THE LIABILITY OF COMPANY DIRECTORS AND COMPETENT PERSONS FOR RESOURCE/RESERVE DISCLOSURE

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ABSTRACT

The provisions in the ASX Listing Rules which require adherence to the JORC Code and identification of the competent person who "signs off" on resource and reserve disclosures, and which require the company to obtain that person's consent to the use of the information provided for the report in the form in which it is issued, give a role of central and publicly visible responsibility to the reporting geologist or other mining professional. The professional's reputation will obviously be at stake if the work is done with insufficient care such that the information may be said to be misleading or deceptive either by commission or omission. In addition, legal liability for loss flowing from defective disclosure may attach to the professional as well as to the disclosing company and its directors. Defective reporting may, in some circumstances, amount to an offence under the Corporations Law. This paper outlines some of the situations in which directors and mining professionals may become exposed to legal liability at common law and under statute in connection with reporting on resources and reserves.

INTRODUCTION

Australia has a well-developed legal and regulatory framework that governs the disclosure and reporting of mineral resources and ore reserves by listed public companies. The regulatory framework is set out principally in the Corporations Law and the Listing Rules of the Australian Stock Exchange Limited (***ASX***). It is underpinned by the requirements of the *Australasian Code for Reporting of Mineral Resources and Ore Reserves* (the ***JORC Code***).

Company directors and mining professionals, such as geologists, are responsible for implementing the requirements of this disclosure regime on a day to day basis.
This paper will outline the requirements for disclosure of information about resources and reserves to the ASX by way of continuous and regular reporting and to investors in the course of fundraising and takeovers and will discuss the nature of legal liability that may arise for directors and mining professionals in connection with resource/reserve disclosure. The paper assumes an absence of fraudulent intent on the part of directors and mining professionals and will instead focus on the legal liability that may flow from taking insufficient care in preparing and releasing reports.

DISCLOSURE TO THE ASX

The ASX Listing Rules contain a regime for continuous disclosure and periodic reporting for companies listed on the ASX. A failure by a listed company to comply with this regime may expose the company and its directors to liability under the Corporations Law.

Listing Rule 3- continuous disclosure

Listing Rule 3.1 requires immediate notification by a listed entity to the ASX of any information concerning the entity that a reasonable person would expect to have a material effect on the price or value of the entity's securities unless *each* of the following applies:

(a) A reasonable person would not expect the information to be disclosed.

(b) The information is confidential.

(c) One or more of the following applies:

- *The information concerns an incomplete proposal or negotiation.*
- *The information comprises matters of supposition or is insufficiently definite to warrant disclosure.*
- *The information is generated for internal management purposes of the entity.*
- *The information is a trade secret.*

Listing Rules 4 & 5 – regular reporting based on the JORC Code

Listing Rule 4 deals with periodic disclosure generally and Listing Rule 5 contains requirements for additional reporting on mining and exploration activities. Reports on resources and reserves must be prepared in accordance with Appendix 5A of the Listing Rules, which contains the JORC Code.

The JORC Code

The JORC Code is applicable to all solid minerals, including diamonds, other gemstones and coal, for which public reporting of exploration results, mineral resources and ore reserves is required by the ASX. This paper assumes the reader is familiar with the contents of the JORC Code and with its governing principles of transparency, materiality and competence.

Competent persons and recognised mining professionals

The requirement for a report on mineral resources and ore reserves to be compiled by competent person is central to the Code. A competent person is a person who is a Member or Fellow of The AusIMM and/or the Australian Institute of Geoscientists with a minimum of five years experience which is relevant to the style of mineralisation and type of deposit under consideration and to the activity which that person is undertaking. Such a person is subject to professional disciplinary control and is answerable to the ethics committee of the respective organisations for failure to comply with JORC requirements. A report on resources/reserves located outside Australia may be made by a “recognised mining professional” – being a person who has equivalent professional qualifications and who is subject to a similar regime of professional discipline.

The Listing Rules provide that a report must not only be based on information compiled by a competent person or a recognised mining professional; it must also name that person, identify the person’s employer and state that the person gives his or her consent to the information which he or she has provided and which is included in the report in the form which the company proposes to issue.

Enforcement of ASX Listing Rules

A company listed on the ASX is deemed by s777 of the Corporations Law to be under an obligation to comply with the ASX Listing Rules. On the application of ASIC, the ASX or a “person aggrieved”, the court may order that the listed company or its directors must comply with the Listing Rules. A person who holds securities in the listed company is taken to be a person aggrieved by the failure - but this is not to the exclusion of any other person who may in fact be so aggrieved. The sanctions for failure to comply include suspension of the company’s securities from quotation or removal of the company from the official list.

In addition, Section 1001A of the Corporations Law provides that it is an offence for a listed company which is subject to notification obligations of a securities exchange intentionally or recklessly to fail to notify the securities exchange of price sensitive information. A negligent failure to disclose is a breach of the Corporations Law, but not an offence.

Breach of directors duties in connection with defective disclosure

Directors who fail through a lack of care to ensure that a company complies with the Listing Rules in making resource/reserve disclosure either at all or in compliance with the JORC Code may be in breach of the statutory and common law duties which they owe to the company – in particular:

- the duty under s180 of the Corporations Law to exercise their powers and discharge their duties with the requisite degree of care; and
- the duty under s181 to exercise powers and discharge duties in good faith in the best interests of the company and for a proper purpose.

Directors who fail to exercise reasonable care to ensure that reporting (to the ASX and otherwise) is not misleading or deceptive through omission or commission may also be guilty of an offence under Part 9.4 of the Corporations Law and be exposed to legal liability under the law of negligence.

The new business judgment rule

The recently enacted Corporate Law Economic Reform Program reforms, which came into effect on 13 March 2000, have made a number of changes to the Corporations Law in connection with disclosure requirements and liability for defective disclosure.
For example, the CLERP reforms have introduced into the Corporations Law a business judgment rule which creates a safe harbour from personal liability for directors and officers in respect of their duty of care and diligence under the Corporations Law and under the law of negligence – but only in relation to informed and rational judgments made in good faith.

Specifically, s180(2) provides that directors of a corporation who make a business judgment will be taken to have met the requirements of the statutory duty of care and diligence and equivalent duties at common law and in equity in respect of the judgment if the directors:

- make the judgment in good faith for a proper purpose;
- do not have a material personal interest in the subject matter of the judgment;
- inform themselves about the subject matter of the judgment to the extent they reasonably believe to be appropriate; and
- rationally believe that the judgment is in the best interests of the corporation.

However, this new rule applies only to protect a director from being in breach of the duty of care and diligence in respect to a *business judgment*, which is defined to mean any decision to take or not take action in respect of a matter that is relevant to the business operations of the corporation. The rule does not give protection in relation to any other duties or obligations under statute or common law. So, for example, a director who failed to make proper disclosure in a prospectus or takeover document could not call upon the business judgment rule for protection.

A director may rely on others in certain circumstances

The common law has not been clear as to the circumstances in which a director can rely on information and the advice of others without breaching his or her duty of due care and diligence. The CLERP reforms have introduced an express statutory right for a director to rely on information or advice provided by another person (such as a mining professional).

Directors may rely on advice given by (amongst others):

- an employee whom the director believes on reasonable grounds to be reliable and competent in relation to the matters concerned; and
- a professional adviser or expert in relation to matters that the director believes on reasonable grounds to be within the person's professional or expert competence.

The director's reliance on the information or advice provided by a professional reporting on resources/reserves will be taken to be reasonable unless the contrary is proved, provided that:

- the director's reliance on such information or advice is made in good faith; and
- the director has made an independent assessment of the information and advice, having regard to the director's knowledge of the corporation and the complexity of the structure and operations of the corporation.

Disclosure documents regulated by the Corporations Law

Responsibility for disclosure on resources and reserves arises not only in connection with the ASX reporting regime but also in connection with the Corporations Law requirements for proper disclosure to be made to shareholders and investors in connection with fundraisings, takeovers and other corporate activities.

An offer of securities for sale or issue generally requires the preparation of a disclosure document and draws in the prospectus provisions of the Corporations Law. Disclosure of resources and reserves can also be required in the bidder's statement (formerly a Part A or C statement) and target's statement (formerly a Part B or D statement) in connection, for example, with a takeover or merger.

Prospectus disclosure and liability regime

After the CLERP reforms, the general disclosure test for a prospectus remains essentially as it has been; namely that the prospectus must contain all the information that investors and their professional advisers would reasonably require to make an informed assessment of, amongst other things, *"the assets and liabilities, financial position and performance, profits and losses and prospects of the body that is to issue (or issued)"* the relevant securities. A prospectus issued by a mining company will invariably contain an expert's report setting out disclosure of mineral resource and ore reserve estimates and a mining titles report on the company's tenements.

However, the CLERP reforms have eased disclosure requirements in some respects. Certain types of offers or issues (including those to sophisticated investors and small scale offerings involving 20 or fewer issues or sales over a period of 12 months to raise $2 million or less) no longer need a regulated disclosure document. The new disclosure provisions also allow a company to raise up to a total of $5 million by issuing securities under a new form of document – an offer disclosure statement – to which a lower standard of disclosure applies.

Under s728 of the Corporations Law it is an offence for a person to offer securities under a disclosure document if there is a misleading statement in the disclosure document or material required by the Corporations Law to be included is omitted and the statement or omission is materially adverse from the point of view of an investor.
Section 729 provides that a person who suffers loss or damage because an offer of securities under a disclosure document contravenes s728, may recover the loss from (amongst others):

(a) each director (including a shadow director), in relation to any loss or damage caused by any contravention of s728;

(b) a person named in the disclosure document with their consent as having made a statement that is included therein or upon which such a statement is based, in relation to loss or damage caused by the inclusion of the statement in the disclosure document; and

(c) a person who contravenes (or is involved in a contravention of) s728, in relation to any loss or damage caused by that contravention.

An action under s729 may be brought at any time within 6 years after the day on which the cause of action arose.

A due diligence defence is available if the person seeking to escape liability can prove that he or she made all inquiries (if any) that were reasonable in the circumstances and, after doing so, believed on reasonable grounds either that the relevant statement was not misleading or deceptive or that there was no material omission from the prospectus in relation to the relevant matter.

A person may also escape liability if he or she can show reasonable reliance on information given to them by:

- if the person is a company – someone other than a director, employee or agent of the company; or
- if the person is an individual – someone other than an employee or agent of the individual.

Note that this reliance defence would not be of assistance to a director seeking to pass legal responsibility for defective disclosure of resources/reserves to an employed reporting professional. Nor would it be of assistance to an employed mining professional who seeks to pass legal responsibility to a fellow employee or to a director.

Where an “offer disclosure statement” is used by a company to raise up to $5 million, it is a defence to civil and criminal liability under s728 and s729 if the person can prove that he or she did not know that the relevant statement in the offer disclosure statement was misleading or deceptive or that there was an omission. There is no requirement that the person prove that he or she had made due inquiry and had reasonable grounds to believe there was no defect.

This new test could be seen as encouraging those involved in preparation of the disclosure to “turn a blind eye” to material which may put the person on notice of a defect.

However, s1308 provides generally that a “*person who, in a document required by or for the purposes of this Law or lodged:*

(a) makes or authorises the making of a statement that is false or misleading in a material particular; or

(b) omits or authorises the omission of any matter or thing without which the document is misleading in a material respect. without having taken reasonable

> *steps to ensure that the statement was not false or misleading or to ensure that the statement did not omit any matter or thing without which the document would be misleading, as the case may be, is guilty of an offence.*

Section 1309 makes it an offence for an officer of a company to furnish information relating to the affairs of the company which he or she knows to be false or misleading. A failure by an officer to take steps to ensure released information is not false or misleading is also an offence. An officer of a company includes a director (including a shadow director) but would not generally include an employee unless that employee was participating in decisions that affect the whole or a substantial part of the business of the company.

Takeovers disclosure and liability regime

The Corporations Law contains disclosure requirements for takeover documentation. Where scrip forms a component of the consideration, the bidder's statement will also need to comply with prospectus type disclosure requirements.

Where there is a common director or the offeror already owns at least 30% of the target, the Corporations Law requires that an independent expert's report must accompany the target's statement. If this requirement is not present, the directors of the target company may anyway wish to commission a report by an expert to determine a value for the shares and/or to advise whether, in his or her opinion, the offer is fair and reasonable.
A criminal offence occurs if a defect in a prospectus is materially adverse from the point of view of an investor. Civil (but not criminal) liability arises even if the plaintiff does not establish that the misleading and deceptive statement or omission in takeover documentation is "material", provided that loss was suffered as a result of the defect.

Defences to liability for misstatements or omissions in takeover documents include establishing that the defendant believed on reasonable grounds that the document was not misleading or deceptive or that the defendant placed reasonable reliance on another (not being a director, an employee or agent).

Liability in tort for negligent misstatement

Liability for loss flowing from careless reporting on resources and reserves may arise under the law of negligence. The loss that would typically flow from defective disclosure of resources and reserves is economic loss – loss flowing from a decision to invest or not to invest, to sell or not to sell the company's securities made on the basis of the defective disclosure. The courts have traditionally been reluctant to find, as a general rule, that one person owes a duty to another to take care not to cause reasonably foreseeable financial harm. However, the courts have come to recognise that a duty of care may arise in the case of negligent misstatements made to a person who, to the knowledge of the maker of the statement, relies upon the advice or information provided. In these circumstances the courts may permit recovery of pure economic loss.

The tort measure of damages is to place the plaintiff in the position he or she would have been in had the defendant exercised care.

Liability in tort for a negligent misstatement made in connection with reporting on resources and reserves may attach to the listed company, its directors or to the geologist (and other mining professionals) involved in the negligent conduct.

The liability of a consultant professional and an employed professional

The legal exposure in connection with defective disclosure of a geologist or other professional who contracts with a company as a consultant is different from that of an employed professional.

Position of a consultant professional

If a professional involved in preparing disclosure on resources/reserves is acting as a consultant to the company, the liability of the consultant professional may arise under the Corporations Law or be (in tort) directly to the person who has suffered loss and (in contract) to the company for breach of an implied or express duty of care in the consultancy agreement.

Where a breach of contract arises from a failure to perform a contractual obligation to the required standard of duty, the breach may be termed a negligent breach and often there will be a concurrent liability in tort for negligence.

Until recently it was generally believed that in such a situation state apportionment legislation would apply to allow for a reduction of contractual damages to what the court believed was just and equitable where the plaintiff was also at fault. However, the recent decision of the High Court in *Astley v Austrust Limited* (1999) 161 ALR 155 held that contributory negligence applies only to assessment of damages in tort and has no application to contractual claims. Thus, where there is concurrent liability in contract and tort, the contractual damages will not be apportioned. The High Court also confirmed that contributory negligence may not be raised as a defence in an action for breach of contract.

The case is important for experts and advisers who wish to limit their contractual liability by reference to the negligence of the plaintiff. For example, the company retaining a professional to prepare reports may itself have been negligent in the provision of information to the professional and the professional may wish to limit his or her liability to take account of the company's contribution to the loss. Contractual damages for negligent misrepresentation will not be reduced under apportionment legislation where the defendant is sued in contract alone or in contract and tort. Only where sued in tort alone can such an expert call upon the apportionment legislation to reduce any damages award.

Consultant professionals may wish to consider inserting in their contract with the company a provision that allows apportionment of damages where the company is also negligent. This would be in addition to the cap on damages which may already be found in such a contract. Where a plaintiff opts to sue in tort for negligence to avoid such a cap or apportionment clause, any tortious damages awarded may be reduced on account of the plaintiff's contributory negligence under the apportionment legislation.

The position of an employed professional

An employed professional has a general duty to exercise reasonable care in carrying out duties for the employer. An employee also has a duty of fidelity and good faith which arises under the contract of employment, including a duty to perform the work in a competent manner and honestly and to obey lawful orders of the employer.

Where a third party suffers economic loss as a result of the negligent conduct of an employed professional during the course of his or her employment, both the professional and the employer will be liable to the person who has suffered loss. The employee is directly liable to the third party. The employer is said to be vicariously liable to the third party for the employee's conduct - even if the employer is not personally at fault. An employer would be personally at fault if it were to authorise or ratify conduct that is wrongful. By contrast, an employer is not generally liable for the act of an independent consultant or the consultant's employees.

The question of whether the relevant conduct by the employee is "in the course of employment" is often at issue in litigation. It would seem likely that a court would find that a professional who fails to exercise due care in compiling information on resources and reserves for a company report is acting "in the course of employment" such that the doctrine of vicarious liability is attracted.

An employer is generally insured against liability. While it would be rare for an employer to turn around and sue an employee who has exposed the employer to a suit for damages, it was in the past more common for an insurance company to step into the shoes of the employer and make a claim against the employee. Commonwealth legislation now protects an employee from such a suit by an insurer.

Where an employer has been sued by an injured third party on the basis that it is vicariously liable for its employee's conduct, the employee would have been liable at common law to indemnify the employer both because his or her conduct had been a breach of the duties owed under the contract of service to perform duties with reasonable care and because an employer could claim contribution from the employee under various statutes which allow contribution in respect of joint tortfeasors.

However, in New South Wales (and also in the Northern Territory and South Australia) an employer who is vicariously liable is required to indemnify the employee and cannot recover contribution or indemnity from the employee unless the employee has been guilty of serious <u>and</u> lawful misconduct.

Furthermore, if the employer is insured and the policy is one to which *The Insurance Contracts Act 1984 Cth* applies, the insurer has no right to bring the proceedings in the employer's name to recover an indemnity from the employee unless the conduct of the employee involves serious <u>or</u> wilful misconduct.

Whether negligent conduct would be regarded as serious or wilful misconduct would be a matter for the court. Reckless conduct would arguable fall within wilful misconduct. Accordingly, a professional who prepares a report recklessly without due regard to accuracy and completeness may be exposed to an action from the employer to recover from the employee personally any amount which the employer has had to pay to a third party and/or be the subject of a suit from the employer's insurer to cover that amount.

The legislation which prevents an employer from seeking an indemnity from the employee for damages paid by the employer to a third party does not prevent an employer from suing an employee for loss suffered directly by the employer as a result of the employee's negligence and, in New South Wales, neither does it protect an employee if the injured third party chooses to sue the employee directly. It is not a defence for an employee who is sued by an injured third party to assert that he or she was acting bona fide within the course of employment and on the employer's orders.

At common law, an employee had no entitlement to be indemnified by an employer in such a situation. However, Commonwealth legislation *(The Insurance Contracts Act 1984)* generally provides that in such a situation an employee is entitled to the benefit of the employer's insurance policy even though he or she is not a party to that contract of insurance.

Although an employee in a supervisory capacity is not vicariously liable for the conduct of employees under his or her supervision, a supervisor could, of course, be liable for his or her own negligence in failing to give appropriate directions or to supervise properly.

Liability under the Trade Practices Act 1974

Finally, it should be noted that directors and professionals may be liable under the *Trade Practices Act, 1974 Cth* to compensate a person who suffers loss through reliance on defective reporting (other than in the context of fundraising, takeover disclosure or securities dealings). This could occur because a company that engages in misleading and deceptive conduct in breach of the *Trade Practices Act* may be liable to pay damages to any person who suffers loss or damage as a result of the contravention (such as, for example, a purchaser of tenements) and that liability is extended to persons who are directly or indirectly knowingly concerned or party to the contravention. There is no due diligence defence available to liability under the *Trade Practices Act* for engaging in or being involved in misleading and deceptive conduct. Neither does liability require proof of intent to mislead or deceive.

CONCLUSION

Defective disclosure to the ASX may lead to liability under the Corporations Law for the company and for directors. Where such conduct by directors amounts to a breach of their statutory or common law duties, the business judgement rule recently introduced into the Corporations Law will be of limited assistance if the conduct relates to defective disclosure. However, the newly introduced provisions which allow directors to rely in certain circumstances upon employees and experts do clarify the position of directors who, without having a specialist knowledge, are perforce required to rely on the professionals reporting to them.

Defective disclosure in connection with a prospectus or takeover documents can lead to liability under the Corporations Law for the company, for directors and for employee or consultant professionals. In certain circumstances a "due diligence" defence is available.

A failure to take proper care in reporting on reserves/resources can expose those involved in such reporting to an action in negligence on the part of a person who has suffered a loss as a result of reliance on that reporting.

A consultant professional may be liable not only directly to the person who has suffered loss either in negligence or under the Corporations Law but also may be liable in contract for breach of the consultancy agreement with the company.

An employed professional has some (but not total) protection from liability for negligent reporting under the doctrine of vicarious liability and the statutory protection given by insurance legislation. An employer is vicariously liable for an employee's conduct and the employer cannot recover an indemnity or contribution from an employee in relation to any damages the employer must pay to a third party as a result of the employee's conduct unless the employee has engaged in misconduct which is both serious and wilful. An employer's insurer cannot claim against an employee for recovery of an amount paid out under a claim by a third party unless the misconduct by the employee is either serious or wilful. An employer may sue an employee for loss suffered by the employer directly as a result of the employee's conduct and a third party may also sue the employee directly, in which case it is no defence that the employee was acting on the employer's orders. In the latter situation the employee may have a statutory right to access the employer's insurance to cover any damages award against the employee.

The prohibition on misleading and deceptive conduct contained in the Trade Practices Act is a prohibition giving rise to strict liability. It is no defence to plead a lack of intent to mislead and deceive, and it is no defence to say that all due care was taken.
In summary, a director or professional who is involved in preparing material for reporting on resources/reserves should bear in mind that a failure to take all due care and to make proper disclosure either to the ASX or to investors may lead to personal liability on the part of the director or the professional in certain circumstances. Careful compliance with the JORC Code requirements and adherence to the principles which are set out in the Code for the guidance of professionals should place a professional in a position where he or she is able to assert the "due diligence" defence where that defence is available.

However, even where such a defence is not available and strict liability applies, adherence to the Code and the taking of all due care should lessen the likelihood that any act or omission will leave mining professionals or company directors exposed to legal liability.