DIRECTORS' LIABILITY FOR FORWARD-LOOKING INFORMATION DISCLOSURE

Why and how the controversy has arisen in the contexts of Australian corporate law and our broader attitudes towards the law

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A note from Alex Malley FCPA, Chief Executive, CPA Australia

The Integrated Reporting <IR> Framework released by the International Integrated Reporting Council (IIRC) in December 2013, is appropriately principle-based. It is designed to be applied across a wide range of businesses in different legal jurisdictions all around the world.

An area of complexity in the IIRC's Integrated Reporting Framework that attracts frequent comment relates to the potential legal liability arising from forward-looking disclosures that are prepared against the Framework's Guiding Principle of Strategic focus and future orientation. Despite the Framework being principle-based and jurisdiction-neutral, the <IR> Framework states that: "legal or regulatory requirements may apply to certain future-oriented information in some jurisdictions."

The complexities of corporate regulation should not be seen as a barrier to <IR>, rather, they form part of the external environment in which the company's business model functions to create value. This recognition provides a sharp focus on the need to identify aspects of national legal frameworks that enable the adoption of <IR> and offer appropriate protections based on established principles such as due diligence and reasonable grounds.

What follows is the first part of CPA Australia's endeavour to find a sensible and practical path through the legal complexities which have, at least in some quarters in Australia, been regarded as a barrier to wide and wholehearted adoption <IR>. If you have any questions or comments on this discussion paper please contact Dr. John Purcell CPA Australia's Policy Adviser ESG at john.purcell@cpaaustralia.com.au

Alex Malley FCPA

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DIRECTORS' LIABILITY FOR FORWARD-LOOKING INFORMATION DISCLOSURE: WHY AND HOW THE CONTROVERSY HAS ARISEN IN THE CONTEXTS OF AUSTRALIAN CORPORATE LAW AND OUR BROADER ATTITUDES TOWARD THE LAW

> *Man in Black:* All right where is the poison? The battle of wits has begun. It ends when you decide and we both drink, and find out who is right - - - and who is dead.
>
> *Vizzini:* But it's so simple. All I have to do is divine from what I know of you: are you the sort of man who would put the poison into his own goblet or his enemy's? Now, a clever man would put the poison into his own goblet, because he would know that only a great fool would reach for what he was given. I am not a great fool, so I can clearly not choose the wine in front of you. But you must have known I was not a great fool, you would have counted on it, so I can clearly not choose the wine in front of me.
>
> *Man in Black:* You've made your decision then?
>
> *Vizzini:* Not remotely. Because iocane comes from Australia, as everyone knows, and Australia is entirely peopled with criminals, and criminals, are used to having people not trust them, as you are not trusted by me, so I can clearly not choose the wine in front of you.
>
> *Man in Black:* Truly, you have a dizzying intellect.
>
> (The Princess Bride (1987))

Some context

Relying on another dizzying intellect, this time the late English legal theorist Professor Peter Birks[1], it may well be that an assumed absence of trust is a feature of Australian commercial law, and corporate law in particular. To use Birks's own words, "the habit of thinking of the law in terms of wrongs and remedies encourages a malignant criminal model of civil law." Specific criminal elements[2] and orientation aside[3], Australia's corporate law is indeed fraught, containing a labyrinth of complex rules bolted on to what was once a relatively certain and navigable statute of clearly definable purpose.

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[1] 1941-2004, was up until his passing the Regius Professor of Civil Law at the University of Oxford.
[2] The Corporations Act 2001 functions with a comprehensive scheme of civil penalties. The various requirements and duties to which a Court will make a declaration of contravention are listed s 1317E (a list of 46 items cross-referenced to the specific statutory requirement or duty). Significantly though, allowance is made for criminal consequences of contravention. For example, a director or offices of a corporation commits an offence under s 184 where an element of recklessness or intentional dishonesty is evident in relation to the duty of good faith, and improper use of position or information (ss 181, 182 and s 183).

[3] The manner in which Australian law has evolved to attribute criminal liability to corporations and the presence across a range of non-corporate statute of non-delegable corporate duty to which criminal penalties apply is beyond the purpose and scope of this paper. It is worthwhile however repeating the introductory word from Part 2.5 (Corporate criminal responsibility) of the Schedule to the Criminal Code Act 1995: "(1) This Code applies to bodies corporate in the same way as it applies to individuals. It so applies with such modifications as are set out in this Part, and with such other modifications as are made necessary by the fact that criminal liability is being imposed on bodies corporate rather than individuals.

(2) A body corporate may be found guilty of any offence, including one punishable by imprisonment."

In Australia then integrated reporting <IR>, which is both innovative and novel, is prone to preexisting complexities and the habit of focusing on the wrongs which may arise and the remedies which might be sought. Birks's central thesis in "Rights, wrongs and remedies"[4] is that we should commence analysis of the law - particularly private law – from the standpoint of rights. Although I do not pursue the idea further, it may well be that looking at <IR> through the lens of rights – right to information, right to make informed assessments, right to gauge broadly defined performance and stewardship and rights of a diversity of interests – would assist <IR>'s acceptance by potential adopters. A rights-based perspective might also give clarity to how corporate and market regulators could facilitate <IR>'s uptake, whilst at the same time building stakeholders understanding of <IR>'s worth. Only then might we be able to fully trust our willingness to give better and frank disclosures, trust the fact that future-oriented disclosure is a function of professional judgment and trust that such information is context-based. Such romantic notions will however not do and we need now descend into the marketplace of practical legal reality.

Introduction

The objective of this and the two papers that follow is to examine the basis of current resistance to <IR> in the Australian legal context and to identify possible avenues for reform. In this paper features of both complexity in corporate law and the law's liability orientations are explained. These features make the forward-looking disclosure elements of <IR> appear uncertain and problematic. The second paper examines three specific aspects of directors' duties against which <IR> might be understood. These are the general duty of care and diligence[5], continuous disclosure[6] and listed company directors' operations and financial reviews[7]. Building on the second paper's emphasis on duties, the third paper addresses liability and defence relationships in a number of existing statutory based disclosures[8] that either require or encourage forward-looking disclosures and information about prospects. The objective is to further clarify the nature of current concerns and, in so doing, point to possible avenues of law reform.

Some general background

Australian listed entities are subject to a wide and complex range of disclosure obligations. Some of these are periodic, for example annual financial reports and directors' reports, whilst others are episodic, for example continuous disclosure and securities and financial product offers. Across a wide range of disclosures there is often an obligation, need or desire to present forward-looking information; say for example in a prospectus (an episodic disclosure) or a directors' annual report (a periodic disclosure) information about likely developments in the entity's future financial years. In the case of obligatory disclosures, the disclosure obligation is on the listed entity itself. Nonetheless, the

[4] Oxford Journal of Legal Studies 1 (2000) pp 1-37.
[5] Corporations Act 2001 section 180
[6] Corporations Act 2001 Chapter 6CA and Australian Stock Exchange (ASX) Listing Rules Chapter 3.
[7] Corporations Act 2001 section 299A(1)
[8] Corporations Act 2001 Part 6D.2 - Disclosure to investors about securities and Part 7.9 - Financial product disclosure and other provisions relating to issue, sale and purchase of financial products

law makes the entity's directors and officers personally liable in particular circumstances and through a range of means. This is particularly relevant in relation to the misleading and deceptive conduct provisions within both the Corporations Act 2001 and the Australian Securities and Investments Commission Act 2001. The uncertainties created by these dual provisions are discussed further.

Given the range of disclosures, alleged failure around a particular factual circumstance can lead to a director breaching both specific and general duties.[9] Moreover, personal liability can arise either through involvement 'in a contravention'[10] or based in negligence when a person, or persons, has or have suffered a reasonably foreseeable harm, or where the company itself is seen to have suffered harm. In the latter regard, a consistent view expressed by courts is that the company is a 'real thing' whose interests are to be safeguarded and that the privileges of incorporation and limited liability are not to be abused.

The liability regime around corporate disclosure is complicated and unpredictable. Some argue that it is even prone to 'strategising' by the Australian Securities and Investments Commission (ASIC) through expanding the breadth of source of liability applicable to a particular set of facts.[11] This might be evident in the 'Centro' circumstances (*ASIC v Healey* [2011] FCA 717) where directors in approving what proved to be erroneous accounts of group member companies, were subject to specific sanction (Corporations Act 2001 Part 2M.7) pertaining to, amongst other matters, statutory requirements to comply with accounting standards (s 296), whilst breaching also the general duty requiring the exercise of powers, and discharge of duties, with care and diligence.

There are also related concerns around the manner in which the courts and the regulator are seen to aggressively apply the disqualification provisions [12] of the Corporation Act, along with the comprehensive mechanism for the application of pecuniary penalties.[13] Judicial attitude has been that board responsibility is collegiate thus placing sharp focus on each individual director's responsibility to be actively engaged and inquiring, particularly around issues of finance and solvency, and the reporting thereon. These expectations are pointedly emphasised by Justice Middleton in his decision in *ASIC v Healey* where, in summary, he stated that there is "a core, irreducible requirement of

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[9] Directors' general duties in the Corporations Act are embodied in 'shorthand' statutory statements of the general law principle built up over many decades, with the Act also replete with highly specific duties across a range of actions and behaviours.
[10] Corporations Act 2001 section 79, Involvement in Contraventions, is contain in Part 1.2 – Division 7 – Interpretation of other expressions , and explains the term "involved in contravention" found in sections such as s 181, 182 and 183 (respectively the general duties of Good faith, Use of position and Use of information) and includes behaviours such as aiding, abetting, counseling and conspiring.
[11] For a comprehensive analysis see T. Bednall and P. Hanrahan "Officers' liability for mandatory corporate disclosure: tow paths, two destinations?" (2013) 31 *Company and Securities Law Journal 8*
[12] Corporations Act 2001 Part 2D.6
[13] Corporations Act 2001 section 1317G(1): "A Court may order a person to pay to the Commonwealth a pecuniary penalty of up to $200,000 if - - - a declaration of contravention by the person has been made under section 1317E etc.". Section 1317E lists 46 civil penalty provisions. This, in turn, is overlayed by sections such s 1317H – Compensation orders – Corporate/ scheme civil penalty provisions, enabling Courts to order compensation to the corporation/ scheme for damages suffered. Moreover, drawing possibly on equitable principles, s 1317H(2) recognises damages also to include profits made by the person resulting from the contravention or the offence.

directors to be involved in the management of the company" and that "all directors must carefully read and understand financial statements before they form the opinions which are to be expressed in the declaration required by s 295(4)[14]."[15] This attitude follows a long line of development leading to the seminal NSW Court of Appeal decision in *Daniels v Anderson* (1995) 37 NSWLR 438, which, amongst a range of matters, confirmed directors as the essential component of corporate governance and that the duty of care and diligence was to understood with reference to developments in the civil wrong (tort) of negligence. A further noteworthy observation drawn by Justice Middleton was that "there has been no suggestion that each director did not honestly carry out his responsibilities as a director". They had however, he concludes, "failed to take all reasonable steps required of them". Whilst the Centro decision is highly fact specific, the manner in which the recognition of honesty and conscientiousness can be outweighed by the positive character of a duty, has been a further source of agitation for reform of business judgment relief[16], and in the integrated reporting context, contributes to concerns about honest and fair endeavours to present views on expectations, which may, in time, not eventuate. This, as will be further elaborated on in the subsequent papers, is all the more pronounced with the legislative trend towards developing precise 'pigeonholes' of statutory-based disclosure into which <IR> does not comfortably fit.

Though not pleaded in the Centro litigation, a further provision having bearing on understanding directors' power of management[17] and how it is discharged in a practical sense is the protection relating to reliance on information or advice provided by others.[18]

A further feature of the Australian corporate landscape is an increasing threat of class actions, often supported by litigation funders. Australia is estimated to be at least the fifth largest common law litigation market in the world. Aside from the risk of multimillion-dollar damages, the mere hint of such action can inflict damage on reputation and share price, along with being highly disruptive to day-to-day business. Australia is seen as particularly fertile ground for such actions because of both statutory

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[14] These include (c) the solvency declaration and (d)(i) and (d)(ii), respectively, compliance with accounting standards and true and fair view.
[15] Paras. 16 and 17.
[16] Corporations Act section 180(2). The *business judgment rule,* is a safe harbour from liability in relation to the duty of care and diligence and requires the meeting of a series of requirements: (a) makes the judgment in good faith for a proper purpose; and (b) do not have a material personal interest in the subject matter of the judgment; and (c) inform themselves about the subject matter of the judgment to the extent they reasonably believe to be appropriate; and (d) rationally believe that the judgment is in the best interests of the company. The section wording stresses that the test is an objective one of what a reasonable person in their position would hold. A note to the section emphasises that the protection does not operate in relation to duties under any other provision of the Corporations Act or under any other law. Finally, it is noteworthy to observe that the onus for satisfying the rule falls upon the party invoking it. (*ASIC V Adler* (2002) 41 ACSR 72 per Santow J [406] to [409])
[17] Corporations Act section 198A(1) The business of the company is to be managed by or under the direction of the directors. NOTE: s 198A is noted as a Replaceable Rule (s 135) so it is certainly conceivable that a corporate constitution might be so drafted as to constrain or limit directors' powers in a particular way.
[18] Corporations Act section 189

prohibitions on commercial deceptive conduct and well developed recognition of economic harm[19] as a basis for awarding remedy to plaintiffs. The litigation funded class actions span a wide range of private and commercial claims. Typical in the corporate environment, multiple defendants (advisers and the like) are drawn into plaintiff compensation claims arising out of forward-looking information contained in a company's or scheme's product disclosure statements prepared under the Part 7.9[20] of the Corporations Act. Although specifically related to public offerings and fund raising, the type of exposure to allegations of misleading information, or material omissions around prospective information, is the source of much of the nervousness uttered in relation to integrated reporting, this of course, notwithstanding a far looser causal relationship. In the absence of any likely law reform to carve out large corporate transactions from exposure to what is a highly onerous consumer protection regime, widespread advancement of integrated reporting in Australia would seem likely to require measures additional to the current reliance on 'pioneer' leadership and the 'pull' of capital-provider demand. A purely voluntary approach relying on market forces may not create in Australia the breakthrough in adoption that would achieve IIRC's objective of <IR> being the reporting norm by around 2018. Adopting this perspective the subsequent papers give consideration to both current legislatively-based platforms and safe harbour or defence arrangements which might be adapted to support integrated reporting's advancement.

First however, it is vital to address two threshold questions in determining whether a company report prepared with reference to the IIRC's December 2013 <IR> Framework might be subject to all, or parts of, Australia's complex legal settings. These are to determine whether an <IR> prepared in accordance with the Framework has sufficient formality to set it in a legal context and the degree to which future-oriented disclosures are integral to an <IR>.

Is an <IR> a 'document of the company'?

The <IR> Framework is principle-based and intended to have wide application on a non-jurisdiction specific basis. Notwithstanding these neutralities, local, at least Australian, application requires addressing whether or not any particular company's <IR> is a 'document of the company' so as to attract consideration of possible liability for both the company and its directors and officers. The meeting of these criteria would depend on whether the directors:

- Acknowledge their responsibility to ensure the integrity of the integrated report
- Acknowledge that they have applied their collective mind to the preparation and presentation of the integrated report
- Opine or conclude about whether the integrated report is presented in accordance with the Framework.

[19] Refer the line of development related to recognising negligence claims for pure economic loss which includes the High Court decisions in *Perre v Apand Pty Ltd* (1999) 198 CLR 180, *Woolcock Street Investments Pty Ltd v CDG Pty Ltd* [2004] HCA 16 and *Barclay v Penberthy* [2012] HSC 40.

[20] Chapter 7 – Financial services and markets Part 7.9 – Financial product disclosure

On these matters, the Framework is quite emphatic with each requirement addressed in 1G ("Responsibility for an integrated report") of *Using the Framework* shown in **bold**[21] text as a requirement of the Framework, rather than mere explanation. The Framework does allow some lower level attestation, though by way of exception.

Beyond this though, we do not have a sufficiently precise understanding of the character of <IR> within an Australian legal context that would allow identification of the type of information <IR> is, who the audience is, the reliance it can place on it and the liability possibly generated. This is a case of complexity generating a desire for certainty, without even getting to the stage of considering the business case and benefits of integrated reporting. Hence the current reticence and widespread reluctance to engage in testing the opportunity to embark on the <IR> journey.

To what extent is <IR> fundamentally future oriented and prospective in nature?

The <IR> Framework released in December 2013 contains as one of its Guiding Principles the following:

> ### 3A Strategic focus and future orientation
>
> 3.3 ***An integrated report should provide insight into the organization's strategy, and how it relates to the organization's ability to create value in the short, medium and long term and to its use of and effects on the capitals.***
>
> 3.4 Applying this Guiding Principle is not limited to the Content Elements 4E Strategy and resource allocation and 4G Outlook. It guides the selection and presentation of other content, and may include, for example:
>
> • Highlighting significant risks, opportunities and dependencies flowing from the organization's market position and business model
>
> • The views of those charged with governance about:
>
> o the relationship between past and future performance, and the factors that can change that relationship

[21] The International <IR> Framework, IIRC, December 2013, p 9.

- how the organization balances short, medium and long term interests
- how the organization has learned from past experiences in determining future strategic directions.

3.5 Adopting a strategic focus and future orientation (see also paragraphs 3.52–3.53) includes clearly articulating how the continued availability, quality and affordability of significant capitals contribute to the organization's ability to achieve its strategic objectives in the future and create value.

Future-oriented information is further elaborated upon in the Framework under section 3F **Reliability and completeness:**

3.52 Legal or regulatory requirements may apply to certain future-oriented information in some jurisdictions, covering for example:

- The types of disclosures that may be made
- Whether cautionary statements may be required or permitted to highlight uncertainty regarding achievability
- An obligation to publicly update such information.

3.53 Future-oriented information is by nature more uncertain than historical information. Uncertainty is not, however, a reason in itself to exclude such information. (See also paragraph 4.50 regarding disclosures about uncertainty.)

In their development as part of the Framework, these particular features were the subject of specific concerns raised in the public consultation, particularly in terms of the implications for unreasonably attracting legal liability and threat of competitive harm. It was on these bases that the abstainer in the Council decision to endorse the Framework had sought, amongst other actions:

- " - - - inclusion of an explicit statement on the cover of the Framework and in paragraph 1A - - - that the Framework is voluntary."
- " - - - inclusion of cautionary language in the Integrated Report that advises users of that information disclosed is future oriented in nature and is inherently uncertain and that users should exercise caution - - - ."

The IIRC's handling of the legal liability issue is outlined in the following extract from its published ***Basis for Conclusions:***

> 9.2 With respect to legal liability: The IIRC noted the importance of this issue and the fact that it is being considered from a policy perspective, including the call for “safe harbours” raised by some respondents. The IIRC also retained the exclusion in paragraphs 1.17–1.18 of the Framework allowing an integrated report to not apply the Framework to the extent that specific legal prohibitions result in the inability to disclose material information, and noted the relevance of the:
>
> - Discussion of completeness (paragraphs 3.47–3.53 of the Framework, particularly with respect to future-oriented information at paragraphs 3.52-3.53 of the Framework)
> - Reference in paragraph 4.39 of the Framework to legal or regulatory requirements regarding the Content Element Outlook.
>
> The IIRC did not, however, think that substantive changes were needed in the Framework (particularly given its principles-based and market-led nature) to respond to the **possibility that some information might, in some circumstances in some jurisdictions, result in a potential legal liability to the preparer.** (Emphasis added)

In relation to the ‘possibility that some information might, in some circumstances, in some jurisdictions, result in a potential legal liability to the preparer’ we can speculate:

- firstly, how the structure and basis for developing corporate law in Australia generally impedes innovation in disclosure, and
- secondly how, more specifically, the misleading and deceptive conduct elements of the Australian corporate liability regime represent a significant source of concern contributing to reluctance by companies, outside of ‘<IR> pioneers’, to seriously engage in exploring adoption. These are of course not the only relevant liability regimes. Others will be discussed in the two subsequent papers. Misleading and deceptive conduct is highlighted here to emphasise both the source of complexity and uncertainty engendering reluctance, or even hostility, towards integrated reporting, and the need therefore to identify where and how <IR> could be accommodated within an existing structure with modest adjustment to either, or both, the regulatory framework or the <IR> Framework itself.

Liability for misleading and deceptive conduct – its developed in the corporate context and potential influence of attitudes towards <IR>

It is appropriate to preface discussion here with some short comment on the sources of Australian corporate law and its interaction with other major bodies of legal rules. This paper was introduced with reference to the fragmented and possibly reactionary way in which Australian corporate law has evolved. This observation is now developed further.

Law can cautiously be viewed as an evolving accumulation of rules. Both civil and common law have a long history of endeavours to either discern or impose order in the law through taxonomic processes of classification and categorisation. As such, it would seem reasonable to expect clear delineation between bodies of legal rules, and within a discrete body of rule, a coherent and organised structure. This, all the more so, where the 'black letter' law statute is, as with corporate law, intended to be permissive of behaviours through targeting exceptions. Ideally, corporate law should encourage independent actions towards wealth creation and accumulation. Alas, in many regards this degree of unity and coherence in the Corporations Act does not appear to be occurring either by deliberate design or arising from some other circumstance such as coordination between ministries, and between the Commonwealth and the States. Moreover, we have instances of contrasting statutory orientations applied to particular behaviours and factual circumstances. In other circumstances inconsistency and absence of coherence may arise through inadvertence.

These sources of complexity are worthy of consideration to our understanding of the current 'blockers' to <IR>.

Statutory corporate law and its continued interaction with the common law

First, examples of overlap through deliberate design. These arise in many instances through progressive codification of common law rules into modern statute. One instance of deliberate preservation of common law rules, and thus a basis upon which the Corporations Act falls short of self-contained internal coherence, is section 185 which provides that the 'shorthand' statutory statements of general duties have effect in addition to, and do not lessen or set aside, any rule of law applied to a person's office or relation to a company. This, for example, preserves the right to bring civil proceedings for monetary compensation without reference to the statutory duties and allows the common law and fiduciary rule that have evolved in relation to conflict, profit and misappropriation to be applied to the same set of facts that would attract the statutory provisions. This duality of common law and statutory rules ideally allows the law to remain cognisant of changing circumstances and allows each body of rules, judge-made and statutory, to inform understanding and application of the other. Critics would argue though, that such incrementalism renders the law prone to uncertainty and open to both judicial activism and strategising by regulators. Vagueness in the law, be it real or perceived, provides a basis for arguing against <IR>, the controversy falling squarely within the friction which often besets debate on how corporate law should be structured – on the one hand, demanding that the rules should provide certainty, yet on the other hand, urging a significant degree of flexibility to apply professional judgment and engage in reasonable risk taking which, after all, is what the existence of limited liability is all about. In summary then, we have here one general source, amongst a number of more specific concerns, creating inertia against innovation in external reporting that seriously impedes wider adoption of <IR> in Australia.

Secondly now, an example of overlapping and complexity within the Corporations Act, and as between the Corporations Act and other bodies of legal rules. The key messages. First, the law is uncertain and messy notwithstanding the desire and attempts to make it otherwise. Secondly, specifically in relation to disclosures, their legal implications cannot be fully understood without reference to wider duty and liability regimes. It is in this latter regard that the way in which the misleading and deceptive conduct rules have evolved, and been applied, are major sources of concern and resistance to integrated reporting. Aside from the Centro litigation discussed above, a further significant series of cases engendering nervousness about prospective disclosures, are those ultimately concluding with the High Court decision is *ASIC v Hellicar* [2012] HCA 17. This, notwithstanding these cases even more specific, and in many regards, notorious factual setting which might raise questions about broader development of legal principle. At a general level though, a noteworthy similarity with Centro is that the directors of the companies concerned are highly qualified and professional individuals.

To fully appreciate the notoriety of the facts and surrounding circumstances dealt with in the lower court cases leading up to *ASIC v Hellicar*, we need to jump back to the 2004 New South Wales (Jackson QC) Special Inquiry into the Medical Research and Compensation Foundation. One of the key Terms of Reference was to examine:

> "The circumstances in which MRCF [Medical Research and Compensation Foundation] was separated from the James Hardie Group and whether this may have resulted in or contributed to a possible insufficiency of assets to meet its future asbestos-related liabilities."

This potential for a deficiency of assets to meet the claims of potential plaintiffs raises ethical concerns as to the validity of strategic corporate restructuring, as well as highlighting uncertainty as to the manner in which corporate insolvency rules will be applied to deal fairly with such an eventuality. The MRCF had been established to control two former companies of the James Hardies Group, Amaca Pty Ltd and Amaba Pty Ltd, which had previously been manufacturers of asbestos-based products. These companies have acquired, and will continue to acquire, legal liabilities to identified, and as yet unidentified, victims of Hardie's asbestos products. In his conclusions Jackson identifies the motive for the reorganisation, an essential part of which was also the relocation of the Group's control to the Netherlands:[22]

> "The principal purpose of separation was to enable the Group thereafter to obtain capital or loan funding or to use its own share capital for future acquisitions without the stigma of possible future asbestos liabilities."[23]

Another conclusion was that the Foundation's funds would "be exhausted in the first half of 2007 and it had no prospect of meeting the liabilities of Amaca and Amaba in either the medium or long term." Without some form of intervention these companies would become insolvent. Clearly to allow these companies to reach this point would result in a significant injustice to future claimants. The 'nub' of the problem here was:

> "The negligence of the James Hardies companies occurred in the past, but the liabilities flowing from that negligence only arise day to day, now and in the future, as the diseases are acquired or manifest themselves."[24]

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[22] JHI NV

[23] 1.6 p 8.

Such circumstance is illustrative of interaction between bodies of legal rules – tort of negligence, corporations law and bankruptcy ordering – the complexities of which remain unresolved. Though remote from <IR>, persistence of this type of uncertainty further compounds unwillingness by many companies to venture into new forms of disclosure to, and discourse with, markets. The specific conclusions though in the James Hardie cases about misleading and deceptive announcements do, as will elaborated, have more direct bearing on present attitudes towards forward-looking information disclosures.

Jackson in the Special Commission Report acknowledges that the attempt to operate in the future "without the stigma of future asbestos liability" is not of itself objectionable. What, however, is regarded as objectionable are the actions and pattern of behaviour by which the under-funding of the Foundation was allowed to arise[25] and systematically denied.

The dual features of under-funding and systematic denial were ultimately played out in the series of cases commencing with *ASIC v Macdonald and Others* (No 11) (2009) 256 ALR 199 and finally concluding in the High Court with *ASIC v Hellicar* which was decided concurrently with ASIC appeals in relation to a further seven former directors and officers of James Hardie Industries. The course of the litigation is extensively drawn out and complex, a substantial element of the High Court decision dealing with matters around "the duty of fairness" involved in the manner in which ASIC had conducted the litigation. Although a number of matters concerning relief from liability and disqualification were remitted to the NSW Court of Appeal, the essential elements of the decision of Justice Gzell in the NSW Supreme Court were restored. Much of the litigation centred on a February 2001 announcement to the Australian Stock Exchange and accompanying media release concerning the funding sufficiency of MRCF. Amongst the numerous matters decided by Gzell J, was the fact that the "ASX announcement was false and misleading - - - JHIL [had therefore] engaged in conduct that was misleading and deceptive, or likely to mislead or deceive, contrary to section 995(2) of the Corporations Act." (2009) 256 ALR 199 at 388). To reiterate earlier observations concerning capacity for both corporate and director liability arising out the same factual circumstances, Peter Macdonald, the JHIL CEO, was found to have breached the s 180(1) duty of care and diligence in approving the ASX announcement.

Space here precludes any further detailed analysis, however in the context of our concerns about future oriented-disclosures, the problem was that the statements in the announcement were emphatic and contained no qualifications or cautions. For example: "The Foundation has sufficient funds to meet all legitimate compensation claims anticipated from people injured by asbestos products that

[24] 1.25 p 13. Ethical issues associated with deficiencies in corporate insolvency law and the possible perverse incentives of the separate entity were 'not on trial' in the litigation we are considering here, but are of course critical questions of public policy and law reform.
[25] See 1.14 p 10.

were manufactured in the past by former subsidiaries of JHIL", and ""James Hardie is satisfied that the foundation has sufficient funds to meet anticipated future claims," Mr Macdonald said." Concerning these statements, Jackson QC in his Report stated:

> " - - - its terms conveyed that the Foundation had been provided with sufficient funds to meet all legitimate future asbestos-related claims, and that accordingly there was "certainty" for persons who might suffer from such diseases and for JHIL shareholders."

In terms of balancing disclosure duties and wider management responsibilities, the trial judge held that the ASX announcement was designed to encourage support for the separation proposal and had a positive reaction by the market to JHIL's share price. Although <IR> is a long way remote from the factual complexities of the James Hardie Industries litigation, the legislative context is highly relevant to current fatigue about reporting burden and concerns about liability for nonfinancial disclosures. It is in this context that the legislative history and current state of civil liability for misleading and deceptive conduct as an instance of statutory overlap is now addressed.

Liability for misleading and deceptive conduct and its various statutory sources

The authors of Ford's Principles of Corporations Law (15th ed., LexisNexis, 2013) commence their discussion of misleading and deceptive conduct with the remark that these statutory provisions "have had a troubled history."[26] The origin of the problem stems from a period of concurrent application of Corporations Law provisions (former Pt 7.11) pertaining to the authorizing of a defective prospectus, subject to a reasonable inquiry defence, and the broader Trade Practices Act 1974 section 52[27] statutory liability for misleading and deceptive conduct in trade and commerce. The latter Commonwealth legislation, along with comparable State-based Fair Trading legislation, afforded no defences so that liability would occur regardless of absence of deliberate intention or negligence. A succession of measures has been made to achieve a fault-based liability regime for fundraising and takeover documents. From July 1998 the Commonwealth and State consumer protection legislation ceased to apply in the realm of financial services. This nonetheless did not put an end to concurrent application and statutory overlap.[28] The principal operating sections dealing with misleading and deceptive conduct as they stand today are respectively:

- **Corporations Act 2001 Section 1041H Misleading or deceptive conduct (civil liability only) 1041H(1) [Prohibition]** A person must not, in this jurisdiction, engage in conduct, in relation to a financial product or a financial service, that is misleading or deceptive or is likely to mislead or deceive.
- **ASIC Act 2001 Section 12DA Misleading or deceptive conduct 12DA(1) [Prohibition]** A person must not, in trade or commerce, engage in conduct in relation to financial services that is misleading or deceptive or is likely to mislead or deceive.

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[26] Page 1328.
[27] Now section 18 of the Australian Consumer Law
[28] Refer the recommendations of the Corporations Law Simplification Task Force report "Section 52 Trade Practices Act and Dealing in Securities" (September 1996)

A related attempt to give greater certainty is contained in s 1041(3) which is intended to exclude from the operation of s 1041H(1) the offering of securities under a misleading or deceptive documentation for both takeovers and fundraising, though, it would seem, not necessarily the actions of issuing and distributing. The assumed rationale is that the takeover and fundraising regimes have their own statutory statement of a nexus between the misstatement or omission and material adverse outcomes for an investor. See, for example, the structure of s 728 (Misstatements in, or omissions from, disclosure documents) which commences in sub-section 1 with a prohibition "must not offer securities under a disclosure document if", then draws a nexus in s 729 establishing a right to compensation, though subject earlier in sub-section 728(3) to a qualification that the misleading or deceptive statement, or the omission, be "materially adverse from the point of view of the investor." On this type of basis, the strict liability regime contained in s 1041H is regarded as inappropriate.

A similar 'carve out' for takeover and fundraising is contained in ASIC Act s 12 DA(1A), though it is crucial to note that the definitions of "financial product" and "financial service" (respectively, ss 12BAA and 12BAB) are wider than the corresponding definitions in the Corporations Act (Pt 7.1 – Div 3 – What is a Financial Product?). This, along with the continuity of trade practices type terminology of "in trade or commerce" emphasises the ASIC Act's stronger consumer protection orientation and the legislature's intention of statutory overlap. These important distinctions aside, understanding of ASIC Act s 12DA can be based on judicial interpretation and application of Corporations Act s 1041H.

A relevant case dealing with s 1041H(3) is *Selig v Wealthsure Pty Ltd* [2013] 94 ACSR 308 where at [1090] Lander J stated "The reason why conduct of the kind mentioned in s 1041H(3) is not conduct which s 1041H(1) proscribes is because each of those sections have their own section that provides for a remedy for contraventions, independently of s 1041H." This might leave open to speculation the possibility that an alleged misleading or deceptive disclosure within an <IR> might be capture by s 1041H(1) absent a specific statutory recognition and associated protections. This latter formality of arrangement, it is conceded, is not contemplated by the IIRC being beyond its formal remit of developing a principle-based framework.

Nevertheless, development of reporting frameworks and standards, be they financial or nonfinancial, have ramifications once applied in a domestic legal setting of wide ranging corporate regulation and specific regimes of liability. I now, with some caution, examine existing understanding of s 1041H(1) focusing on judicial interpretation and application of the misleading and deceptive conduct rules as one of the significant sources of resistance to wider <IR> adoption in Australia.

"in relation to" – how broad the conduct?

The authors of Ford's state emphatically that "the words "in relation to" are words of expansive meaning."[29] This is amply illustrated in the case *ASIC v Narain* (2008) 247 ALR 659. As with *ASIC v Macdonald* discussed above, this case involved an announcement to the Australian Stock Exchange. The announcement from the company's chief executive was that the company was able to offer a pharmaceutical solution reducing and stopping the spread of HIV/AIDS. Upon release to the market of the announcement by the ASX, the company's share price, as one would expect, rose dramatically attracting the attention of ASIC. At first instance, ASIC's claim for contravention of s 1041H was rejected on the basis that the announcement did not relate directly to the company's shares. This however was overturned on appeal with the Full Federal Court adopting an approach that s 1041H contemplated an indirect or less than substantial connection. To do otherwise would artificially distinguish between the company's shares and the value in them, and not accord with commercial reality.[30]

Such broadness and the nexus drawn between a matter pertaining to a company's products (and/ or strategy) and traded securities does, prima facie, point to some potential for <IR> disclosures to come within the ambit of s 1041H.

Intention

Whilst I have noted above that Commonwealth and State consumer protection legislation no longer has application in relation to financial services, application of those provisions (TPA s 52) are likely to provide strong indication of interpretation of s 1041H. As such, it seems most likely that the mental elements of knowledge, dishonesty and intention in a person making a false representation, is not critical.[31] Again in an <IR> context, this focuses attention on the degree of involvement and quality of oversight required of a director and the risk of innocent or inadvertent mistake in such a disclosure.

To whom are representations made

One of the issues I have identified as problematic with <IR> as it currently stands in an Australian legal context, is the identification of audience and the potential claim of reliance. Again, some inferences can be drawn which, tentatively, would bring <IR> within the scope of s 1041H. The authors of Ford's under the heading **Representations to individuals, and to the public at large** observe that "conduct - - - will be misleading or deceptive, or likely to mislead or deceive, only if there is a nexus between the representation and some actual or anticipated misconception or deception."[32] Obviously in circumstances where the representation is to an individual deciding whether the representation is misleading or deceptive is comparatively straightforward. Here elements around knowledge as to the truth of a purported fact will be more discernable. Where the

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[29] R P Austin and I M Ramsay, *Ford's Principles of Corporations Law* (15th edition, 2013 LexisNexis Australia) p 1333.
[30] Per Jacobson and Gordon JJ at [82].
[31] See *Donald v ASIC* (2000) 18 ACLC 794.
[32] R P Austin and I M Ramsay, *Ford's Principles of Corporations Law* (15th edition, 2013 LexisNexis Australia) p 1339.

representation is made to the public at large, as would seem likely with <IR>, matters of identifying sufficient nexus become more difficult, and to repeat the words of the authors of Ford's, are applied "at a level of abstraction." In these terms, it is suggested by the authors of Ford's that a court would consider the effect upon ordinary reasonable members of a class, gauge the potential for misconception or deception and decide the effect of such misconception or deception. As to the identification of potentially affected classes amongst the public at large, the authors of Ford's again refer to the authority established in *ASIC v Macdonald* stating "that the class may be very broad, including investors and market analysts and also stakeholders across a wide range". Absent any specific legal protections, disclosures under an <IR>, which I have observed at the outset are 'a document of the company' are, prima facie, open to challenge under s 1041H on this basis.

As a final remark, and as a further concern in the context of <IR> content, the authors of Ford's caution against assumptions of a nebulous character within a class. It may well be that through adoption of an objective approach a reasonable level of sophistication can be assumed so that the measure of misleading conduct need not require reference to both the astute and the gullible.[33] Nonetheless, it is clear that in dealing with such issues, courts will recognize "the boundaries within which reasonable responses will fall."[34]

Misleading statements: Profit forecasts and statements about agreements

Both profit forecasts and statements about agreements it can be speculated, would readily be the type of desired forward-looking disclosure coming within the scope of integrated reporting. For profit forecasts we again need to refer to judicial consideration given to s 52 of the TPA as a basis for informing our understanding of <IR> and possible exposure to challenge under s 1041H. I deal more fully with profit forecasts in a subsequent paper. Whereas regarding the possibly more specific aspect of disclosures about agreements, we have with the *Fortescue Metals* line of cases greater certainty as to the operation of s 1041H given the eventual testing in the High Court. The outcome in *Fortescue Metals* might be a source of comfort to advocates of <IR> and those claiming that the legal issues are illusory. I would caution though, jumping from the specifics of the *Fortescue Metals* facts to assume what might, or might not, happen in relation to <IR>-based statements.

Bell Resources Ltd & Anor v BHP Co Ltd & Ors (1986) ATPR 40-702 concerns the issuing by a board to its shareholders, forecasts of the company's profitability which were accompanied by a covering letter. It was claimed by the applicants that a number of assertions in both disclosures were

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[33] This is examined by Austin and Ramsay with reference to Finkelstein J's analysis of the contrasting approaches taken by the High Court in *Campomar Sociedad Limitada v Nike International Ltd* (2000) 202 CLR 45 and the Full Federal Court in *Taco Company of Australia Inc v Taco Bell Pty Ltd* (1982) 42 ALR 177. The noteworthy proposition in *Taco Bell* is that once the relevant section of the public is established, those who come within it include "the astute and the gullible, the intelligent and not so intelligent, the well educated as well as the poorly educated, men and women of various ages pursuing a variety of vocations." Though narrowed by the High Court, this proposition still has potency.

[34] R P Austin and I M Ramsay, *Ford's Principles of Corporations Law* (15th edition, 2013 LexisNexis Australia) p 1340.

untrue in so much as they were overly optimistic giving an undue sense of reliability. This against the backdrop that some within the company concerned viewed matters more pessimistically, being prone to uncertainty about exchange rates and future oil prices. Moreover, it was claimed, the forecasts were not supported by appropriate professional and scientific opinion. The decision of the Federal Court determined a number of matters potentially germane to our understanding of the misleading and deceptive conduct treatment of profit forecasts presented within the scope of an <IR>. The Court's analysis of the facts in *Bell Resources* proved that the forecasts were balanced, and under these circumstances, supported a conclusion that shareholders would understand them in the context of assumptions to which management had applied reasonable professional judgment. All in all then, the shareholders could fairly be assumed to understand the disclosures to be the opinion of the company, not incontrovertible truths about the future.

The *Fortescue Metals* cases. The factual setting concerns a proposed mining project in Western Australia. The project proposal consisted of a mine in the Pilbara, a port at Port Hedland and an interconnecting railway. During August and November 2004 Fortescue sent letters to the ASX and made media releases about the project which said, amongst other things, that Fortescue had entered binding contract with three Chinese SOEs to build, finance and then transfer the infrastructure and mine to the project. Media reports appeared in March 2005 suggesting that the contracts made were not binding prompting Fortescue to then provide ASX with the framework agreement, subsequent to which ASIC commenced its proceedings. ASIC alleged that contrary s 1041H, Fortescue had engaged in misleading or deceptive conduct, or likely to mislead or deceive, in relation to a financial product (the company's shares) by publishing these notices. At first instance, ASIC's claims were dismissed, but on appeal to the Full Federal Court declarations of contravention were made. Special leave was granted resulting in the High Court decision *Forrest v ASIC* [2012] HCA 39 which set aside the decision of the Full Federal Court.

The determinative issue dealt with by the High Court was "what did the impugned statements convey to their intended audience when they said that the parties to each framework agreement had made a "binding contract"?".[35] These are not abstract matters of judicial construction of the words used by the parties. The practicalities, and the context in which the purpose of s 1041H is interpreted and applied, requires investigation of what is conveyed to the intended audience as to the legal finality, quality and enforceability of the contracts and agreements. Critical in the majority decision (French CJ, Gummow, Hayne and Keifel JJ) are the facts that the dealings are with Chinese SOEs raising uncertainty about such matters as the legal forum where performance of the obligations might be interpreted and enforced [46 – 50] and that the bargain was not at a point of finality where all relevant details of works and price were concluded and from which the parties could not readily resile [50 -51]. Set in its context, Their Honours regarded it essential to bear in "mind that the impugned statements were made to the business and commercial community."[36] Such audience

[35] *Forrest v ASIC* [2012] HCA 39 at [31].
[36] *Forrest v ASIC* [2012] HCA 39 at [48].

would not interpret "the impugned statements conveying to their intended audience - - - that [these were] an agreement containing all of the essential elements that would constitute a contract under Australian law."

In a separate judgment from Justice Heydon, though having the same outcome, an equally pragmatic approach is taken to identifying the nexus between the representation and risk of misconception by the intended audience. His Honour at [105] observed that:

> "Fortescue's remarks were not directed to the public as a whole. They were directed at a section of the public. It comprised superannuation funds, other large institutions, other wealthy investors, stock brokers and other financial advisers [and] specialised financial journalists."

Concluding thus:

> "The audience was sufficiently tough, shrewd and skeptical to know something of the difficulties of "forcing" a builder to build and finance anything."

One broad thing that can at least be drawn from these deliberations on s 1041H from the High Court which is relevant to <IR>, is that understanding of the audience and their levels of sophistication is vital.[37]

A final observation. Though decided in favour of Mr Andrew 'Twiggy' Forrest, the case again shows ample evidence of the interlinking of diverse statutory provision applied to a specific factual setting. Had Fortescue contravened s 1041H it would follow, according at least to Keane CJ in the appeal decision, that an obligation to correct the position under the continuous disclosure regime (s 674) arose, and following from contravention of both, Mr Forrest would have breached the s 180 duty of care and diligence which, as I have discussed, brings with it significant personal liability. A final remark about the development of legal principles in Australia and the process of adjudication in relation to corporate disclosures. Their Honours at [69] state:

> "What message is conveyed to the ordinary or reasonable member of the intended audience cannot be determined without a close and careful analysis of the facts. In this, as in so many others, the facts of and evidence in the particular case are all important."

Significantly, Their Honours make reference to *ASIC v Hellicar* which I have discussed at some length above. What does this signify for our understanding of <IR> in an Australian legal context? Yes, there is significant complexity and the potential for liability cannot be assessed with absolute certainty. Nonetheless, the risks of potential challenge are real rather than illusory. It would seem appropriate thus to pursue avenues of a legislative 'platform' for presentation within which appropriate defences could be articulated. These matters are explored in the next two papers.

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[37] Post script – the project did proceed: http://www.fmgl.com.au/our_business/Port_and_Rail_Infrastructure

Conclusion

- Whilst we might not be able with precision to point to where, how and by what circumstances <IR> disclosures would fall foul of the misleading or deceptive conduct regime, the uncertainty itself is sufficient to be a real barrier for significant corporate engagement. This, in combination with the wider characteristics of the Australian corporate law landscape which I have described, necessitates a deeper consideration of a 'statutory home' for <IR> and associated defences in relation to the forward-looking and prospective elements. It is not that we do not have experience in such arrangements; the opposite is in fact true. However, the present imprecise circumstance that "an integrated report may be prepared in response to existing compliance requirements"[38] simply leaves too many questions unanswered to enable the leap of faith that would give true and significant critical mass to <IR> in Australia. Moreover, the Framework further notes "<IR> is consistent with numerous developments in corporate reporting taking place within national jurisdictions across the world."[39] The real source of friction is with national jurisdiction corporate regulation which, carries greater weight once <IR> is applied in a jurisdiction, such as Australia, which has a complex intertwined of rules related to duties, rights and liabilities, pertaining to both corporate reporting and broader corporate conduct. To reiterate, these circumstance should not be a basis for concluding that the challenges are too great and insurmountable. Rather they should stimulate dialogue and a sense of urgency about identifying appropriate legislative and other regulatory accommodations.

[38] The International <IR> Framework, IIRC, December 2013, p 4.
[39] The International <IR> Framework, IIRC, December 2013, p 2.