

University of New South Wales:
2012 Directors Duties Seminar

Directors in the Regulatory Enforcement Pyramid — Recent Developments

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Regulatory Enforcement Action in the Global Financial Crisis - Risks for the Director

1 The general risk environment for directors in 2012

This paper considers the position of the Australian director in 2012 against the framework of the directors' place in the regulatory enforcement environment. The purpose of this paper is not to undertake a technical legal review of the various sanction regimes that are applicable to the Australian director. Instead, the purpose is to make some practical comments on the position of the director by reference to recent litigation patterns.¹

1.1 Implications of the Global Downturn

The adverse conditions caused by a change in the Australian business environment have been apparent over recent years. The regulatory consequences of that change are still being worked through.

Before the second half of 2007, Australia and global markets enjoyed favourable financial market conditions that had most noticeably been marked by a private equity boom.² The onset of the Global Financial Crisis in the second half of 2007 resulted in a deep and continuing financial crisis that remains unresolved.³ This has led to a number of Australian entities suffering financial difficulty and a number of investors suffering significant losses in the Australian capital markets.

Some of the more challenging financial collapses that have occurred in Australia over this time are depicted in the following table.

Corporate entity	When crisis developed	Broad features of financial crisis
Basis Capital	July 2007	Liquidation. Margin calls lead to disposal of assets at distressed prices.
Absolute Capital	July 2007	Voluntary administration. Investment strategy based on CDO market.
Rams Home Loans	August 2007	IPO June 2007. Inability to rollover short term debt to fund business model. Share price decline from 2007 high of \$2.51
Centro	December 2007	Difficulty in refinancing \$2.3 billion of short term debt. Share price decline from 2007 high of \$10.06.

¹ This paper makes reference to a number of circumstances where litigation is unresolved or where litigation has been foreshadowed but not commenced. Nothing in this paper should be interpreted to infer that the authors consider liability for any person should arise or is appropriate in these matters.

² For the mood of the time see R Austin & A Tuch (Ed) "*Private Equity and Corporate Control Transactions*" Ross Parsons Centre of Commercial, Corporate and Taxation Law Monograph Series, Sydney, 2007.

³ See R Austin and A. Biliski (Eds) "*Directors in Troubled Times*" Ross Parsons Centre of Commercial, Corporate and Taxation Law Management Series, Sydney 2009.

Corporate entity	When crisis developed	Broad features of financial crisis
Octaviar (MFS)	January 2008	Difficulty in refinancing \$180 million of short term debt. Share price decline from 2007 high of \$0.98. Receivers and administrators appointed September 2008.
Allco Finance Group	February 2008	Voluntary administration. Unexpected margin call against substantial shareholder in January 2008. Difficulty in refinancing \$1.15 billion of debt. Share price decline from 2007 high of \$12.61. Receivers and administrators appointed 4 November 2008.
ABC Learning	February 2008	Voluntary administration. Poor half year result on 25 February 2008. Unexpected margin call against key director shareholdings. Share price decline from high of \$7.66. Receivers appointed 18 December 2008.
Opes Prime	March 2008	Receivership. Margin loans called in by banks.
Babcock and Brown	June 2008	Market capitalisation fell allowing its lenders to review financing arrangements amidst fears of high debt levels and bad debts. Share price decline from 2007 high of \$16. Administrators appointed 3 March 2009.
Octaviar	September 2008	Voluntary administration (administrators appointed September 2008) and liquidation (liquidators appointed August 2009). Share price falls significantly in early 2008 following market announcement of a demerger.
Oz Minerals	November 2008	Failure to refinance a US\$560 million loan.
Storm Financial	January 2009	Voluntary administration. Administrators appointed 9 January 2009. Margin loans called in by CBA. Ceased trading on 15 January 2009.
Timbercorp	April 2009	Voluntary administration. Administrators appointed 23 April 2009. Difficulty in refinancing \$200 million debt. Share price decline from 2006 high of \$4.00.
Great Southern	May 2009	Receivership. Receivers and Managers appointed 19 May 2009. Controversial capital raising conducted in January 2009, with scheme investors trading \$88 million worth of cattle in return for Great Southern shares in order to refinance \$600 million owed to banks. Share price decline from 2007 high of \$3.00.
Allied Brands	June 2010	Voluntary administration. Administrators appointed October 2010. Business said to have struggled in an uncertain

Corporate entity	When crisis developed	Broad features of financial crisis
		economic environment combined with continued expansion which led to cash flow constraints.
National Leisure & Gaming	October 2011	Voluntary administration. Administrators appointed 6 October 2011. Despite strong operational performance, company could not satisfy its lease liabilities.

For similar business conditions in the past it is probably necessary to look to the tech wreck of the second half of 2001 and the subsequent corporate collapses of HIH Insurance, One.Tel, Ansett and a host of technology company start ups, and before that, to the entrepreneur collapses of 1989-1990 involving Bond Corporation, Adsteam and Qintex, among others.

To be sure, boom and bust is a recurring feature of Australian securities markets and the role of the regulator is not that of a guarantor of investors' finances.

1.2 The enforcement pyramid and a more finely nuanced environment

In the early 1990's it was argued⁴ that one solution to the perceived regulatory failings arising out of the entrepreneur collapses of the late 1980s was a redesigned securities law which employed an enforcement pyramid where the regulator had available to it a broader range of remedies. The availability of that enforcement pyramid would allow for more appropriate sanctions based on the degree of culpability of the individual. It was argued that such a range of sanctions was particularly important in addressing the position of the director.

Traditionally, the director's position has been primarily regulated by the common law duties of care, skill and diligence and loyalty, and the statutory codification of those duties in the 1970's.⁵ It has been persuasively argued that the balance of those standards of conduct are appropriate and have worked well in Australia in recent years when assessed by reference to the reported case law.⁶ However the traditional remedies are not the end of the story for the director in 2012.

There are a broad range of sanctions that are now part of the regulatory enforcement pyramid as it applies to the director.⁷ The regulatory enforcement

⁴ See for example R Tomasic "Sanctioning Corporate Crime and Misconduct Beyond Draconian and Decriminalisation Solutions" (1992) 2 Australian Journal of Corporate Law 82.

See also V Comino "The enforcement record of ASIC since the introduction of the civil penalty regime" (2007) 20 Australian Journal of Corporate Law 183 at 188-193.

⁵ See H Ford, R Austin & I Ramsay "Fords Principles of Corporations Law" (looseleaf) Chapter 8 and Chapter 9.

⁶ N Young "Has directors liability gone too far or not far enough? A review of the standard of conduct required of directors under ss 180-184 of the Corporations Act" (2008) C&SLJ 216.

⁷ During the private-equity boom of 2006/2007 it was often said that private equity is an attractive alternative to a public company directorship. Directors of public companies are said to have onerous obligations as well as increased media criticism, whereas the private equity board provides the same or more monetary outcome, without the same shareholder and regulatory scrutiny.

It was argued that there is little incentive for an independently wealthy non-executive director to subject themselves to the risks attendant upon the position of a listed company directorship and the media scrutiny that position entails when the position of a private company director owned by private equity does not involve the same risks or media scrutiny.

pyramid as applied to the director in 2012 can be depicted by the following diagram.

The regulatory pyramid in 2011		
Type of liability	Theories of liability	General observations
Criminal	Traditional sanction under Corporations Act 2001 (Cth) (" Corporations Act ") and Crimes Act legislation. For market disclosure see sections 1308(2), 1309, 728(3) and 670A(3). For directors duties see s1311 (there is no criminal offence for a contravention of the duty of care and diligence in section 180). For other provisions see section 1311.	High burden of proof. Prosecuted by DPP.
Disqualification from managing corporations	Part 2D.6. If criminal conviction, civil penalty violation, repeated insolvency, repeated Corporations Act violations.	Court or ASIC discretion depending on circumstances.
Civil penalty	Part 9.4B. Violations of director duties, insolvent trading, continuous disclosure, market manipulation and insider trading, financial disclosure.	Civil burden of proof. Prosecuted by ASIC.
Civil liability	Various direct theories of liability against the director - see sections 729 and 670B. Directors duties see section 1324. For other situations where a director contravenes the Corporations Act see section 1324.	Relevance of class actions. Query role for section 50 of ASIC Act.
Fine (infringement notice)	Part 9.4AA. Continuous disclosure only.	Not applicable to the director.

The primary new initiative of the 1990's was the introduction of civil penalty liability, as recommended by the Cooney Committee in 1989.⁸ Where a court declaration of contravention is obtained, ASIC may seek a pecuniary penalty order, a disqualification order or a compensation order. The court may make a compensation order whether or not it makes a declaration of contravention. A company may seek a compensation order but not a pecuniary penalty order or a disqualification order.⁹

For this view at its strongest, see The Age, "*Directors at Risk of Becoming an Endangered Species*", 28 January 2008, Opinion & Analysis, p.6. See also Australian Institute of Company Directors Submission to Treasury Review of Sanctions in Company Law 8 June 2007, www.treasury.gov.au/contentitem.asp?NavId=8ContentID=1285.

⁸ Senate Standing Committee on Legal and Constitutional Affairs "*Company Directors Duties and Obligations of Company Directors*" (1989).

⁹ Section 1317J; see also H Ford, R Austin & I Ramsay "*Fords Principles of Corporations Law*" (looseleaf) Chapter 8 and Chapter 9 at paragraph 3.400.

Where a court has declared that a person has contravened a civil penalty provision, the court may disqualify that person from managing companies for a period that the court considers appropriate.¹⁰

The civil penalty regime has gradually expanded over the last decade to encompass a broad range of conduct that has potential application to the director. Initially the effectiveness of the remedy was subject to some debate.¹¹ However, most commentators now believe that the remedy has been a success.¹²

From the civil liability perspective the most significant development over the last decade has been the rise of mass enforcement of investor rights through class actions.¹³ Commencing with the settlement of the GIO class action in 2003, securities law class actions have proliferated to the point where the general orthodoxy is that class actions are now pervasive as a feature of business life in Australia, even if in the securities law area:

- there have been no significant judicial findings of liability in a class action;
- there have only been a small number of significant settlements of securities law class actions but those settlements now exceed \$500 millions;¹⁴ and
- there are only about a dozen class actions outstanding.

Prior to this development the only mass enforcement mechanism for the pursuit of investor rights was the ASIC representative action contemplated by section 50 the ASIC Act. That power was used with little ultimate success in the early 1990's by ASIC in corporate collapses such as Adsteam.

In November 2007 ASIC commenced a section 50 proceeding against various parties involved in the collapse of the Westpoint Group, including directors and officers¹⁵, the auditor¹⁶, various financial planners¹⁷ and the note trustee. By

¹⁰ Section 206C Corporations Act. The criteria to be used in determining the length of the banning order were considered in *Re HIH Insurance (in prov liq)* and *HIH Casualty and General Insurance Ltd (in prov liq)* (2002) 42 ACSR 8D and as well as in *ASIC v Adler* (2002) 42 ACSR 80; Austin, Ramsay & Ford - supra note 9. See most recently *ASIC v Macdonald & Ors (No 12)* [2009] NSWSC 714. In *Rich v ASIC* (2003) 48 ACSR 6, the majority of the court emphasised that the purpose of a disqualification order is protective rather than punitive.

¹¹ See H Bird "The Problematic Nature of Civil Penalties in the Corporations Law" (1996) 14 C&SLJ 405.

¹² See V Comino "The enforcement record of ASIC since the introduction of the civil penalty regime" (2007) 20 AJCL 183; M. Welsh "Eleven years on – An examination of ASIC's use of an expanding civil penalty regime" (2009) 17 AJCL 175; M. Welsh "The regulatory dilemma: The choice between overlapping criminal sanctions and civil penalties for contraventions of the directors' duty provisions" (2009) 27 C&SLJ 370.

¹³ For early discussion see J Donnan "Class actions in securities fraud in Australia" (2000) 18 C&SLJ 82. See also C Waters "The new class conflict: The efficacy of class actions as a remedy for minority shareholders" (2007) 25 C&SLJ 300 and K. Lindgren (Ed) "Investor Class Actions" Ross Parsons Centre for Commercial, Corporate and taxation Law, Sydney 2009.

¹⁴ See tables below.

¹⁵ See ASIC Media Release 07-291 "ASIC to pursue compensation for Westpoint investors" (8 November 2007).

¹⁶ See ASIC Media Release 08-207 "ASIC commences action against KPMG over Westpoint collapse" (13 October 2008).

¹⁷ One of the class actions brought by ASIC against Masu Financial Management Pty Ltd on behalf of 85 investors who were sold Westpoint products was settled privately; with the claims

early 2011 the vast majority of these claims had been settled for more than \$92.95 million allowing ASIC to advance proceeds of \$67.45 million to the liquidators of the Westpoint companies.¹⁸

1.3 An impressionistic tour of the 2012 environment

Against the preceding survey of the regulatory environment in the next sections, the authors conduct a review of recent litigation landscape to draw some conclusions as the landscape of potential liability the director confronts.

Instead of focussing on the direct enforcement of traditional directors duties we focus on the following areas:

- Directors and large scale class actions;
- Directors and civil penalty proceedings; and
- Directors and general criminal prosecutions.

2 Directors and class actions

2.1 Background

The potential impact of securities law class actions on the Australian corporate landscape is currently a work in progress.

of the final two investors being settled on confidential terms approved by the Federal Court on 27 November 2008.

¹⁸ For more information see ASIC's Westpoint Investors website at <http://westpoint.asic.gov.au> Total investor losses exceeded \$388 million.

A list of the finalised class actions is set out below:

Company	Parties	Nature of allegations	Commenced	Settlement details	Plaintiff law firm	Litigation Funding
GIO	Company Directors Advisors	Misleading representations in takeover	1999	The Federal Court approved the \$112 million settlement in 2003.	Maurice Blackburn	No
TrackNet Australia Limited	Company Directors	Prospectus was misleading and deceptive, and that the scheme never properly commenced	December 2000	Settlement June 2004 for \$4.3 million	Maurice Blackburn	
Sentinel MPA (Financial Wisdom)	Company Financial Wisdom Ltd	Claimed advisers acted in a negligent and fraudulent manner	2001	The case settled after test cases were successful in the Supreme Court of Victoria and in the Court of Appeal in June 2004.	Corrs Chambers Westgarth	IMF (Australia) Ltd
Australian Cotton Project (Corporate Investment Australia Funds Management Ltd)	Company	Claimed managed investment scheme never properly commenced because minimum subscription was not reached and prospectus was misleading and deceptive.	September 2001	In September 2003, shareholders received judgement in their favour and were awarded refund of investment monies. The case then settled for effectively payment in full. [Spangaro v Corporate Investment Australia Funds Management Ltd, [2003] FCA 1025]	Maurice Blackburn	
HIH Insurance Limited	Company Director Auditors Reinsurer	Misleading and deceptive conduct	April 2002	[Appeal under way in respect of proof of debt lodged by De Bortoli Wines - for hearing before Full Federal Court 3 November 2011]	DC Legal Pty Ltd	
Harris Scarfe Holdings Limited (Guglielman v Trescowthick)	Directors	Directors engaged in false, deceptive and misleading conduct	June 2002	October 2006 settled for \$3 million	Duncan Basheer Hannon	

Company	Parties	Nature of allegations	Commenced	Settlement details	Plaintiff law firm	Litigation Funding
Nomad Telecommunications Ltd	Directors	Breach of directors duty to prevent the company from trading whilst insolvent	2002	The case settled in October 2007.	Maurice Blackburn	IMF (Australia) Ltd
Reiffeil v ACN 075 839 226 Ltd	Company	Misleading and deceptive conduct and prospectus misstatement	September 2003	In March 2003, awarded lost income and incidental expenses	Slater & Gordon	
AM Corporation / LifeTrack Superannuation Fund	Company Directors	Alleged numerous breaches of duty, misrepresentation and misleading conduct, negligence and breach of trust.	2003	The case conditionally settled in July 2010, subject to Court approval. Court approval given. The full details of the settlement were confidential.	Maurice Blackburn	IMF (Australia) Ltd
Sons of Gwalia Ltd	Company Directors Auditors Officers	Non disclosure of material information and misleading and deceptive conduct.	September 2004	Confidential settlement September 2009	Solomon Brothers	IMF (Australia) Ltd
Concept Sports	Company Directors	Prospectus misstatement and continuous disclosure violations	2004	Confidential settlement September 2006	Maurice Blackburn	IMF (Australia) Ltd
Aristocrat	Company	Continuous disclosure violation	2004	The Federal Court approved the \$144.5 million settlement in August 2008.	Maurice Blackburn	IMF (Australia) Ltd
Reynolds Wines Ltd (in liquidation)	Directors	Alleged insolvent trading	2004	Judgment awarded in favour of plaintiff on 23 November 2007.	Blake Dawson Waldron	IMF (Australia) Ltd
Telstra	Company	Continuous disclosure violation	2006	Settled December 2007 for \$5 million.	Slater & Gordon	

Company	Parties	Nature of allegations	Commenced	Settlement details	Plaintiff law firm	Litigation Funding
Westpoint	Financial planners	Inappropriate advice	2006 Mediation of all claims June 2009	In March 2010 the Federal Court approved a \$13.5 million settlement with State Trustee Limited. In February 2011, ASIC reached a settlement of 'up to \$67.5 million' with KPMG and the former Westpoint directors.	Australian Securities and Investments Commission Slater & Gordon	IMF (Australia) Ltd
Media World	Promoter Directors Advisors	Misleading statements as to prospects of technology	Commenced 2006 Mediation was conducted in April 2008	Supreme Court of Victoria approved Confidential Settlement in October 2010	Maurice Blackburn	
Hydrocool	Directors	The claims primarily arise out of allegations that various of the Respondents breached fiduciary duties and/or duties under the Corporations Act 2001 they owed Hydrocool or knowingly assisted in such breaches, thereby causing loss to Hydrocool.	12 September 2006	16 May 2011	Swaab Attorneys	IMF (Australia) Ltd
Multiplex	Company	Continuous disclosure violation	2007	Settled for \$110 million. The settlement, made without admission of liability, was approved in the Federal Court on 21 July 2010.	Maurice Blackburn	International Litigation Funding Partners
AWB	Company	Continuous disclosure violation	2007	A settlement between the class action applicants and AWB of \$39.5m was approved by the Federal Court on 27 April 2010.	Maurice Blackburn	IMF (Australia) Ltd
Centaur Mining	Directors	Breach of directors duty to prevent the company from trading whilst insolvent	6 March 2007	The case settled on 20 February 2009 subject to creditor approval which was subsequently given	Maurice Blackburn	IMF (Australia) Ltd

Company	Parties	Nature of allegations	Commenced	Settlement details	Plaintiff law firm	Litigation Funding
Village Life (Fig-tree Developments)	Company Directors	Prospectus misstatement and continuous disclosure violations	May 2007	Confidential settlement March 2009	Slater & Gordon	IMF (Australia) Ltd
Timbercorp Limited	Company	Failed to disclose certain risks and "adverse matters" required to disclose in accordance with its statutory obligations	2009	1 September 2011, the claim was rejected in its entirety	Macpherson + Kelley	No
Commonwealth Financial Planning Ltd	Company	Breaches of the Corporations Act, engaging in misleading or deceptive conduct and negligence.	February 2011	Confidential settlement announced 5 October 2011	Maurice Blackburn	
OZ Minerals	Company	Continuous disclosure violation and engaged in misleading and deceptive conduct and failure to disclose material information.	October 2009.	Federal Court approved settlement on 1 July 2011 for the MB proceedings of \$35.9 million (plus costs); and for the S&G proceedings of \$19.2 million, (plus costs)	Maurice Blackburn and Slater & Gordon	IMF and Litigation Lending Services
Fincorp / Sandhurst Trustees Limited	Company	Alleged Sandhurst Trustees, the appointed trustee of Fincorp, breached its duties as trustee for the investors under the Corporations Act.	September 2010	In May 2011, the Federal Court approved a \$29 million settlement	Slater & Gordon	

Company	Parties	Nature of allegations	Commenced	Settlement details	Plaintiff law firm	Litigation Funding
Pan Pharmaceuticals	Company	Alleged misfeasance in public office and negligence relating to regulatory action taken by the Therapeutic Goods Administration against Pan in April 2003 which caused Pan to fail and had a material impact on others including Pan's customers and creditors.	November 2010	In March 2011, it was reported that the final settlement figure was \$67.5 million	McLachlan Thorpe Partners	IMF (Australia) Ltd

A list of currently outstanding class actions is set out below:

Company	Parties	Nature of allegations	Status	Next Step in proceedings	Plaintiff law firm	Litigation Funding (Y/N) Who?
ION Limited	Company	Continuous disclosure violation and engaged in misleading and deceptive conduct.	2005	Proofs of claims have been lodged, waiting on Deed Administrators adjudication.	Slater & Gordon and DC Legal Pty Ltd	IMF (Australia) Ltd
Challenger Managed Investments Limited	Responsible entity	Prospectus misstatement	Commenced 2006 Interlocutory stages	Questions were ordered for separate determination in 2008 (O'Sullivan v Challenger Managed Investments Ltd [2008] NSWSC 602) Current status unclear.	Maurice Blackburn	IMF (Australia) Limited
Lehman Brothers	Company	Misleading or deceptive conduct	Commenced December 2007	Final hearing concluded, listed for submissions on 1 December 2011	Piper Alderman	IMF Australia
Octaviar and KPMG	Company Directors	Breach of duty of care; contraventions of sections 601HG, 601FC, 601FD of the Corporations Act	Commenced April 2007	Trial heard in July 2011. Judgement Reserved	Carneys Lawyers	IMF (Australia) Ltd
Credit Corp Group Ltd	Company	Alleged misleading and deceptive conduct and failure to disclose material information concerning Credit Corp's profitability, in the period 7 November 2007 to 11 February 2008.	23 December 2008	On 19 August 2011 the Court noted that the parties have reached an in principle settlement and are in the process of negotiating the terms of such settlement.	William Roberts Lawyers	IMF (Australia) Limited
Centro	Centro Properties Ltd; Centro Retail Ltd	Continuous disclosure violation and misleading and deceptive conduct	Commenced May 2008	Set for 8-week hearing from March 2012 to May 2012	Maurice Blackburn (Kirby proceedings)	IMF (Australia) Limited

Company	Parties	Nature of allegations	Status	Next Step in proceedings	Plaintiff law firm	Litigation Funding (Y/N) Who?
					Slater and Gordon (Vlachos Proceeding)	Comprehensive Legal Funding LLC
Opes Prime	Company Banks	Misleading statements and negligence	Commenced May 2008	Conditional settlement July 2009 after company's creditors voted in support of a Scheme of Arrangement	Slater and Gordon	IMF (Australia) Limited
ABC Learning	Company	Non-disclosures and misleading or deceptive conduct	17 December 2010	In July 2011 leave granted to commence and proceed with a civil proceeding against ZYX Learning Centres Limited	Maurice Blackburn	IMF (Australia) Limited
Sigma Pharmaceuticals	Company	Misleading or deceptive conduct and failure to comply with continuous disclosure obligations	Commenced October 2010	The case is currently in the discovery phase, with a directions hearing scheduled for 2 December 2011	Slater and Gordon	Comprehensive Legal Funding LLC
Local Government Financial Services (ABN Amro and Standard & Poors)	ABN Amro Bank NV McGraw-Hill International (UK) Limited	Investors were misled because of flaws in S&P's ratings method.	Commenced 2010	Trial commenced 4 October 2011 and is ongoing. Due to be completed June 2012.	Piper Alderman	IMF Australia
Great Southern/ Bendigo and Adelaide Bank	Company	Misled investors by not disclosing the risks associated with managed investment schemes and the company's poor financial performance	Commenced 2010	Proceedings have commenced. Waiting on defences and then case will move into discovery	Macpherson + Kelley	IMF Australia
Bank of Queensland	Company	Representations alleged to have been made by BoQ to the branch owners in relation to the viability of BoQ's franchise model including	2010	Trial listed to commence on 23 April 2012 in New South Wales Supreme Court	McCabe Terrill Lawyers	IMF (Australia) Limited

Company	Parties	Nature of allegations	Status	Next Step in proceedings	Plaintiff law firm	Litigation Funding (Y/N) Who?
		expected business volume and revenue levels.				
Commonwealth Bank and Colonial First State Investments Ltd (Storm)	Company	Failed to register managed investment scheme	1 July 2010,	On 23 September 2011 Justice Reeves the related proceedings will continue to be case managed together and will be a trial of all proceedings to commence on 10 September 2012	Levitt Robinson Solicitors	
Nufarm Limited	Company	Misleading conduct and material non disclosures.	Commenced January 2011	Parties ordered to engage in a mediation no later than 31 March 2012	Maurice Blackburn	International Litigation Partners Pte Ltd and Comprehensive Legal Funding LLC
Gunns Ltd	Company	Failure to disclose to information regarding a significant deterioration in its likely financial performance.	Commenced 20 April 2011	The case is currently in the discovery phase, with a directions hearing scheduled for 25 November 2011	Maurice Blackburn	IMF (Australia) Limited

We look at some of these class actions to develop some observations on the position of the director. The preliminary question to ask in reviewing this material is why do theories of breach of directors duty not feature in the allegations.

2.2 GIO class action

The trigger for the current wave of class actions was the approximate \$100 million settlement of the GIO class action in 2003.¹⁹

This litigation relates to a class action bought in the name of approximately 67,000 shareholders of GIO Holdings Limited for recommendations made in relation to a hostile takeover bid by AMP Limited in 1998.²⁰ In December 1999, AMP compulsorily acquired all remaining shares in GIO at a price which was almost half the price offered a year earlier (\$5.35 versus \$2.75).

The respondents to the class action were GIO, each of its directors and an independent expert that provided an opinion on the fairness of the bid price.²¹

All parties settled the case before the trial had been scheduled to commence. It had been estimated that the trial would have taken many months to be heard.²²

The representative group were shareholders in GIO who did not accept the hostile takeover bid by AMP Insurance Investment Holdings Pty Ltd. The applicant argued that by retaining the shares, he and the other members of the group suffered loss. That loss was alleged to be caused by the misleading and deceptive conduct of the respondents.

The \$97 million settlement was approved by the Federal Court on 26 August 2003 as appropriate and fair in the circumstances.

The total value of the claim had been estimated at \$151 million.²³ The plaintiff law firm received \$15 million of the settlement proceeds, reflecting an uplift fee of 25%.²⁴

2.3 Telstra class action

On 20 January 2006, a class action was commenced in the Federal Court of Australia against Telstra Corporation Limited. On 13 December 2007, a \$5 million settlement was approved by the Federal Court, approximately two weeks before the case was due to be heard in the Federal Court.²⁵

The applicant had claimed damages estimated at \$300 million for himself and on behalf of investors who purchased shares in Telstra in the period between 11 August 2005 and 6 September 2005. The applicant alleged that Telstra

¹⁹ See *King v AG Australia Holdings Ltd (formerly GIO Australia Holdings Ltd)* [2003] FCA 980 (Moore J). Also, also see Kristen Svoboda, "Corporate Governance Issues Arising from the 1998-1999 AMP-GIO Takeover" (2000) 18 C&SLJ 395.

²⁰ Of that number, the number of shareholders that joined the class action was approximately 23,000: [2003] FCA 980 at paragraphs 4-10.

²¹ Cross claims were also bought against the accounting advisor and financial advisor to GIO in relation to the bid.

²² [2003] FCA 980 at paragraph 3.

²³ [2003] FCA 980 at paragraph 14.

²⁴ [2003] FCA 980 at paragraphs 15-16.

²⁵ *Taylor v Telstra Corporation Ltd* [2007] FCA 2008 (Jacobson J).

contravened the continuous disclosure requirements of the ASX Listing Rules and the Corporations Act.

The applicant argued that Telstra breached its continuous disclosure requirements as the Telstra chief executive had formed the opinion that Telstra had significantly underspent on its infrastructure, and had informed the federal government that Telstra expected a decline in revenue of about \$1.2 billion for its fixed line phone business from 2005 to 2008. The applicant claimed that the investors that bought shares in Telstra between 11 August 2005 and 6 September 2005 (closing) paid an inflated price, and should be compensated.

Telstra claimed that the chief executive's view was preliminary and that this provisional opinion merely stated that Telstra would have been better positioned to differentiate its services to customers and provide more valuable customer experiences if Telstra had spent approximately \$2-3 billion in additional investments. As such, Telstra claimed that this opinion was not required to be disclosed to the ASX.

Approximately 29,000 Telstra shareholders shared in about \$3.7 million in compensation (as opposed to the original claim of \$300 million). Slater & Gordon received \$1.25 million for their costs.²⁶

2.4 Aristocrat class action

In late 2003 a class action was commenced against Aristocrat Leisure Limited. Following profit downgrade announcements that resulted in a A\$1.5 billion reduction in Aristocrat Leisure's market capitalisation, a claim was lodged on 27 November 2003 against Aristocrat Leisure in the Supreme Court of Victoria alleging that the company misled shareholders through earnings forecasts and subsequent downgrades in February and May 2003.²⁷

Aristocrat made statements to the market from 22 May 2002 that it was comfortable with a market consensus forecast of \$107-\$110m profit after tax for the year ended 31 December 2002. On 7 February 2003 Aristocrat announced that it would not meet the market consensus forecast and its profit after tax for 2002 was now expected to be \$80.2m (subject to audit). Following this announcement 40% of its total shares were traded in 10 days and Aristocrat's capitalisation decreased from \$2 billion to \$1 billion.

The revision in earnings had largely arisen as a result of a substantial Colombian poker machine contract that had been finalised in December 2002. Subsequently the Colombian client had defaulted on the contract leading to an inability to recognise that revenue.

On 13 March 2003 Aristocrat released its annual report for 2002 which stated that all of Aristocrat's businesses were profitable and expected to remain so. On 4 April 2003 Aristocrat announced further charges of \$14.3 million as a result of restructuring certain South American contracts. On 27 May 2003 it was announced revenue and profit levels would be down for the first half of the year and that a loss of \$32-\$37 million was now expected.

²⁶ [2007] FCA 2008 at para 72-74. The amount included no uplifts or success fees and approximately one third of the amount represented out of pocket costs.

²⁷ The circumstances are apparent from the facts referred to in *Randall v Aristocrat Leisure Limited* [2004] NSWSC 411 (Einstein J) (an action brought by the then Chief Executive Officer for damages against the Company).

In addition to alleging misleading and deceptive conduct, the claim alleged that Aristocrat Leisure breached its continuous disclosure obligations under ASX Listing Rule 3.1.

The class extended to shareholders who bought Aristocrat shares between 20 September 2002 (the date of release by Aristocrat of earnings guidance for the 2002 financial year) and 26 May 2003 (the day before the final earnings downgrade).

The litigation had a protracted journey through the Federal Court. In early 2007 Aristocrat successfully challenged the composition of the class being determined by reference to agreeing to the fee arrangements with the plaintiff law firm and litigation funder.²⁸ The statement of claim was repleaded as a result.

Shortly before the commencement of the trial in October 2007 Aristocrat conceded certain key factual matters concerning liability with the result that argument was largely restricted to the question of damages.²⁹

On 15 May 2008, Aristocrat announced agreement had been reached to settle the matter.

On 28 August 2008, the Federal Court approved a settlement between Aristocrat and the class action plaintiffs of \$144.5 million.³⁰ The plaintiffs legal costs were approximately \$8.5 million. Aristocrat announced that the terms of the settlement resulted in the Aristocrat group incurring a net cost after expenses and tax of approximately \$40 million.³¹

2.5 Multiplex class action

On 18 December 2006 a class action was commenced against Multiplex Limited and Multiplex Funds Management Limited.

The statement of claim alleged that from 2 August 2004 until 30 May 2005 Multiplex breached the continuous disclosure requirements of the ASX Listing Rules and the Corporations Act, and engaged in misleading and deceptive conduct by not properly disclosing all material information regarding the cost

²⁸ See *Dorajay Pty Limited v Aristocrat Leisure Limited* [2005] FCA 1483 (Stone J).

²⁹ A contravention of the misleading and deceptive conduct provisions of the Corporations Act requires a finding of causation and causation is normally established through proof of reliance on the misleading conduct - see *Wardley Australia Limited v State of Western Australia* (1992) 175 CLR 514. In a typical class action the need to prove each member of the class relied on the allegedly misleading conduct is likely to be challenging.

It is unclear whether causation could be established without reliance. In some cases it has been considered sufficient that reliance be established by derivative impacts on the plaintiff without direct reliance by the plaintiff on the defendants conduct. An example of such a case is *Janssen - Cilag Pty Ltd v Pfizer Pty Limited* (a passing off case).

In the securities law context the issue is whether reliance can be established through a "fraud on the market" theory where the fact the market trades on information is sufficient to establish reliance.

Attempts to prove reliance in this way have failed to date. See *Digi-Tech (Australia) v Brand & Ors* [2004] NSWCA 58 (Sheller JA, IPP JA, McColl JA) at 155-9 and *Ingot Capital Investments & Ors v Macquarie Equity Capital Markets & Ors* [2008] NSWCA 206 (Giles, Hodgson & Ipp JA) at 22 and 612-619.

For discussion see D.Grave, L.Watterson and H. Mould "Causation, loss and damage: Challenges for the new shareholder class action" (2009) 27 C&SLJ 483

³⁰ See *Dorajay Pty Ltd v Aristocrat Leisure Limited* [2009] FCA 19 (Stone J).

³¹ Aristocrat Leisure Limited ASX announcement dated 28 August 2008.

increases and delays in the construction of the Wembley National Stadium and the consequences of those events on the Multiplex earnings forecast.

The commencement of the class action followed closely upon Multiplex entering into an enforceable undertaking with ASIC pursuant to section 93AA of the ASIC Act.³² In that enforceable undertaking Multiplex offered to compensate investors who had acquired securities between 3 February 2005 and 23 February 2005, up to a maximum amount of \$32 million.

Multiplex's financial statements for the year ended 30 June 2004 included a component of profit of £35.7 million attributable to the Wembley project. On 2 August 2004 a key subcontractor to the project (CBUK, the steelworks contractor) advised Multiplex that it considered Multiplex to have repudiated the contractual relationship between them.

On 24 February 2005 Multiplex reassessed its interim financial statements and disclosed that it had written the project back to break-even but stated that overall results for the 2005 financial year remained in line with market forecasts.

On 30 May 2005 Multiplex announced a revised forecast for the Wembley project of a loss of £45 million with total profit for the 2005 financial year revised down to \$170 million from the earlier guidance of \$235 million.

The ongoing announcements about deterioration of the profitability of the Wembley project by Multiplex in February and May 2005 was associated with substantial falls in the price of Multiplex securities.³³

The proceeding was brought on behalf of security holders who purchased or acquired an interest in Multiplex securities during the period 2 August 2004 and 30 May 2005.

During 2007 there was significant preliminary litigation around the question of whether the litigation funding arrangements could impact on the definition of the class.³⁴ That litigation was resolved in favour of the plaintiff law firm.

On 18 November 2008, Multiplex filed an application at the Federal Court seeking to restrain the litigation funder from providing funding in relation to the class action, arguing that the funding arrangements constituted a managed investment scheme which is required to be registered under the Corporations Act. This application was dismissed by the Federal Court on 6 May 2009.³⁵ This decision was appealed to the Full Federal Court. On 20 October 2009, the Court (with Jacobson J dissenting) overturned Finkelstein J's decision and accepted the argument proffered by Multiplex.³⁶

³² ASIC Media Release 06-443 "ASIC accepts an enforceable undertaking from the Multiplex Group" (20 December 2006).

³³ On 24 February 2005 the Multiplex security price fell from \$5.57 to \$4.76. By 30 May 2005 the Multiplex security price had fallen to \$2.56.

³⁴ See *P Dawson Nominees Pty Ltd v Multiplex Limited and Multiplex Funds Management Limited* [2007] FCA 1061 (Finkelstein J).

³⁵ *Brookfield Multiplex Limited v International Litigation Funding Partners Pte Ltd (No.3)* [2009] FCA 450 (Finkelstein J).

³⁶ *Brookfield Multiplex Limited v International Litigation Funding Partners Pte Ltd* [2009] FCA 11.

On 4 November 2009, ASIC responded to the Full Federal Court's finding by granting transitional relief to lawyers and litigation funders involved in legal proceedings structured as funded class actions.³⁷

On 21 July 2010 (before the trial scheduled for October 2010), Justice Finkelstein of the Federal Court approved settlement of the class action, without admission of liability, for \$110 million.³⁸ The plaintiff's legal costs were approximately \$11 million. The proceedings have now been dismissed.

2.6 Centro class action

There are five separate shareholder class actions in respect of two different Centro ASX listed staples - Centro Properties Group ("**Centro Properties**") and Centro Retail Group ("**Centro Retail**").

Broadly, the statements of claim in the class actions allege that Centro Properties and Centro Retail breached their obligations of continuous disclosure under the ASX Listing Rules and the Corporations Act and engaged in misleading and deceptive conduct by failing to adequately disclose to their security holders and to the ASX:

- the full extent of their maturing debt obligations;
- the risk that they may not be able to refinance their maturing debts at forecast cost or at all; and

failed to:

- consolidate the accounts of Centro Properties and Centro Retail and a related United States entity (Super LLC);³⁹ and
- disclose in its financial reports a guarantee given by Centro Properties of certain debt of Super LLC.

In May 2009, Centro filed a cross-claim against its auditors, PricewaterhouseCoopers. In addition, in late 2010 the Applicants in the class actions joined PricewaterhouseCoopers and PricewaterhouseCoopers Securities Limited (the investigating accountant who prepared a report that was contained in a prospectus issued by Centro Retail during 2007) as respondents, alleging they are directly liable to group members along with the Centro entities. In early 2011, the PricewaterhouseCoopers parties cross claimed against Centro Properties, Centro Retail and their directors and officers.

On 8 October 2011 Justice Middleton recused himself from hearing the Class Actions, as a result of having heard the case against the directors and officers of Centro Properties and Centro Retail. The class actions are set down for hearing before Justice Gordon commencing March 2012.

2.7 Some observations

Some general conclusions can be drawn from the analysis above.

³⁷ ASIC Media Release 09-218MR "*ASIC grants transitional relief from regulation for funded class actions*" (4 November 2009).

³⁸ P Dawson Nominees Pty Ltd v Brookfield Multiplex (No 4) [2010] FCA 1029 (Finkelstein J)

First, these cases reflect a conscious decision by plaintiff lawyers to pursue theories of liability based on poor disclosure rather than theories of liability based on breach of directors duties. A number of the cases outlined above may have been pleaded as a breach of duty rather than poor disclosure practices.⁴⁰

Second, since the GIO case plaintiff lawyers have had little appetite to join directors in cases involving major corporations, and major corporations appear to be more popular targets than smaller enterprises. The current preference would be to simplify the parties to a class action in the hope of streamlining a settlement negotiation. Of course, that tactic is predicated on the corporate having deep pockets. Plaintiff law firms cannot be oblivious to the insurance arrangements that directors and professional advisors enjoy where liability might seem to be clearer.⁴¹

Third, the legal difficulties in successfully mounting securities laws class actions are not yet satisfactorily resolved from a plaintiff's perspective. The requirements for proof of damage remain very much unresolved in a typical disclosure case.⁴² In addition, the political dimensions of the potential class action explosion remain simmering.⁴³

Fourth, if the legal difficulties can be satisfactorily resolved from a plaintiff's law firm perspective, the potential rewards to those persons could be significant.⁴⁴

3 Civil penalty proceedings

3.1 An introduction

It has already been noted that one of the most significant developments in the growth of a pyramid enforcement structure in Australian corporations law over the last decade has been the civil penalty sanctions under Part 9.4B of the Corporations Act.

It is understandable that issues of directors duties are more evident in the civil penalty sphere than in class action claims in view of the initial focus on this area

⁴⁰ A similar observation has been made in the United States in recent years where the most substantial claims arising out of the corporate collapses of 2001/2002 were pursued using theories of liability based on violations of Federal securities laws rather than theories of liability based on breach of fiduciary duty under state corporations legislation - see R Thompson & H Sale "Securities Fraud as Corporate Governance: Reflections upon Federalism" (2003) 56 Vand L Rev 859.

⁴¹ The history of the Centro class action illustrates how that position can break down.

⁴² The principles of causation discussed at footnote 32 above.

⁴³ In late 2005 the Standing Committee of Attorneys General agreed that consultation and research should be undertaken into regulating the litigation funding industry. A discussion paper was produced in June 2006. There has been little further progress since then.

⁴⁴ See the returns of the plaintiff law firms involved in the GIO, Telstra and Aristocrat settlements discussed above. In relation to the Aristocrat settlement, IMF (Australia) Limited announced that it would gain revenues of \$37 million from its investment in the class action (See ASX announcement 28 August 2008).

In the United States the returns to plaintiff law firms from securities class actions can be huge. In the WorldComm settlement in 2006 the two lead plaintiff law firms shared fees of US\$335 million in a US\$6.1 billion settlement.

It is interesting to note in that regard that in May 2006 the United States leading class-action securities law firm, Milberg Weiss Bershad & Schulman, were charged with making more than US\$11 million in secret payments to individuals who served as plaintiffs in more than 150 lawsuits.

in introducing the sanction and the fact that ASIC (rather than the DPP) has the primary responsibility for enforcement of this regime.

We will consider the following case studies.

3.2 ASIC v Rich

One.Tel Ltd was listed on the Australian Stock Exchange in 1995 until 2001. One.Tel suffered large trading losses and asset impairments immediately prior to 29 May 2001.⁴⁵ One.Tel was placed in voluntary administration on 29 May 2001 and into liquidation, upon a decision made by creditors in the administration, on 24 July 2001.⁴⁶

In December 2001, ASIC commenced civil penalty proceedings in the Supreme Court of New South Wales against Messrs Jodee Rich and Bradley Keeling, the former Managing Directors of One.Tel, Mr Mark Silbermann, the former Finance Director of One.Tel, and Mr John Greaves, the former Chairman of One.Tel. ASIC chose not to commence proceedings against the other directors.

The proceedings were formulated on the basis that each director failed to discharge their statutory duties of care and diligence in the period prior to the collapse of One.Tel.

Since this time, a brief chronology of events was as follows:

- On 24 February 2003, the Court refused an application by former chairman John Greaves to strike out the claim brought by ASIC on the basis that the duties of a Chairman were not, at law, as extensive as ASIC wished to establish.⁴⁷
- On 21 March 2003, pursuant to court orders following a settlement with Brad Keeling, Mr Keeling was banned from being a director (or otherwise being involved in the management of any corporation) for 10 years, was liable to pay compensation of \$92 million to One.Tel and agreed to pay ASIC's costs of \$750,000.⁴⁸
- On 6 September 2004, pursuant to court orders following a settlement with John Greaves, Mr Greaves was banned from being a director for 4 years, was liable to pay compensation of \$20 million to One.Tel and agreed to pay ASIC's costs of \$350,000.⁴⁹
- On 6 September 2004 ASIC's civil penalty proceeding against Messrs Rich and Silbermann commenced hearing evidence in the New South Wales Supreme Court.

⁴⁵ During this period One.Tel incurred a net trading loss of at least \$92 million.

⁴⁶ *ASIC v Rich and Ors* [2003] NSWSC 186 (21 March 2003).

⁴⁷ See *ASIC v Rich and Ors* [2003] NSWSC 186 (Austin J); John Keeves "Directors' Duties - ASIC v Rich - landmark or beacon?" (2004) 22 C&SLJ 181 at 183.

⁴⁸ *ASIC v Rich & Ors* [2003] NSW SC 186

⁴⁹ *ASIC v Rich & Ors* [2004] NSWSC 836 (White J). See also ASIC Media Release 04-283 "ASIC reaches agreement with John Greaves in One.Tel proceedings" (6 September 2004).

As part of the terms of agreement, Mr Greaves admitted that during the period January 2001 to 30 March 2001, he failed to take the steps that he should have in order to ensure that he and the board of One.Tel properly monitored management and were aware of the true financial position of the company.

- On 25 October 2007 ASIC's civil penalty case against Messrs Rich and Silbermann concluded and judgment was reserved.
- On 18 November 2009 the trial judge handed down his decision on Messrs Rich and Silverman dismissing the civil proceedings.⁵⁰
- On 26 February 2010 ASIC announced it would not appeal the trial judge's decision.⁵¹

The key issue that arises from the Rich proceedings is the period of more than 8 years that passed since the events in question and resolution of the civil penalty proceedings. To be sure the interlocutory skirmishing added very significantly to the court timetable.⁵²

3.3 Fortescue

Proceedings are being pursued by ASIC seeking civil penalty orders against Fortescue Metals Group Limited and its chief executive officer, Andrew Forrest.⁵³

Fortescue Metals Group Limited is a listed company that is developing a project to mine iron ore in the Chichester Ranges in the Pilbara region of Western Australia and exporting it from Port Hedland. The allegations relate to alleged misleading and deceptive conduct and breach of the continuous disclosure requirements of the ASX Listing Rules and the Corporations Act when Fortescue announced various contracts with Chinese entities on 23 August 2004 and 5 November 2004, including "binding contracts" with:

- China Railway Engineering Corporation to build and finance a railway from its tenements to the export hub at Port Hedland;
- China Harbour Engineering Corporation to design, build and finance a shiploading and stockyard facility at Port Hedland; and
- China Metallurgical Construction (Group) Corporation to design, build and finance a mine process plant.

The specific allegations against Fortescue are that it did not disclose that the parties to the contracts had not reached a concluded agreement on vital aspects of the projects. Instead it is alleged that they had merely agreed that they would in the future jointly develop and agree on such matters.

In addition, ASIC asserts that Fortescue's chief executive officer was knowingly concerned in the contraventions by Fortescue and breached his duty as a director to exercise care and diligence by failing to ensure that Fortescue complied with its obligations.

⁵⁰ *ASIC v Rich* [2009] NSWSC 1229 (Austin J).

⁵¹ ASIC Media Release 10-34AD "*ASIC not to appeal One.Tel decision*". Reason given for that decision were public interest considerations, cost and effluxion of time.

⁵² A significant issue related to the obligation of Messrs Rich and Silbermann to provide discovery and file witness statements - see *ASIC v Rich* [2003] NSWSC 328 (Austin J); *Rich v ASIC* [2003] NSWCA 342 (Spigelman CJ, IPP & McColl JJA); *Rich v ASIC* [2004] HCA 42.

⁵³ ASIC Media Release 06-062 "*ASIC commences proceedings against Fortescue Metals Group and Andrew Forrest*" (2 March 2006).

ASIC is seeking penalties of up to \$6 million against Fortescue. ASIC is seeking penalties of up to \$4.4 million against Forrest and an order that he compensate Fortescue for any pecuniary penalty it is liable for.⁵⁴ If ASIC requests are granted by the court the only detriment of the case will be borne by the chief executive officer.⁵⁵

The proceedings have now had a tortured progress through the court system:

- On 23 December 2009 the trial judge found no contravention of the continuous disclosure obligations.⁵⁶
- On 4 February 2010 ASIC announced that it had appealed the trial judge's decision.⁵⁷
- On 18 February 2011 the Full Federal Court granted ASIC's appeal and declared that Fortescue and Forrest had contravened the continuous disclosure obligations.⁵⁸
- On 29 September 2011 the High Court granted Fortescue and Forrest special leave to appeal the Full Court decision.
- The High Court heard the appeal in February 2012 and has reserved judgment.

3.4 Citrofresh

In August 2006 ASIC commenced proceedings against Citrofresh International Limited and its chief executive officer, Mr Navi Narain.⁵⁹ Citrofresh International Limited was a listed company licensed to market and sell products for cleaning and disinfection in the hospital, food processing and agriculture industries.

ASIC alleged that on 27 September 2005, Citrofresh issued an ASX release containing false claims that the product promoted by Citrofresh was a vaccine for various diseases (HIV and STDs) rather than a disinfectant.⁶⁰

⁵⁴ ASIC Media Release MR09-55 "ASIC Takes Action Against Fortescue Metals and CEO Andrew Forrest" (3 April 2009).

⁵⁵ To be sure there is a serious policy issue in imposing financial penalties on the company itself. This is because the penalty harms the shareholders of the company and does not advance any in *terrorem* policy.

⁵⁶ *ASIC v Fortescue Metals Group Ltd* [No. 5] [2009] FCA 1586 (Gilmour J).

⁵⁷ ASIC Media Release 10-13AD "ASIC appeals Federal Court decision in Fortescue Metals Group civil penalty proceedings" 4 February 2010.

⁵⁸ *ASIC v Fortescue Metals Group Ltd* [2011] FCAFC 19 (Keane CJ, Emmett & Finkelstein JJ).

⁵⁹ ASIC Media Release 06-295 "ASIC Acts Against Misleading Statements by Listed Company" (25 August 2006). The following facts are taken from the media release.

⁶⁰ In the ASX announcement on 27 September 2005 it was claimed:

- Citrofresh can now offer a global solution to reduce and eventually stop the spread of human immunodeficiency virus (HIV) using Citrofresh;
- Citrofresh provides a non-hazardous, non-toxic and effective solution that deal (sic) with emergency disease control and prevention for HIV, human influenza A virus, the SARS virus and the human rhinovirus;
- Citrofresh will market a range of 'barrier protection' products to be used in the first instance of men's health (post intercourse spray or lotion);

ASIC sought a declaration of contravention of the misleading and deceptive conduct provisions of the Corporations Act against Citrofresh. In addition ASIC sought a declaration that the chief executive officer also contravened the misleading and deceptive conduct provisions and breached his directors duties of care and diligence by drafting, approving and sending to ASX the release. ASIC sought a civil penalty of \$200,000 and the disqualification of the chief executive officer from managing corporations.

On 5 September 2007 Citrofresh consented to the orders sought by ASIC against it.⁶¹ Those orders were a declaration that Citrofresh engaged in misleading conduct and an order that Citrofresh pay ASIC's costs.

On 6 December 2007 the claims against the chief executive officer were dismissed.⁶² Goldberg J found that the statements made in the release concerning the properties of the Citrofresh product was not conduct in relation to a financial product within the meaning of the relevant misleading and deceptive conduct provisions.⁶³ The view was also expressed that the participation of the chief executive officer in the drafting of the release and his approval of the release would not mean he personally engaged in the relevant conduct.⁶⁴

ASIC appealed against the Federal Court's decision to dismiss the claim against the chief executive officer.⁶⁵ That appeal was successful.⁶⁶ The Full Federal Court held that the media release was conduct in relation to a financial product.⁶⁷ Further it was found that the involvement of the chief executive officer could constitute prohibited conduct under the statutory provisions.⁶⁸ The case was remitted to the trial judge to determine if the statements were misleading or deceptive. The High Court refused an application for special leave to appeal by the chief executive officer in December 2008.⁶⁹

On the further hearing the trial judge found on 2 February 2010 that the chief executive officer engaged in misleading and deceptive conduct and contravened his statutory duties of care and diligence by causing Citrofresh to release a misleading and deceptive statement.⁷⁰ At the penalty hearing on 29 March 2010

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- the use of Citrofresh as a postcoital application will act as an 'invisible condom' for the prevention of STDs including HIV; and
 - the ability to use Citrofresh as a postcoital application will have a significant impact on reducing the transmission of HIV and STDs.

⁶¹ ASIC Media Release 07-233 "ASIC obtains orders against Citrofresh International" (5 September 2007) (Goldberg J).

⁶² *ASIC v Citrofresh International Ltd* [2007] FCA 1873 (Goldberg J). See also ASIC Media Release 07-319 "Application against former director of Citrofresh International Ltd dismissed" (6 December 2007).

⁶³ [2007] FCA 1873 at paragraph 74.

⁶⁴ [2007] FCA 1873 at paragraph 87-8. It was noted that the chief executive officer may have faced accessory liability, but this was not pleaded by ASIC.

⁶⁵ ASIC Media Release 07-325 "ASIC lodges appeal in proceeding against former Citrofresh International Limited director" (14 December 2007).

⁶⁶ *ASIC v Narain* [2008] FCAFC 120 (Finkelstein, Jacobson & Gordon JJ, 3 July 2008).

⁶⁷ [2008] FCAFC 120 at paragraphs 12 and 87.

⁶⁸ [2008] FCAFC 120 at paragraphs 19-21 and 94-100.

⁶⁹ *Narain v Australian Securities and Investments Commission* [2008] HCA Trans 408 (5 December 2008).

⁷⁰ *ASIC v Citrofresh International (No. 2)* [2010] FCA 27 (Goldberg J).

the chief executive officer received a seven year banning order and a pecuniary penalty of \$20,000.⁷¹

3.5 James Hardie

In 2007 ASIC commenced civil penalty proceedings in the Supreme Court of New South Wales relating to disclosures by James Hardie Industries Limited in respect of the adequacy of the funding of the Medical Research and Compensation Foundation and statements made as to the adequacy of that funding.⁷² The proceedings arose from ASIC's investigation of matters identified by the Special Commission of Inquiry into the Medical Research and Compensation Foundation.⁷³

ASIC sought declarations that a number of former and current directors, including non-executive directors, and former executives failed to act with requisite care and diligence in relation to those matters. ASIC also asked the court to ban individuals from acting as directors and impose fines.

The action also sought declarations that James Hardie Industries Limited and James Hardie Industries NV made misleading statements and contravened continuous disclosure requirements. ASIC alleged that James Hardie Industries NV failed to act with requisite care and diligence in relation to its then-subsidiary, James Hardie Industries Limited.

At first instance, the trial judge found that seven former non-executive directors and three former company executives had contravened their statutory duties of care and diligence by releasing the statements.⁷⁴ The trial judge imposed five year banning orders on each of the non-executive directors and pecuniary penalties of \$30,000. Banning orders of between five years and fifteen years and pecuniary penalties of between \$35,000 and \$350,000 were imposed on the executive officers.⁷⁵ The trial judge also found that James Hardie Industries

⁷¹ *ASIC v Citrofresh International (No. 3)* [2010] FCA 292 (Goldberg J).

⁷² ASIC Media Release 07-35 "ASIC commences proceedings relating to James Hardie" (15 February 2007). The following facts are taken from the media release.

⁷³ The civil penalty actions allege various breaches of duties under the Corporations Act, including:

- JHIL's ASX announcement of 16 February 2001 and related press conference statements in relation to the establishment of the MRCF. ASIC alleges these communications were misleading.
- The failure to disclose the existence of the Deed of Covenant and Indemnity between the MRCF and JHIL, which created, amongst other things, an ongoing asbestos-related liability of JHIL.
- The Information Memorandum (IM) for the 2001 Scheme of Arrangement that proposed a restructure of the James Hardie group. The restructure had the effect of JHIL (the then-ASX-listed company) becoming a subsidiary of JHINV, a Netherlands company. ASIC alleges the IM was misleading in failing to disclose pertinent information relating to the meeting of JHIL's future liabilities.
- A series of presentations by a senior executive to institutional investors in 2002. ASIC contends these presentations contained misleading information about the adequacy of the funding of the MRCF and the James Hardie group's asbestos liabilities.
- The cancellation of the partly paid shares in JHIL, which were held by JHINV and represented as having been issued for the purpose of JHIL meeting any future liabilities. ASIC alleges that JHINV failed to act with the requisite care and diligence in requesting JHIL to cancel these shares. ASIC also alleges that JHINV failed to disclose certain important information to the ASX regarding the cancellation.

⁷⁴ *ASIC v Macdonald (No. 11)* [2009] NSWSC 282 (Gzell J).

⁷⁵ *ASIC v Macdonald (No. 12)* [2009] NSWSC 714 (Gzell J).

Limited and James Hardie Industries NV contravened their continuous disclosure obligations.

All of the former non-executive directors, two of the former company executives and James Hardie Industries NV appealed the decision of the trial judge. On 17 December 2010 the appeals of the non-executive directors were allowed by the NSW Court of Appeal.⁷⁶ The Court of Appeal found that ASIC had not proved, with sufficient clarity and cogency, that the non-executive directors had passed a resolution approving the draft announcement to the ASX. The appeal by the former company secretary and former general counsel succeeded in part. The appeal by James Hardie Industries NV was dismissed.

On 13 May 2011 ASIC was granted special leave by the High Court to appeal the decision of the NSW Court of Appeal in relation to the former non-executive directors and officers.⁷⁷

3.6 Centro

On 21 October 2009 ASIC commenced civil penalty proceedings against the directors and certain officers of Centro Properties Group and Centro Retail Group.⁷⁸ The factual background is as outlined in section 2.6 above. ASIC contended each officer breached the duties of care and diligence in approving financial statements that misclassified the liabilities of the Centro group.

On 27 June 2011, Justice Middleton of the Federal Court handed down his judgment in the proceedings.⁷⁹ It was held that each of the defendants had breached their duties of care and diligence.

ASIC had sought orders to disqualify the directors and officers from managing corporations and asked the Court to impose pecuniary penalties. On 31 August 2011, Justice Middleton handed down his penalties judgment.⁸⁰ The key outcomes of the penalties judgment are:

- Declarations were made that the directors and officers had breached the Corporations Act and their applications for relief from liability were dismissed;
- Despite submissions from ASIC, no disqualification or pecuniary penalty orders were imposed on the non-executive directors;
- Mr Scott (the former managing director and CEO) was ordered to pay a pecuniary penalty of \$30,000;
- Mr Nenna (the former CFO) was disqualified from managing corporations for 2 years; and

⁷⁶ *Morley & Ors v ASIC* [2010] NSW CA 331 (Spigelman CJ, Beazley JA, Giles JA).

⁷⁷ ASIC Media Release 11-98MR "ASIC granted special leave to appeal James Hardie decision." 13 May 2011.

⁷⁸ ASIC Media Release 09-202AD "ASIC commences proceedings against current and former officers of Centro" (21 October 2009).

⁷⁹ *ASIC v Healey* [2011] FCA 717 (Middleton J).

⁸⁰ *ASIC v Healey (No 2)* [2011] FCA 1003 (Middleton J).

- The directors and officers were ordered to pay ASIC's costs (although it would seem this liability was covered by insurance).⁸¹

His Honour determined that disqualification orders in relation to the directors would have been excessive, unnecessary and inappropriate in the circumstances given the directors' "past and future contribution to the corporate world."⁸² His Honour also took account of the widespread commentary and analysis since he handed down his decision in the liability proceeding and the consequent reputational implications for the directors. Although his Honour suggested that the directors could have gone further in expressing remorse, he noted the fact that each of the directors faced further litigation.

Justice Middleton justified the pecuniary penalty imposed on Mr Scott by reference to his role as the former managing director and CEO, the implication of which was a higher level of responsibility relative to that of the other directors.

In respect of Mr Nenna's disqualification for a period of 2 years, Justice Middleton considered that the disqualification order, taken together with the declaration of contravention, was sufficient to achieve the objective of general deterrence and, therefore, did not impose a pecuniary penalty.

3.7 Some observations

Some conclusions can be drawn from these case studies.

First the time periods involved in each of these case studies (other than Centro) are extreme and is unfortunate from a regulatory policy perspective. It would be hoped that these cases represent anomalies rather than a feature of this type litigation going forward.

It has been said by an experienced and influential company director that it is not the balance of the legal requirements that are at fault but the time periods that are involved in establishing lack of culpability.⁸³ In that context it was suggested that if a director is sued it typically takes around 7 years to defend the claim and in the meantime their career is shot to pieces.⁸⁴

Second, the combination of proceedings based on violation of directors duties and disclosure violations reflected in these proceedings reflects a measured and appropriate regulatory response to the regulatory issues raised by matters of that nature, if the allegations are correct. The focus on remedial orders against directors involved in alleged wrongdoing, rather than the entities that have suffered loss appears an appropriate regulatory strategy.

Third, the limitations of the civil penalty regime need to be acknowledged by the regulator. A pecuniary penalty of \$200,000 for an individual, the compensation order and the banning order will not be appropriate for significant wrongdoing. The issues in this area are well illustrated by the penalty decision of the civil penalty imposed on the prominent public identity Steve Vizard⁸⁵ for breach of

⁸¹ At paragraph 228.

⁸² At paragraph 102.

⁸³ Australian Financial Review "*Process not up to speed: Gonski*" 22 February 2008, pg 65. The article refers to comments made by Mr David Gonski at the 2008 ASIC Summer School.

⁸⁴ It was suggested by Mr Gonski that the solution to this concern may be to establish a specialist tribunal to determine if a director should have a case to answer.

⁸⁵ *ASIC v Vizard* [2005] FCA 1037 (Finkelstein J).

fiduciary duty. The judge in that case considered the financial penalty imposed of \$130,000 to be low and suggested that Parliament may need to review the upper amount that may be imposed.⁸⁶ Further, the judge doubled the banning period proposed by ASIC to better reflect objectives of deterrence.⁸⁷ Notwithstanding those steps there was still public criticism of the lightness of the penalty imposed.⁸⁸

4 General criminal prosecutions

Finally the authors consider ASIC's assessment of its regulatory report card, as measured by statistics published in its annual reports, particularly as addressed to the position of directors.

In the latest ASIC Annual Report (2010-2011) enforcement outcomes for the year can be summarised as follows:⁸⁹

- % total litigation successful – 90%
- criminal proceedings completed – 26
- criminals jailed – 16
- civil proceedings completed – 34
- people banned from directing companies – 72
- people/companies banned from financial services or consumer credit – 64
- enforceable undertakings entered – 14

These results are consistent with reported outcomes in recent years.

In the context of recent corporate collapses, including those referred to in section 1.1, the criminal enforcement record to date consists of the following:

Collapse	Individual Charged	Status
Westpoint	CFO (Rundle) ⁹⁰	Guilty finding - false or misleading statement - s.178BB <i>NSW Crimes Act</i> - 18 months suspended sentence.
	CEO and CFO (Carey & Rundle) ⁹¹	Charged - breach of duty - s.184 & s.601FD <i>Corporations Act</i>
Opes Prime ⁹²	CEO (Emini)	Guilty plea - breach of duty -

⁸⁶ [2005] FCA 1037 at paragraph 45.

⁸⁷ From 5 to 10 years - [2005] FCA 1037 at paragraph 47.

⁸⁸ See V Comino "The enforcement record of ASIC since introduction of the civil penalty regime" (2007) 20 Australian Journal of Corporate Law 183 at 208-213.

⁸⁹ ASIC Annual Report 2010-2011 at p87.

⁹⁰ ASIC Media Release 11-200MR "Sentencing decision in the Westpoint CFO criminal Case" 9 September 2011.

⁹¹ ASIC Media Release 11-132AD "ASIC brings criminal charges against Westpoint's Norm Carey and Graeme Rundle" 1 July 2011.

Collapse	Individual Charged	Status
		24 months jail
	Director (Blumberg)	Guilty plea - breach of duty - 12 months jail
	Director (Smith)	Trial pending - breach of duty
Australian Capital Reserve	Directors (Pogson & Lapham) ⁹³	Guilty plea - false or misleading statement - s.178BB <i>NSW Crimes Act</i> – 2 years jail by intensive correction order.
	Director (Pogson)	Guilty plea - false or misleading statement, s1308(2) <i>Corporations Act</i>
Fincorp	Chairman and CEO (Krecichwost) ⁹⁴	Guilty finding - dishonest use of position as director of companies in Fincorp Group with intention of directly or indirectly gaining advantage for himself or others - 3.5 years in jail, subject to grant of parole scheduled for December 2011.
ABC Learning ⁹⁵	CEO (Groves) and COO (Kemp)	Charged – breach of duty – s.184 <i>Corporations Acts</i> – trials pending.

5 Conclusions of our analysis

Having undertaken the analysis above, we have four main conclusions from our analysis.

First, in 2012 there is a much broader enforcement pyramid in existence that is relevant to the company director than applied with prior corporate collapses. A director considering his or her liability position in 2012 faces much broader liability concerns than those based on the traditional areas of directors duties.

Second, the future of the class action in Australia remains very much unresolved in the securities law area. It will be fascinating to see how that debate plays itself out at the judicial and political level over the next few years in Australia.

Third, creative use of civil penalty provisions of the Corporations Act remain very prospective sanctions available to ASIC. ASIC should be congratulated in the way it has used this sanction in recent years.

Four, for appropriate cases criminal action still needs to be pursued by the regulator to instil an appropriate in terrorem effect. The effectiveness of the pyramid enforcement structure very much requires that the regulatory response to allegations of wrong doing be proportionate and appropriate. While ASIC and

⁹² ASIC Media Release 11-150MR “Opes Prime directors jailed” 27 July 2011.

⁹³ ASIC Media Release 12-44D “Former Australian Capital Reserve directors sentenced” 8 March 2012.

⁹⁴ ASIC Media Release 11-25AD “Fincorp director guilty on criminal charges” 17 February 2011.

⁹⁵ ASIC Media Release 11-16AD “Former ABC directors charged” 28 January 2011 and ASIC Media Release 11-153AD “Former ABC director to start trial” 29 July 2011.

the DPP are active in this area, most of the results are below the radar for mainstream corporate Australia.

The primary message of this paper is simple. In 2012 the director lives in a much more complicated world of potential liability than that described by the traditional bounds of directors duties.