Client Alert

September 2021

Australia: The Arrium Series (#4) - When may company officers and employees be personally responsible for representations?

In brief

The Arrium Series

Welcome to issue #4 of our **Arrium Series**, where senior members of the Baker McKenzie team involved in the successful defence of proceedings against the former CFO, former Treasurer and other former employees of the Arrium Group, consider key issues arising in those and related insolvent trading proceedings and from the judgment handed down on 17 August 2021.[1]

A summary of the relevant background to the Arrium proceedings, some key terms and the key issues to be considered in this **Arrium Series** can be found in issue #1 here, issue #2 (which considers solvency in the context of large debts due in the relatively distant future) can be found here, while issue #3 (which considers when and how duties of care may be owed to lenders) can be found here.

In this issue

Today's issue - When may company officers and employees be personally responsible for representations?

Key issues in the Lender Proceedings included whether:

- Arrium's Treasurer and Treasury and Finance team members who signed drawdown and/or rollover notices as "Authorised Officers" of Arrium entities made, and were personally responsible for, representations and warranties given to lenders by those notices.
- Arrium's CFO and Treasurer (who were also directors of Arrium borrowing subsidiaries as a requirement of their employment) were liable for inducing or procuring breaches of contract or negligence by those entities and/or had accessorial liability under the Australian Consumer Law (**ACL**) for procuring or directing, or otherwise being involved in, what was alleged to be misleading representations to lenders.

These are critical issues for every company officer or employee and of particular relevance to corporate Finance and Treasury teams.

[1] *Anchorage Capital Master Offshore Ltd v Sparkes (No 3); Bank of Communications Co Ltd v Sparkes (No 2)* [2021] NSWSC 1025

Ultimately, for the reasons discussed below, the Court found that, in all of the circumstances, neither the signatories to the notices, nor the CFO or Treasurer[2], were personally liable for the representations and warranties made and given to lenders.

Court's findings

No personal representations

In holding that the signatories to the drawdown and rollover notices had **not** personally made, nor become personally liable for, representations and warranties made and given by those notices to lenders, the Court concluded that:

- the key question was "whether, in all of the circumstances of the case, the signatories are to be understood as taking personal responsibility for the statements or whether they were merely the conduits by which those statements were made by the relevant company".
- in considering that question, it was necessary to consider "whether all of the elements of the contravention are made out against the individual" or whether they merely acted as a corporate organ, binding the company but not the person individually.
- the signatories in this case, including the Treasurer, had no particular knowledge or expertise which enabled them to form a view on the matters that were subject of the representations and warranties, such as the solvency of the Arrium Group or the complicated question of whether there had been adverse changes in financial position which had a "material adverse effect" on the capacity of Arrium entities to meet their obligations under facility agreements (a MAE)[3].
- the signatures were required as part of a contractual mechanism between the Arrium entities and the lenders under which Arrium borrowers (rather than individual signatories) were required to make representations and give warranties whereby lenders were entitled to their contractual remedies against the Arrium entities if the representations or warranties were breached.
- these facts "strongly suggested" that the representations were given by the corporate entities, not the signatories, as "the parties could not have intended that the signatories themselves were giving personal warranties concerning the absolute truth of the representations".
- also, as a matter of construction of the *pro forma* drawdown and rollover notices, the reference to "We" in the notices was a reference to the Arrium borrower seeking to rely on the notices to drawdown or rollover a loan (i.e. a "royal" we), rather than the two individuals signing the notice.
- ultimately, the individual signatories were simply fulfilling a "ministerial function", the effect of which was (assuming they occupied the position they claimed to have) that the relevant Arrium entity was conclusively bound by the relevant notice and the consequences that followed from what was contained in it.

No inducing or procuring breaches by corporate entities or accessorial liability under ACL

In holding that neither the CFO nor Treasurer were liable for inducing or procuring breaches of contract or negligence by the relevant Arrium entities or as accessories under the ACL, the Court concluded that:

[2] The plaintiffs in one of the Lender Proceedings also claimed that the Treasurer had separately made misstatements in the course of a telephone discussion with one lender. As discussed in *Arrium Series* issue #3 (which considers when and how duties of care may be owed to lenders), the Court did find that the Treasurer owed a duty of care in that instance but that the particular duty had not been breached

[3] Issue #5 of our *Arrium Series* will consider the interpretation and assessment of material adverse change and effect (MAE) provisions

- under the terms of the facility agreements, a relevant breach could only arise where a representation and warranty was untrue, incorrect or misleading and the relevant lender(s) acting reasonably considered the consequences of those circumstances constituted a MAE and those consequences were not remedied within 15 Business Days of receipt of a notice from the lender requiring that to be done, which never happened so **no** breach of contract could arise.

- even if there had been a breach of contract, the CFO and Treasurer would have had to also knowingly and intentionally induce the breach of contract, which would have at least required knowledge of the contract and sufficient of its terms to know that what the company was induced or procured to do would be in breach of contract, and there was **no** evidence that this was so.

- the Arrium entities did **not** owe lenders the duty of care which was a pre-condition to any finding of negligence (and, in turn, any liability for inducing or procuring negligence), because:

    - there is **no** duty in tort to take reasonable care to perform a contract.

    - there was **no reason to recognise a duty of care** owed by the Arrium Borrowers having regard to the "salient features" of the relationship, including where the terms of the representations and warranties, and the consequences if they were misleading, were negotiated between sophisticated parties who were quite capable of protecting their own interests (i.e. no requisite vulnerability) and there was **no** reason to overlay a quite different set of obligations and consequences on those already set out in the relevant contracts (i.e. the contract had "primacy").

- even if the Arrium borrowers owed lenders a duty of care and the representation was misleading, the claims against the CFO and Treasurer still **failed** because:

    - their conduct would need to "go beyond" causing the company to take a commercial or business course of action or directing the company's decision making, where both steps are in good faith and a reasonable expression of the discharge of a director's duties.[4].

    - it also made "little sense" to say that a director is liable if the director was sufficiently closely involved in the relevant conduct and negligently failed to appreciate that the company's conduct was negligent.

- there had also been **no misrepresentations** in any event, including because the Arrium Group had remained solvent.

- even if there had been a misrepresentation by Arrium entities:

    - in order for a person to be “knowingly concerned” in a contravention, the person must have "knowledge" of the essential facts constituting the contravention which, in this context, meant either actual (and not merely imputed or constructive) knowledge or wilful blindness to the falsity of a representation.

    - the relevant lenders failed to establish that the Treasurer had the "substantial information" that was required in order to have that knowledge and it could not be inferred from the information she did have that there had been a MA.

    - there was also "no evidence" that the CFO knew any representations amounted to a breach of any agreement or were misleading.

- the CFO was also not relevantly "concerned" with any contravention (even if there had been one) because:

    - in order for a person to be "concerned" with a contravention, there must be a sufficient "practical connection" between the person and the contravention.

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[4] citing the Full Federal Court in *JR Consulting & Drafting Pty Ltd v Cummings* (2016) 329 ALR 625; [2016] FCAFC 20 at [350]

- the Plaintiffs' claim that the CFO was "concerned" with the alleged contraventions boiled down to a claim that the CFO was involved in the contravention because, as CFO and a director of the Arrium borrowers, he bore "ultimate responsibility" for the drawing down of funds and the contents of the notices but it was **not** clear what "ultimate responsibility" was meant to mean and it was, in any event, **not** correct to say the CFO bore ultimate responsibility in any event as that rested with the Board.

- it was also **not** enough that the CFO was simply "the executive with overall responsibility for managing the financial aspects of Arrium's business under the supervision of the CEO and the Board" and the CFO would, instead, have to "personally have taken some action or fail to take some action expected of him in relation to the particular drawdown notices and the statements contained in it so that it could be said that he had a practical involvement in the making of the statements in the particular notices in question", which the Plaintiffs had not established that he did (including in circumstances where the CFO had neither prepared, reviewed, signed or delivered the relevant notices).

- even if there had been misrepresentations, it was also necessary for the plaintiffs to establish that the CFO knew the representations to be misleading (and not just facts from which that conclusion could be drawn) and it was also "not obvious" that the CFO *ought* to have formed that opinion that there was a MAE (there being no evidence that he actually had).

Ten key takeaways

In summation, the 10 key takeaways from the judgment for assessing whether a company officer or employee may be personally liable for company actions, or representations, are as follows:

1. A company officer or employee **may** be personally liable for misrepresentations or other actions even where acting in their corporate role.
2. The **key question** is whether they are to be properly understood as taking **personal responsibility** or are merely acting as the conduit (a "corporate organ") for their company.
3. In the case of statements and other representations, **relevant considerations** will include whether they were required as part of a **contract** between the company and the third party, precisely who is indicated to be making the representation, the **extent and nature of the role** played in preparing, approving and distributing representations (e.g. was it simply administrative), the **extent of their knowledge or expertise** and whether the parties could have **reasonably intended** the company officer or employee was **personally** warranting the absolute truth of representations.
4. A company officer or employee **can** potentially be liable for inducing or procuring a breach of contract by their company if they have **knowledge of the contract and sufficient of its terms** to know that what the company was induced or procured to do would be in breach of its contract.
5. Even with that knowledge, however, their conduct needs to go **beyond** simply causing the company, in good faith and in the discharge of their duties to the company, to take a commercial course of action or otherwise directing the company's decision making, even if that results in the company breaching its contract.
6. A company officer or employee **cannot** be directly liable to a third party, in negligence, for actions undertaken in the discharge of their role for the company (or at all) unless they personally owed that third party a **personal duty of care**.
7. The mere fact that the company officer or employee was acting in the discharge of their corporate duties does **not** exclude the assumption of a personal duty of care to a third party.
8. A personal duty of care **may** arise if the court is satisfied that is **appropriate** in all of the circumstances, including having regard to the f**oreseeability and nature of harm**, the **relationship** with the third party (particularly the terms of any contract), the defendant's actual or constructive **knowledge** that their conduct will cause harm, whether the impugned conduct was sufficiently personal and whether the defendant **assumed personal responsibility** (e.g. by agreeing to provide information) and whether the plaintiff reasonably relied upon the defendant's **personal knowledge or expertise**.
9. Defendant **vulnerability** (in the sense of an inability to protect against a want of reasonable care rather than only a likelihood of loss if reasonable care was not taken) is also key and the more **commercially sophisticated** a

plaintiff is, and the more **power** a plaintiff may have had to address risk through contractual arrangements (including guarantees), the less likely that plaintiff will be considered vulnerable to a want of care.

10. Courts will also be **hesitant** to impose a personal duty of care where the impugned conduct involves **purely internal-decision making**, and particularly **reluctant** where imposing a duty of care would place the company officer or employee in **conflict** with their statutory, contractual or other duties to their company.

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