

Forrest in the High Court: What Lessons Does *FMG v ASIC & Anor* [2012] HCA 39 Hold for the Future?

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*On 2 October 2012 the long-running dispute between the Australian Securities and Investments Commission (ASIC) and Fortescue Metals Group (FMG), was brought to a close by the High Court of Australia (High Court). *FMG v ASIC & Anor*¹ was heralded as an overwhelming victory² for FMG and its Chief Executive Officer Andrew Forrest, vindicating FMG's consistent denial that a series of statements made in 2004 misled and deceived the market. Moreover, the High Court's findings that Andrew Forrest had not breached his director's duty of skill, care and diligence (director's duty of care) cleared the way for Forrest to continue his directorship unhindered by the prospect of disqualification. This case note will comment on the implications of FMG's victory for the director's duty of care. Further, it will suggest that ASIC's loss may have profound implications for the corporate regulator's approach to achieving compliance.*

BACKGROUND

In 2004 FMG entered into negotiations with China Railway Engineering Corporation (CREC) to design and construct infrastructure for the purposes of the Pilbara Iron Ore Infrastructure project. The result of these negotiations was a series of 'Framework Agreements', that provided that the parties would 'jointly develop and agree'³ terms for proposed Build and Transfer Contracts. Importantly, these Framework Agreements did not stipulate prices, create terms of obligation, or set out a scope for the proposed works. In August and November 2004, FMG announced in a number of letters and press releases that the Framework Agreements were 'binding'.⁴

In response to FMG's announcements, in 2006, ASIC instituted civil penalty proceedings against FMG and its Chief Executive Officer Andrew Forrest. ASIC alleged that FMG's representation that the Framework Agreements were binding misled and deceived the market in contravention of section 1041H of the

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1 *FMG v ASIC & Anor* [2012] HCA 39 (2 October 2012)

2 Andrew Burrell, *High Court Rebukes ASIC Over Andrew Forrest Case* (3 October 2012), Herald Sun, < <http://www.heraldsun.com.au/news/high-court-rebuked-asic-over-andrew-forrest-case/story-e6frf7jo-1226486888792>>

3 *FMG v ASIC & Anor* [2012] HCA 39 (2 October 2012) [12].

4 *FMG v ASIC & Anor* [2012] HCA 39 (2 October 2012) [13]-[15].

Corporations Act 2001 (Cth) (CA).⁵ ASIC also argued that FMG’s misleading statements generated an obligation to disclose that the Framework Agreements were not legally binding under section 674(2) of the CA.⁶ Further, ASIC claimed Andrew Forrest had ‘breached his duty as a director to exercise care and diligence by failing to ensure that FMG complied with its obligations’⁷ and should be disqualified from acting as a director.

FIRST INSTANCE

At first instance, Gilmour J dismissed ASIC’s claim,⁸ holding that FMG’s announcements were not misleading or deceptive because they were statements of opinion which were reasonably held by the company.⁹ Gilmour J held that FMG had no obligation to disclose that the agreements were not in fact legally binding under section 674(2) CA.¹⁰ FMG submitted that ASIC must prove the allegations against the company as a pre-condition for any attempt to ascribe liability to Andrew Forrest.¹¹ In the absence of a contravention by FMG, Andrew Forrest was not liable. However, Gilmour J noted that ordinarily a director would be liable where he or she has not acted reasonably to prevent their company’s contravention *and* where the contravention adversely affects the interests of the company.¹²

FULL FEDERAL COURT

The Full Federal Court allowed ASIC’s appeal.¹³ The Court held that the Framework Agreements were not certain, enforceable and legally binding.¹⁴ Further, FMG’s representations that the Framework Agreements were binding would be likely to mislead or deceive investors under section 1041H CA.¹⁵ FMG’s failure to correct its earlier misstatement constituted a breach of FMG’s continuous disclosure obligations under the CA since a reasonable investor would expect the non-binding nature of the Framework Agreements to be disclosed.¹⁶ The Full Federal Court further held that Andrew Forrest was a person ‘involved’ in a contravention of FMG’s continuous disclosure obligations and liable for breach of the director’s duty of care under s180(1). Forrest’s ‘involvement’ in FMG’s contravention of its continuous disclosure obligations arose because it could ‘not be inferred

5 *ASIC v FMG (No 5)* (2009) 264 ALR 201, 329 (Gilmour J).

6 *ASIC v FMG (No 5)* (2009) 264 ALR 201, 215.

7 Australian Securities and Investments Commission, ‘ASIC commences proceedings against Fortescue Metals Group and Andrew Forrest’ (Press Release, 2 March 2006).

8 *ASIC v FMG (No 5)* (2009) 264 ALR 201,215 (Gilmour J).

9 *ASIC v FMG (No 5)* (2009) 264 ALR 201, 215 (Gilmour J).

10 *ASIC v FMG (No 5)* (2009) 264 ALR 201,213 (Gilmour J).

11 *ASIC v FMG (No 5)* (2009) 264 ALR 201,212.

12 *ASIC v FMG (No 5)* (2009) 264 ALR 201, 378,380 (Gilmour J).

13 *ASIC v FMG* (2011) 274 ALR 731, 789 [202] (Keane CJ).

14 *ASIC v FMG* (2011) 274 ALR 731, 773 [135] (Keane CJ); 791 [212-217] (Emmett J)

15 *ASIC v FMG* (2011) 274 ALR 731, 769 [116] (Keane CJ).

16 *ASIC v FMG* (2011) 274 ALR 731, 747 [40] (Keane CJ).

that reasonably necessary steps had been taken [by Forrest]¹⁷ to ensure that the agreement with CREC was binding before disclosure to the market.

Interestingly, there was no evidence presented to the Court that FMG's statements misled investors or caused loss to shareholders or the company.¹⁸ The Full Federal Court concluded that FMG's conduct was misleading and deceptive because a member of the relevant section of the public *may* have been misled or deceived by the statements made.¹⁹ Indeed, Finkelstein J considered that the objective of chapter 6CA of the CA is to ensure that 'there is a fully informed and efficient market for listed securities'.²⁰ According to Finkelstein J, the goal of market efficiency should not be sidestepped merely because shareholders have made a 'serendipitous' gain.²¹

THE HIGH COURT DECISION

The High Court of Australia reversed²² Forrest and FMG's liability on appeal by special leave.

Misleading and Deceptive Conduct

The High Court held that FMG's conduct was not misleading and deceptive.²³ The Court distinguished the *legal consequences* of the Framework Agreements from what the Framework Agreements *actually said*.²⁴ ASIC's case, according to Heydon J, focused on the legal consequences of the Framework Agreements and 'boil[ed] down to the question of whether Fortescue was right to call the agreement a binding contract'.²⁵ In this respect, Heydon J noted that the agreement was 'certainly a binding contract to negotiate further contracts'.²⁶

The primary focus of the High Court judgment was on what the Framework Agreements actually said. French CJ, Gummow, Hayne, and Kiefel JJ focused their judgment on whether FMG's impugned statements expressed the consequences of the Framework Agreements accurately.²⁷ FMG's references to the 'binding' nature of the Framework Agreements expressed only that the parties intended to enter

17 *ASIC v FMG* (2011) 274 ALR 731, 732 (Keane CJ, Emmett and Finkelstein JJ agreeing)
 18 *ASIC v FMG* (2011) 274 ALR 731, 789 [201] (Keane CJ).
 19 *ASIC v FMG* (2011) 274 ALR 731, 769 [116] (Keane CJ).
 20 *ASIC v FMG* (2011) 274 ALR 731, 796 [232] (Finkelstein J).
 21 *ASIC v FMG* (2011) 274 ALR 731, 796 [233] (Finkelstein J).
 22 *FMG v ASIC & Anor* [2012] HCA 39 (2 October 2012) [117] (Heydon J)
 23 *FMG v ASIC & Anor* [2012] HCA 39 (2 October 2012) [60] (French, Gummow, Hayne, Kiefel JJ)
 24 *FMG v ASIC & Anor* [2012] HCA 39 (2 October 2012) [35] (French, Gummow, Hayne, Kiefel JJ)
 25 *FMG v ASIC & Anor* [2012] HCA 39 (2 October 2012) [92] (Heydon J)
 26 *FMG v ASIC & Anor* [2012] HCA 39 (2 October 2012) [27] (Heydon J).
 27 *FMG v ASIC & Anor* [2012] HCA 39 (2 October 2012) [23] (French, Gummow, Hayne, Kiefel JJ)

into a binding agreement to enter final negotiations in the future.²⁸ The impugned statements, according to the High Court, were an accurate reflection of the effect of the Framework Agreements.²⁹

Further, the High Court did not accept ASIC's submission that the intended audience would infer that a 'binding' framework agreement empowers FMG to force CREC to 'design, build, transfer, and finance the railway'.³⁰ Heydon J in particular noted that the intended audience for FMG's statements was a particular portion of the investing public equipped with knowledge of the Western Australian mining industry.³¹ Given the complex commercial environment within which mining and exploration transactions take place, Heydon J found that this specific audience was unlikely to be misled or deceived that there were wider legal implications to the Framework Agreements, such as the power to compel performance.³²

Continuous Disclosure

In light of the finding on section 1041H, the High Court also overturned FMG's liability for breaching continuous disclosure obligations contained in section 674 of the CA.³³

Andrew Forrest's Liability

The High Court held that Forrest's liability 'depended upon'³⁴ ASIC demonstrating FMG's contraventions. Since ASIC failed to demonstrate that FMG had contravened s1041H and s674, Forrest's liability was not made out.

SHOULD THE DIRECTOR'S DUTY OF CARE BE LINKED WITH THE COMPANY'S LIABILITY?

The High Court held that Andrew Forrest's liability 'depended upon'³⁵ FMG's liability. The High Court did not, however, address whether Forrest could be liable for a breach of the director's duty of care in the absence of loss suffered

28 *FMG v ASIC & Anor* [2012] HCA 39 (2 October 2012) [37] (French, Gummow, Hayne, Kiefel JJ)

29 *FMG v ASIC & Anor* [2012] HCA 39 (2 October 2012) [70] (French, Gummow, Hayne, Kiefel JJ)

30 *FMG v ASIC & Anor* [2012] HCA 39 (2 October 2012) [22] (French, Gummow, Hayne, Kiefel JJ)

31 *FMG v ASIC & Anor* [2012] HCA 39 (2 October 2012) [105] (Heydon J)

32 *FMG v ASIC & Anor* [2012] HCA 39 (2 October 2012) [105] (Heydon J)

33 *FMG v ASIC & Anor* [2012] HCA 39 (2 October 2012) [64] (French, Gummow, Hayne, Kiefel JJ)

34 *FMG v ASIC & Anor* [2012] HCA 39 (2 October 2012) [67] (French, Gummow, Hayne, Kiefel JJ)

35 *FMG v ASIC & Anor* [2012] HCA 39 (2 October 2012) [67] (French, Gummow, Hayne, Kiefel JJ)

by the company. In doing so, the High Court may have left the door open for the use of the director's duty of care to punish directors for corporate behaviour that adversely affects the public interest rather than the company's interest. This generates difficulties for two reasons discussed below.

Subverts the compensatory function of negligence

Liability for breaching the director's duty of care in the absence of loss may subvert the compensatory function of the general law of negligence that underpins the director's duty of care. As with a claim in general law negligence,³⁶ to recover for breach of the director's duty of care at common law, the breach must cause some harm, loss or damage to the company.³⁷ The position for the statutory director's duty of care is less settled, but it seems likely that there is a requirement for at least potential harm to the company for the director's conduct to be considered negligent.³⁸ The case law indicates that the types of harms remedied by the director's duty of care can span from exposure to litigation³⁹ to the reduction of the value of the company's securities.⁴⁰ The High Court did not directly address whether the loss suffered by FMG or its shareholders was too remote to be compensated by the director's duty of care.

Civil 'Derivative Liability'

Deriving the liability of the director from the liability of the company imposes a civil 'derivative liability' on the director. The use of derivative liability by regulators (particularly in the criminal regulatory context) has been criticized⁴¹ and is subject to on-going reform.⁴² The criticisms of derivative liability are likely to be less acute where civil, and not criminal penalties are imposed given that civil sanctions do not carry the stigma of criminal blame. Nonetheless, where the director's liability is derived from the liability of the company, there is potential for over-deterrence since it will be difficult for directors to predict the level of compliance needed to avoid sanctions.⁴³ Imposing liability on directors for breaching

36 *March v E & MH Stramare Pty Ltd* (1991) 171 CLR 506,515 (Mason CJ), 422 (Deane J).

37 *Permanent Building Society (in liq) v Wheeler* (1994) 11 WAR 187, 241-243 (Ipp J).

38 See *Vrisakis v ASC* (1993) 11 ACSR 162, 213 (Ipp J); *ASIC v Maxwell* (2006) 59 ACSR 373, 397 (Brereton J).

39 *ASIC v Macdonald (No 11)* (2009) 256 ALR 199, 201 (Gzell J)

40 *ASIC v Macdonald (No 11)* (2009) 256 ALR 199, 269 [395], 289 [550], 300 [633], 309 [693], 312 [724] (Gzell J).

41 See, eg, Bob Baxt, 'Future Directions for Corporate Law: Where Are We Now and Where Do We Go From Here? The Dilemmas of the Modern Company Director' (2011) 25 *Australian Journal of Corporate Law* 213,214; Corporations and Markets Advisory Committee, *Personal Liability for Corporate Fault Report* (26 September 2006), 26 [3.1.2].

42 See, eg, Personal Liability for Corporate Fault Reform Bill 2012 (Cth).

43 In May 2008, the Treasury surveyed company directors and asked them to rate how each potential liability imposed on them contributed to their perception of risk. The highest rated potential liabilities were derivative liabilities: Treasury, *Survey of Company Directors* (18 December 2008), Treasury Archive Website <<http://archive.treasury.gov.au/contentitem>.

their duty of care in the absence of a direct relationship between the director's conduct and the director's liability may therefore stifle entrepreneurial risk.

WHAT ARE THE IMPLICATIONS FOR THE CORPORATE REGULATOR?

ASIC's prosecution of Andrew Forrest in the absence of discernible harm to the company reflects ASIC intervening in the wider public interest to protect the integrity of the market and promote accurate information sharing in the market.⁴⁴ This is a controversial approach; nonetheless there appears to be some academic,⁴⁵ government,⁴⁶ and judicial⁴⁷ support for the notion that public interest alone could give rise to sufficient standing for an action for a breach of the director's duty of care.

In the wake of FMG's win in the High Court, the question is whether scope remains for ASIC to launch similar prosecutions in the future. On the one hand, the High Court did not address whether a director could be liable for a company's contravention in the absence of harm to the company. In that sense, ASIC may well continue to have *legal* scope to mount a similar case where a company has breached a regulation that protects the wider public interest. However, on the other hand, the High Court's decision reveals an awareness of and focus on commercial realities. Specifically, Heydon J interpreted FMG's statements in light of the conditions of the Western Australian resources market. It follows that there might be disapproval for future legal action launched without a sound commercial rationale.

Much commentary has been directed at ASIC and its apparent strategy of high-profile prosecutions. ASIC's case against FMG and Forrest has been labeled 'misguided',⁴⁸ 'over-zealous'⁴⁹ and its defeat 'embarrassing'.⁵⁰ In the corporate

asp?NavId=&ContentID=1387.>

44 See further, *ASIC v Maxwell* (2006) 59 ACSR 373; *ASIC v Elm Financial Services* (2005) 55 ACSR 544; *ASIC v Rich* (2009) 236 FLR 1; *ASIC v Narain* (2008) 169 FLR 211.

45 Jason Harris, Anil Hargovan and Janet Austin, 'Shareholder Primacy Revisited: Does the Public Interest Have Any Role In Statutory Duties?' (2008) 26 *Company and Securities Law Journal* 335, 367; Helen Anderosn and Michelle Welsh, Submission Number 1 to Corporations and Markets Advisory Committee, *Personal Liability for Corporate Fault* 2005, 6 Corporations and Markets Advisory Committee Website: <http://www.camac.gov.au/CAMAC/camac.nsf/byHeadline/SubmissionsPersonal+liability+for+corporate+fault?openDocument>.

46 Australian Securities and Investment Commission, *Better Regulation ASIC Initiatives* (2006) 6, Australian Securities and Investments Commission Website <http://www.asic.gov.au/asic.nsf/byheadline/06-139+ASIC+outlines+better+regulation+initiatives?openDocument>.

47 *ASIC v Adler* (2002) 168 FLR 253,264 [22] (Santow J).

48 Jennifer Hewett, 'ASIC Found Wanting', *Australian Financial Review* (Sydney) 3 October 2012, 2.

49 Jennifer Hewett, 'ASIC Found Wanting', *Australian Financial Review* (Sydney) 3 October 2012, 2.

50 Jennifer Hewett, 'ASIC Found Wanting', *Australian Financial Review* (Sydney) 3 October

regulatory context, regulators usually rely on a number of techniques in order to administer an ‘optimal regulatory mix’⁵¹ which maximizes compliance. Specialized agencies such as ASIC, are empowered to use their discretion to utilize sanctions to best achieve compliance ends. ASIC’s loss may trigger a shift in strategy from the corporate regulator from prosecution to the conciliatory end of the corporate regulatory ‘pyramid of sanctions’.⁵²

CONCLUSIONS

The High Court did not comment extensively on Andrew Forrest’s liability in finding in his and FMG’s favour in *FMG v ASIC & Anor*.⁵³ In doing so, the High Court failed to clearly delineate that Andrew Forrest’s liability was a separate but related consideration to the liability of the company. This could leave space for the use of the director’s duty of care to punish directors for corporate contraventions that are contrary to the public interest even where the company has not suffered loss. Overall, FMG’s victory in the High Court does not create profoundly new directions in the law of continuous disclosure, misleading and deceptive conduct or the director’s duty of care. It could however, have significant commercial and regulatory implications. The High Court has signaled a focus on commercial realities in applying the *Corporations Act 2001* (Cth) and disapproval for ASIC’s strategy of using high profile prosecutions to deter non-compliance.

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51 R Sarre and R Johnstone, ‘Introduction’ in R Johnstone and R Sarre (eds) ‘Regulation: Enforcement and Compliance’ (Research and Public Policy Series Report No 57, Australian Institute of Criminology, January 2004) 4, Australian Institute of Criminology Website <<http://www.aic.gov.au/publications/current%20series/rpp?41-60/rpp57.aspx>>

52 Ian Ayers and John Braithwaite, *Responsive Regulation: Transcending the Deregulation Debate* (Oxford University Press, 1991) 6.

53 *FMG v ASIC & Anor* [2012] HCA 39 (2 October 2012)