180(1) and relied on *Adler* to espouse the following objective test:

> In determining whether a director has exercised reasonable care and diligence one must ask what an ordinary person with the knowledge and experience of the defendant might be expected to have done in the circumstances if he or she was acting on their own behalf …[92]

Turning to the facts and applying this objective assessment, his Honour held that all of the non-executive directors knew or should have known of the

83 *Maxwell* (2006) 59 ACSR 373, 397 (Brereton J) (citations omitted). See also *Vrisakis v Australian Securities Commission* (1993) 9 WAR 395, 448–50 (Ipp J) ('*Vrisakis*'); *Australian Securities and Investments Commission v Doyle* (2001) 38 ACSR 606, 641 (Roberts-Smith J); *Australian Securities and Investments Commission v Sydney Investment House Equities Pty Ltd* (2008) 69 ACSR 1, 9–12 (Hamilton J).

84 See *Macdonald* (2009) 256 ALR 199, 249–50.

85 See (1992) 7 ACSR 759, 866–7.

86 (1995) 37 NSWLR 438, 502.

87 Ibid 501.

88 *Macdonald* (2009) 256 ALR 199, 245–50, citing *Statewide Tobacco Services Ltd v Morley* (1990) 2 ACSR 405; *Group Four Industries Pty Ltd v Brosnan* (1992) 59 SASR 22; *Vrisakis* (1993) 9 WAR 395; *Permanent Building Society (in liq) v Wheeler* (1994) 11 WAR 187; *Adler* (2002) 168 FLR 253; *Maxwell* (2006) 59 ACSR 373; *Vines* (2007) 62 ACSR 1.

89 (2002) 168 FLR 253.

90 *Macdonald* (2009) 256 ALR 199, 250 (Gzell J), quoting ibid 347 (Santow J).

91 *Macdonald* (2009) 256 ALR 199, 250.

92 Ibid 247.

negative impact of the defective draft ASX announcement on the company upon its release to the public.[93] According to his Honour, 'there was the danger that JHIL would face legal action for publishing false or misleading … or deceptive statements, its reputation would suffer and there would be a market reaction to its listed securities.'[94]

Based on the evidence that revealed the shortcomings and unreliability of the cashflow model used in the actuarial reports, which was expressly brought to the board's attention on many previous occasions, Gzell J concluded that:

> The shortcomings of the cashflow model must have been obvious to the non-executive directors, or at least they ought to have been and they should have realised that they were prevented from approving the unequivocal and unqualified statements as to certainty of sufficient funding in the draft ASX announcement.[95]

Gzell J commented on the failure of the non-executive directors to discharge their monitoring role as constituting a breach of the statutory duty of care and diligence:

> it was part of the function of the directors in monitoring the management of the company to settle the terms of the draft ASX announcement to ensure that it did not assert that the foundation had sufficient funds to meet all legitimate compensation claims …[96]

Furthermore, his Honour held that the matter before the board, which should have occupied the board's attention, was not a matter of 'operational responsibility'.[97] After observing that the non-executive directors had 'no qualms about a request from management to consider' the draft ASX announcement (an attitude which found favour with his Honour), Gzell J held that the directors' conduct thereafter fell short of the standards expected to discharge duty of care obligations under s 180(1) for the following reasons:

> The *formation of the foundation* and the [restructure of the relevant entities described earlier] *were potentially explosive steps*. Market reaction to the announcement of them was critical. This was a matter within the purview of the board's responsibility: what should be stated publicly about the way in which asbestos claims would be handled by the James Hardie group for the future.[98]

In such circumstances, Gzell J concluded that it was incumbent on the non-executive directors to 'speak against or in modification of the announcement', both of which they failed to do.[99] Based on this reasoning and the application of the objective test under s 180(1), his Honour held that a reasonable person with

[93] Ibid 250–1.
[94] Ibid.
[95] Ibid 259–60.
[96] Ibid 261.
[97] Ibid.
[98] Ibid (emphasis added).
[99] Ibid.

similar responsibilities would not have voted in favour of the resolution that the company approve and release the draft ASX announcement to the ASX.[100]

Turning attention to the two United States non-executive directors (Messrs Gillfillan and Koffel) who attended the relevant board meeting by telephone and claimed that the draft ASX announcement was neither provided nor read to them, Gzell J accepted that claim due to the equivocal nature of evidence on this key issue.[101] His Honour, nonetheless, held that both directors breached s 180(1) by voting in favour of the resolution since

> neither [non-executive director] raised an objection that [they] did not have a copy of the draft ASX announcement at the 15 February 2001 meeting. Nor did they ask that a copy be provided to them. Nor did they abstain from approving the … announcement.[102]

Applying an objective test under s 180(1), his Honour concluded that the failure to request a copy of the draft ASX announcement dealing with a most significant event in the life of JHIL, 'to familiarise themselves with its terms' or 'to abstain from voting' was inconsistent with the actions of 'a reasonable person in their shoes with their responsibilities'.[103]

The remaining non-executive directors, Messrs O'Brien and Terry, were similarly found to have breached s 180(1) despite their decision not to offer evidence on their role at the relevant board meeting.[104] Having found that the board had a duty to consider the draft ASX announcement upon a request by management, Gzell J focused attention on the conduct of both these non-executive directors. His Honour had little difficulty in concluding that the approval of the announcement meant that neither director 'put forward a case that they abstained from approving the draft ASX announcement.'[105] The board's approval of the announcement with its overstatement meant that, according to his Honour, both directors 'failed in their duty … to protect [the company] from the harm it potentially faced upon publication of the draft ASX announcement.'[106]

In finding that all seven non-executive directors had breached their duty of care and diligence under s 180(1), Gzell J was influenced by the direct evidence of many of the directors who readily conceded that the level of funding described in the draft ASX announcement was 'so unequivocal and unqualified' that none of the directors would have approved it if they had considered it at the board meeting on 15 February 2001.[107]

In relation to the conduct of the five non-executive directors who approved the IM (discussed earlier in Part II), Gzell J dismissed ASIC's claim of breach of s 180(1). His Honour was satisfied that the IM was not false or misleading as

100 Ibid.
101 Ibid 245.
102 Ibid.
103 Ibid 261.
104 Ibid 262 (Gzell J).
105 Ibid.
106 Ibid.
107 Ibid 251, quoting Mr Gillfillan's statements during trial.

there was no intention at the relevant time on part of the company to cancel the partly paid shares.[108] His Honour found that 'ASIC relie[d] on snippets of statements' which could not be attributed to the 'collective view of the board', who were unaware of such a plan when approving the IM.[109] Furthermore, Gzell J reaffirmed the principle that, even if one director is aware, '[a]n individual director has no implied authority to act unilaterally.'[110] His Honour held that '[v]iews in the minds of individual directors not communicated to other directors nor made the subject of board decision … can not be taken as being the plans of the company'.[111]

D *Non-Executive Directors' Reliance Defence*

Gzell J accepted the legal proposition that, while directors are required to take reasonable steps to place themselves in a position to guide and monitor the management of the company, they are entitled to rely upon others, except where they 'know, or by the exercise of ordinary care should have known, any facts that would deny reliance on others.'[112] Gzell J held, however, that the wording of the draft ASX announcement was not a matter for reliance upon management or outside experts. In addressing the question of whether the non-executive directors' reliance on management was reasonable or not, his Honour held that delegation was inappropriate on the facts of this case as

> [t]his was not a matter in which a director was entitled to rely upon those of his co-directors more concerned with communications strategy to consider the draft ASX announcement. *This was a key statement in relation to a highly significant restructure of the James Hardie group.* Management having brought the matter to the board, none of them was entitled to abdicate responsibility by delegating his or her duty to a fellow director.[113]

Similarly, based on the facts which showed management's referral of the draft ASX announcement to the board for consideration, his Honour rejected defences based on reliance on experts (for example, Trowbridge). Gzell J, in framing the issue in the following way, offered this reason for his Honour's intolerance of the reliance defence: 'it is the emphatic nature of the draft ASX announcement [with use of the term "fully funded"] that is at fault. And that is not a matter for reliance upon management or outside experts.'[114]

Furthermore, a more emphatic reason for Gzell J's rejection of the reliance defence arose from the fact that the board's 'task of approving the draft ASX

[108] Ibid 314–40.
[109] Ibid 339.
[110] Ibid. Gzell J relied upon *Northside Developments Pty Ltd v Registrar-General (NSW)* (1990) 170 CLR 146, 205 (Dawson J).
[111] *Macdonald* (2009) 256 ALR 199, 339, quoting *Stirling Resources NL v Capital Energy NL* (1996) 14 ACLC 1005, 1010 (Hill J).
[112] *Macdonald* (2009) 256 ALR 199, 248, quoting *Adler* (2002) 168 FLR 253, 347–8 (Santow J), which in turn cited *Daniels v Anderson* (1995) 37 NSWLR 438, 502–3 (Clarke and Sheller JJA).
[113] *Macdonald* (2009) 256 ALR 199, 251 (emphasis added).
[114] Ibid 259.

announcement involved no more than an understanding of the English language used in the document.'[115]

E *Executive Directors' Breach of Duty of Care and Diligence*

Gzell J found that Mr Macdonald, as a director and chief executive officer of JHIL with reporting duties directly to the board, had 'ultimate responsibility for planning the separation proposals.'[116] The evidence showed that he was the 'driving force behind Project Green.'[117] Furthermore, he was 'appointed to make public statements on behalf of JHIL concerning separation proposals' and, in keeping with his position, was 'responsible for dealing with the board on this issue.'[118]

As a result of these responsibilities, Gzell J concluded that the chief executive officer 'bore a high standard of care'[119] and that in voting in favour of the resolution to approve the announcement was 'a fortiori' in breach of the duty of care and diligence in s 180(1).[120] In applying an objective test, his Honour concluded:

> For the reasons [applicable] to the non-executive directors, a reasonable person, if a director of a corporation in JHIL's circumstances who occupied the office of director and chief executive officer and had the same responsibilities within the corporation, would not have voted in favour of a resolution that JHIL approve the draft ASX announcement and JHIL authorise … [its execution and release] to the ASX.[121]

Gzell J, however, rejected ASIC's allegation that the chief executive officer breached s 180(1) through failure to enquire of each director as to whether they had formed an opinion on the adequacy of the quantum expressed to meet all present and future asbestos claims brought against Amaca and Amaba. The imposition of such a duty, according to his Honour, is unwarranted as

> it was [not] any part of the [chief executive officer's] duty to monitor the individual bases upon which his co-directors voted on the issue. A director is not obliged to analyse the basis upon which fellow directors intend to vote before determining his or her own course.[122]

Furthermore, his Honour considered it 'insulting for the chief executive officer to ask each board member whether he or she really meant what they were about to do.'[123]

115 Ibid 251.
116 Ibid 262.
117 Ibid.
118 Ibid 262–3.
119 Ibid 263.
120 Ibid.
121 Ibid.
122 Ibid.
123 Ibid.

Gzell J found the negligent conduct of the chief executive officer resulted in multiple breaches of the statutory duty of care and diligence.[124] The chief executive officer's failure to advise the board of the limited nature of the reviews on the cashflow model undertaken by external consultants — Pricewaterhouse-Coopers and Access Economics — also constituted a breach of s 180(1).[125] The review was restricted to issues concerning 'logical soundness and technical correctness'.[126] According to his Honour, a reasonable person with the same responsibilities would have informed the board that the external consultants 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.'[127] As the 'driver of this separation proposal',[128] Mr Macdonald's failure to draw his co-directors' attention to the lack of verification of key data was held to be negligent.

The failure by the chief executive officer to advise the board that the draft ASX announcement was expressed in too emphatic terms in relation to the adequacy of funding was misleading and deceptive and also constituted a breach of s 180(1).[129]

Likewise, in discharging his duties as director and chief executive officer of JHINV, Mr Macdonald was found to have breached s 180(1) with respect to representations made during international roadshows in Edinburgh and London to promote the company. Gzell J found that, '[d]espite his knowledge that the foundation was seriously under-funded,' Mr Macdonald was prepared to convey the opposite impression to an international audience through the use of false or misleading material during the slide presentations.[130] His Honour, however, rejected ASIC's claim that such conduct was in breach of the duty of good faith and proper purpose under s 181, for reasons discussed below.

Similar to the finding in relation to the five non-executive directors,[131] Mr Macdonald was held not to have breached s 180(1) in relation to the IM connected with the scheme of arrangement on the basis of Gzell J's finding that the document was not false or misleading at the time of its preparation.[132]

The belated publication of the DOCI information in JHIL's annual report in June, rather than at the time of decision at the 15 February 2001 board meeting, resulted in JHIL's breach of its continuous disclosure obligations under ASX *Listing Rules* r 3.1 and s 1001A(2) of the *Corporations Law*.[133] Based on the same facts, Gzell J held that both Messrs Macdonald and Shafron (secretary and general counsel) breached s 180(1) by failing to provide advice to the chair of

[124] Ibid 264–5.
[125] Ibid 265.
[126] Ibid.
[127] Ibid.
[128] Ibid.
[129] Ibid 264.
[130] Ibid 353.
[131] See above nn 108–9 and accompanying text.
[132] *Macdonald* (2009) 256 ALR 199, 340–2.
[133] Ibid 280–1 (Gzell J).

the board about the need for disclosure.[134] Significantly, his Honour rejected Mr Macdonald's statutory defence under the business judgement rule in s 180(2) due to his failure to offer any evidence in support of the defence.[135] Similarly, Gzell J rejected Mr Macdonald's defence of reliance on others under s 189 for the same reason.[136]

Through the seminal role played by Mr Macdonald in the cancellation of the partly paid shares, JHINV was found to have breached its statutory duty of continuous disclosure and ASX *Listing Rules* r 3.1 by failing to disclose such information that would materially affect the price of its securities.[137] Gzell J found that the steps taken by the company to disseminate information were inadequate.[138]

F *Officers' Breach of Duty of Care and Diligence*

Gzell J found that the company secretary (Mr Shafron), who was legally qualified and performed the role of general counsel, participated in the making of decisions that affected the whole or a major part of the company's business.[139] Mr Shafron's expansive role in the affairs of JHIL therefore meant that he was a company officer within the statutory definition[140] and, significantly, attracted the stringent statutory duties applicable to officers.[141]

'Guarding against legal risks to JHIL' was, according to his Honour, 'at the core of Mr Shafron's responsibilities as general counsel.'[142] In that capacity, Mr Shafron was regarded as having a 'high degree of responsibility' at the board meeting on 15 February 2001 to protect JHIL from legal risks flowing from the draft ASX announcement.[143]

His Honour rejected Mr Shafron's argument that he had no duty to warn the board of the emphatic statements in the draft ASX announcement because, according to the defendant, a reasonable director would be capable of assessing the statement as false and misleading. On the contrary, according to Gzell J, the duty to speak was enlivened in such circumstances:

> Mr Shafron had a duty to protect JHIL from legal risk and if the directors were minded to approve the release of the draft ASX announcement in its false and misleading form, there was the danger that JHIL would be in breach of ss 995(2) and 999. Against that harm it was [the] duty [of Mr Shafron] to warn

134 Ibid 289, 292.
135 Ibid 288.
136 Ibid 288–9.
137 Ibid 370.
138 Ibid 371–2.
139 Ibid 269.
140 Ibid, citing *Commissioner for Corporate Affairs v Bracht* [1989] VR 821, 831 (Ormiston J). See also *Corporations Act* s 9 (definition of 'officer').
141 *Corporations Act* ss 180–3, which provide that duties are imposed on officers as well as directors.
142 *Macdonald* (2009) 256 ALR 199, 269.
143 Ibid 270 (Gzell J).

> the directors that [such an] announcement should not be released in its too emphatic form.[144]

Relying upon the objective test in s 180(1), Gzell J held that:

> a reasonable person … who occupied the office of secretary and general counsel and had the same responsibilities within the corporation … would have advised the board that the draft ASX announcement was expressed in too emphatic terms concerning the adequacy of … funding to meet all … asbestos claims and in that respect it was false or misleading.[145]

Accordingly, in failing to warn of this jeopardy, Mr Shafron breached the statutory duty of care and diligence.[146]

Mr Shafron's failure to advise the board of the limited nature of the reviews on the cashflow model undertaken by external consultants also constituted a breach of s 180(1), for the same reasons discussed earlier with respect to the chief executive officer's failure to inform the board that the cashflow model omitted to consider key variables.[147] Gzell J held that Mr Shafron had a 'duty in protecting JHIL from legal risk to [advise] the board of the limitations' associated with the cashflow model.[148]

Gzell J, however, rejected a duty on the part of Mr Shafron to enquire into each director's opinion on the adequacy of funding for the same reasons discussed earlier relating to the chief executive officer.[149] His Honour also held that Mr Shafron did not breach s 180(1) with respect to the IM connected to the scheme of arrangement for the same reasons discussed earlier relating to the non-executive directors and the chief executive officer.[150] For the reasons discussed above, Mr Shafron was held to breach s 180(1) for failure to advise the board of its continuous disclosure obligations.[151]

Gzell J found that Mr Morley, who was appointed chief financial officer of JHIL, was also an officer due to his 'participation … in far-reaching decisions of the board'.[152] Mr Morley 'attended all meetings of the board … in 2000 and 2001' and 'was responsible for all of the finance, audit, tax and treasury aspects of the James Hardie group's affairs.'[153] As with Messrs Shafron and Macdonald, his Honour was satisfied that the chief financial officer had a high degree of responsibility with respect to the separation plan and the draft ASX announcement.[154]

[144] Ibid.
[145] Ibid 271.
[146] Ibid.
[147] Ibid 271–2. See above nn 125–7 and accompanying text.
[148] *Macdonald* (2009) 256 ALR 199, 271.
[149] Ibid 267. See above nn 122–3 and accompanying text.
[150] *Macdonald* (2009) 256 ALR 199, 342. See above nn 108–9, 131 and accompanying text.
[151] *Macdonald* (2009) 256 ALR 199, 289–92 (Gzell J).
[152] Ibid 273.
[153] Ibid.
[154] Ibid 273–4.

Gzell J upheld ASIC's allegation that the chief financial officer breached s 180(1) through failure to explain to the board the limited nature of the cashflow model reviews by the external consultants. His Honour agreed with ASIC's claim that Mr Morley's failure 'to say anything [to the board] to dispel an erroneous belief … that the reviews … were more significant than they were' was a material omission to do more.[155]

Engaging in an analysis on this issue similar to that with respect to the conduct of the chief executive officer and general counsel described earlier, his Honour held that s 180(1) was breached by the chief financial officer for identical reasons, concerning the failure to address the limitations of the cashflow model and its key assumptions. In Gzell J's view, the 'assumptions upon which the cashflow model was based were essential to its integrity.'[156] According to his Honour, if the directors were advised of the limitations underpinning the cashflow model, it might have engendered a 'different attitude to the draft ASX announcement.'[157] His Honour found that 'it must have been obvious to Mr Morley, or at least it ought to have been, that if nothing more was said [to the board] … the directors might act under the misapprehension that the reviews were more significant than they were.'[158] In this context, it was incumbent upon the chief financial officer to have advised the board that the review conducted was not unlimited in scope.[159]

Mr Morley, however, was found not to have breached s 180(1) in respect of his role in the execution of the DOCI. Gzell J rejected ASIC's claim that Mr Morley should have secured greater funding for the two subsidiaries due to a lack of evidence that the agreed price was less than market value. Based on the evidence, his Honour was satisfied that Mr Morley's assessment of the financial situation was adequate.[160]

G *Directors' Duty to Act in Good Faith in the Best Interests of the Corporation and for a Proper Purpose*

ASIC alleged that the central role played by Mr Macdonald in disseminating false and misleading information on the sufficiency of funding in the separation plan evidenced a failure to act in good faith in the best interests of the company and for a proper purpose, as enshrined in s 181 of the *Corporations Act*.[161] Gzell J rejected ASIC's allegation that the chief executive officer had breached s 181 through deliberate and repeated use of the phrase 'fully-funded' in press conference statements to justify and influence acceptance of the separation proposal.[162]

155 Ibid 276.
156 Ibid 275.
157 Ibid.
158 Ibid.
159 Ibid 276–7.
160 Ibid 292–8.
161 Ibid 304–6.
162 Ibid 306.

Gzell J reached this result by favouring the test of subjective dishonesty in *Marchesi v Barnes*,[163] as opposed to objective dishonesty in *Australian Growth Resources Corporation Pty Ltd v Van Reesema*,[164] and found that Mr Macdonald's conduct may have been misguided and 'overzealous'[165] but fell short of the requirements to establish breach of s 181 since

> there was no conflict between his personal interest and that of JHIL. He did not take advantage of his position to make a secret profit. … [Nor did he] misappropriate the company's assets for himself. Like the non-executive directors in approving [the] draft ASX announcement, Mr Macdonald may have believed it was in the best interests of JHIL to be as emphatic as he could in selling the separation proposal.[166]

This conclusion was fortified by the fact that the 'evidence [did] not establish that Mr Macdonald acted for an improper or collateral purpose.'[167] Based on this reasoning, Gzell J also rejected ASIC's claim that Mr Macdonald's role in the release of the false and misleading media announcements to the ASX on 23 February 2001 and 21 March 2001 was in breach of s 181(1).[168] Similarly, his Honour found that Mr Macdonald's role with respect to the roadshow representations in Edinburgh and London did not constitute bad faith or evidence of acting for an improper purpose. His Honour was satisfied that, in all such instances, there was 'no conflict between [the] personal interest' of the chief executive officer and that of the company.[169]

H *Penalties*

In a separate judgment dealing with the civil penalty consequences of breach of the law, Gzell J in *Australian Securities and Investments Commission v Macdonald [No 12]* dismissed the defendants' applications to be exonerated from their contraventions, pursuant to ss 1317S and 1318 of the *Corporations Act*.[170] These provisions confer judicial discretion to grant relief from liability on the basis that the defendants had 'acted honestly' and, in the circumstances, 'ought fairly to be excused' for their contravention.

Significantly, Gzell J adopted a rigorous approach to the application of the duty of care and diligence and held that the defendants could not be excused from liability despite the existence of the following circumstances surrounding the decision-making at the key board meeting on 15 February 2001:

163 [1970] VR 434, 438 (Gowans J).
164 (1988) 13 ACLR 261, 270–1 (King CJ).
165 *Macdonald* (2009) 256 ALR 199, 306 (Gzell J).
166 Ibid.
167 Ibid.
168 Ibid 309, 313.
169 Ibid 355.
170 (2009) 259 ALR 116.

1 '[t]he board meeting was attended by JHIL management and a number of external advisers [none of whom] raised any concerns about the content of the [draft ASX announcement]';[171]

2 JHIL was in receipt of legal advice on issues surrounding the separation plan which addressed directors' duties (but not the resolution to approve the draft ASX announcement);[172]

3 'there was contravention of standard practice', which 'required the approval of a draft press release by line management and senior executives before its provision to the board';[173] and

4 it was a busy board meeting and the approval of the draft ASX announcement by the non-executive directors, who had lengthy and accomplished careers of service on other boards, was an isolated act.[174]

In denying relief under such circumstances, Gzell J was influenced by the following key features of the case:

> This was a serious breach of duty and a flagrant one. The non-executive directors were endorsing JHIL's announcement to the market in emphatic terms that the Foundation had sufficient funds to pay all legitimate present and future asbestos claims, when they had no sufficient support for that statement and they knew, or ought to have known, that the announcement would influence the market.[175]

Furthermore, while this event may have been an isolated one, it was nonetheless a very significant event in the life of the company and demanded attention. His Honour was also influenced by the fact that reliance on advisers was inappropriate on the facts of this case. According to his Honour, the task before the board involved 'no more than an understanding of the English language used in the document.'[176]

In light of these findings, Gzell J made the following disqualification orders under s 206C and imposed the following pecuniary penalties under s 1317G(1) of the *Corporations Act* payable to the Commonwealth of Australia:[177]

1 Mr Macdonald was banned from management for a period of 15 years and liable to pay a pecuniary penalty of $350 000;

2 Mr Shafron was banned from management for a period of 7 years and liable to pay a pecuniary penalty of $75 000;

3 Mr Morley was banned from management for a period of 5 years and liable to pay a pecuniary penalty of $35 000;

[171] Ibid 129.
[172] Ibid 130.
[173] Ibid 129.
[174] See ibid 130.
[175] Ibid 133–4.
[176] Ibid 129.
[177] Ibid 201–2.

4 all of the seven non-executive directors were banned from management for a period of 5 years each and liable to pay a pecuniary penalty of $30 000 each; and

5 JHINV was liable to pay a pecuniary penalty of $80 000.

In a separate judgment, Tobias JA in *O'Brien v Australian Securities and Investments Commission* dismissed an application brought by three of the defendants for a stay of the disqualification orders.[178] The need for general deterrence, which involves an element of public protection, and the lack of adequate evidence to demonstrate that the consequences of a refusal of a stay would constitute an unacceptable burden on the defendants were influential reasons in the decision.[179]

IV IMPLICATIONS[180]

Macdonald is the latest decision to demonstrate corporate law's new-found love of s 180(1)[181] and in many respects is in line with Australian authorities on the stringent nature of directors' duties.[182]

Although *Macdonald* relied on some of the legal principles espoused by Brereton J in *Maxwell*,[183] the judicial approach adopted by Gzell J towards the enforcement of directors' statutory duties represents a welcome departure from the contentious propositions expressed in *Maxwell*.[184] Brereton J was of the view in *Maxwell* that 'it is a mistake to think that [s 180 is] concerned with any general obligation owed by directors at large to conduct the affairs of the company in accordance with law generally or the *Corporations Act* in particular'.[185] According to his Honour, part 2D.1 of the Act (which contains the directors' duties) is not directed to 'securing compliance with the various requirements of the *Corporations Act*.'[186] Gzell J in *Macdonald*, on the other

178 (2009) 74 ACSR 324.

179 See ibid 343–4 (Tobias JA).

180 Some of the defendants in *Macdonald* have lodged an appeal: 'James Hardie Appeals Court Rulings', *ABC News* (online), 23 September 2009. The discussion in this part is predicated on the original decision being upheld.

181 See Anil Hargovan, 'Corporate Law's New Love: Section 232(4) and the Director's Duty of Care' (1994) 3 *Asia Pacific Law Review* 20. Prior to the insolvent trading cases in the late 1980s, which articulated higher standards of care, there was a dearth of reported cases on directors' statutory duties of care and diligence: at 21–8.

182 For a useful collection of legal principles on the modern standards required for diligence and skill, see *Australian Securities and Investments Commission v Rich* (2009) 236 FLR 1, 127–34 (Austin J) ('*Rich*'). Note, however, the different approaches to the statutory standard of skill required by directors and officers in *Rich* (an objective standard) compared to the lesser (corporation-specific) standard expressed in *Maxwell* (2006) 59 ACSR 373, 397–8 (Brereton J), and adopted in *Macdonald* (2009) 256 ALR 199, 245–7 (Gzell J).

183 See above Part III(C).

184 For a more detailed discussion of these propositions, see Harris, Hargovan and Austin, above n 8, 357–9, 362–72.

185 (2006) 59 ACSR 373, 399. Compare the approach in *Australian Securities and Investments Commission v Narain* (2008) 169 FCR 211, 217, where Finkelstein J held it was open for ASIC to prove a director's breach of s 180(1) for 'having caused [his company] to contravene s 1041H' in instructing the release of a misleading ASX announcement.

186 *Maxwell* (2006) 59 ACSR 373, 400.

hand, appropriately linked the conduct of the directors of JHIL to a breach of s 180, which is consistent with the concept of community expectations as fashioned by the courts.[187] The judicial attitude to shareholder acquiescence espoused in *Maxwell* towards breaches of directors' statutory duties, in effect, de-emphasises the public interest function in setting minimum standards of corporate managerial behaviour and the role of public enforcement of statutory duties.[188]

Macdonald, with its concentrated focus on the statutory duty of care and diligence, can be viewed as another step in the legal journey started in the late 1980s which shifted the perception of directors from being passive managers to being active monitors with an obligation to stay informed about the affairs of the company. Nearly two decades ago, tapping into community sentiment following the corporate greed of the 1980s, the law farewelled the concept of the 'sleeping' or 'passive' director.[189] Indeed, the following judicial observations, made in 1991, ring as true today as they as did then:

> the community has of necessity come to expect more than formerly from directors … In response, the parliaments and the courts have found it necessary in legislation and litigation to refer to the demands made on directors in more exacting terms than formerly; and the standard of capability required of them has correspondingly increased.[190]

Any doubts that may have existed with regard to the application of a more onerous duty of care to directors were dispelled in the landmark decision of *Daniels v Anderson*.[191] The courts have, since then, continued to map the contours of directors' and officers' duties of care, skill and diligence with reference to the role of the executive director,[192] the non-executive director,[193] the chair[194] and the chief financial officer.[195]

[187] See *Commonwealth Bank of Australia v Friedrich* (1991) 5 ACSR 115, 126 (Tadgell J), and *Australian Securities and Investments Commission v Rich* (2003) 174 FLR 128, 147 (Austin J) ('*Rich (Strike-Out Application)*'), where the courts have emphasised the role of 'contemporary community expectations' in elevating the standard of care and diligence expected of directors.

[188] A similar charge, it would appear, can be made to the approach in *Rich* (2009) 236 FLR 1, 134 (Austin J), where it is arguable that tacit support has been offered to the propositions in *Maxwell*. See Harris, Hargovan and Austin, above n 8, 356, for a more detailed discussion on the 'fundamental purpose and rationale of directors' statutory duties'.

[189] See generally *Statewide Tobacco Services Ltd v Morley* (1990) 2 ACSR 405; *Morley v Statewide Tobacco Services Ltd* [1993] 1 VR 423. For discussion on the changing attitudes to and expectations of the modern director, see Hargovan, above n 181; A S Sievers, 'Farewell to the Sleeping Director — The Modern Judicial and Legislative Approach to Directors' Duties of Care, Skill and Diligence' (1993) 21 *Australian Business Law Review* 111; A S Sievers, 'Directors' Duty of Care: What Is the New Standard?' (1997) 15 *Company and Securities Law Journal* 392; Julie Cassidy, 'An Evaluation of Section 232(4) of the *Corporations Law* and the Directors' Duty of Due Care, Skill and Diligence' (1995) 23 *Australian Business Law Review* 184.

[190] *Commonwealth Bank of Australia v Friedrich* (1991) 5 ACSR 115, 126 (Tadgell J).

[191] (1995) 37 NSWLR 438.

[192] See *Adler* (2002) 168 FLR 253.

[193] See *Elliott v Australian Securities and Investments Commission* (2004) 10 VR 369.

[194] See *Rich (Strike-Out Application)* (2003) 174 FLR 128.

[195] See *Vines* (2007) 62 ACSR 1.

Macdonald, in focusing the judicial spotlight on the conduct of management during decision-making, has been hailed by ASIC as 'a landmark decision in Australia on corporate governance.'[196] To the extent that the decision in *Macdonald* provides boardrooms with important guidance and direction on the practical application of directors' duties and sheds light on the role of company secretaries and general counsel, it is a landmark decision. However, from a jurisprudential point of view, *Macdonald* does not add to the existing line of authorities on the duties of directors. The significance of the case lies in its robust application of current legal principles and the manner in which it illuminates their operation in the context of management of a publicly listed company.

Attention is now directed to the manner in which the decision in *Macdonald* contributes to the mapping of the contours of directors' and officers' duties and to the light it sheds on the relationship between management and the board and on their respective responsibilities.

A *Non-Executive Directors*

Macdonald is significant for the legal treatment of non-executive directors for at least two reasons. First, it squarely addresses the expectations and performance standards expected of non-executive directors when entrusted with a specific task by management. Secondly, and of equal importance, it addresses and clarifies the extent to which directors are justified in trusting and relying upon officers of the company. The application of the reliance on management defence and the delegation defence is permitted by both the common law[197] and statute,[198] but its reach and application are uncertain. As noted by Gzell J, '[t]he law has not yet established the extent to which the position of a non-executive director shapes the content of the duty of care.'[199] The decision helps clarify this position, albeit in a case where the facts are unusual.

Macdonald, as discussed above in Part III(C), is in alignment with a string of judicial authority which favours the equal treatment of both executive and non-executive directors in determining the standard of care and diligence required. Consistent with the modern legal principles applied by the courts in NSW since *Daniels v Anderson*,[200] *Macdonald* suggests a swinging of the pendulum away from the lower standard contemplated by Rogers CJ Comm D in *AWA Ltd v Daniels*, where his Honour was of the view that a board of non-executive

196 ASIC, 'James Hardie Proceedings' (Media Release No 09-69, 23 April 2009).

197 For a useful collection of the principles surrounding the reasonableness of reliance or delegation, see *Adler* (2002) 168 FLR 253, 347–8 (Santow J).

198 *Corporations Act* s 189 allows for reliance by directors on information or advice provided by others. Section 198D permits delegation to, inter alia, a committee of directors, a company employee or any other person.

199 *Macdonald* (2009) 256 ALR 199, 249. His Honour quoted with approval an explanation for this result proffered by the learned authors in Austin and Ramsay, above n 9, 444: 'Part of the reason is the absence of any shared body of detailed expert knowledge of what is involved in the directing of companies. The diversity of companies and varieties of business endeavour are such as to allow uniformity of standards only on very general matters.'

200 (1995) 37 NSWLR 438.

directors 'does not [ordinarily] expect to be informed of the details of how the company is managed' and that such a board would only expect to be informed of 'anything untoward' happening.[201] His Honour was of the following view:

> In contrast to the managing director, non-executive directors are not bound to give continuous attention to the affairs of the corporation. Their duties are of an intermittent nature … [T]here is no objective standard of the reasonably competent company director to which they may aspire.[202]

Daniels v Anderson, which marks the stiffening of the law on the duty of care, emphatically rejected the lower standard for non-executive directors and took the broader view that all directors have a 'continuing obligation to keep informed about the activities of the corporation'[203] and should bring an independent judgement to bear on the various matters that come to the board for decision.[204] Furthermore, all directors are expected to 'become familiar with the fundamentals of the business in which the corporation is engaged'[205] and 'take reasonable steps … to guide and monitor the management of the company.'[206] These legal principles were affirmed by the Court of Appeal in *Adler v Australian Securities and Investments Commission*[207] and were influential in assessing the standard of care expected of the non-executive directors in *Macdonald*,[208] notwithstanding judicial support for the alternative standard expressed in *AWA Ltd v Daniels*.[209]

In favouring the line of authority which has expressed heightened expectations of directors, it was open for Gzell J in *Macdonald* to find that the non-executive directors failed to discharge their monitoring function adequately, which included the task of monitoring management's attempts to settle the terms of the draft ASX announcement. The extent of the board's duty to monitor was enhanced by the facts of this case. The board was aware of the strategic direction in which the company was headed by following the separation plan and, moreover, the board was specifically entrusted with the task of considering the draft ASX announcement prior to its public release. The board's failure to speak against the announcement or take remedial action, in such circumstances, was fatal to its prospects of discharging the duty of care and diligence.

The facts of the case also took the board's duty to monitor outside the realm of operational responsibility, for which the duty to monitor does not arise. The strategic nature of the separation plan, which was to take the company in a new

[201] (1992) 7 ACSR 759, 867.
[202] Ibid. Rogers CJ Comm D (at 866) relied upon *Re City Equitable Fire Insurance Co Ltd* [1925] Ch 407, 426 (Romer J).
[203] (1995) 37 NSWLR 438, 503 (Clarke and Sheller JJA).
[204] Ibid 500–4.
[205] *Adler* (2002) 158 FLR 253, 347 (Santow J).
[206] *Daniels v Anderson* (1995) 37 NSWLR 438, 501 (Clarke and Sheller JJA).
[207] (2003) 179 FLR 1, 116–17 (Giles JA); see also at 5 (Mason P and Beazley JA).
[208] See (2007) 256 ALR 199, 250 (Gzell J).
[209] Ipp J in *Vrisakis* (1993) 9 WAR 395, 452, however, added the caveat that the judicial remarks in *AWA Ltd v Daniels* were 'statements of broad principle alone and act merely as signposts' in determining the particular standard of care. These remarks were repeated in *Permanent Building Society (in liq) v Wheeler* (1994) 11 WAR 187, 240 (Ipp J).

direction and divest it of its asbestos liabilities, ensured that the draft ASX announcement fell within the purview of the board's responsibility. The salient lesson here is that a board is expected to focus on matters brought before it and to seriously consider such matters and take appropriate action. Failure to engage in any of these tasks, which demand critical and detailed attention, runs the real risk of there being a dereliction of duty and attracting the civil penalty provisions under the *Corporations Act*.

B *Statutory Defences*

Macdonald also sheds light on the operation of directors' defences against a breach of the duty of care and diligence. In particular, the case affirms the modern approach to the reliance and delegation defences. In common with the approach in *Daniels v Anderson*, *Macdonald* rejected the greater latitude conferred on directors in *AWA Ltd v Daniels*, where Rogers CJ Comm D followed earlier authority on the operation of the reliance defence:

> Reliance would only be unreasonable where the director was aware of circumstances of such a character, so plain, so manifest and so simple of appreciation that no person, with any degree of prudence, acting on his behalf, would have relied on the particular judgment information and advice of the officers …[210]

In noting that the reliance test offered in *AWA Ltd v Daniels* did not represent 'modern company law',[211] *Macdonald* highlights the limitations on the reliance defence by drawing on the judgment of Santow J in *Adler*, which identified, inter alia, the following factors as relevant in determining reasonableness of the reliance or delegation:

- 'the function that has been delegated is such that it "may properly be left to" such [directors and] officers';[212]
- 'the extent to which the director [or officer] is put on inquiry, or given the facts of a case, should have been put on inquiry';[213] and
- 'the risk involved in the transaction' and its nature.[214]

Whilst these legal principles surrounding the limitations on reliance and delegation are clear to state, they are often difficult to apply given the diversity of companies and varieties of businesses, which defy a one-size-fits-all approach. Unsurprisingly, the application of this defence is uncertain and generally falls to be determined on a case-by-case basis. Herein lies the

[210] (1992) 7 ACSR 759, 868 (citations omitted). The origin of this extract can be traced back to *The Overend & Gurney Co v Gibb* (1872) LR 5 HL 480, 486–7 (Lord Hatherley LC).

[211] (2009) 256 ALR 199, 248 (Gzell J), quoting *Daniels v Anderson* (1995) 37 NSWLR 438, 502 (Clarke and Sheller JJA).

[212] *Adler* (2002) 168 FLR 253, 348, quoting *Re City Equitable Fire Insurance Co Ltd* [1925] Ch 407, 429 (Romer J).

[213] *Adler* (2002) 168 FLR 253, 348, citing *Re Property Force Consultancy Pty Ltd (in liq)* [1997] 1 Qd R 300.

[214] *Adler* (2002) 168 FLR 253, 348, citing *Permanent Building Society (in liq) v Wheeler* (1994) 11 WAR 187. Santow JA restated these propositions in *Vines* (2007) 62 ACSR 1, 149, upon which Gzell J then relied in *Macdonald* (2009) 256 ALR 199, 248–9.

significance of *Macdonald*, which applied these legal principles to the board of a large publicly listed company that was assisted by management and external experts and, within that context, rejected both the delegation and reliance defences.

The important lesson which emerges from *Macdonald* is that directors cannot substitute reliance upon the advice of management in place of their own attention and examination of a strategic matter that falls within the board's responsibilities. The facts of this case demonstrate that management had made plain that they entrusted the board with the specific task of vetting the draft ASX announcement, which, on the face of it, was misleading. Consequently, each member of the board was charged with the responsibility of attending to and focusing on an important strategic matter and, under these circumstances, could not delegate or 'abdicate'[215] that responsibility to others.

The peculiar facts of this case, however, warrant a caution against generalisation and the need for all boards to examine each and every ASX statement issued by the company (such as 'run of the mill' announcements). *Macdonald* is not authority for such an onerous proposition. On the contrary, Gzell J endorsed[216] the following approach advocated by Santow JA in *Vines v Australian Securities and Investments Commission*:

> What is expected here is a level of scrutiny as befits supervision, not the detailed direct involvement that is associated with operational responsibility. Where there is no cause for suspicion nor circumstances demanding critical and detailed attention, it is reasonable for an officer to rely on advice, without independently verifying the information or scrutinising the data or circumstances upon which that advice is based …[217]

The reach of the reliance and delegation defences is ultimately dependent on the facts of each case. Subject to the decision on appeal, this much is clear: *Macdonald* signals the need for board attention and scrutiny when an ASX statement or other type of key media communication is considered to be a strategic issue — as in the case of the unprecedented decision by James Hardie to shelter its assets through transfer of its asbestos liabilities.

Macdonald also illustrates the risks in conducting a defence by a director or officer who elects not to offer supporting evidence beyond reliance on documentation alone. The case illustrates that the reliance defence in s 189 is of limited value to a defendant in such circumstances. Without adequate explanation to shed light on ambiguous documents, the court is likely to be handicapped in its ability to make a proper assessment of whether the necessary statutory criteria in the discharge of the defence have been satisfied.

It is trite to observe that the statutory defence in s 180(2) (the business judgement rule) was unavailable to the non-executive directors due to their chorus of non-recollection of having made a decision at the key board meeting. This defence is also of dubious benefit to a director or officer who elects not to

215 *Macdonald* (2009) 256 ALR 199, 251 (Gzell J).
216 Ibid 248–9.
217 (2007) 62 ACSR 1, 149 (citations omitted).

give oral evidence addressing the extensive statutory criteria.[218] *Macdonald* demonstrates that reliance on documentation alone to determine, for example, whether the defendant had a rational belief that a business judgement was in the best interests of the company can be fatal to the prospects of a successful defence. Gzell J paid short shrift to this defence raised by Mr Macdonald in the absence of direct oral evidence to attach weight to the document.[219] Directors and officers need to be aware of the risks of such a strategy, adopted in *Macdonald*, when contesting liability for breach of the duty of care and diligence.

C *Company Secretaries*

Ominously, for company secretaries, Gzell J in *Macdonald* rejected a narrow interpretation of s 180(1)(b), advanced by the defendant, which sought to confine the provision's reach by limiting the assessment of the officer's responsibilities by reference to the particular office. Gzell J, in reliance upon the interlocutory judgment of *Australian Securities and Investments Commission v Rich* ('*Rich (Strike-Out Application)*'),[220] adopted a wider construction of the relevant words in s 180(1)(b) — 'and had the same responsibilities within the corporation' — and considered it necessary to have regard to every responsibility that officer had within the company.[221] The adoption of such a wide construction allowed his Honour to conclude that s 180(1)(b) ensures that all the responsibilities of a person occupying the office of secretary or general counsel are within the scope of the duty of care and diligence. It is submitted, with respect, that this approach is preferable to the narrow construction, because the functions performed by a company secretary or general counsel in one company may differ considerably from those performed in another company, as recognised by his Honour in the following passage:

> The corporations legislation envisages certain functions for company secretaries. One would readily infer that any company secretary had authority commensurate with those functions. Beyond that, however, one cannot make any assumptions about the authority of a particular company secretary in a particular context.[222]

This broader approach to the construction of s 180(1)(b) clears the way for the courts to focus on the range of responsibilities held by a company secretary or

[218] The business judgement must be made 'in good faith for a proper purpose' with the director 'inform[ing] themselves about the subject matter' with rational belief 'that the judgment is in the best interests' of the company and the director must 'not have a material personal interest' in that decision: *Corporations Act* s 180(2). For judicial consideration on the operation and utility of this defence, see *Rich* (2009) 236 FLR 1, 144–55 (Austin J).

[219] For judicial caution on sole reliance of documentary evidence, see *Rich* (2009) 236 FLR 1, 74–7 (Austin J); see also at 160–1.

[220] See (2003) 174 FLR 128, 140 (Austin J).

[221] *Macdonald* (2009) 256 ALR 199, 247, 269.

[222] Ibid 269, quoting *Tim Barr Pty Ltd v Narui Gold Coast Pty Ltd* [2008] NSWSC 657 (Unreported, Barrett J, 27 June 2008) [10].

general counsel. Austin J, in *Rich (Strike-Out Application)*, reaffirmed that 'responsibilities'

> is a wid[e] concept, referring to the acquisition of responsibilities not only through specific delegation but also through the way in which work is distributed within the corporation in fact, and the expectations placed by those arrangements on the shoulders of the individual director [or officer].[223]

It is trite to observe, based on this expansive judicial approach, that a higher level of potential liability will flow commensurate with a higher level of corporate responsibility held by a director or officer. Viewed in this context, and given the pivotal role played by Mr Shafron in the board's deliberations and wider management, it is unsurprising to see an elevation in performance standards required in the conduct of his office.

D *General Counsel*

The decision in *Macdonald* illustrates the consequences of the growing role of general counsel in management of a company and their wider participation in the company's affairs. In such circumstances, general counsel will attract the label of company officer and the attendant duties and liabilities that flow from such a management position. Furthermore, as general counsel, it appears that the duty to guard the company against legal risks is expansive in scope. Gzell J in *Macdonald* suggested that the ambit of general counsel's duty went beyond protecting the company from infringement of statutory obligations, such as the continuous disclosure laws. According to his Honour, the duty to guard against legal risks extended to corporate reputational risk and the risk of harm arising from market perception of the company.[224]

Moreover, it is inadequate for general counsel to dismiss key issues as being self-evident and, therefore, fail to draw management's attention to it. *Macdonald* demonstrates the court's intolerance of such an attitude. Despite the self-evident nature of the emphatic language in the draft ASX announcement, Gzell J was still prepared to impose a duty of care on general counsel to warn the board of potential harm as part of the duty owed to the company to avoid legal risks which may jeopardise its interests.

The fact that the company had internal mechanisms to deal with questions of continuous disclosure was also of cold comfort to general counsel. The imposition of liability underscores the need for general counsel to have a 'degree of awareness and sensitivity to the need to consider regulatory obligations as a routine incident of corporate decision-making.'[225]

[223] (2003) 174 FLR 128, 140.
[224] *Macdonald* (2009) 256 ALR 199, 269–70.
[225] *Re Chemeq Ltd; Australian Securities and Investments Commission v Chemeq Ltd* (2006) 234 ALR 511, 531 (French J).

E *Continuous Disclosure*

Continuous disclosure is fundamental to the integrity of the Australian securities market and a key factor in investor protection. In the second reading speech introducing the Corporate Law Reform Bill 1992 (No 2) (Cth), the Minister for Administrative Services offered the following policy considerations as underpinning the continuous disclosure regime:

> An effective disclosure system will often be a significant inhibition on questionable corporate conduct. Knowledge that such conduct will be quickly exposed to the glare of publicity, as well as criticism by shareholders and the financial press, makes it less likely to occur in the first place.
>
> In essence, a well informed market leads to greater investor confidence and in turn to a greater willingness to invest in Australian business.[226]

Macdonald emphasises the need for companies to take their continuous disclosure obligations seriously when dealing with price-sensitive information. The failure of JHIL to disclose the DOCI information to the ASX in a timely fashion and to achieve an informed market for its securities was a flagrant breach of ASX *Listing Rules* r 3.1 and s 1001A(2) of the *Corporations Law*. Similarly, the failure of JHINV to inform the market of the cancellation of the partly paid shares, which the investing public would have regarded as having a material effect on the share price, was also a flagrant breach of s 674(2) of the *Corporations Act*.

Furthermore, the decision in *Macdonald* is significant for the guidance it offers on the operation of the law on continuous disclosure by rejecting the view that a complex series of filings with ASIC discharges the statutory obligation under s 674. It cannot be said, on the basis of such a convoluted filing practice (and given the requirement to pay a search fee to access filed information), that the company is exempt from disclosure because the information released is generally available to and readily observable by the public.[227] Public access to information, in such circumstances, is either hindered or obscured and fails the statutory test for exemption. Nor is the company's obligation to disclose discharged if it files documents with ASIC as required by statute for other purposes.[228] Preclusion in this manner demonstrates the importance attached in *Macdonald* to continuous disclosure obligations.

The consequences of breach of s 674 of the *Corporations Act* are not only harmful for the company, due to reputational loss and sanctions, but extend to individual officers as well. *Macdonald* is also instructive, in this context, for the performance standards expected of the chief executive officer and general counsel in discharging the statutory obligation of the company. Significantly, breach of the continuous disclosure requirement under s 674(2) of the *Corporations Act* attracts the civil penalty provisions and allows for, inter alia, the disqualification of individual directors. Equally importantly, as evidenced in

226 Commonwealth, *Parliamentary Debates*, Senate, 26 November 1992, 3581 (Nick Bolkus).
227 *Macdonald* (2009) 256 ALR 199, 372 (Gzell J).
228 Ibid.

Macdonald, the failure of the chief executive officer and general counsel to advise the chair or the board of the need to make disclosure of information to the ASX impacted adversely on these company officers.

The conduct of both officers, in such circumstances, constituted breach of the statutory duty of care and diligence. Ominously for general counsel, Gzell J was prepared to find liability notwithstanding that: (a) the continuous disclosure obligation should have been readily apparent to the chief executive officer and the non-executive directors, and (b) the company had internal mechanisms to deal with questions of continuous disclosure. This finding underscores the requirement for 'a degree of awareness and sensitivity to the need to consider regulatory obligations as a routine incident of corporate decision-making', as recommended by French J in *Re Chemeq Ltd; Australian Securities and Investments Commission v Chemeq Ltd* ('*Re Chemeq Ltd*').[229]

Directors and officers, in discharging the company's obligations under the continuous disclosure regime, should be mindful of the risks involved in adopting a cavalier attitude to disclosure. The dangers are spelt out clearly in *Re Chemeq Ltd*: 'those who play calculated risk games of non-disclosure in the shadow of the [continuous disclosure] rules cannot expect indulgence from the courts if their assessments are not accepted.'[230]

F *Lessons*

Given its complexity, the large cast and the multiple breaches of law, it is worth distilling the principles and salient lessons for sound corporate governance practices flowing from this mammoth case.

Macdonald, as a baseline matter, is a lesson for passive and compliant boards which approve resolutions without exercising the degree of care and diligence required. It signals that there is no place for a ceremonial board which merely serves to rubber-stamp management decisions. The underlying theme is the need for boards to be more vigilant, diligent and careful in the conduct of their monitoring role. The following important points for effective boardroom governance practice emerge from *Macdonald*:

- The board should have a formal, comprehensive agenda and make decisions by passing formal resolutions. Abstention of votes should be recorded.
- The board should ensure that minutes are properly recorded and are a full and accurate record of what was discussed and decided; otherwise, it runs the risk of losing the special evidentiary value of the minute book.[231] The value of strict compliance and recording minutes contemporaneously is underscored by Gzell J:

> One thing that has emerged clearly in this case is that recollection is fallible. If a minute is to be given evidentiary value, it ought to be a contemporaneous

[229] (2006) 234 ALR 511, 531.
[230] Ibid (French J).
[231] See also *Claremont Petroleum NL v Cummings* (1992) 110 ALR 239, 258 (Wilcox J).

> document, for then it is more likely to be an accurate reflection of the proceedings of the meeting rather than a reconstruction of them.[232]

- If management brings a matter before the board for its consideration, the directors are not allowed to abdicate responsibility by delegating their duty to a fellow director. The express referral to the board by management provides all the more reason for a detailed consideration by each director of the matters raised and, consequentially, elevates the standards required to discharge the duty of care and diligence. In such circumstances, where the board accepts the task, the board has a duty to pay attention and make relevant enquiries should the information be deficient.
- Significant decisions, such as those impacting on the company's reputation or risk of harm, should be considered by the board rather than delegated.
- Directors who are not physically present at a board meeting but participate, for example by telephone, should ensure that they have the same documents as their co-directors or should take steps to satisfy themselves that the absence of the document is not material to the matters before the board. If the director cannot achieve full and effective participation through familiarising themselves with issues before the board, they should formally abstain. The latter point underscores the need for a director's full attention to matters before the board.
- Communications strategy, particularly in relation to substantial developments in the company, should be taken seriously and vetted for accuracy. Significantly, the board ought to be aware that disclaimers in a document are of little value where misrepresentation has been established on the face of the document.[233]

Macdonald is also instructive for the guidance it offers on the role of general counsel:

- The core responsibility of general counsel is to protect the company from legal risk, which extends to reputational harm.
- Where board papers do not address continuous disclosure issues, but such issues are a relevant matter for consideration, it is the duty of general counsel to direct the board's attention to them regardless of other mechanisms in place.

Consistent with existing authority, *Macdonald* also affirms the following legal principles that are of relevance to directors and officers:

- The degree of negligence required to establish a breach of s 180(1) is not higher than that which would support a similar finding at common law.[234]

[232] *Macdonald* (2009) 256 ALR 199, 218.

[233] *Lezam Pty Ltd v Seabridge Australia Pty Ltd* (1992) 35 FCR 535, 556–7 (Burchett J).

[234] *Macdonald* (2009) 256 ALR 199, 276 (Gzell J), citing *Vines* (2007) 62 ACSR 1, 34–5 (Spigelman CJ). Austin J, in *Rich* (2009) 236 FLR 1, 130, rejected the contention that the legislative scheme only applies to gross negligence and regarded that view as being 'untenable'.

- All directors have a continuing obligation to guide and monitor the management of the company and to keep informed about its activities. This means, in particular, that non-executive directors must be fully informed on any proposal before the board.
- Overzealous and misguided conduct does not necessarily equate to a director's breach of the requirement in s 181 to act in good faith and for a proper purpose. The courts favour the application of a subjective test to determine dishonesty and breach of s 181 which is directed 'to prevent[ing] abuses of directors' powers for their own or collateral purposes.'[235] Directors may take some comfort that, for purposes of s 181, '[t]he issue is not whether a management decision was good or bad'.[236]
- The statutory definition of 'officer' in s 9 of the *Corporations Act* is applicable to a person who has a 'real and direct' participation in management 'but not necessarily in a role in which ultimate control is exercised, although it would have to be more than the administrative carrying out of orders'.[237]

The lessons from the James Hardie experience are not, however, purely legal. Other salient lessons concern the need for ethical standards and increased social responsibility.[238] The strategy embarked upon by James Hardie to divest itself of its asbestos liabilities has been described by the Australian Council of Trade Unions as 'one of the most morally and legally repugnant acts in Australian corporate history.'[239] Although the actions of the James Hardie group are not unprecedented,[240] the conscience of the former directors of JHIL, in relation to strategic behaviour in the separation plan and the limited funding set aside to meet the claims of its asbestos victims, has been found to be sorely wanting.[241] The extent of the company's patent failure to observe corporate social responsibility norms was crystallised in the following observation in the *Jackson Report*:

> The notion that the holding company would make the cheapest provision thought 'marketable' in respect of those [asbestos] liabilities so that it could go off to pursue its other more lucrative interests insulated from those liabilities is

235 *Maxwell* (2006) 59 ACSR 373, 400 (Brereton J).

236 *Permanent Building Society (in liq) v Wheeler* (1994) 11 WAR 187, 218 (Ipp J).

237 *Commissioner for Corporate Affairs v Bracht* [1989] VR 821, 831 (Ormiston J), quoted in *Macdonald* (2009) 256 ALR 199, 269 (Gzell J).

238 For the views of the leading advocate on corporate goals and social responsibilities, see E Merrick Dodd Jr, 'For Whom Are Corporate Managers Trustees?' (1932) 45 *Harvard Law Review* 1145.

239 ABC Television, 'James Hardie Executives Accused of Fraud', *The 7:30 Report*, 28 July 2004 (Greg Combet, Secretary of the Australian Council of Trade Unions) <http://www.abc.net.au/7.30/content/2004/s1164158.htm>.

240 For a critical and valuable examination of the use of the limited fund strategy by the largest manufacturer and supplier of asbestos products in the United States, see Peta Spender, 'Blue Asbestos and Golden Eggs: Evaluating Bankruptcy and Class Actions as Just Responses to Mass Tort Liability' (2003) 25 *Sydney Law Review* 223, 226–9.

241 See Peta Spender, 'Weapons of Mass Dispassion: James Hardie and Corporate Law' (2005) 14 *Griffith Law Review* 280.

> singularly unattractive. Why should the victims and the public bear the cost not provided for?[242]

It would appear that the directors of James Hardie also failed the basic moral test expected of directors — namely, as articulated by a former judge, to be 'the guiding hand and conscience of a company'.[243]

V CONCLUSION

The value of *Macdonald*, for corporate governance, lies in its contribution to outlining the contours in the cartography of the duty of care and diligence, with particular reference to the role of non-executive directors, company secretaries and general counsel when considering strategic issues.

The decision in *Macdonald* underscores the need for boards to pay attention to key aspects of corporate governance, including risk management, due diligence and compliance. The non-executive directors' substandard conduct in *Macdonald* signals the risks associated with an attitude that shows a readiness to go through the motions and a failure to consider the real issues. The case also exposes the risks associated with the board's failure to be actively engaged and take their monitoring role seriously and, together with the civil penalty provisions, has large potential to improve the deterrence calculus, as shown in the disqualification orders in *Australian Securities and Investments Commission v Macdonald [No 12]*.

In the United States, according to one commentator, the judicial approach to 'directors' liability at the turn of the twenty-first century seems to be, if anything, an ideal with no practical effect.'[244] In contrast, the Australian experience, particularly in the last two decades, has seen a robust approach to enforcement of directors' duties that has changed the contours of the duty of care and diligence. Notwithstanding the corporate regulator's mega-loss in *Australian Securities and Investments Commission v Rich*,[245] the civil penalty provisions will continue to propel the majority of litigation given that directors' statutory duties are inextricably intertwined with part 9.4B of the *Corporations Act*.[246] The wave of investigations[247] and litigation alleging breach of directors' statutory duties in a variety of contexts, ranging from approval of misleading financial reports in

242 *Jackson Report*, above n 11, vol 1, 13.

243 Neil Young, 'Has Directors' Liability Gone Too Far or Not Far Enough? A Review of the Standard of Conduct Required of Directors under Sections 180–184 of the *Corporations Act*' (2008) 26 *Company and Securities Law Journal* 216, 218.

244 Dalia Tsuk Mitchell, 'Status Bound: The Twentieth Century Evolution of Directors' Liability' (2009) 5 *New York University Journal of Law and Business* 63, 69.

245 (2009) 236 FLR 1.

246 For criticism of 'ASIC's perceived failure to use criminal sanctions in cases of serious corporate misconduct', see Vicky Comino, 'The Challenge of Corporate Law Enforcement in Australia' (2009) 23 *Australian Journal of Corporate Law* 233.

247 ASIC is currently investigating the conduct of certain officers following the collapse of Opes Prime, Westpoint, Chartwell Enterprises, Fincorp and Storm Financial: ASIC, *ASIC Annual Report 08–09: A Year of Consolidation* (2009) 16–17.

Centro Properties[248] and ASX announcements in Fortescue Metals Group[249] to causing reputational harm by engaging in corporate conduct contrary to UN resolutions in AWB,[250] ensure that *Macdonald* will not be the last word on, or provide the last lessons for, Australian corporate governance practices.

248 ASIC, 'ASIC Commences Proceedings against Current and Former Officers of Centro' (Advisory No 09-202AD, 21 October 2009).

249 ASIC brought civil penalty proceedings against the company and its officers alleging failure to comply with continuous disclosure obligations and breach of the misleading or deceptive provisions concerning ASX announcements. However, ASIC's claims were dismissed in late 2009: ASIC, 'ASIC's Proceedings against Fortescue Metals Group Ltd and Andrew Forrest Dismissed' (Advisory No 09-268AD, 23 December 2009). For criticism of ASIC's approach to recent litigation, see Peter Ryan, 'Fortescue Loss: "ASIC Must Learn Lessons"', *ABC News* (online), 24 December 2009 <http://www.abc.net.au/news/stories/2009/12/24/2780119.htm>.

250 An example is the preliminary hearing on statement of claim alleging breach of directors' statutory duties in *Re AWB Ltd; Australian Securities and Investments Commission v Lindberg [No 5]* [2009] VSC 258 (Unreported, Robson J, 17 July 2009).