



Directors and Officers Alert May 2009

Entire board of directors and executives facing heavy fines and bans

The New South Wales Supreme Court last week found ten former directors and executives of James Hardie liable for misleading the public about the certainty of a compensation fund for victims of asbestos exposure. Here we provide a summary of this landmark decision and why it is an important reminder for all company directors and officers to be aware of their duties.

James Hardie's entire former board of directors and executives are facing substantial fines and bans after last week's NSW Supreme Court decision in *Australian Securities and Investments Commission v Macdonald (No 11)* [2009] NSWSC 287.

Brief facts of the case

James Hardie issued a press release in February 2001 announcing a "fully-funded" foundation to compensate victims of the well-publicised asbestos exposure caused by its products. The release included a statement by Chief Executive Officer Peter Macdonald that:

"James Hardie is satisfied that the Foundation has sufficient funds to meet anticipated future claims."

It was revealed just two years later that the \$293 million fund was suffering an \$800 million shortfall. ASIC immediately launched an action against the directors and officers for breaching their duties of care and diligence to the company under section 180(1) of the *Corporations Act 2001* (Cth). Officers include:

- > directors;
- > secretaries; and
- > people making decisions affecting the whole; or
- > a substantial part of a company.

Reasonable care and diligence is determined by what a reasonable person in the director or officer's role would do in their circumstances. ASIC alleged that the Board of Directors could not have been satisfied from the material before them that there was sufficient funding to meet all current and future claims against the company.

The NSW Supreme Court decision

Justice Gzell of the NSW Supreme Court found that each director breached this duty by approving a draft press release which misled and deceived the public to believe that the Foundation's funding was sufficient.

His Honour rejected the evidence of all eight directors that the draft was not tabled, discussed or approved at a board meeting the week before it was published. Instead, he preferred the evidence of an objective witness to the meeting in ruling that it had been approved in "the usual way", where resolutions passed if some directors nodded in agreement and the others did not raise an objection.

Finding that the directors should not have approved the release he emphasised:

"Once asked, the Board had a duty to consider its content carefully."

This was especially so where neither the Board, management nor the company's external lawyers had seen the draft before the meeting.

Two of the directors denied having seen a copy of the draft release, claiming that they would not have voted for its publication had they known its content was misleading.

However, they were taken to have approved the release as they did not:

- > ask for a copy;
- > object; or
- > refrain from voting.



The CEO and CFO were found to have breached their duties by failing to advise the Board not to approve the draft release. Together with the company's in-house lawyer, they were also found to have breached their duties by failing to properly advise the Board that the consultants' estimate of the fund could not be relied on as it advised only on technical correctness while neglecting to consider key assumptions such as future claim costs.

Despite management's failure to inform the Board of this, however, each director was held liable for approving the misleading release and is now facing a fine of up to \$200,000 and a ban from serving on company boards. They will respond to ASIC's penalty suggestions in court next month.

What it means for you

This finding is a startling reminder to all company directors and officers of the importance of forming independent judgements in day-to-day decision-making.

It can be difficult to determine the extent of your duty of care and diligence. However, you should always satisfy yourself that you have all of the information you need to come to your own decision and you should always object or refrain from voting on a resolution if you are not confident in your decision. Before relying on independent valuations in particular, directors should ensure that all figures can be substantiated. The need to properly record the raising of objections or reasons for refraining from voting in a boardroom setting are critical to minimising the potential for such claims against officers of a company.

Thomson Playford Cutlers will be providing a training program for company directors and officers shortly to assist you in understanding the extent of your duties and ensure you minimise the potential of similar liability.

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