From Enactment to *Mariner*: Does the Statutory Business Judgment Rule Change the 'Acoustic Separation' Between Conduct Rules and Decision Rules in Australia?

SERGIO ALBERTO GRAMITTO RICCI, Cornell Law School (Postdoctoral Associate and Adjunct Professor of Law)

JAKE MIYAIRI, University of Sydney (BA, LLB Candidate 2016)

Keywords (Four): Business Judgment Rule; Duty of Care; Acoustic Separation, Directors

FROM ENACTMENT TO *MARINER*: DOES THE STATUTORY BUSINESS JUDGMENT RULE CHANGE THE 'ACOUSTIC SEPARATION' BETWEEN CONDUCT RULES AND DECISION RULES IN AUSTRALIA?

SERGIO ALBERTO GRAMITTO RICCI[1]
JAKE MIYAIRI[2]

In the past 25 years, the Australian courts' and legislatures' endeavour to strike an appropriate balance between directors' accountability for the exercise of due care and the promotion of legitimate risk-taking has resulted in a plethora of developments in the regulation of directors' liability for breach of their duty of care. In 2000, the Commonwealth Parliament enacted a statutory business judgment rule in an attempt to further refine this balance. The express purpose of this provision was two-fold: first, to clarify and confirm the existing general law standard of review; and second, to protect directors' authority to make honest, informed and rational business decisions in order to encourage entrepreneurial decision-making.

Yet the implementation of the statutory business judgment rule in Australia poses theoretical issues, and an enduring question remains over the extent to which it has actually modified the standard of review for directors' duty of care. An examination of the efficacy of the rule is particularly timely in light of the Federal Court's decision in *Australian Securities and Investments Commission v Mariner Corporation Limited* [2015] FCA 589 — the first case in which the statutory business judgment rule has been unequivocally invoked by directors in its 15 year history.

Against this backdrop, the objective of this Conference Paper is to assess whether the statutory business judgment rule has substantially altered the 'acoustic separation' characterising the existing relationship between conduct rules and decision rules governing directors' liability for breach of their duty of care. In particular, this Conference Paper suggests that although the precise theoretical boundaries of the statutory business judgment rule and general law 'business judgment principle' differ, the practical ramifications of the 'acoustic separation' remain fundamentally unchanged.

Along these lines, this Conference Paper reflects on the extent to which the statutory business judgment rule has achieved its intended purpose of clarifying the existing standard of review while simultaneously encouraging legitimate risk-taking. An analysis of the case law reveals a fundamental tension between the intended purposes of the provision, such that the rule has created further complexity rather than granting directors greater certainty in respect of their liability.

This Conference Paper is set out in four parts. Part I traces the evolution of directors' liability for breach of their duty of care in Australia. In particular, this section examines the underlying rationales of the statutory business judgment rule and its interaction with the existing legal framework. It also introduces the paradigm of acoustic separation under which the relative theoretical and practical implications of the duty of care, general law

[1] Postdoctoral Associate and Adjunct Professor of Law, Cornell Law School.
[2] BA, LLB candidate, University of Sydney. The views expressed in this Conference Paper are personal to the author and do not necessarily reflect the views of any organisation that he is affiliated with.

business judgment principle, and statutory business judgment rule will be assessed. Part II surveys the recent cases in which the statutory business judgment rule has received judicial consideration in Australia, with a view to delineating the theoretical distinctions between the statutory business judgment rule and the general law ‘business judgment principle’ from their practical ramifications. Part III evaluates the extent to which the statutory business judgment rule achieves its intended purposes by scrutinising whether the provision improves the efficacy and clarity of the legal framework regulating corporate directors’ liability for due care. Part IV concludes.

I Evolution of Directors' Liability for Due Care in Australia

Directors' duties constitute one of the cornerstones on which corporate governance is regulated in Australia by providing human accountability for specific corporate failings.[3] Under Australian law, shareholders are granted the authority to appoint and remove directors, and the corporation entrusts its board of directors with the power to exercise independent management over the day-to-day affairs of the company.[4] As such, directors' duties are traditionally a product of the fiduciary relationship between the corporation and its board of directors, which arises from the selection process wherein shareholders may evaluate directors' personal qualities and their ability to exercise prudent and effective business judgment.[5] Within a framework of loyalty (ie good faith and trustworthiness) and due care (ie business acumen, professional skills, knowledge, and dedication), directors pursue the interests of the corporations they manage.[6] Effective management requires directors to exercise 'business judgment'. 'Business judgment' extends to the ability to mediate the interests of the constituencies —particularly those who have contributed specific investments[7]. The inherently risky nature of business decision-making entails a higher degree of vulnerability for all of the corporation's constituents or 'co-venturers' who have made specific investments — both 'equity' and 'non-equity' — in the business corporation.[8] As such, this vulnerability requires solutions under which those investors are protected against controllers' potentially harmful decisions.[9]

---

[3] As Edward (Baron) Thurlow acknowledged, a corporation itself has 'no soul to be damned and no body to be kicked': John Coffee, 'No Soul to Damn: No Body to Kick — An Unscandalized Inquiry into the Problem of Corporate Punishment' (1981) 79 *Michigan Law Review* 286, 401-2, quoting Edward Thurlow, First Baron Thurlow (1731-1806): 'Did you ever expect a corporation to have a conscience, when it has no soul to be damned, and no body to be kicked?'; see also *Comptroller-General of Customs v D'Aquino Bros Pty Ltd* (1996) 85 A Crim R 517; *Australasian Temperance & General Mutual Life Assurance Society Ltd v Howe* (1992) 31 CLR 290, 334. Directors duties are one means of providing human accountability where losses are sustained by the corporation as a result of the directors' conduct: Kane Loxley, '"Unashamedly More Interventionist" Courts and the Fading Significance of a Director's State of Mind' (2014) 32 *Company and Securities Law Journal* 486.

[4] It is a replaceable rule that directors are entrusted with the power to exercise all of the powers of the corporation, except those required by the *Corporations Act 2001* (Cth) or the company's constitution (if any) to be carried out by the shareholders in general meeting: *Corporations Act 2001* (Cth) s 198A. Under a replaceable rule, shareholders have the power, by default, to appoint directors under s 201G of the *Corporations Act 2001* (Cth). Sections 203C–203D of the *Corporations Act 2001* (Cth) provide shareholders with the power to remove directors by ordinary resolution in proprietary corporations and public corporations respectively. Unlike s 203C, s 203D is a mandatory rule that applies notwithstanding anything contained in the company's constitution or in any agreement between the corporation, its members and its directors.

[5] Sergio Alberto Gramitto Ricci, *Assessing Shareholders' Personal Qualities: Intuitus Personae, Implications for Corporate Governance and Policies* (PhD Thesis, Bocconi University, 2015) 197. Many directors' duties are now imposed under the *Corporations Act 2001* (Cth). Nevertheless, these duties traditionally arose from the director's position as a fiduciary, even though — as will be discussed below — it appears that not all of these duties were 'fiduciary duties' per se: see L C B Gower, *The Principles of Modern Company Law* (Stevens and Sons, 3rd ed, 1969) 516–7, 549–51.

[6] See Gower, above n 5. For an analysis on how board-controlled public business corporations can shift wealth from the present to the future and from the future to the present, see Lynn A Stout, 'The Corporation As Time Machine: Intergenerational Equity, Intergenerational Efficiency, and the Corporate Form' (2015) 38 *Seattle University Law Review 685*.

[7] Margaret M Blair and Lynn A Stout, 'A Team Production Theory of Corporate Law' (1999) 85 *Vanderbilt Law Review* 247, 298.

[8] Ibid. See also Gramitto Ricci, above n 5, 30; Raghuram G Rajan and Luigi Zingales, 'Power in a Theory of the Firm', (1998) 113 *Quarterly Journal of Economics* 387, 442.

[9] Blair and Stout, above n 7.

The traditional measure protecting the corporation and its constituents is an initial and ongoing assessment of the personal qualities of controllers, via the process of appointment and removal. However, the increased separation between the ownership and control of corporations poses sizeable agency costs.[10] Moreover, the sustainable growth of corporations requires both a process of controller selection and a sound framework of controllers' liability.[11] Hence, the evolution of corporate governance regulation has placed an increasing focus on the liability imposed on directors through their duties to the corporation.

Since the control rights over corporations are centralized and delegated, directors' duties broadly correspond with the two main risks faced by the legal entity and those who contributed specific investments: foolish and knavish management.[12] Shareholders and other specific-investors relinquish their rights to control the decisions of the corporate entity to the board of directors. Though centralized decision-making is an inherent corporate feature, directors may be active, but not in pursing the interests of the corporation; or may be shirking or incompetent.[13] Directors' liability for their exercise of due care can thus be seen as a core mechanism for holding them accountable to the corporation — particularly in protecting specific investors' increased vulnerability for shirking. In order to elaborate on this concept, a brief historical overview of the framework governing directors' liability for the exercise of care will be given — first, in the context of the duty of care itself; and second, in relation to the general law 'business judgment principle' and statutory business judgment rule.

In order to consider how the duty of care, the general law business judgment principle and the statutory business judgment rule interact to determine directors' liability, it is first useful to introduce the concept of 'acoustic separation'. Melvin Eisenberg famously distinguished between standards of conduct and standards of review in the regulation of corporate governance.[14] Jennifer G Hill and Julie Cassidy have more recently applied this distinction in the Australian context.[15] Under this paradigm, a standard of conduct (or 'conduct rule') states a normative standard to which an actor should aspire.[16] A standard of review (or 'decision rule') states the standard at which actual liability is imposed on the actor.[17] In the present context, the conduct rule is the standard of care purportedly required of directors, while the decision rules are those rules under which liability for non-

---

[10] See, eg, John E Parkinson, *Corporate Power and Responsibility: Issues in the Theory of Company Law* (Clarendon Press, 1993) 51–74.
[11] See Gramitto Ricci, above n 5, 199.
[12] Blair and Stout, above n 7.
[13] Paul L Davies, *Gower and Davies: Principles of Modern Company Law* (Sweet and Maxwell), 8th ed. (2008) 488.
[14] Melvin Eisenberg, 'The Divergence of Standards of Conduct and Standards of Review in Corporate Law' (1993) 62 *Fordham Law Review* 437. See also Meir Dan-Cohen, 'Decision Rules and Conduct Rules: on Acoustic Separation in Criminal Law' (1983) 97(3) *Harvard Law Review* 625 who introduced the concept of 'acoustic separation' in the context of criminal law.
[15] Jennifer G Hill, 'Evolving Directors' Duties in the Common Law World' in Adolfo Paolini (ed), *Research Handbook on Directors' Duties* (Edward Elgar, 2014) 3, 4; Julie Cassidy, 'Standards of Conduct and Standards of Review: Divergence of the Duty of Care in the United States and Australia' 28 *Australian Business Law Review* 180. Hill uses the phrase 'acoustic separation' to refer to the divergence between conduct and decision rules, whereas Dan-Cohen uses to term metaphorically to refer to the 'acoustic separation' between the conduct of the general public and the decisions of officials with respect to the general public where each of these groups occupies separate 'acoustically sealed chambers': Dan Cohen, above 14, 630. We adopt the term in the former sense.
[16] Cassidy, above n 15, 180, citing Eisenberg, above n 14, 437, 462.
[17] Ibid.

compliance with those standards of conduct is assessed when the relevant behaviour is challenged. The abstract void between conduct rules and decision rules constitutes the 'acoustic separation.'[18]

A *THE EVOLUTION OF THE CONDUCT RULE REGULATING DIRECTORS' LIABILITY FOR DUE CARE*

As was discussed above, directors' duty to exercise care, skill and diligence is a core element in the fiduciary relationship vis-à-vis the corporation.[19] As such, it must hold directors sufficiently accountable to the corporation and its constituents for the exercise of due care, while also permitting adequate scope for entrepreneurial risk-taking.[20] In Australia, directors' duty of care has been increasingly heightened at both a judicial and legislative level.[21] This evolution reflects an attempt to refine the balance between due care and entrepreneurial risk-taking in light of changing community perceptions about the role of directors in society.[22]

---

[18] Hill, above n 15, 4; Cassidy, above n 15, 180.

[19] The expression 'duty of care' will be used to encompass concepts of 'care' 'skill' and 'diligence'. The difference in terminology appears to no longer be of any legal consequence: Greg Golding, 'Tightening the Screw on Directors: Care, Delegation and Reliance' [2012] 35(1) *University of New South Wales Law Journal* 266, 266. An intriguing uncertainty remains over whether this equitable duty of care can properly be characterized as fiduciary in Australia. The duty certainly arises by virtue of the directors' fiduciary status, but this does not necessarily entail that the duty is itself fiduciary: *Permanent Building Society v Wheeler* (1994) 11 WAR 187, 237; *Bristol and West Building Society v Mothew* [1998] Ch 1, 17 (per Millet LJ); John H Farrar, 'Duties of Care — Issues of Classification, Solvency and Business Judgment and the Danger of Legal Transplants' (2011) 23 *Singapore Academy of Law Journal* 745, 749; LexisNexis, *Ford, Austin and Ramsay's Principles of Corporate Governance* (at 23 November 2015) [8.320.6]. For instance, the equivalent duty of reasonable care owed by a trustee to a beneficiary is not regarded as fiduciary: *Permanent Building Society (in liq) v Wheeler* (1994) 11 WAR 187, 238. By analogy, the dominant position in Australia, the United Kingdom and Canada is that the director's duty of care in equity is not a fiduciary obligation, but rather a *sui generis* equitable obligation: *Permanent Building Society (in liq) v Wheeler* (1994) 11 WAR 187, 238; 14 ACSR 109 (Ipp J, Malcolm CJ and Seaman J agreeing); approved in *O'Halloran v RT Thomas & Family Pty Ltd* (1998) 45 NSWLR 262, 274 (Spigelman CJ, Priestley and Meagher JJA agreeing); *Bell Group Ltd (in liq) v Westpac Banking Corp (No 9)* (2008) 70 ACSR 1, 232; W M Heath, 'The Director's 'Fiduciary' Duty of Care and Skill: a Misnomer' (2007) 25 *Corporate and Securities Law Journal* 370, 370–1. On the other hand, Lee J in the *Bell Appeal* and J D Heydon in an extracurial paper, have both advocated the contrary opinion: J D Heydon, 'Are the Duties of Company Directors to Exercise Care and Skill Fiduciary' in Simone Degeling and James Edelman (eds), *Equity in Commercial Law* (LBC, 2005) 185; *Westpac Banking Corporation v Bell Group Ltd (in liq) (No 3)* (2012) 44 WAR 1, 155 [845], 164 [886], 165 [895]. Although the weight of authority is against this view, a decisive resolution may only be reached when the matter is considered by the High Court: see *Australian Securities and Investments Commission v Rich* (2009) 236 FLR 1, 611('*Rich*') where Austin J left this for determination at appellate level.

[20] See Gramitto Ricci, above n 5, 199.

[21] See, eg, *Morley v Statewide Tobacco Services Ltd* [1993] 1 VR 423; *Group Four Industries Pty Ltd v Brosnan* (1992) 59 SASR 22; *Commonwealth Bank v Friedrich* (1991) 5 ACSR 115; *Rema Industries and Services Pty Ltd v Coad* (1992) 107 ALR 374; *AWA Ltd v Daniels* (1992) 7 ACSR 463; *AWA Ltd v Daniels* (1992) 7 ACSR 759; *AWA Ltd v Daniels* (1992) 9 ACSR 383; *Daniels v Anderson* (1995) 37 NSWLR 438 ('*AWA Appeal*'); *Australian Securities and Investments Commission v Rich* (2003) 174 FLR 128 ('*Greaves*'); *Re HIH Insurance; Australian Securities and Investments Commission v Adler* (2002) 168 FLR 253; *Deputy Commissioner of Taxation v Clark* (2003) 57 NSWLR 113; *Australian Securities and Investments Commission v Healey* (2011) 196 FCR 291 ('*Centro*'); *Australian Securities and Investments Commission v Fortescue Metals Group Ltd (No 5)* (2009) 264 ALR 201; *Australian Securities and Investments Commission v Fortescue Metals Group Ltd* (2011) 190 FCR 364; *Australian Securities and Investments Commission v Macdonald (No 11)* (2009) 256 ALR 199; *Morley v Australian Securities and Investments Commission* (2010) 274 ALR 205; *Australian Securities and Investment Commission v Hellicar* [2012] HCA 17; Golding, above n 19.

[22] In a forthcoming article Goshen and Hamdani argue that the idiosyncratic vision of 'entrepreneurial' shareholders should be protected by the business judgment rule. According to the Authors, controlling

1 *Directors' Duty of Care in Equity*

Directors' obligations to exercise care, skill and diligence in the performance of their duties first originated in the exclusive jurisdiction of equity. The equitable duty of care predated the development of the modern law of negligence in *Donoghue v Stevenson*,[23] and assessed the liability of directors by reference to their subjective knowledge and skills.[24] The resulting standard has been described by commentators as 'ridiculously' or 'comically' low,[25] and is definitively summarised by Romer J's four propositions in *Re City Equitable Fire Insurance Co* listed under the following headings.[26]

(i) *Subjective Test of Skill*

First, a director was not required to exhibit a greater degree of skill than might reasonably be expected from a person of the director's knowledge and experience.[27] In other words, a director's liability was determined on what they knew, rather than what they ought to have known, and what they did, rather than what they ought to have done.[28] The leniency of this standard is vividly illustrated by several 19th Century cases. For example, in *Re Denham* & Co a 'country gentleman' was held not to be liable for failing to detect fraud in the chairman's accounts because he could not reasonably be expected to possess sufficient accounting skills in order to do so.[29] Likewise, in *Re Brazilian Rubber Plantations and Estates* the directors of a rubber company were relieved from liability for serious financial losses sustained by a poor investment because they had no knowledge of the industry.[30] In disposing the case, Neville J held:

> [A director] is, I think, not bound to bring any special qualifications to his office. He may undertake the management of a rubber company in complete ignorance of everything connected with rubber, without incurring responsibility for the mistakes which might result from such ignorance[.][31]

Thus, as Parsons once stated, the equitable standard of care appeared content to 'ask

---

shareholders can be the decision-making fiduciary of the corporation and that the law should recognise the non-board controllers' decisions under the same legal framework regulating the board controllers' decisions. See Zohar Goshen & Assaf Hamdani, 'Corporate Control and Idiosyncratic Vision', *Yale Law Journal* (forthcoming 2016). We take issue with the business judgment rule protection of non-board controllers' decisions, but agree that the idiosyncratic vision of controllers must be protected by the law. The argument is twofold. First, directors decisions ought be protected from shareholders' pressure to pursue investors' goals interfering with the interest of the corporation itself. Second, the decision-making model of corporate entities requires delegated and centralised management: the will of the corporation inherently corresponds with the vision of a loyal and careful board of directors. Blair and Stout, above n 7; Lynn A Stout, *The Shareholder Value Myth: How Putting Shareholders First Harms Investors, Corporations, and the Public* (Berrett Keohler Publications, 2012). See also Gramitto Ricci, above n 5.

[23] [1932] AC 562.

[24] See *Re City Equitable Fire Insurance Co* [1925] Ch 407.

[25] Golding, above n 19, 268; Phillip Lipton and Abe Herzberg, *Understanding Company Law* (LBC, 9th ed, 2000) 299; Parkinson, above n 10, 98. See also M J Trebilcock, 'Liability of Company Directors for Negligence (1969) 32 *The Modern Law Review* 499.

[26] [1925] Ch 407. Parkinson, above n 10, 98.

[27] *Re City Equitable Fire Insurance Co* [1925] Ch 407, 428–9.

[28] *AWA Appeal* (1995) 37 NSWLR 438, 495.

[29] (1884) 25 Ch D 752. A persuasive additional explanation for the courts' decision is that the directors probably would not have discovered the fraud had they made the relevant inquiries: Paul L Davies, *Gower's Modern Company Law* (Sweet and Maxwell, 6th ed, 1997) 644.

[30] *Re Brazilian Rubber Plantations and Estates Ltd* [1911] 1 Ch 425, 437.

[31] Ibid.

of a director that he do only as much as one might fairly expect of someone as stupid and incompetent as the director happens to be.'[32]

(ii) *Periodic Attention*

Second, directors were not required to give continuous attention to the affairs of the corporation.[33] A particularly extreme example is *Re Cardiff Savings Bank* ('*Marquis of Bute's Case*').[34] In that case, the president and director of a bank appointed at six-months of age had attended only one board meeting in 38 years. He was excused from liability for bank fraud because he had no notice of the irregularities in the company's affairs by virtue of his non-attendance. In relieving the director from liability, the court noted that 'neglect or omission of a duty is not the same thing as neglect or omission of a duty which ought to be performed at those meetings.'[35] The position was therefore that *if* a director chooses to attend a board meeting, 'it is their duty to be awake and their being asleep would not exempt them from the consequences of not attending to the business of the company.'[36] On the evidence of *Marquis Bute's Case*, however, it appears as though non-executive directors would not breach this principle if they simply stayed asleep at home and did not attend the board meeting.[37] This is largely because it will be difficult to demonstrate that a non-executive director's non-attendance caused any loss to the corporation. As such, the lower the responsibilities of director within the corporation, the lower their duty of care.[38] Thus, as Sir Douglas Menzies noted,[39] the most effective way for non-executive directors to escape liability appeared to be avoiding board meetings altogether.[40]

(iii) *Delegation and Reliance*

Third, directors were entitled to rely on the judgment, information and advice of other officers or experts in the absence of grounds for suspicion.[41] Thus, directors did not bear a positive obligation to actively supervise management, and were permitted to broadly delegate the day-to-day administration of the business corporation to other officers and managers.[42] Directors' broad latitude for reliance is illustrated in *Dovey v Corey* where it was said:

> It was the duty of the general manager and (possibly) of the chairman to go carefully through the returns from the branches, and to bring before the board any

---

[32] Ross W Parsons, 'The Director's Duty of Good Faith', 5(4) *Melbourne University Law Review* 395, 395.
[33] *Re City Equitable Fire Insurance Co* [1925] Ch 407, 429.
[34] [1892] 2 Ch 100.
[35] Ibid, 109.
[36] *Re City Equitable Fire Insurance Co* [1925] Ch 407, 428.
[37] This is largely because it will be difficulty to demonstrate that a non-executive directors' non-attendance was the cause of any loss to the corporation: *Barnes v Andrews* (1924) 298 F 614.
[38] Gower, above n 5, 551.
[39] Douglas Menzies, 'Company Directors' (1959) 33 *Australian Law Journal* 156, 156–8.
[40] See also Gower, above n 5, 51:

> As in other walks of life, if anything goes wrong there are great advantages in "not being there." The director who stays away runs the risk of not being reappointed for what is done in his absence. Here, as throughout this branch of law, questions of causation are of paramount importance; if a director is party to a decision to take a particular course of action it may be possible to show that this led directly to loss by the company, but it will be next to impossible to show that his laziness was the cause of the damage or that the action would have been different had he attended.

[41] *Re City Equitable Fire Insurance Co* [1925] Ch 407, 429. See also *Australian Securities Commission v Gallagher* (1993) 11 ACLC 286, 10 ACSR 43.
[42] Gower, above n 5, 552.

> matter requiring their consideration; but the [director] was not, in my opinion, guilty of negligence in not examining them for himself.[43]

(iv) *Bare Minimum Objective Requirement*

Lastly, Romer J listed a fourth — often overlooked — proposition whereby a director acting in good faith would not be held liable in the absence of gross or culpable 'negligence'.[44] This bare minimum objective requirement was expressed to be in addition to his Honour's three better-recognised propositions.[45] Nevertheless, either because of a misreading of the case,[46] or a view that the fusion of the four propositions has led the subjective elements to overshadow the objective component,[47] the equitable standard has widely been taken to impose a subjective test.[48]

The low level of liability imposed upon directors under the equitable duty of care was underpinned by a number of historical considerations. First, the subjective equitable standard of care distinguished between the roles that executive and non-executive directors played within the corporation and tailored their liability accordingly. The overwhelming majority of cases in which the matter was addressed considered the liability of non-executive directors. At the time, non-executive directors generally performed their duties without remuneration, and their greatest contribution to the corporation was viewed as lending their name and social connections to the board.[49] Accordingly, non-executive directors were frequently treated as 'window-dressing', with 'good breeding often being a more important ground for selection than business acumen.'[50] Courts were, therefore, reticent to impose liability on non-executive directors by reference to their degree of commercial skill and knowledge. In other words, the low standard reflected the courts' reluctance to deter individuals from taking the office of a non-executive director when their contributions — albeit not in the nature of business acumen or expertise — were nonetheless valuable to the corporation. On the other hand, executive directors were often full-time employees and were generally remunerated for the commercial skills they brought to their office.[51] Accordingly, they were subject to both a higher subjective equitable standard, as well as a more stringent objective duty under the law of contract.[52]

---

[43] [1901] AC 477.
[44] *Re City Equitable Fire Insurance Co* [1925] Ch 407, 427.
[45] Andrew Hicks, 'Director's Liability for Management Errors' (1994) 110 *Law Quarterly Review* 390, 392.
[46] See, eg, Birds et al, *Boyle & Birds' Company Law* (Jordans, 7th ed, 2009) 601.
[47] S Fisher, 'Australia – Reform of the Duty of Care and Diligence of Directors in Australia' (1993) 14 *The Company Lawyer* 145, 146.
[48] Demetra Arsalidou, *The Impact of Modern Influences on the Traditional Duties of Care, Skill and Diligence of Company Directors* (Kluwer Law International, 2001) 45.
[49] Parkinson, above n 10, 102; Stephen Girvin, Sandra Frisby and Alastair Hudson, *Charlesworth's Company Law* (Sweet and Maxwell, 18th ed, 2010) 337.
[49] Since their role was not viewed as a profession in its own right, non-executive directors were treated analogously to non-professional trustees or agents: Parkinson, above n 10, 101–2. The duties of trustees and agents to exercise care in making financial investments was determined by a subjective test: *Re Whitely* (1886) 33 Ch D 347, 355. A non-professional agent was similarly required only to exercise 'such skill and care as persons ordinarily exercise in their own affairs': F M B Reynolds, *Bowstead on Agency* (Sweet and Maxwell, 15th ed, 1985) 152, although a contractual agent must adhere to a higher standard: G H L Fridman, *Law of Agency* (Butterworth and Co, 6th ed, 1990) 142–7.
[50] Parkinson, above n 10, 102.
[51] See, eg, Gower, above n 5, 550.
[52] See, eg, Parkinson, above n 10, 98–9.

Second, the equitable standard of care reflected the view that shareholders ought to bear ultimate responsibility for managerial decision-making by virtue of their ability to appoint and remove directors. Due to the fact that most companies were closely held at the time, shareholders were viewed as being in a position to exercise a genuinely informed decision about the personal qualities of directors (including their trustworthiness, business acumen, knowledge, and dedication).[53] In other words, courts of equity were content to hold directors to the level of skill and acumen they actually possessed, since this was something that shareholders could evaluate and oversee. Consequently, if a director did not exercise the anticipated degree of care, this was viewed as the shareholders' failure to adequately oversee management via their powers of appointment and removal. As Davies puts it, 'if the directors chose incompetent directors, that was their fault and the remedy lay in their hands.'[54] This is clearly illustrated in *Turquand v Marshall* where — in holding that the directors were not liable for an imprudent corporate loan made to an insolvent director, the court stated that '[h]owever ridiculous and absurd the conduct of directors, it was the misfortune of the company that they chose such unwise directors.'[55]

Third, the equitable standard of care demonstrates the long-standing reluctance of courts to 'second-guess' the business decisions of management with the benefit of hindsight.[56] This concept will be discussed at length under the label of 'the general law business judgment principle'.[57]

2 *The Duty of Care in Common Law*

(i) *Contractual Standard of Care*

Even by the standards of the time, the equitable standard of care was arguably inappropriate for executive directors who were generously remunerated for the commercial expertise they were expected to bring to the corporation. As such, a duty to exercise *reasonable* care was imposed on executive directors via an express or implied term of their service contract with the corporation. The contractual standard of care was that which could reasonably be expected of a person who occupied the same office as the

[53] Ville and Merrett have argued that Australian corporations in the early to mid 20th century could be labeled as 'family capitalism', under which the founders could control the majority of corporations through their dual managerial and shareholding positions. Only one third of Australian corporations during this period could be described as 'management controlled': S Ville and D Merrett, '*The Development of Large Scale Enterprise in Australia, 1910–1964*' 43 *Business History* 1, 13–46. Although it must be acknowledged that collective action problems and rational apathy pose an issue in exercising their power, from a theoretical standpoint, shareholders retain the capability to assess, select and appoint directors also in public corporations. See Gramitto Ricci, above n 5.

[54] Davies, above n 13, 488.

[55] *Turquand v Marshall* (1869) LR 4 Ch App 376, 386. In fact, this principle dates as far back as Phaedrus' renowned fable 'The Cow, the Goat the Sheep, and the Lion' in which he warns that if a person entrusts 'a lion' with the power to harm them, they have only themselves to blame. The fable is as follows. 'A cow, a goat and a patient sheep were partners with a lion in the forest. Joining together and having taken a large stag, they divided it into parts and over such shares, the lion spoke to them, "I take the first portion because I am named the lion and addressed as king; the second portion, you will assign to me, since I am your partner; then, because I am stronger, the third will follow to me; and an accident will result, if anyone touches the fourth." Thereby the ruthless lion carried off the whole prey for himself': Phaedrus, 'The Cow, the Goat, the Sheep, and the Lion', in Ben Edwin Perry (ed), *Barbrius and Phaedrus* (Harvard University Press, 1965) 199, 199. See Gramitto Ricci, above n 5.

[56] See Gower, above n 5, 550.

[57] At p 15–19.

director in question.[58] The higher standard of care imposed under contract generally had no relevance to non-executive directors who were performing their duties without remuneration and, by extension, a service contract. Thus, it can be surmised that a director's level of liability was largely dependent on the terms of their appointment and remuneration. If a director were appointed to exercise commercial acumen and expertise in the management of the corporation, they would generally be remunerated for the performance of their duties under a service contract. Accordingly, they would be held to their own subjective ability, skill and professionalism (including any relevant commercial expertise and knowledge) as well as to a heightened standard of care under contract.[59] By contrast, non-executive directors often had no serious role to play in the commercial activities of the corporation, and were correspondingly held only to their (usually) limited level of commercial ability and not to the contractual standard of liability.

(ii) *Standard of Care in Negligence*

The existing standard of care came under increasing scrutiny in Australia in the wake of a number of 'spectacular' corporate collapses in the 1980s,[60] with numerous calls to adopt a more objective standard of care across the board.[61] By this stage, companies were much larger, their business more complex, and their shareholders more numerous.[62] *Daniels v Anderson* (1995) 37 NSWLR 439 ('the *AWA Appeal'*) was the landmark decision in which these changed community standards were directly implemented through the recognition of an unequivocally objective duty of care applicable to *all* directors under the common law of negligence.

In the *AWA Appeal*,[63] the majority of the New South Wales Court of Appeal (Clarke and Sheller JJA) rejected the 'subjective' equitable standard of care, noting that 'neither the law about the duty of directors nor the law of negligence has stood still in the seven years since the decision in *Re City Equitable Fire Insurance Co*'. Clarke and Sheller JJA

---

[58] *Lister v Romford Ice and Cold Storage Co Ltd* [1957] AC 555; LexisNexis, *Ford, Austin and Ramsay's Principles of Corporate Governance* (at 23 November 2015) [8.320.3].

[59] See *National Mutual Life Nominees Ltd v Worn* (1990) 5 NZCLC 66, 406 (Henry J):

> The standard of care to be exercised by a director has been said as being to exhibit the degree of care reasonably to be expected from a person of his knowledge and experience. I would add that the standard is to be assessed by also having regard to the circumstances pertaining to the responsibilities which the director has have undertaken . . . [the directors in the present case] were all knowledgeable and experienced business people, sufficiently versed in the general ramifications of [the company's] operations.

[60] See, eg, the collapse of Trustees, Executors and Agency Co Ltd — the first failure of an Australian trustee company in the country's history, and the subsequent corporate scandals enveloping Rothwell Ltd, Bond Corporation; Tricontinental, Partnership Pacific and Elders Finance; and Pyramid Building Society: Bernard Mees and Ian Ramsay, 'Corporate Regulators in Australia (1961–2000): From Companies' Registrars to the Australian Securities and Investments Commission' (Legal Studies Research Paper No 335, Centre for Corporate Law and Securities Regulation, University of Melbourne, 2008) 32, 44.

[61] Both the *National Companies Bill 1976* (Cth) and the first draft of the *Companies Bill 1981* (Cth) had anticipated an objective duty of care. This approach was also endorsed by the Cooney Report: Senate Standing Committee on Legal and Constitutional Affairs, Parliament of Australia, *Company Directors' Duties: Report on the Social and Fiduciary Duties and Obligations of Company Directors* (1989) ch 3; and the Lavarch Report: House of Representatives Standing Committee on Legal and Constitutional Affairs, Parliament of Australia, *Corporate Practices and the Rights of Shareholders* (1991): see Golding, above n 19, 269, note 14.

[62] Jim F Corkery, *Directors' Powers and Duties* (Longman Cheshire, 1987) 132.

[63] *AWA Appeal* (1995) 37 NSWLR 439, 497. This was a clear reference to the development of the modern law of negligence in *Donoghue v Stevenson* [1932] AC 562 seven years after the decision of *Re City Equitable Fire Insurance Co* [1925] Ch 407.

continued by holding that the common law of negligence could be adapted to impose an objective duty of care on directors to exercise a *reasonable* degree of care in the performance of their functions.[64] The standard of care imposed under the common law in light of the *AWA Appeal* and subsequent cases can be summarised as follows.[65] First, there is now a core, irreducible requirement for directors to take 'all reasonable steps to place themselves in a position to guide and monitor the company'.[66] Second, this bare minimum requirement is assessed by reference to the care, skill and diligence that a reasonable person would exercise in like circumstances.[67] Third, the extent of this objective duty depends on the specific circumstances of the case including: the size and business of the corporation, its particular governance structure, and the experience or skills the director represented themselves as having in support of their appointment to office.[68] Fourth, the director must familiarise themselves with the fundamentals of the corporation's business and — unlike the previous equitable standard — it is no defence that they lack the knowledge needed to discharge the requisite degree of care.[69] Fifth, directors are under a continuing obligation to remain informed about the activities of the corporation and oversee those activities.[70] Sixth, directors are required to maintain a familiarity with the financial status of the corporation by regularly reviewing and understanding the corporation's financial statements.[71] Seventh, the harm that might be caused by a potential breach must be balanced against the potential benefits that could be reasonably expected to accrue to the corporation from such conduct.[72] Finally, executive and non-executive directors are required to discharge the same duty and standard of

---

[64] *AWA Appeal* (1995) 37 NSWLR 439, 504. Their Honours stated that 'this means conduct ordinarily measured by reference to what the reasonable man of ordinary prudence would do in the circumstances', emphasising that:

> skill is that special competence which is not part of the ordinary equipment of the reasonable man but the result of attitude developed by special training and experience, which requires those who undertake work calling for special skill not only to exercise reasonable care but measure up to the standard of proficiency that can be expected from persons undertaking such work . . . As the law of negligence has developed no satisfactory policy ground survives for excluding directors from the general requirement that they exercise reasonable care in the performance of their office. A director's fiduciary obligations do not preclude the common law duty of care. Modern statutory company law points to the existence of the duty. In some circumstances the duty will require action. The concept of a sleeping or passive director has not survived and is inconsistent with the requirements of current company legislation such as, at the relevant time, s 229 and s 269 of the *Companies (New South Wales) Code*.

[65] The following summary is heavily indebted to Greg Golding: see Golding, above n 19, 269.

[66] *Deputy Commissioner of Taxation v* Clark (2003) 57 NSWLR 113, 140. See also *AWA Appeal* (1995) 37 NSWLR 439, 504.

[67] *AWA Appeal* (1995) 37 NSWLR 439, 504.

[68] *AWA Appeal* (1995) 37 NSWLR 439, 505; *Centro* (2011) 196 FCR 291, 320. For the liability placed on a director that is also the chairperson, chief executive officer, and company secretary see *Australian Securities and Investments Commission v Rich* (2004) 50 ACSR 500, 508–9 (White J); *Australian Securities and Investments Commission v Vines* (2005) 55 ACSR 617, 857–8; *Shafron v Australian Securities and Investments Commission* [2012] HCA 18, [20] respectively.

[69] *Australian Securities and Investments Commission v Rich* (2004) 50 ACSR 500, 508–9 (White J); *AWA Appeal* (1995) 37 NSWLR 439, 504–5, quoting *Francis v United Jersey Bank* 432 A 2d 814 (NJ 1981) 503.

[70] *AWA Appeal* (1995) 37 NSWLR 439, 504–5, quoting *Francis v United Jersey Bank* 432 A 2d 814 (NJ 1981).

[71] *AWA Appeal* (1995) 37 NSWLR 439, 503–4, quoting *Francis v United Jersey Bank*, 432 A 2d 814 (NJ 1981); *Centro* (2011) 196 FCR 291, 298.

[72] *Australian Securities and Investments Commission v Mariner Corporation Limited* [2015] FCA 589, [450] ('*Mariner*'); *Vrisakis v Australian Securities Commission* (1993) 9 WAR 395, 448–51; *Australian Securities and Investments Commission v Doyle* (2001) 38 ACSR 606, 641 (Roberts-Smith J); *Australian Securities and Investments Commission v Rich* (2009) 236 FLR 1, 129.

care.[73]

The objective standard in negligence first adopted in the *AWA Appeal* therefore represented a 'quantum shift' in the standard of conduct to which directors are held in Australia,[74] finally coagulating the increasing sentiment of the courts that the days of the 'sleeping director' were over.[75] The imposition of one standard and duty of care for all directors was a radical divergence from the equitable standard of care. This was of particular significance to non-executive directors who would no longer be held to a manifestly lower standard than executive directors. The message from the courts was clear — as Clarke JA declared, 'the concept of the sleeping or passive director has not survived' and is inconsistent with the contemporary regulation of corporate governance.[76]

3 The *Statutory Duty of Care*

These developments in the common law were also mirrored by a number of contemporaneous statutory enactments. The first British Commonwealth jurisdiction to implement a statutory duty of care was Victoria in 1958 with s 107 of the *Companies Act*.[77] This provided the basis for uniform company legislation in each state and territory in Australia shortly thereafter,[78] which stated that 'a director shall at all times act honestly and use reasonable diligence in the discharge of the duties of his office.'[79] Even though this provision could have been construed as imposing a solely objective standard of care, it was instead interpreted as restating the test in *Re City Equitable Insurance Co.*[80]

This provision was subsequently replaced by s 229(2) of the *Companies Act 1981* (Cth), which stipulated that 'an officer of a corporation shall at all times exercise a reasonable degree of care and diligence in the exercise of his powers and the discharge of his duties.' Notwithstanding the similarity of the wording of this section with its predecessor, the way in which the courts began to construe the provision evidenced an increasing strengthening of the standard of care — particularly in the context of insolvent trading cases.[81] In the 1988 case of *Metal Manufacturers Ltd v Lewis*,[82] Kirby P (in dissent) argued that directors' statutory duties required 'higher levels of attention to the

---

[73] *Centro* (2011) 196 FCR 291, 298. See also *AWA Appeal* (1995) 37 NSWLR 438, 503.
[74] Golding, above n 19, 268.
[75] See *Naffai v Haines* (Unreported, NSW Supreme Court, Rogers AJA, 26 November 1991. For seminal cases considering the statutory liability of non-executive directors' for insolvent trading see *Morley v Statewide Tobacco Services Ltd* [1993] 1 VR 423; *Group Four Industries Pty Ltd v Brosnan* (1992) 59 SASR 22; *Commonwealth Bank v Friedrich* (1991) 5 ACSR 115; *Rema Industries and Services Pty Ltd v Coad* (1992) 107 ALR 374; *Deputy Commissioner of Taxation v Clark* (2003) 57 NSWLR 113.
[76] *AWA Appeal* (1995) 37 NSWLR 439, 504.
[77] *Companies Act 1958* (Vic).
[78] *Companies Act 1961* (Vic); *Companies Act 1961* (NSW); *Companies Act* 1961 (WA); *Companies Act 1961* (Qld); *Companies Act 1962* (Tas); *Companies Act 1962 (*SA); *Companies Ordinance 1962* (ACT): *Companies Ordinance 1963* (NT).
[79] See, eg, *Companies Act 1961* (NSW) s 124(1).
[80] Arsalidou, above n 49, 450.
[81] These cases primarily concerned the interpretation and application of s 556 of the *Companies Act 1981* (Cth) (later re-enacted as s 592 of the *Corporations Act 1989* (Cth)). Section 592 did not specifically relate to directors' duty of care. Instead, it imposed liability on directors and officers where the corporation incurred debts in circumstances where there were reasonable grounds to expect that the corporation was insolvent. Sub-section (2) provided directors a defence if they could prove that they reasonable believed the corporation was solvent at the relevant time and would continue to be so after incurring the debt in question *or* if the debt was incurred without the directors' express or implied authority or consent.
[82] (1988) 13 NSWLR 315, 319.

affairs of the corporation and its dealings with the outside world than was the case in the past' — in particular, by requiring even non-executive directors to remain informed about the financial affairs of the corporation. This judgment was subsequently applied two years later in *Statement Tobacco Services Ltd v Morley*,[83] where a non-executive director was held liable for a debt of $165,000 incurred by the corporation when it was insolvent. The director in question had never taken part in the day-to-day management of the corporation and had little knowledge of the corporation's affairs. In stressing that directors' obligations had become more onerous, Ormiston J stated:

> '[a] director should not in those circumstances be entitled to hide behind ignorance of the company's affairs which is of his own making . . . or has contributed to by his own failure to make further necessary enquiries'.[84]

One year later in 1991, directors' duties were arguably strengthened even further in *Commonwealth Bank of Australia v Friedrich.*[85] In that case, an honorary and part-time director was held to be liable for a $97 million corporate debt, again in the insolvency context. In applying an objective test, Tadgell J observed:

> As the complexity of commerce has gradually intensified (for better or for worse) the community has of necessity come to expect more than formerly from directors whose task it is to govern the affairs of companies to which large sums of money are committed by way of equity capital or loan. In response, the parliaments and the courts have found it necessary in legislation and litigation to refer to the demands made on directors in more exacting terms than formerly; and the standard of capability required of them has correspondingly increased.[86]

In 1992, s 229(2) of the *Companies Code* — which by that stage had been re-enacted as s 232(4) of the *Corporations Law* — was subsequently amended to provide that: '[i]n exercise of his or her powers and the discharge of his or her duties, an officer of a corporation must exercise a degree of care and diligence *that a reasonable person in a like position in a corporation would exercise in the corporation's circumstances*.'[87] The additional phrase in italics finally imposed an unequivocally objective statutory duty of care on all directors and corporate officers.

Another paradigm shift in the statutory regulation of directors' liability was the move towards a public enforcement model of directors' duties. Given that the 1980s witnessed 'some of the most egregious, excesses, wrongdoings and corporate failures in Australian corporate history',[88] the previous state-based co-operative public regulators had clearly failed in their stated purposes.[89] In 1989, the Commonwealth Government implemented a national public regulator to enforce corporate law.[90] Its purpose was to unify each of the previous state and territory corporate regulators into a national body, reflecting the views of the time that the behaviour of corporations and their directors was increasingly a matter

---

[83] (1990) 2 ACSR 357.
[84] Ibid 431.
[85] (1991) 5 ACSR 115.
[86] Ibid 16.
[87] *Corporations Act 1989* (Cth) (emphasis added).
[88] Mees and Ramsay, above n 61, 47.
[89] The National Companies and Securities Commission — the public regulator at the time — chairperson's key aim was to restore public confidence in the securities markets: Mees and Ramsay, above n 61, 37.
[90] Mees and Ramsay, above n 61.

of public concern. This process initially took shape in the form of the Australian Securities Commission ('ASC'),[91] and culminated in establishment of the Australian Securities and Investments Commission ('ASIC') in 1998.[92] ASIC is granted with the power to bring both civil and criminal proceedings against directors and companies. As such, directors are subject to public enforcement by ASIC in respect of potential breaches of directors' duties, in addition to private civil enforcement. In fact, the vast majority of enforcement actions in recent years have been brought by ASIC,[93] which may seek a range of orders including financial penalties for directors and director disqualification.[94]

The statutory developments over the past 25 years have, therefore, effectively paralleled the developments in the general law duty of care. Both developments can be seen to implement community concerns that directors — particularly non-executive directors — ought to be held to more onerous standards of care in light of the corporate failures in the 1980s. Additionally, they clearly represent a tipping of the balance between the proper exercise of care and facilitation of entrepreneurial decision-making in favour of the former — at least compared to the previous equitable standard.

4 *The Current Legal Framework*

The *Corporations Act 2001* (Cth) has been the principal statute governing the regulation of corporations in Australia since 15 July 2001.[95] Under the previous regime, each state and territory had enacted legislation that effectively 'adopted' the Corporations Law.[96] A series of cases — namely *Re Wakim; Ex Parte McNally* (1999) 198 CLR 511 and *R v Hughes* (2000) 18 ACLC 394 — exposed the fact that these laws operated as a number of duplicate state laws as opposed to as a single federal law. One consequence was that federal courts — in particular, the Federal Court of Australia, which had previously dealt with many corporate disputes — were deprived of the jurisdiction to hear matter arising under the Corporations Law.[97] Moreover, the finding in *Hughes* that the Commonwealth officers could not carry out a power under state law in the absence of a sufficient nexus with the Commonwealth heads of power meant that ASIC's ability to continue enforcing the Corporations Law as a public regulator became extremely tenuous.[98] The solution to these problems was a referral of powers by the state legislatures pursuant to s 51(xxxvii) of the *Commonwealth Constitution of Australia* (1901), with the end result being the *Corporations Act 2001* (Cth).[99]

The statutory duty of care can now be found in s 180(1) of the *Corporations Act 2001* (Cth). It reads:

---

[91] For a detailed history of public regulators in the Australian corporate sector, see Mees and Ramsay, above n 61.
[92] Ibid.
[93] Between 2006 and 2013 ASIC had completed 1577 actions, with an average success rate of 92.7%: Senate Economics References Committee, Parliament of Australia, *Performance of the Australian Securities and Investments Commission* (2014) [17.2].
[94] See *Corporations Act 2001* (Cth) pt 9.4B for the full range of civil penalty remedies.
[95] CCH, *Australian Company Law Commentary Premium* (at 23 November 2015), [1-000] – [1-100], [16-020]. LexisNexis, *Ford, Austin and Ramsay's Principles of Corporate Governance* (at 23 November 2015) [2.310].
[96] CCH, *Australian Company Law Commentary Premium* (at 23 November 2015), [1-000] – [1-100], [16-020].
[97] Ibid.
[98] LexisNexis, *Australian Corporation Law Legislation* (at 23 November 2015) [1.050].
[99] Ibid.

> A director or other officer of a company must exercise their powers and discharge their duties with the degree of care and diligence that a reasonable person would exercise if they
>
> (a) were a director or officer of a company in the company's circumstances; and
> (b) occupied the office held by, and had the same responsibilities within the company as, the director or officer.

The standard of care imposed by under the statutory and general law duties has 'telescoped' to the point that it is essentially set at the level discussed in relation to the *AWA Appeal* and the following cases.[100] The difference between each of the duties is now evident only in the range of remedies available, and the standing of potential plaintiffs.[101]

Again, the objective duty of care imposed by s 180(1) encapsulates the idea that '[i]t is no longer acceptable for a director to take a passive role in company affairs',[102] and that '[a]n individual should not accept a directorship unless they have appropriate skills and competence to perform the role.'[103] Moreover, the provision was viewed as clarifying the existing state of the law by imposing a standard that 'all individuals would be expected to meet regardless of their particular capacities and circumstances.'[104] However, the more onerous standard imposed under both common law and statute led to several commentators expressing concerns that the resulting balance had been struck too far in favour of director liability. For example, MacPherson stated that '[directors] today are on the front line. So far as exposure to liability is concerned, the "exposures" are increasing in both the criminal and the civil area.'[105] Farrar also warned that 'extreme caution should be exercised at a time of public hysteria', stressing the need for directors' to be able to take 'calculated risks even in times of public outrage over recent corporate failures.'[106] Arguably, the more stringent objective standard now imposed on directors could result in a problem of adverse selection by deterring individuals from taking up the office of a director — and particularly that of a non-executive director — notwithstanding the fact they may possess specialised experience in a valuable area. Against this backdrop, there were increasing calls for the introduction of a statutory business judgment rule on broadly the same terms as that existing in the common law of the United States ('US') in order to effect 'a reversal of a rising standard in corporate governance.'[107]

B *The Evolution of The Decision Rule Regulating*

---

[100] *Re HIH Insurance Ltd (in prov liq); Australian Securities and Investments Commission v Adler* (2002) 41 ACSR 72; *Adler v Australian Securities and Investments Commission* (2003) 46 ACSR 504; *AWA Appeal* (1995) 37 NSWLR 438; *Ingot Capital Investments Pty Ltd v Macquarie Equity Capital Markets Ltd* (2007) 63 ACSR 1; *Rich* (2009) 236 FLR 1; *Australian Securities and Investments Commission v Vines* (2005) 55 ACSR 617; *Vines v Australian Securities and Investments Commission* (2007) 62 ACSR 1.

[101] For a discussion of the remedies available for breach of the common law and equitable duties, see LexisNexis, *Ford, Austin and Ramsay's Principles of Corporate Governance* (at 23 November 2015) [8.320]. For the range of civil penalties ASIC may seek for breach of a statutory duty see *Corporation Act (2001)* (Cth) pt 9.4B.

[102] Corporate Law Economic Reform Program, Parliament of Australia, *Proposals for Reform Paper No 3: Directors' Duties and Corporate Governance* (1997) 44.

[103] Ibid.

[104] Senate Standing Committee on Legal and Constitutional Affairs, Parliament of Australia, *Company Directors' Duties* (1989) 27 [3.22] ('Cooney Report') 27 [3.2].

[105] Ibid.

[106] John H Farrar, 'Report on Modernising Australian Corporations Law', *Australian Institute of Company Directors* (1992).

[107] Ben Keller, 'Australia's Proposed Statutory Business Judgment Rule: A Reversal of a Rising Standard of Corporate Governance' (1999) 4(2) *Deakin Law Review* 125.

1 *General Law 'Business Judgment Principle'*

As was mentioned above, it is a long-standing Anglo-Australian judicial tradition that the enforcement of directors' duties is affected by the reticence of the courts to second-guess the *bona fide* business judgments of directors.[108] As stated by the High Court (Barwick CJ, McTiernan, Kitto JJ) in *Harlowe's Nominees Pty Ltd v Woodside (Lakes Entrance) Oil Co NL*:

> Directors in whom are vested the right and duty of deciding where the company's interests lie and how they are to be serviced may be concerned with a wide range of practical considerations, and their judgment, if exercised in good faith and not in irrelevant purposes, is not open to review in the courts.[109]

Irrelevant purposes in this context were defined as purposes advanced for the directors' personal advantage rather than for the benefit of the corporation.[110] The reluctance of courts to review business judgments with the benefit of hindsight has also been recognised at the highest level in the United Kingdom in *Howard Smith Ltd v Ampol Petroleum Ltd* where the Privy Council held:

> There is no appeal on merits from management decisions to courts of law: nor will courts of law assume to act as a supervisory board over decisions within the powers of management honestly arrived at.[111]

This judicial policy of non-interference has been particularly evident in cases decided by under the 'proper purposes' doctrine.[112] These cases were primarily concerned with the equitable principle of 'fraud on a power' wherein a power must be used only for the benefit of its intended beneficiary. Under this doctrine, directors must exercise their powers of management without 'improper purposes', as objectively assessed by a judicial determination of the purpose and scope of the power in question.[113] In Australia, disputes over business judgments were regularly pleaded as breaches of the proper purposes doctrine rather than as breaches of the duty of care.[114] However, the plaintiff's evidentiary burden of proving 'improper purposes' has often allowed directors' to escape review.[115] One example is *Pine Vale Investments v McDonnell and East Ltd*.[116] In that case, the directors of the McDonnel and East Ltd ('McDonnell') had issued shares to all of its shareholders at a premium of $2.00 above par value in order to finance a takeover of

---

[108] See *Harlowe's Nominees Pty Ltd v Woodside (Lakes Entrance) Oil Co NL* (1968) 121 CLR 483, 493; *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821, 835; *Turquand v Marshall* (1869) LR 4 Ch App 376, 386; *Dovey v Corey* [1901] AC 477, 488; LexisNexis, *Ford, Austin and Ramsay's Principles of Corporate Governance* (at 23 November 2015) [8.025].
[109] (1968) 121 CLR 483, 493.
[110] *Harlowe's Nominees Pty Ltd v Woodside (Lakes Entrance) Oil Co NL* (1968) 121 CLR 493–4, citing *Mills v Mills* (1938) 60 CLR 150. This requirement will subsequently be referred to as an absence of a 'material personal interest', in line with the language used in the statutory business judgment rule.
[111] (1974) 1 NSWLR 68.
[112] See Larelle Law, 'The Business Judgment Rule in Australia: A Reappraisal Since the AWA Case' (1997) 15 *Company and Securities Law Journal* 174, 180–1.
[113] See, eg, *Australian Metropolitan Life Assurance Co Ltd v Ure* (1923) 33 CLR 199.
[114] See, eg, *Southern Resources Ltd v Residues Treatment & Trading Co Ltd* (1990) 3 ACSR 207; *Darvall v North Sydney Brick and Tile Co Ltd* (1989) 15 ACLR 230; Law, above n 98, 15 *Company and Securities Law Journal* 174, 181.
[115] Law, above n 114, 181.
[116] (1983) 8 ACLR 199, 201, 207.

Piggot & Co Pty Ltd ('Piggot'). The plaintiff corporation ('Pine') was a 26% shareholder in McDonnell and was planning to launch a competing takeover bid for Piggot.[117] In dismissing Pine's application to have the share rights issue enjoined, McPherson J was heavily reliant on the principles of non-intervention enunciated in *Harlow's Nominees* and *Howard Smith.*[118] In particular, his Honour's decision appeared to be contingent on the fact that the directors of McDonnell were taking their action in the genuine belief that it was in the commercial best interests of the corporation. His Honour said:

> Had I formed a different view, an adverse finding with respect to their motivation might have followed, perhaps not of course, but certainly without great difficulty.[119]

Consequently, the plaintiffs were unable to establish that the directors had acted with 'improper purposes'.

One qualification on the proper purposes doctrine is that courts may deny directors the benefit of the doctrine if the business decision was one 'that no reasonable board of directors could think to be substantially for a purpose for which the power was conferred',[120] or if 'an intelligent and honest man in the position of the director company concerned could [not], in the whole of existing circumstances, have reasonably believed that the transactions were for the benefit of the company.'[121]

In totality then, it appears as though courts would not review a business judgment made in good faith,[122] for a proper purpose,[123] in the absence of a material personal interest in the transaction,[124] and if the directors' possessed a reasonable belief that the decision was in the best interests of the corporation.[125] This tradition of judicial non-interference has variously been described by commentators as a general law 'business judgment rule',[126] 'business judgment doctrine',[127] or 'self-denying ordinance'.[128] However, it is important to note that this principle has not been explicitly recognised by Australian courts as constituting 'a business judgment rule' akin to that which is well

[117] Ibid 201.
[118] Ibid 208.
[119] Ibid 209.
[120] *Shuttleworth v Cox Bros and Co (Maidenhead) Ltd* [1927] 2 KB 9, 23–4; *Wayde v New South Wales Rugby League Ltd* (1985) 180 CLR 459.
[121] *Charterbridge Corp Ltd v Lloyds Bank Ltd* [1970] Ch 92; *Reid Murray Holdings Ltd (in liq) v David Murray Holdings Pty Ltd* (1972) 5 SASR 386, 402.
[122] *Harlowe's Nominees Pty Ltd v Woodside (Lakes Entrance) Oil Co* (1968) 121 CLR 483, 493; *Whitehouse v Carlton Hotel Pty Ltd* (1987) 162 CLR 285, 292–3.
[123] Ibid.
[124] This requirement is subsumed within the broader definition of proper purposes: *Harlowe's Nominees Pty Ltd v Woodside (Lakes Entrance) Oil Co* (1968) 121 CLR 483, 493–4; citing *Mills v Mills* 1938) 60 CLR 150, 163; *Whitehouse v Carlton Hotel Pty Ltd* (1987) 162 CLR 285, 292–3.
[125] This requirement can also be seen to fall under the umbrella of good faith or proper purposes. Ashely Black makes the same point in LexisNexis, *Australian Corporations Law — Principles and Practice* (at 23 November 2015) [3.2A.0060]:

> The approach adopted in the Australian cases has an equivalent in the principle described in US law as the "business judgment rule", which offers a director protection from civil liability in relation to a business judgment unless he or she had an unauthorised interest in a transaction of the company to which the business judgment related; had not informed himself or herself to an appropriate extent about the subject of the judgment; did not act in good faith or for a proper purpose; or acted in a manner that a reasonable director with his or her training could not possibly regard as being for the benefit of the company.

[126] See *Rich* (2009) 236 FLR 1, 145 (Austin J).
[127] Farrar, above n 23, 756 [35].
[128] G F K Santow, 'Codification of Directors' Duties' 73 *Australian Law Journal* 336, 348.

established in the United States. Nevertheless, it is a flexible principle of judicial intervention which 'in function, if not name, embodies such a rule.'[129]

This tradition of non-interference has been justified on a number of bases. First, it has been said that courts lack the requisite commercial acumen and training in order to accurately evaluate the merits of a business decision.[130] Nevertheless, this has not deterred judges from determining matters of professional competence in other technical areas despite lacking the relevant expertise.[131] For instance, the courts have not refrained from determining matters of medical negligence, notwithstanding their lack of medical training. More compellingly, it might be said that the judicial reticence to review the merits of a business decisions is simply based on the fact that such decisions are of limited justiciability because the exact criteria by which a business decision ought to judged are unclear.[132] Commerce and entrepreneurial flair inherently involve an element of risk-taking. Hence, the determination of whether a risk is commercially justified will often involve an assessment of the amount of profits that might reasonably be expected to accrue from the business decision. But it is difficult to conceive of how a court could accurately gauge whether the expected profits outweigh the risk involved, considering the volatility and indeterminacy surrounding this evaluation.[133] Thus, it will often be challenging for courts to accurately determine the measures by which a business decision ought to be evaluated — as opposed to the steps that should be taken in making that decision.[134]

Second, the common law business judgment principle is buttressed by concerns that judicial scrutiny of business decisions may unduly inhibit legitimate commercial risk-taking and entrepreneurial idiosyncratic vision[135]. For instance, Kay J in *Re Faure Electric Accumulate* stated that 'to apply to directors the strict rule of the Court of Chancery with respect to ordinary trustees might fetter their action to an extent which would be exceedingly disadvantageous to the companies they represent'.[136] As will be discussed below, this is also key justification put forward for a 'business judgment rule' of the type that exists in the US.

Third, the principle — like the US business judgment rule — reflects the role of shareholder selection. More specifically, both rules are based on a delegation of managerial power to the corporate directors by the corporation, which is premised on the shareholders' *ex ante* assessment of the directors, and a resulting expectation that the

---

[129] Paul Redmond, 'Safe Harbours or Sleepy Hollows: Does Australia Need a Statutory Business Judgment Rule?' in Ian M Ramsay (ed), *Corporate Governance and the Duties of Company Directors* (Centre for Corporate Law and Securities Regulation, 1997) 185, 198.

[130] In the context of the United States see, eg, *Solash v. Telex Corp*., Civ. A. Nos. 9518, 9528, 9525, 1988 Del. Ch. LEXIS 7, 21 (Del. Ch. Jan. 19, 1988):

> Because businessmen and women are correctly perceived as possessing skills, information and judgment not possessed by reviewing courts and because there is great social utility in encouraging the allocation of assets and the evaluation and assumption of economic risk by those with such skill and information, courts have long been reluctant to second-guess such decisions when they appear to have been made in good faith.

[131] Parkinson, above n 10, 108.

[132] Ibid.

[133] Ibid.

[134] But, as we shall see, this has not prevented courts from engaging in this determination in certain instances.

[135] Above n 22.

[136] (1888) 40 Ch D 141, 151.

directors will exercise their business judgment in a manner consistent with their personal qualities.[137]

2 *Statutory Business Judgment Rule*

In Australia, the implementation of an objective standard of care in the 1990s sparked a debate on whether this provision should be complemented by a statutory 'US-Style' business judgment rule.[138] This suggestion was rejected by the government of the time, on the basis that the existing general law 'business judgment principle' provided sufficient protection for directors' business judgments.[139] However, the applicability of this general law 'business judgment principle' was brought into question following the *AWA Appeal*.[140] The New South Wales Court of Appeal in the *AWA Appeal* did note that directors have a duty to 'display entrepreneurial flair and accept commercial risks to produce a sufficient return on capital invested', and to 'make business judgments and business decisions in a spirit of enterprise'.[141] This indicates that the general law business judgment principle was retained under the common law to some extent. Moreover, the court said nothing of

---

[137] Gramitto Ricci, above n 5, 200. See also In re ALH Holdings LLC, 675 F.Supp. 2d 462, 477 (D. Del. 2009) suggesting that, pursuant to the separation of corporate control and ownership 'shareholders . . . must depend upon the integrity and deliberate consideration of the directors who manage the corporation,' and that 'the business judgment rule is a corollary that flows from the authority and responsibility inherent in the director's role.'

[138] See Redmond, above n 131; Deborah A Demott, 'Directors' Duty of Care and the Business Judgment Rule: American Precedents and Australian Choices' (1992) 4(2) *Bond Law Review* 133; Ashley Black, 'Recent Developments in Directors' Duties' (1991) 7 *Australian Bar Review* 121; Robert Baxt, 'Corporate Law Reform – Directors' Duties – Objective Standards – Business Judgment Rule – Other Issues' (1992) 66(5) *Australian Law Journal* 294; Michael Duffy, 'You Can't Legislate for Honesty . . .' (1992) 8(6) *Company Director* 29; Jill Rowbotham, 'Company Law to get a New Reality' (1992) 14(35) *Business Review Weekly* 22; R B S MacFarlan, 'Directors' Duties after the National Safety Council Case' (1992) 9(3) *Australian Bar Review* 269; Marc I Steinberg, 'The Corporate Law Reform Act 1992: A View From Abroad' (1993) 3(2) *Australian Journal of Corporate Law* 154; A S Sievers, 'Farewell to the Sleeping Director: the Modern Judicial and Legislative Approach to Directors' Duties of Care, Skill, and Diligence' (1993) 21(2) *Australian Business Law Review* 111; Sue Woodward, 'Directors: to be Informed or Beware' (1993) 67(4) *Law Institute Journal* 274; Cindy A Schipani, 'Defining the Corporate Directors' Duty of Care Standard in the United States and Australia' (1994) 4(2) *Australian Journal of Corporate Law* 152.

[139] Explanatory Memorandum, Corporate Law Reform Act 1992 (Cth), 25–6. The former government's approach was heavily influenced by the CASAC report: which stated:

> the Advisory Committee strongly believes that it is inappropriate to enact a statutory business judgment rule in Australia. [A]ustralian courts have already developed principles that provide protection for the informed business decisions of directors. The Advisory Committee finds it significant that no body which has recommended a statutory business judgment rule for Australia has apparently undertaken the research which (if it had been undertaken) clearly demonstrates that such attempts have never been successful and in fact have engendered prolonged controversy.

Corporate Law Economic Reform Program, Parliament of Australia, *Paper 3 – Directors' Duties and Corporate Governance* (1997) 81, quoting House of Representatives Standing Committee on Legal and Constitutional Affairs, Corporate Practices and the Rights of Shareholders ('CASAC'), *Directors' Duty of Care and Consequences of Breaches of Directors' Duties* (1991).

[140] See, eg, Corporate Law Economic Reform Program, Parliament of Australia, *Paper 3 – Directors' Duties and Corporate Governance* (1997) 22–9; David Tan, 'Delivering the Judgment on a Statutory Business Judgment Rule in Australia' (1995) 5(4) *Australian Journal of Corporate Law* 442; Robert Baxt, 'Do We Now Need a Business Judgment Rule for Company Directors' (1995) 69(8) *Australian Law Journal* 571; John H Farrar, 'The Duty of Care of Company Directors in Australia and New Zealand' (1996) 6(2) *Canterbury Law Review* 228; Peter Costello, 'A Step in the Right Direction' (1996) 12(11) *Company Director* 27; Law, above n 114.

[141] *AWA Appeal* (1995) 16 ACSR 607, 656, citing *Hedley Byrne & Co Ltd v Heller & Partners Ltd* [1964] AC 465.

abandoning this approach.[142] Nevertheless, the perceived uncertainty of the general law business judgment principle in light of the *AWA Appeal*, along with an increasingly stringent standard of care sparked renewed interest in a 'US-style' business judgment rule.[143]

In 1997, a new Commonwealth Government released the Corporate Law Economic Reform Program Papers ('CLERP papers'), which recommended the introduction of statutory business judgment rule.[144] The justification offered was two-fold: first, the rule would codify and clarify the existing standard of care; and second, it would encourage directors' entrepreneurial decision-making by 'lowering their liability.'[145] The business judgment rule proposed by the CLERP papers was ultimately enacted in s 180(2) of the *Corporations Law* in March 2000.[146] It reads:

> A director or other officer of a corporation who makes a business judgment is taken to meet the requirements of subsection (1), and their equivalent duties at common law and in equity, in respect of the judgment if they:
>
> (a) make the judgment in good faith for a proper purpose; and
>
> (b) do not have a material personal interest in the subject matter of the judgment; and
>
> (c) inform themselves about the proper subject matter of the judgment to the extent they reasonably believe to be appropriate; and
>
> (d) rationally believes that the judgment is in the best interests of the corporation. The director's or officer's belief that the judgment is in the best interests of the corporation is a rational one unless the belief is one that no reasonable person in their position would hold.

Section 180(3) defines a 'business judgment' to mean 'any decision to take or not take action in respect of a matter relevant to the business operations of the corporation'.[147]

---

[142] As will be discussed below, the general law business judgment rule was indeed retained.
[143] Jean J du Plessis, 'Open Sea or Safe Harbour? American, Australian and South African Business Judgment Rules Compared (Part 1)' (2011) 32(11) *Company Lawyer* 347, 347-52.
[144] Corporate Law Economic Reform Program, Parliament of Australia, *Paper 3 – Directors' Duties and Corporate Governance* (1997).
[145] Ibid 24.
[146] *Corporate Law Economic Reform Program Act 1999* (Cth) sch I (13 March 2000), inserting the provision at s180(2).
[147] Ibid, inserting the provision at 180(3).

II ACOUSTIC SEPARATION — FROM ENACTMENT TO *MARINER*

Applying the distinction between conduct rules and decision rules to the foregoing discussion, the equitable duty of care exhibited a relatively narrow divergence or 'acoustic separation' between the two standards. Under the conduct rule, the role of directors was to act within their own particular skills and experience. In addition, they were broadly entitled to rely on, and to delegate to, other corporate officers, and were not mandated to pay continuous attention to corporate affairs. Under the decision rule, the courts would not review a directors' *bona fide* action in the absence of culpable or gross 'negligence'. Although admittedly different, the standard of conduct and standard of review did not require two radically different standards of care from directors in practice — at least in the case of non-executive directors. Put another way, the decision rule (under which courts would not review decisions unless there was 'gross negligence') did not impose a tangibly lower level of liability than the standard of conduct under which directors were simply required to act within their own particular skills and experience.[148] As such, any theoretical divergence between the two standards was unlikely to have practical ramifications for directors. In addition, both the standard of conduct and standard of review were subsumed under the director's duty of care and the two concepts were not explicitly delineated.

By the time of the *AWA Appeal*,[149] the divergence between the conduct rules and decision rule had become more distinct. The duty of care as a conduct rule required, among other things, that *all* directors take reasonable steps to place themselves in a position to guide and monitor the corporation, maintain a familiarity with the fundamentals of the corporation's business and its financial status, and oversee the activities of the corporation. On the other hand, the standard of review imposed under the general law business judgment principle had developed such that directors would generally not be liable for falling short of the standard of conduct in respect of management decisions made in good faith, for a proper purpose, in the absence of a material personal interest in the judgment, and if they possessed a reasonable belief that the relevant decision was in the best interests of the corporation. Thus, the standard of review under the business judgment principle clearly required a lower standard than the duty of care in certain instances. In this way, the duty of care could be perhaps viewed as reflecting an aspirational standard to which directors ought to aim, while the standard of review under the business judgment principle actually determined the level at which directors' will be held liable for falling short of this standard. Moreover, while the general law business judgment principle has not been developed to the extent that it is a clearly discrete presumption or rule as it is in the United States, the case law in Australia appears to indicate that is somewhat conceptually distinct from the duty of care itself. Thus, the general law standard of conduct and standard of review now evidence greater theoretical delineation. The following section of this Conference Paper aims to assess whether the implementation of the statutory business judgment rule has substantially altered this 'acoustic separation' by surveying the cases in which the provision has been considered.

A *THE DECISION RULE IN ASIC V RICH*

It is fair to say that Australian judges have not universally embraced the statutory business judgment rule since its enactment.[150] Contrary to initial predictions that the rule would 'put

[148] This proposition is no doubt stronger in the case of non-executive directors.
[149] (1995) 37 NSWLR 439.
[150] See Farrar, above n 23, 759.

the wind into the directors sails',[151] there have been few cases in which the statutory business judgment rule has been considered, let alone applied.[152]

The paucity of cases in which s 180(2) was raised meant that a detailed judicial consideration of the rule was not undertaken until *Australian Securities and Investments Commission v Rich* ('*Rich*') in 2009.[153] This case involved extremely detailed pleadings brought by the ASIC against two former directors of the One.Tel telecommunications company in respect of their conduct in the lead up to the corporation's collapse May 2001. ASIC alleged that the directors had breached their duty of care as a result of their failure, inter alia, to properly assess the corporation's financial situation. The way the case was framed essentially required ASIC to prove their allegations concerning the financial situation of the corporation with a vast amount of evidence. Austin J was highly critical of the way in which the case was pleaded, and accordingly held that ASIC had failed to prove its case beyond the balance of probabilities.[154] In dismissing the complaint, his Honour appears to have contemplated that the directors could have been entitled to the protection of s 180(2), had they been found to be in breach of their duty of care. In doing so, the decision clarified several important matters regarding the operation of the statutory business judgment rule and its interaction with the existing legal framework.

1 The *General Law Business Judgment Principle in ASIC v Rich*

Significantly, Austin J acknowledged that the broader business judgment principle survives in the general law, notwithstanding the enactment of s 180(2). The decision emphasised that 'to take the "business judgment rule" out of the assessment of breach of the general law duty of care would be to remove one of the entrance points to understanding the standard of care itself'.[155] Austin J clarified the operation of this general law principle as follows. First, the general law business judgment principle is not a 'bright-line test', but instead involves a number of 'relevant considerations that are an integral part of . . . the application of the standard applied by the general law.'[156] In particular, it assists in distinguishing a breach of the standard of care for which liability will be imposed, from 'an error going to the merits of a business decision' for which a director will not be held liable. Second, the general law business judgment principle is also relevant to the application of the *statutory* duty of care under s 180(1), not simply the general law duty of care.[157] Third, whereas the considerations under the general law business judgment rule that may affect the application of the duty of care are open-ended, the statutory business judgment rule

[151] See Annette Greenhow, 'The Statutory Business Judgment Rule: Putting Wind into Directors' Sails' (1999) 11(1) *Bond Law Review* 33.

[152] Much of the early difficulty in enlivening the rule centred on providing that the directors' action or inaction satisfied the definition of a 'business judgment'. In *Australian Securities and Investments Commission v Adler* (2002) 41 ACSR 72 each of the defendants was denied the protection of the rule, inter alia, on the basis that they had a material personal interest, did not make a 'business decision' as defined in s 180(3), or even if they had, they failed to prove the decision satisfied the preconditions listed in s 180(2)(a)–(d). Similarly, the Supreme Court of Queensland Court of Appeal declined to apply the provision in *Gold Ribbon (Accountants) Pty Ltd v Sheers* [2006] QCA 335 because it was found that the defendant did not make a 'business judgment' since he did not concern himself at all with the decision at hand, or if he did, could not be found to have believed that the decision was in the best interests of the company: at [247]–[248].

[153] (2009) 236 FLR 1.

[154] Ibid [65]: 'there is a real question whether ASIC should ever bring civil proceeding seeking to prove so many things over such a period of time as in this case.'

[155] Ibid, 145.

[156] Ibid.

[157] Ibid.

explicitly defines the pre-conditions that must be fulfilled in order for it to be enlivened.[158] As such, Austin J concluded that 'it is at least theoretically possible' for the s 180(2) business judgment rule to apply in situations where the general law business judgment principle would not.[159] In doing so, his Honour noted that this would be contingent on the way in which courts interpret the pre-conditions in subparagraphs 180(2)(a)–(d).[160] Specifically, his Honour envisaged that the rule could provide a defence where the duty of care would otherwise be breached — and by extension the general law business judgment principle would not be enlivened — where:

(a) the impugned conduct is a business judgment as defined;
(b) the directors or officers are acting in good faith, for a proper purpose and without any material personal interest in the subject matter;
(c) they make their decisions after informing themselves about the subject matter to the extent they believe to be appropriate having regard to the practicalities listed above;
(d) their belief about the appropriate extent of information gathering is reasonable in terms of the practicalities of the information gathering exercise (including such matters as the accessibility of information and the time available to collect it);
(e) they believe that their decision is in the best interests of the corporation; and
(f) that belief is rational in the sense that it is supported by an arguable chain of reasoning and is not a belief that no reasonable person in their position would hold.[161]

2 *Procedure for Enlivening Section 180(2)*

Austin J also clarified the procedure for applying the statutory defence.[162] First, the court must assess whether the relevant circumstances could amount to a breach of the duty of care by reference to whether the action or inaction is unreasonable in the sense of being more than a 'mere error of judgment'.[163] If the conduct is found to be unreasonable, the second question is whether a business judgment was made as defined in s 180(3).[164] His Honour held that the phrase defining a business judgment as 'a decision to take or not take action in respect of a matter relevant to the business operation' is to be interpreted broadly to include decisions relevant to planning, budgeting and forecasting.[165] However, Austin J noted that the definition does not extend to include general oversight obligations or a case where the directors have simply neglected to deal with a matter.[166] Finally, Austin J noted that the court must consider whether each of the four preconditions in s 180(2)(a)–(d) have been satisfied.[167]

Crucially, Austin J held that the onus of proof in establishing each of these preconditions is placed on the defendant directors.[168] Having noted that the statutory

[158] Ibid.
[159] Ibid.
[160] Ibid 146.
[161] Ibid 155.
[162] Ibid 141.
[163] Ibid 150.
[164] Ibid 150–2.
[165] Ibid.
[166] *Rich* (2009) 236 FLR 1, 151. See also *Australian Securities and Investments Commission v Adler* (2002) 168 FLR 253, [406] (Santow J); *Gold Ribbon (Accountants) Pty Ltd (in liq) v Sheers* [2006] QCA 335, [247] (Keane JA).
[167] *Rich* (2009) 236 FLR 1, 152–4.
[168] Ibid 149.

language is 'profoundly ambiguous', Austin J based his decision on two factors.[169] First, his Honour noted that if the onus were borne by ASIC, the enactment of the business judgment rule in s 180(2) would have the effect of adding elements to be proven by the plaintiff — contrary to the intention expressed in the Explanatory Memorandum and Secondary Reading speech that there was to be no reduction in the standard of care.[170] Second, his Honour noted that it would be strange if ASIC was required to establish the preconditions, since this would effectively require the plaintiff to demonstrate more serious infringements under the *Corporations Act 2001* (Cth) than are subsumed under the duty of care.[171]

In summary then, Austin J's judgment gave a strong indication that, theoretically at least, the statutory business judgment rule has broadened the 'acoustic separation' between conduct rules and decisions rules by potentially protecting a defendant from liability when s 180(1) — and the general law business judgment rule subsumed within it — would otherwise be breached. Nevertheless, since Austin J's remarks were arguably made in obiter, their practical implications remained uncertain until *Australian Securities and Investments Commission v Mariner* ('*Mariner*') in June 2015.[172]

B *THE DECISION RULE IN ASIC V MARINER*

The Federal Court's landmark decision in *Mariner* was the first case in which directors have unequivocally invoked the business judgment rule as a defence in its 15-year existence,[173] an outcome that many commentators thought might never occur.[174] Mariner Corporation Limited ('Mariner') is a public investment company listed on the Australian Stock Exchange.[175] Its principal business was to engage in mergers and acquisitions in the small cap sector.[176] On 2 April 2014, ASIC brought proceedings against Mariner and its three directors — Mr Olney-Fraser, Mr Christie and Mr Fletcher — in relation to an announcement of an off-market takeover bid for all of the issued capital of Austock Group Limited ('Austock') at 10.5 cents per share on 25 June 2012.[177] It was not in contention that, at the relevant time, Mariner did not itself have sufficient resources to satisfy its obligations under the bid had it been accepted.[178] However, the bid was announced at a price only slightly above market rate, and the directors considered that the assets of Austock could be realised for around twice the price of the bid.[179] In addition, Mariner placed numerous conditions on the bid, including a requirement that at least 50% of the shareholders accept the proposal.[180] Since the directors controlled approximately 36% of the shares, it was highly unlikely that this minimum acceptance condition would have been satisfied.[181] On 23 July 2012, Mariner announced that it would withdraw its bid because

[169] Ibid 148.
[170] Ibid 149.
[171] Ibid 149–50.
[172] [2015] FCA 589.
[173] As will be seen below, the rule was previously enlivened in the context of *receivers'* duties in *Deangrove Pty Ltd (Receivers and Managers Appointed) v Bucky and Another* [2006] FCA 212.
[174] Corporate HQ Advisory, *Directors' Duties* (24 June 2015) Minter Ellison <http://chqa.minterellison.com/blogcustom.aspx?entry=971>.
[175] *Mariner* [2015] FCA 589, [7].
[176] Ibid.
[177] Ibid [1].
[178] The question was whether Mariner would have been able to obtain sufficient funding from an external financier to satisfy its obligations under the bid: *Mariner* [2015] FCA 589, [328].
[179] Ibid [123].
[180] Ibid [123].
[181] Ibid [329].

Austock had entered into an agreement for the sale of its property and funds management business with Folkestone Ltd, thereby triggering a defeating condition under Mariner's bid.[182]

Two years later — and notwithstanding Mariner's withdrawal of the bid — ASIC brought proceedings alleging that the announcement of the bid had contravened three provisions of the *Corporations Act 2001* (Cth). First, it alleged that Mariner had breached s 631(2)(b) of the *Corporation Act 2001* (Cth) because it had made the Austock bid, reckless as to whether it would be able to perform its obligations under the bid if a substantial proportion of the offers were accepted.[183] In addition, ASIC alleged that Mariner contravened s 1041H since its announcement of the bid was 'deceptive or likely to mislead or deceive' on the basis that it was not permitted to make a takeover bid for less than 11 cents per share.[184] The prohibitions in ss 631(2)(b) and 1041H apply to Mariner as a corporation, not its directors. However, ASIC also alleged that the directors had contravened their statutory duty of care to Mariner by causing the corporation to contravene ss 631(2)(b) and 1041H, or putting it at risk of such contravention.[185] Further, ASIC asserted that the directors had breached s 180(1) irrespective of whether Mariner had breached ss 631(2)(b) or 1041H.

1 The *Duty of Care in ASIC v Mariner*

Under the circumstances, Beach J held that none of the directors had breached their duty of care under s 180(1). In delivering the judgment, Beach J focused on the actions of Mr Olney-Fraser, with the liability of the other two directors largely continent on their demonstrating reasonable reliance on Mr Olney-Fraser under s 189.[186] First, his Honour acknowledged that the role of a director necessarily involves risk taking. His Honour stated:

> After all, one expects management including the directors to take *calculated* risks. The very nature of commercial activity necessarily involves uncertainty and risk taking. The pursuit of an activity that might entail a foreseeable risk of harm does not of itself establish a contravention of s 180. Moreover, a failed activity pursued by the directors which causes loss to the company does not of itself establish a contravention of s 180.[187]

In this regard, Beach J noted that the foreseeable risk of harm to the corporation resulting from the conduct must be weighed against the potential benefits that could be reasonably expected to accrue to the corporation.[188] His Honour found that Mariner could potentially be in a position to make a substantial gain from realising the assets of Austock if the bid was successful[189] and noted that the risks posed to Mariner were negligible due

182 Ibid [144]–[151].
183 Ibid [1].
184 Ibid.
185 Two additional breaches were alleged. The first was that Mariner's announcement that it would make a bid at 10.5 cents per share was unlawful under s 631(3) (this breach was connected with the alleged contravention of s 1041H of the Act). The second was that the directors had failed to take consider the regulatory constraints on Mainer acquiring more than certain percentages of shares in Austock: *Mariner* [2015] FCA 589 [2].
186 Ibid [5].
187 Ibid [452] (emphasis in original).
188 Ibid [450]–[452].
189 Ibid [333], [456], [460], [461], [482].

to the minimum acceptance conditions placed on the bid.[190] On balance, Beach J found that the potential benefits of the directors' conduct outweighed the risk of harm, and accordingly held that the directors had not breached their statutory duty of care under s 180(1).[191]

In so holding, Beach J placed considerable emphasis on Mr Olney-Fraser's expertise in mergers, acquisitions and finance.[192] Indeed, the decision stressed that this was a factor to bear in mind when 'second-guessing such judgment calls with the benefit of hindsight, using a largely paper-based analysis and viewing the events from a timeframe perspective divorced from the reality of the speed at which the events occurred in real time.'[193] This is entirely consistent with the approach taken by Austin J in *Rich* in relation to the general law business judgment principle, thus reaffirming the efficacy of the existing standard of review.

2 *Statutory Business Judgment Rule*

In addition to holding that the directors' had not breached their duty of care under s 180(1), Beach J also held that the directors' were in any case entitled to the protection of the s 180(2) business judgment rule.[194] Considering the nature of Mariner's business and the benefits that could potentially accrue to the corporation if the bid were ultimately successful, his Honour was satisfied that the directors' decision to announce a takeover bid was a 'business judgment' as defined in s 180(3).[195] In regard to the four preconditions under s 180(2)(a)–(d), Beach J first found that the directors' had acted in good faith and for a proper purpose because Mariner stood to make a substantial profit under the transaction with minimal risks to the corporation.[196] Second, his Honour was satisfied the directors did not have a material personal interest in the transaction.[197] Third, Mr Olney-Fraser was found to have informed himself to the extent that he reasonably believed to be appropriate since he had gathered a substantial amount of information through his discussions with third parties regarding the possibility of — and level of interest in — the on-sale of Austock assets.[198] Additionally, the other directors were held to be entitled to rely on the information provided by Mr Olney-Fraser, and thereby satisfied this requirement as well.[199] Fourth, the above factors led Beach J to conclude that the directors had rationally believed that the judgment was in the best interests of the corporation.[200]

Beach J's judgment in *Mariner* is further evidence that the general law business judgment principle continues to apply. So far the acoustic separation between the standard of conduct and the general law business judgment principle has led to practical effects substantially equal to those evident between the standard of conduct and the statutory business judgment rule. Courts bear on the question of whether the relevant

---

190 Ibid.
191 Ibid [461], [482].
192 Mr Olney-Fraser had practiced as a mergers and acquisitions lawyer for 15 years: *Mariner* [2015] FCA 589, [476].
193 Ibid [13].
194 Ibid [496], [551], [552], [561].
195 Ibid [486]–[487], [543].
196 Ibid [488], [544].
197 This did not appear to be in contention: *Mariner* [2015] FCA 589, [489], [545].
198 Ibid [33], [491]–[492].
199 Ibid [533], [539], [549].
200 Ibid [494], [548], [551].

action (or inaction) is a breach of the standard of care, or simply an error going to the merits of a business judgment and remain reticent to second-guess *bona fide* business judgments by substituting their own judgment for that of experienced professionals to the same extent they have done under the general law business judgment principle.

C *The Standard of Review in Deangrove Pty Ltd v Buckby*

Although *Mariner* was first case in which a director was able to unequivocally enliven the statutory business judgment rule, the statutory business judgment rule had been previously invoked in the context of *receiver's* duties in *Deangrove Pty Ltd (Receivers and Managers Appointed) v Bucky and Another*.[201] This case involved an allegation that the applicant ('Deangrove') had sustained financial losses because the respondents ('Buckby') — bank appointed receivers — had sold Deangrove's property without taking reasonable care to obtain the best price then reasonably available,[202] and had accordingly breached their duties under ss 180 and s 420A.[203] The applicant was unsuccessful because it failed to establish a breach of the duty of care in the sale of the property, and also failed to establish that they had suffered financial damage resulting from the receivers' exercise of their power of sale.[204] In so holding, Branson J held that the receivers were entitled to rely on the s 180(2) business judgment rule.[205]

The facts of the case were as follows. Deangrove was the registered proprietor of strata title units in a development known as 'Holloways Beach Resort'.[206] The Commonwealth Bank of Australia ('the Bank') had advanced finance to Deangrove for the development, and held a first mortgage over the unsold units in the resort.[207] In November 1999, Deangrove entered into a deed with IHL Australia Pty Ltd ('IHL') wherein IHL had the right to compel the sale of 50 of these units on terms determined by IHL.[208] By January 2000, the Bank was dissatisfied by the lack of progress in selling the units and appointed receivers to Deangrove.[209] At the time, 49 of the units had remained unsold and were received by the Bank pursuant to their mortgage.[210]

The alleged breach of receivers' duties related to a decision by the respondents to send a letter to IHL rejecting the offer made in the deed for the purchase of the property.[211] Prior to the sending of the letter, a third party (Culley) had made an offer to purchase the units on terms more favourable than those contained in the deed with IHL.

[201] *Deangrove Pty Ltd (Receivers and Managers Appointed) v Bucky and Another* ('*Deangrove'*) [2006] FCA 212. It is not suggested by the authors that a receiver's ability to rely on s 180(2) would differ from that of a director. The point is raised simply as an observation that the rule had been applied first in the context of a receiver's duties.
[202] Ibid [1].
[203] Section 420A provides that '[i]n exercising a power of sale in respect of property of a corporation, a controller must take all reasonable care to sell the property for: (a) if, when it is sold, it has a market value not less than that market value; or (b) otherwise – the best price that is reasonably obtainable, having regard to the circumstances existing when the property is sold: *Corporation Act 2001* (Cth).
[204] [2006] FCA 212 [2].
[205] Ibid [68].
[206] Ibid [5].
[207] Ibid.
[208] Ibid [7].
[209] Ibid [14].
[210] Ibid.
[211] Ibid [36].

IHL did not make a counter-offer.[212] The 49 units were eventually sold to Culley in October 2000 for a lower price than either IHL or Culley's original offer.[213]

Branson J found that Deangrove had failed to establish that it was unreasonable for the receivers to sell the units to Culley.[214] In particular, his Honour accepted the view of the receivers that IHL was unlikely to complete the purchase of any of the 49 units in light of their continued requests to have the Bank's mortgage extended and the erratic nature of their communication with the receivers.[215] Moreover, Branson J accepted the evidence of the receivers that Culley was a 'safer bet' than IHL in view of the fact it had already entered into a contract for the purchase of 15 units and had maintained regular communication with the receivers.[216] Further, his Honour accepted that if IHL was genuinely interested in purchasing the units, it would have responded to the receivers' letter with a counter offer.[217]

In view of the above, Branson J was satisfied that in authorising the sending of the letter to IHL, the receiver had made a business judgment as defined in s 180(3). Moreover, his Honour was satisfied that the receiver had, within the meaning of s 180(2):

(a) made the judgment in good faith for the proper purpose of seeking to maximise the amount to be received by Deangrove on the sale of the units;
(b) did not have a personal interest in the subject matter of the judgment;
(c) informed himself about the subject matter of the judgment to the extent that he reasonably believed to be appropriate; and
(d) rationally believed that the judgment was in the best interests of Deangrove.[218]

Additionally, his Honour simply stated that the receivers had not breached their duty of care '[f]or the reasons expressed above'.[219] His Honour did not elaborate any further regarding either the application of the statutory business judgment rule or the duty of care, save for his remarks that the receiver had acted in 'good faith without wilfully or recklessly sacrificing the interests of Deangrove'.[220] Although Branson J's judgment did not contain a detailed consideration of the operation of the statutory business judgment rule, it did effectively confirm the reluctance of the courts to review *bona fide* business decisions under the general law business judgment principle.[221] It also confirms that, as in *Mariner*, there is a close relationship between the reluctance of courts to review business decisions under the general law business judgment and the statutory business judgment principle.

---

212 Ibid [19], [21]–[22].
213 Ibid [29]–[31], [43]. The contract for the sale of all 64 units was completed on 18 October 2000. However, it appears as though Culley did not ever settle for the 15 units it originally contracted to purchase.
214 Ibid [63].
215 Ibid [61]–[63].
216 Ibid.
217 Ibid [67].
218 Ibid [68].
219 Ibid [69].
220 Ibid [69].
221 Jenifer Varzaly, 'Protecting the Authority of Directors: An Empirical Analysis of the Statutory Business Judgment Rule' (2012) 12(2) *Journal of Corporate Law Studies* 429, 449.

III THE STATUTORY BUSINESS JUDGMENT RULE: 'SAFE HARBOUR' OR 'SLEEPY HOLLOW'?[222]

The judgments in *Rich*, *Mariner*, and *Deangrove* provide valuable insight into the requirements that need to be satisfied to enliven the s 180(2) business judgment rule. They also confirm that the provision *can* be applied as a defence in certain circumstances. However, an empirical survey of the cases considering the statutory business judgment rule reveals that the defendant has successfully invoked the provision in only two of 21 cases.[223] Moreover, these decisions leave the question of whether the statutory business judgment rule actually modifies the liability of directors wide open, since it has yet to be applied in a situation where the directors would otherwise have been found to be in breach of their duty of care. Against this backdrop, two fundamental questions warrant further examination. The first is whether the enactment of the statutory business judgment rule has achieved its goal of clarifying the framework enforcing directors' duty of care. The second, and related, point is whether the implementation of the statutory business judgment rule has achieved its intended goal of promoting entrepreneurial decision-making by providing directors' greater protection in respect of *bona fide* business decisions by widening and defining the acoustic separation between conduct rules and decision rules. It will be argued that the above cases reveal a fundamental tension between the intended purposes of the provision — that of providing directors with greater protection in respect of *bona fide* decisions, while also clarifying and codifying the existing standard of review — with the result that so far the rule has added complexity rather than granting directors enhanced certainty or protection in respect of their business decisions.

A *GREATER CLARITY OR GREATER COMPLEXITY?*

On its face, the statutory business judgment rule ought to intuitively provide greater certainty for directors compared to the pre-existing decision rule.[224] For a start, it lists certain pre-conditions with fixed outcomes, whereas the general law business judgment principle remains open-ended and flexible. Indeed, any so-called general law 'business judgment principle' is — at best — a composite doctrine patched together from a broad variety of cases. There is no single Australian case that definitely defines its parameters or the scope of its operation. Nor are the circumstances in which the defendant will be entitled to the benefit of the principle — if it even is a 'principle' properly so called — entirely certain.

Even so, it is questionable whether the statutory business rule has in fact provided directors with greater certainty with respect to their liability. This is for two closely interrelated reasons. First, the 'fixed' criteria that must be satisfied in order for the rule to be enlivened have posed a number of difficulties in interpretation. As Varzaly notes,[225] if a Supreme Court Justice — such as Austin J in *Rich*, who extracurially is a renowned expert in commercial law — characterises the legislative drafting as 'ambiguous', 'confusing' and

[222] See Redmond, above n 131.
[223] *Rich* (2009) 236 FLR 1, 145.
[224] Cf Santow, above 130, 348:

> Yet this manic impetus for legislation to bind the courts in charting the desired safe harbor for directors, takes place where the courts have, on the whole, been less intrusively prescriptive and less interventionist than the promised legislation. What could be clearer than the High Court's self-denting ordinance in *Harlowe's Nominees v Woodside Oil NL*?

[225] Varzaly, above n 223, 445–6.

‘opaque’, the provision can hardly be seen to provide greater certainty to those directors who seek to enliven it. Moreover, these difficulties in interpretation may also have a profound effect on the efficacy of the rule, such that it may suffer from underuse — as has proved to be the case — and thereby not be given the opportunity to alter the general law standard of review on a practical level. Second, if the statutory business judgment rule has not created a noticeably larger separation between conduct rules and decision rules — as was previously contended — then it arguably adds just another component to the already complex framework governing directors’ liability for breach of their duty of care. Thus, although the following discussion is framed in terms of the certainty that the rule provides directors, in many respects it is equally relevant to the question of whether the statutory business rule has modified the general law standard of review in practice.

1 *A Difficult Transplant*

Many of the difficulties faced in interpreting the statutory business judgment rule reflect the fact that it is a difficult legal transplant from the law of the US.[226] As was previously mentioned, s 180(2) was strongly based on the American Law Institute’s (‘ALI’) model formulation in §4.01(a) of their Principles of Corporate Governance.[227]

The US business judgment rule is a common law principle with at least 150 years of case law expounding the doctrine.[228] The ALI formulation — on which the Australian provision is based — was drafted as part of a recommendation for the enactment of a statutory business judgment rule in the US.[229] Although it is persuasive, it remains unenacted in most US states.[230] Hence, it does not capture the true complexity or nuances of the common law business judgment rule in the United States. By extension, the transplant of the ALI provision will not necessarily incorporate the intricacies of the rule that ensure it functions in the way that the common law business judgment rule does in the US.[231] In this context, there are a number of points to note.

(i) *The placement of onus of proof*

First, s 180(2) — like the ALI formulation on which it is based — fails to specify the party on whom the onus of proof is placed. The placement of the onus is a fundamental factor in the operation of the business judgment rule. Indeed, an analysis of the US business judgment rule reveals that it is arguably not a rule at all.[232] For a start, it does not

---

[226] See Farrar, above n 23, 791.

[227] That formulation provides:

> A directors or officer who makes a business judgment in good faith fulfils the duty under this section if the director or officer (1) is not interested in the subject of the business judgment; (2) is informed with respect to the subject of the business judgment to the extent to which the director or officer reasonably believes to be appropriate under the circumstances; and (3) rationally believes that the business judgment is in the best interests of the corporation.

American Law Institute, *Principles of Corporate Governance: Analysis and Recommendations — Volumes 1 and 2* (American Law Institute, 1994).

[228] Keller, above n 109, 125.

[229] Ibid 126–9.

[230] Ibid 125.

[231] In short, the Australian provision appears to be transplanted without sufficient research being conducted into the operation of the rule in the US. See Farrar, above n 23, 791.

[232] See Douglas M Branson, ‘A Business Judgment Rule for Incorporating Jurisdictions in Asia?’ (2011) 23 *Singapore Academy of Law Journal*’ 687, 687; Douglas M Branson, *Corporate Governance* (Lexis Law, 1993) [7.01]–[7.20].

mandate a standard of conduct for directors.[233] Instead, it imposes a standard of judicial review under which directors are generally entitled to a 'powerful *presumption* in favor of the actions taken by the directors' in respect of honest business decisions.[234] As such, the rule provides directors a 'safe harbour' from liability if the *plaintiff* fails to demonstrate that the relevant preconditions are not met.[235] Accordingly, the failure of the Commonwealth Parliament to explicitly specify that the onus of proof is placed on the plaintiff has precluded s 180(2) from operating as a general presumption in favour of directors as it does in the US.[236]

The failure to specify the placement of the onus has a crucial impact on both the certainty and efficacy of the business judgment rule. Where the onus is placed on the defendant — as Austin, Beach and Santow JJ have deemed to be the case in Australia — it becomes significantly more challenging for a director to be granted the protection of the business judgment rule.[237] First, if the defendant is required to prove that it has acted in good faith, for a proper purpose, and without a material personal interest, this essentially requires the defendant to prove the lack of more serious breaches of their directors' duties under the *Corporations Act*.[238] Additionally, the onus places a significant evidential burden on directors — particularly non-executive directors — to have sufficient materials to prove satisfaction of the requirements.[239] As Findlay noted prior to the enactment of s 180(2), 'if the enhanced quantum of proof is not part of the Australian business judgment rule, then practically the rule would appear to have added little to the existing law.'[240] Moreover, the failure to place the onus of proof on the plaintiff has ensured that the rule has neither confirmed nor clarified the common law position that courts will rarely review *bona fide* business decisions. Although it has been argued that the statutory business judgment rule does encapsulate many of the same *considerations* as the common law business judgment doctrine, the courts' placement of the onus on the defendant means that courts

---

[233] Branson, 'A Business Judgment Rule for Incorporating Jurisdictions in Asia?', above n 234, 689.
[234] *Cede & Co Technicolor*, 634 A.2d 345, 361 (Del. 1993), (emphasis added). See also *Brehm v Eisner*, 746 A.2d 244, 264 (Del. 2000):

> In applying the business judgment rule, '[c]ourts do not measure, weigh or quantify directors' judgments . . . Irrationality is the outer limit of the business judgment rule'.

[235] Branson, 'A Business Judgment Rule for Incorporating Jurisdictions in Asia?', above n 234, 689.
[236] The usage of the word 'presumption' in the Explanatory Memorandum provides some indication that the plaintiff was in fact intended to bear the onus of proof:

> In particular, while the substantive duties of directors will remain unchanged, absent fraud or bad faith, the business judgment rule will allow directors the benefit of a *presumption* that, in making business decisions, they have acted on an informal basis, in good faith, and in the honest belief that the decision was taken in the best interests of the company'

Explanatory Memorandum, Corporate Law Economic Reform Bill 1999 (Cth) [6.1] (emphasis added). Nevertheless, courts have observed that the preceding phrase 'the substantive duties of directors will remain unchanged' negatives such an intention: *Rich* (2009) 236 FLR 1, [7269].
[237] *Rich* (2009) 236 FLR 1 (Austin J), [7269]; *Mariner* [2015] FCA 589, [485] (Beach J); *Australian Securities and Investments Commission v Adler* (2002) 41 ACSR 72, [410] (Santow J). See also, *Australian Securities and Investments Commission v Fortescue Metals Group Ltd* (2011) 190 FCR 364, [197]; *Australian Securities and Investments Commission v Macdonald (No 11)* (2009) 230 FLR 1.
[238] Namely, contraventions of the duty to act in good faith in the best interests of the corporation and for proper purposes under s 181(1), and the duty to refrain from improper use of position or information under ss 182(1) and 183(1) of the *Corporations Act 2001* (Cth): Neil Young, 'Has Directors Liability Gone Too Far or Not Far Enough? A Review of the Standard of Conduct Required of Directors' (2008) *Company and Securities Law Journal* 216, 223.
[239] Anne Findlay, 'CLERP: Non-Executive Directors' Duty of Care, Monitoring and the Business Judgment Rule' (1999) 27 *Australian Business Law Review* 98, 111; Andrew Lumsden, 'The Business Judgment Defence: Insights from ASIC v Rich' (2010) 28 *Companies and Securities Law Journal* 164, 168.
[240] Findlay, above n 241.

will inevitably have to scrutinise directors' decisions in order to analyse whether the pre-conditions of the statutory rule have been satisfied. Hence, the statutory rule arguably offers even less protection to directors' than the common law principle — which does not place such a significant evidentiary burden on directors in most cases — in this respect.

(ii) *The 'good faith' and 'proper purpose' pre-requisites*

Second, the good faith and proper purpose pre-condition in s 180(2) has created a number of complications.[241] Directors' duties to act in good faith and for proper purposes derive from their fiduciary duties, and not their duty of care. As such, the good faith and proper purposes precondition in s 180(2) amounts to somewhat of a 'double jeopardy' since it requires the defendants to prove the lack of a more serious contravention of the law.[242] Further, Fridman has argued that requirement in 180(2)(a) 'adds a level of analysis that causes great confusion its application' because of this doctrinal commingling. He continues:

> It is surprising to find that a corporate law reform program that is expressly motivated by an economics-inspired desire to render the law more certain chooses to include expressly a reference to the proper purpose rule. Even more surprising is that a business judgment rule, motivated by a desire to offer directors a safe harbor from personal liability in relation to honest, informed and rational business judgments incorporates the proper purpose rule by reference.[243]

After all, although the proper purposes doctrine was a large component of the general law business judgment principle, this was arguably more appropriate since that principle applies to *all* directors' duties and not simply the duty of care. As such, it is difficult to see how the inclusion of the doctrine as a pre-requisite to the application of the statutory business judgment rule has in any way 'clarified' the general law position when it simply incorporates it by reference.

(iii) *The interpretation of 'rationality' and 'reasonability' standards*

Lastly, a crucial component of the statutory business judgment rule that has proved difficult to construe is the requirement in s 180(2)(d) that 'the director *rationally* believes that the judgment is in the best interests of the corporation'. The particular difficulty with this provision is that it imports the concept of 'rationality' — which is largely foreign to the Australian legal system — and subsequently defines a rational belief as 'one that no *reasonable* person in their position would hold' in the following paragraph. This has led to a debate over whether 'rationality' is equated with 'reasonability' under provision, and if not, whether the term 'rationality' imposes a lower standard than the term 'reasonable'. Young QC has suggested that the provision does equate rationality with reasonability, and hence 'propounds a standard no less stringent than that required by s 180(1)'.[244] On the other hand, Austin J was informed by the dictionary definition of rationality and accordingly held:

---

[241] The 'proper purposes' requirement is absent in the United States formulations and reflects the fact that it is distinct from the requirement of good faith under Anglo-Australian law: Santow, above n 130, 349,
[242] See *Rich* (2009) 236 FLR 1, [7269] (Austin J); *Australian Securities and Investments Commission v Adler* (2002) 168 FLR 253, [410] (Santow J).
[243] Saul Fridman, 'An Analysis of the Proper Purposes Rule' (1998) 12(1) *Bond Law Review* 164, 183.
[244] Young, above n 240, 222.

> [i]t is *plausible* to say that the drafters of the definition of 'rationally believe' intended to capture this latter idea, namely that the director's or officer's belief would be a rational one if it was based on reason or reasoning (whether or not the reasoning was convincing to the judge and therefore 'reasonable' in the objective sense), but it would not be a rational belief if there was no arguable reasoning process to support it. The drafters articulated the latter idea by using the words 'no reasonable person in their position would hold'.[245]

To add further fuel to the discussion, Mathew Hooper has argued that the correct approach is to interpret the provision in light of the case law on *Wednesbury* unreasonableness in order to determine whether the belief was so unreasonable as to be 'not rational'.[246] It is likely that this debate will remain unresolved until it is considered at an appellate level.[247]

B *ENHANCED 'ACOUSTIC SEPARATION'?*

A fundamental question remains over the extent to which the statutory business judgment rule has broadened the 'acoustic separation' between conduct rules and decisions rule in practice, and not simply on a theoretical level. Specifically, it remains dubious whether the statutory business judgment rule is able to offer directors greater protection for legitimate risk-taking and *bona fide* business decisions than the general law business judgment principle in a concrete way.

The conclusion that can be gleaned from *Rich*, *Mariner* — and implicitly at least, *Deangrove* — is that the general law business judgment principle remains as a standard of review. It still appears to be a fundamental consideration in determining whether the directors' action or inaction was simply an error going to the merits of a business decision (in which case the courts will decline to review the directors' conduct), or if it constitutes a breach of the standard of care for which liability will be imposed. In other words, the general law decision rule remains integral to the determination of whether the duty of care — either at general law or under s 180(1) — has been breached. Additionally, as Austin J acknowledged in *Rich*, it is not a bright line test and the grounds on which the 'exception' may be invoked remain open-ended.[248]

On the other hand, the statutory business judgment rule operates as a specific *defence* to a breach of directors' duty of care — again, either at general law or under s 180(1) — if the directors can prove that they have made a 'business judgment' as defined, and the preconditions in s 180(2)(a)–(d) are satisfied. Since the general law business judgment principle is a factor in determining whether the duty of care is *itself* breached, it remains a theoretical possibility that the statutory business judgment rule can be applied in circumstances where the directors would otherwise be liable under the duty of care and general law principle. But as Austin J noted, whether this theoretical possibility can be manifested in practice is contingent on the extent to which the preconditions in s

---

[245] *Rich* (2009) 236 FLR 1, [7289].
[246] See Mathew Hooper, 'The Business Judgment Rule: (2011) ASIC v RICH and the reasonable-rational divide' *Bond Corporate Governance eJournal* <http://epublications.bond.edu.au/cgej/22>.
[247] See *Rich* (2009) 236 FLR 1 [2009], 7269.
[248] Although we contend that the rule generally entails that courts will not review a business judgment made in good faith, for a proper purpose, in the absence of a material personal interest in the judgment, and if the directors' possessed a reasonable belief that the decision was in the best interests of the corporation: at 17.

180(2)(a)–(d) differ from the considerations under the general law business judgment principle.[249]

In fact, Beach J's judgment in *Mariner* demonstrates that many of the same factors fall for consideration under the general law business judgment principle and the statutory business judgment rule. For instance, the fact that Mr Olney-Fraser was found to have acted in good faith and on the basis that the potential benefits of his conduct outweighed the risk of harm was instructive both in relation to fulfilment of the duty of care under s 180(1), and the prerequisites under s 180(2)(a), (c) and (d) of the statutory business judgment rule.[250] Moreover, Mr Olney-Fraser's substantial experience in the relevant area went to the existence of a 'business decision' as defined under s 180(3), and also informed Beach J's reluctance to 'second-guess' the merits of the directors' business decision under the general law principle.[251] Additionally, the director's lack of a material personal interest in the transaction appeared to be relevant to both the duty of care and the pre-condition under s 180(2)(b).[252] The substantial overlap between the general law business judgment principle and statutory business judgment rule was also evident in *Deangrove*, where Branson J simply determined that the receivers had fulfilled their duty of care '[f]or the reasons discussed above' in relation to s 180(2).[253]

Indeed, as Berkahn and Black noted prior to the enactment of s 180(2), the general law business judgment principle appears to encapsulate the same essential elements as the statutory business judgment rule, albeit using different terminology.[254] If, as we contend, the general law principle provides for a flexible exception for business judgments made in good faith,[255] for a proper purpose,[256] in the absence of a material personal interest in the transaction,[257] and with a reasonable belief that the decision was in the best interests of the business corporation,[258] it is difficult to conceive of a situation where the statutory business judgment rule would offer directors additional protection in practice.[259]

---

[249] *Rich* (2009) 236 FLR 1, 146

[250] *Mariner* [2015] FCA 589 [453]–[482], [486], [487], [488], [544], [492].

[251] Ibid [9], [11], [12], [13], [441], [476], [486]–[487], [500], [558].

[252] Ibid [448], [489], [545].

[253] *Deangrove* [2006] FCA 212 [69].

[254] Mathew Berkahn, 'A Statutory Business Judgment' (1999) 3 *Southern Cross University Law Review* 215, 226; LexisNexis, *Australian Corporations Law – Principles and Practice* (at 23 November 2015) [3.2A.0060].

[255] *Harlowe's Nominees Pty Ltd v Woodside (Lakes Entrance) Oil Co* (1968) 121 CLR 483, 493.

[256] *Harlowe's Nominees Pty Ltd v Woodside (Lakes Entrance) Oil Co* (1968) 121 CLR 483, 493; *Whitehouse v Carlton Hotel Pty Ltd* (1987) 162 CLR 285, 292–3.

[257] *Harlowe's Nominees Pty Ltd v Woodside (Lakes Entrance) Oil Co* (1968) 121 CLR 483, 493–4, quoting *Mills v Mills* 1938) 60 CLR 150, 163; *Whitehouse v Carlton Hotel Pty Ltd* (1987) 162 CLR 285, 292–3. Contra Santow, above n 130, 350, who states

> the CLERP version has the onus of proving the five elements before there is any presumption in her or his favour . . . [O]n of them, not however part of our general law, precludes any material personal interest — thus for example excluding from its protection the director who has shares in the company but bone fide causes the company to enter into a price sensitive transaction. One might have thought a duty to act in good faith or proper purposes sufficed as a safeguard.

However, as was argued above, the approach taken in *Harlowe's Nominees Pty Ltd v Woodside (Lakes Entrance) Oil Co* (1968) 121 CLR 483 appears to indicate that a directors' material personal interest in a transaction would preclude the 'proper purposes' doctrine from applying: 493–4; see also Berkahn above n 256, 226.

[258] Berkahn, above n 256, 226; see also *Reid Murray Holdings Ltd (in liq) v David Murray Holdings Pty Ltd* (1972) 5 SASR 386, 402, citing *Charterbridge Corp Ltd v Lloyds Bank Ltd* [1970] Ch 92 where the test was phrased as whether 'an intelligent and honest man in the position of the director company concerned could, in the whole of existing circumstances, have reasonably believed that the transaction were for the benefit of

One difference in the criteria that need to be satisfied appears to be that none of the cases in which the general law principle has been considered have explicitly listed a requirement that the directors must 'inform themselves about the subject matter of the judgment to the extent they reasonably believe to be appropriate'.[260] Nevertheless, the *AWA Appeal* indicates that a director must remain informed about the corporation's activities and will not be liable for legitimate commercial risk-taking at common law — which appears to cover much of the same ground.[261] Another difference is the requirement under the proper purposes doctrine that the directors possesses a *reasonable* belief that their decision was in the best interests of the corporation, compared to s 180(2)(d) which specifies that the requisite belief must be *rational*. However, as discussed above, the practical ramifications of this distinction remain uncertain.[262]

The extent of this overlap between the two decision rules was anticipated even before the statutory business judgment rule was enacted. For instance, Cameron noted that the statutory business judgment rule 'would not change the substantive law at all',[263] a sentiment echoed by Redmond who stated that the general law principle 'in function, if not name, embodies such a business judgment rule.'[264] This in fact appears to have been Parliament's express intention when enacting s 180(2). As the Australian Institute of Company Directors argued, the business judgment rule was not designed to lower the current standard of care or conduct — it was simply designed to lower the 'risk of liability [by] articulating the circumstances in which the courts will enquire no further into the nature and quality of a decision made by directors.'[265] This appears to be consistent with the Explanatory Memorandum introducing s 180(2) which stated:

> the statutory formulation of the business judgment rule will clarify and confirm the common law position that the Courts will rarely review *bona fide* business decisions . . . [i]n particular, while the substantive duties of directors will remain unchanged, absent fraud or bad faith, the business judgment rule will allow directors the benefit of a presumption that, in making business decisions, if they have acted on an informal basis, in good faith, and in the honest belief that the decision was taken in the best interests of the corporate entity, they will not be challenged regarding the fulfilment of their duty of care and diligence.[266]

---

the company.' See also *Shuttleworth v Cox Bros and Co (Maidenhead) Ltd* [1927] 2 KB 9, 23–4; *Wayde v New South Wales Rugby League Ltd* (1985) 61 ALR 225, 232 where it was said that in cases in which 'no reasonable board of directors could think [the action or inaction] to be substantially for a purposes for which the power was conferred, the court may infer that the decision was not made in good faith for a purpose within the power and may intervene on that ground'.

[259] See Santow, above 130, 350–1; Redmond, above n 131.

[260] *AWA Appeal* (1995) 16 ACSR 607, 656, citing *Hedley Byrne & Co Ltd v Heller & Partners Ltd* [1964] AC 465; Berkahn, above n 256, 226.

[261] In *Harlowe's Nominees Pty Ltd v Woodside (Lakes Entrance) Oil Co NL* (1968) 121 CLR 493-4, citing *Mills v Mills* (1938) 60 CLR 150, 'improper purposes' for which the general law business judgment principle could not be invoked were said to include a transaction in which a director has a 'personal interest'.

[262] At 32–3.

[263] Alan Cameron, 'The Perspective of the Australian Securities Commission on the Enforcement of Directors' Duties and the Role of the Courts' in Ian M Ramsay (ed), *Corporate Governance and the Duties of Company Directors* (Centre for Corporate Law and Securities Regulation, 1997) 205, 207.

[264] Redmond, above n 131, 198.

[265] Australian Institute of Company Directors, Submission to the Attorney-General of the Commonwealth of Australia, *Exposure Draft (February 1992) of the Corporate Law Reform Bill 1992* (May 1992) 32.

[266] Explanatory Memorandum, Corporate Law Economic Reform Bill 1999 (Cth) [6.4].

Further support for this interpretation is provided by the Second Reading speech, which reads:

> The rule will not lead to any reduction in the level of director accountability, but will ensure that they are not liable for decisions made in good faith and with due care. Directors will benefit from the certainty that the rule provides in terms of their liability as they will be encouraged to take advantage of business opportunities and not behave in an unnecessarily risk averse way.[267]

Insofar as the statutory business judgment rule was intended to encapsulate largely the same elements as the general law business judgment rule it might be deemed a success. However, this reveals a crucial difficulty with the s 180(2) business judgment rule. If the statutory business judgment rule were to provide a defence to s 180(1), it appears to follow that it would have to insulate directors from liability in respect of *bona fide* decisions to a greater extent than under the general law business judgment principle. This leads to a fundamental conundrum. As Redmond noted, either the statutory business judgment merely encapsulates the standard of conduct and/or review imposed under the duty of care (in which case it is redundant), or it lowers those standards (in which case it is contrary to Parliaments' stated intention in the above paragraphs).[268] As such, it appears as though the statutory business judgment rule has not substantially altered the 'acoustic separation' between conduct rules and decisions rules since it arguably encapsulates largely the same considerations as the existing general law standard of review. Moreover, as was previously discussed, any potential for the statutory business judgment rule to offer directors a practical 'defence', over and above that already existing in the general law, has arguably been neutered by the courts' interpretation of the provision as placing the onus of proof on the plaintiff. This is borne out by the fact that the statutory business judgment rule has yet to be applied in circumstances where the general law business principle would otherwise be inapplicable, or the duty of care would have been breached.

In view of the above discussion, the following conclusions can be made. From the early 20th century, the framework regulating directors' liability for the exercise of due care has imposed a standard of review which largely insulates directors from liability in respect of *bona fide* decisions. As was previously discussed, the equitable duty of care precluded the judicial review of *bona fide* decisions, unless the directors had acted with gross or culpable negligence. Subsequently, the decision rule evolved to shield directors from hindsight review of business decisions made in good faith, so long as they had not acted with improper purposes.[269] As a result of an increasingly stringent duty of care, a greater 'acoustic separation' between conduct and decision rules governing directors' liability for due care can be observed. At each stage, the lower standard of review has been justified on the basis that it protects directors' ability to take legitimate commercial-risks. The statutory business judgment rule was also enacted for this express purpose. But — to date — the introduction of the statutory business judgment rule does not appear to have altered this 'acoustic separation' in practice, largely because of Parliament's intention that the rule was to confirm the existing general law standard of review. By extension, it is dubious whether the statutory business judgment rule has been able to offer directors any

[267] Commonwealth, *Parliamentary Debates*, Senate, 3 December 1998, 1286 (Joe Hockey).
[268] Redmond, above 131, 203–4.
[269] As was previously argued, the additional requirements of a lack of material personal interest in the transaction, and a reasonable belief that the transaction was in the best interests of the corporation can be viewed as being subsumed within this requirement, above n 259.

greater clarity and certainty about when the business judgment principle could be enlivened than is already provided under the general law. [270]

[270] See, eg, Commonwealth, *Parliamentary Debates*, Senate, 3 December 1998, 1286 (Joe Hockey).

IV Conclusion

An analysis of the relevant case law reveals a fundamental tension between the express purposes for which the statutory business judgment rule was enacted. Parliament's stated desire to confirm the existing general law standard of review has seemingly led the provision to be interpreted in a manner such that it has not altered the existing 'acoustic separation' to an extent where it can be said to enhance directors' ability to take advantage of business opportunities. Moreover, the difficulties faced by the courts in construing the provision suggest that it has added greater complexity to the framework governing for directors' liability, rather than providing directors with greater clarity. As it stands, there are now three duties of care with different remedial consequences. In addition, a business judgment principle — which influences the applicability of these duties of care — subsists in the general law, and is complemented by a statutory business judgment rule that serves largely the same function — arguably with no more predictability or certainty.

One particular point of concern arises specifically in relation to non-executive directors. Historically, the law relating to directors' duty of care was able to distinguish between the liability of executive and non-executive directors, according to the role they were expected play within the corporation. The introduction of a heightened objective standard of care — which imposes the same bare minimum standard and duty of care on all directors — was heavily influenced by the standard of care in the United States. However, it is not accompanied by the presumption provided in favour of directors under the standard of review in that jurisdiction. As a result, the placement of the burden of proof on the defendant in enlivening the statutory business judgment rule is likely to significantly limit the ability of non-executive directors to seek protection under this standard of review. Although it is beyond the scope of this Conference Paper, this is an area that needs to be carefully considered as it may give rise to problems of adverse selection — with persons of specialized expertise being dissuaded from undertaking the responsibilities of a non-executive director for fear of the liability that currently attaches to the office.

None of the above is to say that the statutory business judgment rule cannot get closer to achieving its stated goals in the future. A theoretical distinction remains between the general law and statutory standards of review. Although this theoretical difference has not manifested in practice to date, this by no means precludes it from doing so in the future. The theoretical boundaries of the general law business judgment rule remain imprecise, and the statutory business judgment rule has not yet been considered by an appellate court. Indeed, as Austin J noted in *Rich*,[271] matters such as the onus of proof will eventually need to be resolved at the appellate level, and it might be that upon reaching this stage there will be dramatic changes both regarding the current acoustic separation, and the clarity of s 180(2). Nevertheless, given the limited role the statutory business judgment rule has played in the past 15 years, it is unlikely that directors will take much comfort in any of this. In particular, it is difficult to see how the statutory business judgment rule could be judicially reinterpreted to adequately address the particular difficulties faced by non-executive directors.

The perceived failure of the statutory business judgment rule to either clarify or confirm the existing general law position, or provide directors with an effective safe harbour has

---

[271] (2009) 236 FLR 1, [7296]

again intensified the debate surrounding the appropriate level of director liability.[272] Although the various proposals for amendment of the rule are beyond the scope of this Conference Paper, the following comments will be made. The enactment of the statutory business judgment rule was just one product of the perennial judicial and legislative endeavour to strike an appropriate balance between directors' accountability for due care and the promotion of legitimate risk-taking. This balance, as the above discussion suggests, is not one that is easily struck. Any potential revision of the liability placed on directors must carefully consider the existing framework, and specifically, the subsisting role of the general law business judgment rule. Moreover, the fundamental tension that can be observed between the parliamentary policies in implementing the rule must be understood, particularly when proposing further legislative changes in view of '[f]ulfilling parliament's intention'.[273] In fact, there is much to be said for the judicial development of the existing general law business judgment principle due to its inherently flexible nature, and the complicated state of the law now governing directors' liability for due care given the two overlapping standards of review.[274] As Davies puts it:

> I would like to suggest that ex post customising of the standard of care is likely to be of greater benefit to directors than ex ante fixing of identifiable safe harbours — because the former is feasible whilst the latter is not without producing an unacceptable rigidity in judicial decision-making.[275]

---

[272] See, eg, Lysarne Pelling, 'Fulfilling parliament's intention: A business judgment rule to stimulate responsible risk-taking and economic growth' (2015) 67(6) *Governance Directions* 344; Judith Fox, 'Honest and reasonable director defence' (2015) (67)(4) *Governance Directions* 218; Malcolm Broomhead, 'The business judgment rule: A case for change to the AICD model' (2015) 67(3) *Governance Directions* 138; Jason Harris and Anil Hargovan (2014) 66(10) *Governance Directions* 634; Dean Jordan and Michael Legg, 'The Australian business judgment rule after ASIC v Rich: balancing director authority and accountability (2013) 34(2) *Adelaide Law Review* 403. One author has been particularly scathing about what he perceives to be the 'relentless, uninspiring, evidence-free campaign for the change to the business judgment rule': Dean Paatsch, 'The business judgment rule; A case for a 'known quantity' (2015) 67(3) *Governance Directions* 67(3) *Governance Directions* 140, 140.

[273] See Pelling above n 274.

[274] In the context of the United States, Melvin Eisenberg puts the argument for a common law rule of flexible dimension as follows:

> The business judgment rule protects directors and officers from the unfair imposition as a result of hindsight bias, by providing directors and officers with a large one of protection when their decisions are attacked. The need for this zone of protection is highlighted by comparing business decision makers with other kinds of actors who must make decisions on the basis of incomplete information and in face of obvious risks. Many such actors — for example, doctors — can often shield themselves from liability for bad outcomes by showing that their decision was based on accepted protocols or practices. In contrast, directors and officers can seldom shield themselves in that way because almost every business decision is unique. In this respect, perhaps the closest analogy to business decision makers would be executive officers of governments, who also cannot resort to established protocols and practices to justify their decisions, and are shielded by a qualified immunity . . . Furthermore, as a matter of policy the shareholders' own best interests may be served by conducting a only a very limited review of the quality of directors' and officers' decisions. It is often in the interests of shareholders choose the riskier of two alternative decisions, because the expected value of the more risky decisions may be greater than the expected value of the less risky decision.

Melvin Eisenberg, 'The Duty of Care and the Business Judgment Rule in American Corporate Law' (1997) *CFLICR* 185, quoted in Santow, above n 130, 350–1.

[275] Paul Davies, 'Self-Incrimination, Fair Trails, and the Pursuit of Corporate and Financial Wrongdoing' in Markesinis (Ed), *The Impact of the Human Rights Bill on English Law* (Oxford University Press, 1998) 50, quoted by Santow, above n 130, 351.

Given the role the general law principle continues to play in regulating directors' liability, claims that legislative developments will grant directors' greater certainty with respect to their liability must be heeded with caution. The business community will no doubt benefit from greater clarification in this area as it emerges from the financial crisis. It may be that legislative development is indeed the best method for achieving this clarity. But any clarification must be weighed against the undue rigidity it may pose. Future developments must also adopt a measured approach, and it questionable whether Australia ought to directly emulate the regulatory environment of Delaware, not least because of the evident difficulties legal transplants may face.[276] The balance between directors' authority and their liability for due care continues to be the goal to which both the judiciary and legislature must aspire. But any developments must first conduct a careful analysis of the existing legal framework, policies and case law.

[276] See Fox, above n 274, 41.