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The Abstract Void in Practice: Has the Statutory Business Judgment Rule Changed the 'Acoustic Separation' Between Conduct and Decision Rules for Directors' Duty of Care?

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A recent outpouring of director sentiment claims that the stringency of directors' duty of care is stifling entrepreneurial growth. This article explores whether the statutory business judgment rule has enhanced directors' protection for legitimate commercial decisions, or clarified their liability for due care — the two express justifications behind its enactment. Directors' protection for entrepreneurial decision-making cannot be amplified without broadening the pre-existing abstract void between the duty of care — as a conduct rule — and the general law 'business judgment principle' — as a decision rule. But Parliament's desire to clarify and confirm the existing general law business judgment principle, and not lower it, has neutered the statutory rule's potential to safeguard directors' entrepreneurial discretion in practice. This article explores the inherent tension underlying the current rule, investigates its practical ramifications, and cautions that any future legislative proposals must address this tension to overcome the current rule's shortcomings.

Introduction

Balancing directors' accountability for due care and the promotion of entrepreneurial decision-making remains central in corporate governance. In 2001, the Federal Government controversially enacted the statutory business judgment rule in s 180(2) of the *Corporations Act 2001* (Cth) to strike an equilibrium between legitimate risk-taking and due care.[1] The rule had two express purposes: first, to clarify and confirm the existing general law standard of review; and second, to safeguard directors' authority to make honest, informed and rational business decisions and thereby encourage enterprise.[2]

Prior to the statutory business judgment rule's enactment, commentators expressed concerns that it would unduly shift the balance towards directors' impunity and compromise their accountability.[3]

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[1] For the controversy surrounding the rule see, eg, A Croome, 'Is the Business Judgment Rule being whittled away – AICD Review' (1 May 2005) *Company Director Magazine* <http://www.companydirectors.com.au/director- resource-centre/publications/company-director-magazine/2000-to-2009-back-editions/2005/may/is-the-business-judgment-rule-being-whittled-away-aicd-review>; The Treasury, 'Review of Sanctions in Corporate Law', 2007 <http://www.treasury.gov.au>, at p 29; D Tan, 'Delivering the Judgment on a Statutory Business Judgment Rule in Australia' (1995) 5 *AJCL* 442; R Baxt, 'Do We Need a Business Judgment Rule for Company Directors?' (1995) 69 *ALJ* 571; L Law, 'The Business Judgment Rule in Australia: A Reappraisal Since the AWA Case' (1997) 15 *C&SLJ* 174.

[2] See Explanatory Memorandum, Corporate Law Economic Reform Bill 1999 (Cth), at [6.4]; Commonwealth, *Parliamentary Debates*, Senate, 3 December 1998, at p 1286 (Joe Hockey).

[3] See, eg, B Keller, 'Australia's Statutory Business Judgment Rule: A Reversal of a Rising Standard in Corporate Governance' (2001) 71 *LIJ* 60; G Lyon, 'Directors' Duty of Care and Business Judgment Rule' (1998) 72(1) *LIJ* 59.

Yet a recent outpouring of director sentiment claims the burden of their duty of care is engendering risk-aversion and stifling economic growth.[4] Directors have identified s 180(2)'s failure to protect legitimate business decisions as particularly problematic and have called for broader statutory protection for directors' personal liability.[5] Against this background, an appraisal of the extent to which the rule has fulfilled its intended purposes is both timely and necessary — particularly in light of the rare decision to invoke the rule in *Australian Securities and Investments Commission v Mariner Corporation Limited* (2015) 106 ACSR 343 ('*Mariner*').

This article evaluates the operation of the statutory business judgment rule through the lens of 'acoustic separation'. Acoustic separation characterises the abstract void between the standard of conduct (or 'conduct rule') the duty of care theoretically prescribes for directors, and the standard of review (or 'decision rule') under which courts apply these theoretical standards in practice.

The article's central contention is that the statutory business judgment rule fails to provide directors' superior protection for business decisions due to an inherent tension between its dual purposes of clarifying the existing standard of review and enhancing directors' entrepreneurial decision-making. The business judgment rule cannot enhance directors' protection for legitimate risk-taking without lowering the standard of review. But Parliament's stated desire to 'confirm' the existing general law standard of review means it cannot alter the acoustic separation between conduct and decision rules and, by extension, amplify directors' protection for legitimate enterprise. For this reason, we contend that the tension between these competing aims poses difficulties of interpretation, serving only to heighten the complexity of the framework governing directors' liability instead of providing directors with greater clarity and superior protection for entrepreneurial decision-making.

The article is set out in four parts. Part I traces directors' evolving liability for due care to illuminate the underlying rationales for the statutory business judgment rule. Part II discusses the general law standard of review and surveys the key cases involving the statutory business judgment rule to determine the extent to which it has altered the framework governing directors' liability for care. Part III scrutinises the provision's success in enhancing directors' autonomy and clarifying their liability for due care. Part IV concludes.

I Evolving Standards of Conduct

Granting the board with control over the corporation poses two inherent risks: knavishness and shirking. The board's formal managerial powers create an informational asymmetry between the board as 'controllers' of the corporation and other stakeholders.[6] This informational division

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[4] See, eg, Australian Institute of Company Directors, *The Honest and Reasonable Director Defence: A Proposal for Reform* (August 2014) <http://www.companydirectors.com.au/~/media/resources/director-resource-centre/policy-on-director-issues/2014/the-honest--reasonable-director-defence-a-proposal-for-reform_august-2014_f.ashx?la=en>; N Hunt, E Bruce and D Friedlander, 'Business Judgment Rule Needed', *The Australian Financial Review* (online), 18 July 2014 <https://global-factiva-com.ezproxy1.library.usyd.edu.au/ha/default.aspx#./!?&_suid=146434187718107240893807463404>; M Papadakis, 'Vexed Debate on Directors' Personal Liability Rages', *The Australian Financial Review* (online), 8 May 2015 <https://global-factiva-com.ezproxy1.library.usyd.edu.au/ha/default.aspx#./!?&_suid=146434187718107240893807463404>; M Papadakis, 'Is Directors' Liability a Drag on Growth?', *The Australian Financial Review* (online), 7 May 2015 <http://www.afr.com/business/legal/is-directors-liability-a-drag-on-growth-20150505-ggu92o>; J Whyte, 'Risk-Averse Directors are Stifling Growth', *The Australian Financial Review* (Online), 6 December 2015 <http://www.afr.com/leadership/management/decision-making/riskaverse-directors-are-stifling-growth-20151204-glfv9d>.

[5] See, eg, Australian Institute of Company Directors, above n 4; Papadakis, 'Is Directors' Liability a Drag on Growth?', above n 4.

[6] M J Whincop, *An Economic and Jurisprudential Genealogy of Corporate Law*, Ashgate/Dartmouth, Aldershot, Hants, England, 2001, p 73.

heightens the risk of director misbehaviour by minimising their accountability.[7] In other words, stakeholders' imperfect knowledge of the board's activities amplifies the possibility of directors being active, but not in pursing the interests of the corporation, or directors' shirking their responsibilities.[8] Stakeholders must incur monitoring costs to narrow this informational asymmetry and thereby reduce the risk of these agency costs.[9]

The central legal mechanisms for minimising these agency costs are directors' duties. Directors' fiduciary duties target the risk of knavishness, while directors' duty of care aims to address shirking or lack of due care.[10] Traditionally, directors' duty of care set a very low yardstick and was enforced leniently. One commentator notes an 'almost total absence of civil decisions' where a director was held liable for breach of their duty of care until the 1990s.[11] But from this point onwards, the legal expectations for directors set by the duty of care have been amplified at both a judicial and legislative level.[12] Even a cursory survey of academic and legislative focus reveals an increasing emphasis placed on directors' duty of care as a lynchpin of contemporary Australian corporate governance.[13] This evolution reflects a judicial and legislative attempt to refine the balance between accountability and legitimate business enterprise in light of heightened community expectation of directors' roles in corporate governance.

Directors' obligations to exercise care, skill and diligence in performing their duties originated in the exclusive jurisdiction of equity. The equitable duty of care assessed directors' liability by reference to their subjective knowledge and skills, with 'gross or culpable negligence' the only objective yardstick.[14]

The equitable duty of care's leniency was underpinned by the commercial realities of the time. First, the equitable standard distinguished between executive and non-executive directors' respective roles in commercial practice and tailored their liability accordingly. At the time, non-executive directors were 'window-dressing', and their greatest contribution to the corporation was viewed as lending their name and social connections to the board.[15] Second, the equitable standard of care reflected a view that shareholders ought to bear ultimate responsibility for the board, because of their ability to appoint and remove directors.[16] Professor Gower aptly captured the sentiment of the time when he stated that 'if [the shareholders] chose incompetent directors, that was their fault and the

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[7] Ibid.

[8] P L Davies, *Gower and Davies: Principles of Modern Company Law*, 8th ed, Sweet and Maxwell, London, 2008, p 488.

[9] See Michael C Jensen and William H Meckling, 'Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure' (1976) 3 *Jnl Fin Econ* 305.

[10] Davies, above n 8.

[11] P Redmond, *Corporations and Financial Markets Law*, Lawbook Co, Sydney, 2013, p 428.

[12] 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;; *Daniels v Anderson* (1995) 37 NSWLR 438; *Australian Securities and Investments Commission v Rich* (2003) 174 FLR 128; *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*').

[13] See, eg, R P Austin, 'Foreword' (2012) 35 *UNSWLJ* 248; G Golding, 'Tightening the Screw on Directors: Care, Delegation and Reliance' (2012) 35 *UNSWLJ* 266.

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

[15] See, eg, J E Parkinson, *Corporate Power and Responsibility: Issues in the Theory of Company Law*, Clarendon, London, 1993, p 101–2; *Re Whitely* (1886) 33 Ch D 347 at 355.

[16] In the early to mid 20th century, only one third of Australian corporations could be described as 'management controlled', see S Ville and D Merrett, 'The Development of Large Scale Enterprise in Australia 1910–1964' (2000) 43 *Business History* 13.

remedy lay in their hands.'[17] 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.[18] As the Delaware Court of Chancery acknowledged:

> The essence of business is risk – the application of informed belief to contingencies whose outcomes can sometimes be predicted, but never known. The decision-makers entrusted by shareholders must act out of loyalty to those shareholders. They must in good faith act to make informed decisions on behalf of the shareholders, untainted by self-interest. Where they fail to do this, this Court stands ready to remedy breaches of fiduciary duty.
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> Even where decision-makers act as faithful servants, however, their ability and the wisdom of their judgments will vary. The redress for failures that arise from faithful management must come from the markets, through the action for shareholders and the free flow of capital, and not from this Court. Should the Court apportion liability based on the ultimate outcome of decisions taken in good faith by faithful directors or officers, those decision-makers would necessarily take decisions that minimize risk, not maximize value.[19]

The low equitable standard of care, therefore, was not without reason. But even by the standards of the time, the lenient benchmark was arguably inappropriate for executive directors who were remunerated for the commercial expertise they were expected to bring to the corporation. For this reason, courts recognised a duty to exercise *reasonable* care for executive directors based on an express or implied term of their service contract with the corporation. But the contractual standard of care did not apply to non-executive directors who performed their roles without an executive service contract.

Directors' duty of care came under increasing scrutiny in Australia following a number of 'spectacular' corporate collapses in the 1980s.[20] By this stage, companies were larger, their business more complex, and their shareholders more numerous.[21] The Australian community came to expect more of directors, and particularly non-executive directors —who had acquired a more prominent role in corporate governance with increased responsibilities. *Daniels v Anderson* (1995) 37 NSWLR 439 (the '*AWA Appeal'*) was the landmark decision where these changed community standards were directly recognised through an unequivocally objective duty of care owed by *all* directors in negligence. In the *AWA Appeal*, the majority of the New South Wales Court of Appeal (Clarke and Sheller JJA) rejected the 'subjective' equitable standard of care, acknowledging that 'neither the law about the duty of directors nor the law of negligence has stood still' since the formulation of the equitable duty of care. [22]

Directors' amplified general law duty of care was mirrored by a number of refinements to their statutory duty of care. The current statutory duty of care can be found in s 180(1) of the *Corporations Act 2001* (Cth). The standard of care imposed by under the statutory and general law duties have

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[17] L C B Gower, *The Principles of Modern Company Law*, Stevens and Sons, London 3rd ed, 1969, p 488. See also *Barnes v Andrews* 298 F 614 at 618 (1924) (Judge Learned Hand).
[18] Gower, above n 17, pp 488, 550.
[19] *In re Walt Disney Co. Derivative Litigation*, 907 A 2d 693 (Del. Ch. 2005) at 698.
[20] Both the National Companies Bill 1976 (Cth) and the first draft of the Companies Bill 1981 (Cth) 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 by 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 13, at 269, note 14.
[21] J F Corkery, *Directors' Powers and Duties*, Longman Cheshire, Melbourne, 1987, p 132.
[22] *AWA Appeal* at 497.

converged to essentially the same set of obligations.[23] 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'.[24] Second, this bare minimum requirement is assessed according to the care, skill and diligence that a reasonable person occupying the same position would exercise in like circumstances.[25] Third, the content of this objective duty varies according to 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 her or himself as having in support of their appointment to office.[26] Fourth, a director must familiarise her or himself with the corporation's fundamental business and it is no defence that a director lacks the knowledge needed to discharge the requisite degree of care.[27] Fifth, directors must remain informed about the activities of the corporation and oversee those activities.[28] Sixth, directors must maintain a familiarity with the corporation's financial status by regularly reviewing and understanding the corporation's financial statements.[29] Seventh, the possible harm caused by a director's action or inaction must be weighed against the potential benefits reasonably expected to accrue to the corporation.[30]

The objective standard of care is underpinned by the idea that a person should not accept a directorship unless they have the appropriate skills and commitment to perform the role. But the heightened standard spurred concerns that the regulatory balance had shifted too far in favour of director liability, deterring legitimate risk-taking and dissuading valuable candidates from boardrooms.[31] Seemingly in response to these concerns,[32] the Federal Government enacted a statutory business judgment rule in 2001 to clarify and confirm the existing general law standard of review, and protect directors' ability to make good faith business decisions.[33] As such, an evaluation of the extent to which the rule has met its legislative purposes first requires an understanding of the pre-existing general law standard of review.

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[23] See *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*; *Ingot Capital Investments Pty Ltd v Macquarie Equity Capital Markets Ltd* (2007) 63 ACSR 1; *Australian Securities and Investments Commission v 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. The following summary is indebted to Golding, above n 13, at 269.

[24] *Deputy Commissioner of Taxation v Clark* (2003) 57 NSWLR 113 at 140. See also *AWA Appeal* at 504.

[25] *AWA Appeal* at 504.

[26] *AWA Appeal* at 505; *Centro* at 320. See also *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 at 857–8; *Shafron v Australian Securities and Investments Commission* (2012) 88 ACSR 126 at [20].

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

[28] *AWA Appeal* at 504–5, quoting *Francis v United Jersey Bank* 432 A 2d 814 (NJ 1981).

[29] Ibid, at 503–4, quoting *Francis v United Jersey Bank*, 432 A 2d 814 (NJ 1981); *Centro* at 298.

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

[31] Baxt, above n 1.

[32] See F Carrigan, 'The Role of Capital in Regulating the Duty of Care and Business Judgment Rule' (2002) *AJCL* 215.

[33] Explanatory Memorandum, Corporate Law Economic Reform Bill 1999 (Cth), at [6.4]; Commonwealth, *Parliamentary Debates*, Senate, 3 December 1998, at p 1286 (Joe Hockey).

II Evolving Standards of Review

A *General Law Business Judgment Principle*

Anglo-Australian courts have long been reticent to second-guess the directors' bona fide business judgments.[34] As the High Court stated in *Harlowe's Nominees Pty Ltd v Woodside (Lakes Entrance) Oil Co* (1968) 121 CLR 483 ('*Harlowe's Nominees*'):

> 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.[35]

This judicial policy of non-interference was also evident at the highest level in the United Kingdom. In *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821 ('*Howard Smith*'), 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.[36]

Again, the judicial hesitance to review honest business decisions largely explains the traditional dominance of directors' fiduciary duties and the comparatively rare litigation involving breach of the duty of care. But the judicial policy of non-interference was evident even outside of the duty of care.[37] The 'proper purposes' doctrine provides a good illustration. 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.[38] Because the duty of care traditionally set a lenient bar, disputes over business judgments were regularly pleaded as breaches of the proper purposes doctrine.[39] But even framed in this way, directors often escaped judicial review.[40]

One example is *Pine Vale Investments v McDonnell and East Ltd* (1983) 8 ACLR 199.[41] In that case, the directors of the McDonnell and East Ltd ('McDonnell') issued shares to all of its shareholders at a $2.00 premium above par value to finance a takeover of Piggot & Co Pty Ltd ('Piggot'). The plaintiff corporation, Pine Vale Investments Ltd, held 26% of the shares in McDonnell and was planning to launch a competing takeover bid for Piggot.[42] In dismissing the plaintiff's application to have the share rights issue enjoined, McPherson J based his decision on the principles of non-intervention enunciated in *Harlow's Nominees* and *Howard Smith*.[43] In particular, his Honour's decision appeared to be contingent on the fact that the McDonnell's directors genuinely believed that their actions were in the company's best commercial interests. McPherson J stated:

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[34] See *Harlowe's Nominees* at 493; *Howard Smith* at 835; *Turquand v Marshall* (1869) LR 4 Ch App 376 at 386; *Dovey v Corey* [1901] AC 477, 488; LexisNexis, *Ford, Austin and Ramsay's Principles of Corporate Governance* (at 23 November 2015), at [8.025].
[35] *Harlowe's Nominees* at 493.
[36] *Howard Smith* at 831.
[37] See L Law, above n 1, at 180–1.
[38] See *Australian Metropolitan Life Assurance Co Ltd v Ure* (1923) 33 CLR 199.
[39] See *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.
[40] Law, above n 1, at 181.
[41] *Pine Vale Investments v McDonnell and East Ltd* (1983) 8 ACLR 199 at 201–7.
[42] Ibid, at 201.
[43] Ibid, at 208.

> 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.[44]

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

One qualification on the judicial practice of non-intervention was that courts may deny directors the benefit of non-intervention 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.'[45] Put another way, a pre-condition to the benefit of judicial self-ordinance was whether 'an intelligent and honest man in the position of the company director concerned could, in the whole of existing circumstances, have reasonably believed that the transactions were for the benefit of the company.'[46] An additional limitation is that a director must not have acted with a tainted interest.[47]

In totality then, courts apparently declined to review a business judgment made in good faith,[48] for a proper purpose,[49] in the absence of a material personal interest in the transaction,[50] and if the directors possessed a reasonable belief that the decision was in the best interests of the corporation.[51] Commentators have variously labelled this tradition of judicial non-interference as a general law 'business judgment principle',[52] 'business judgment doctrine',[53] or 'self-denying ordinance'.[54] But importantly, Australian courts have not explicitly characterised the business judgment doctrine as constituting 'a business judgment rule' akin to that which is well established in Delaware. Nevertheless, it is a flexible principle of judicial intervention which 'in function, if not name, embodies such a rule.'[55]

Perhaps the main reason the general law business judgment principle remains relative obscure in Australian jurisprudence is because the traditionally lenient standard of care removed the necessity for detailed judicial consideration of the doctrine. Previously, when the standard of care was set at 'gross or culpable negligence', the protection courts granted to directors who exercised their judgment honestly, for proper purposes, reasonably, and without a conflict of interest was largely irrelevant for alleged breaches of care. Put another way, the business judgment principle, as a conduct

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[44] Ibid, at 209.

[45] *Shuttleworth v Cox Bros and Co (Maidenhead) Ltd* [1927] 2 KB 9 at 23–4; *Wayde v New South Wales Rugby League Ltd* (1985) 180 CLR 459.

[46] *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 at 402.

[47] *Harlowe's Nominees* at 493–4.

[48] *Harlowe's Nominees* at 493; *Whitehouse v Carlton Hotel Pty Ltd* (1987) 162 CLR 285 ('*Whitehouse*') at 292–3.

[49] *Whitehouse* at 292–3.

[50] This requirement is subsumed within the broader definition of proper purposes: *Harlowe's Nominees* at 493–4; citing *Mills v Mills* (1938) 60 CLR 150 at 163; *Whitehouse* at 292–3.

[51] See LexisNexis, *Australian Corporations Law — Principles and Practice* (at 1 July 2016), at [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.

[52] See *Australian Securities and Investments Commission v Rich* (2009) 236 FLR 1 at 145 (Austin J).

[53] J H Farrar, 'Duties of Care — Issues of Classification, Solvency and Business Judgment and the Danger of Legal Transplants' (2011) 23 *SAcLJ* 745, at [35]

[54] G F K Santow, 'Codification of Directors' Duties' 73 *ALJ* 336, at 348.

[55] P Redmond, 'Safe Harbours or Sleepy Hollows: Does Australia Need a Statutory Business Judgment Rule?' in I M Ramsay (Ed), *Corporate Governance and the Duties of Company Directors*, Centre for Corporate Law and Securities Regulation, Melbourne, 1997, p 198.

rule, did not impose a tangibly lower level of liability than the duty of care itself. Hence, any theoretical divergence between the two standards was unlikely to have practical ramifications for directors.

Following the *AWA Appeal*, the standards of conduct and review appeared to diverge: the former was heightened whereas the second appeared to remain substantially unaltered. Clarke and Sheller JA elevated the duty of care as a conduct rule by obliging directors to, among other things, take reasonable steps to guide and monitor the corporation, maintain a familiarity with the fundamentals of the corporation's business and its financial status, and oversee its activities.[56] On the other hand, their Honours said nothing about altering the general law business judgment principle. In addition, their Honours recognised that directors are expected 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'.[57] These comments implied that the general law business judgment principle survived to some extent. Thus, the standard of review under the business judgment principle appeared to set a lower standard than the duty of care in certain instances. As such, 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 courts would actually find directors liable for falling short of this standard.

B *Statutory Business Judgment Rule*

Even before the heightened standard of care following the *AWA Appeal*, the enactment of a more robust Delaware-style business judgment rule was a hot topic for regulatory reform.[58] The government of the time rejected proposals for a statutory business judgment rule on the basis that the existing general law 'business judgment principle' sufficiently protected directors' business judgments.[59] But the *AWA Appeal* reignited the debate over the necessity for a statutory business judgment rule to safeguard corporate enterprise. Part of the concern was that the *AWA Appeal* raised

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[56] *AWA Appeal* at 504–6.

[57] *AWA Appeal* at 494, 501.

[58] See Redmond, above n 55; D A Demott, 'Directors' Duty of Care and the Business Judgment Rule: American Precedents and Australian Choices' (1992) 4 *Bond LR* 133; A Black, 'Recent Developments in Directors' Duties' (1991) 7 *ABR* 121; R Baxt, 'Corporate Law Reform – Directors' Duties – Objective Standards – Business Judgment Rule – Other Issues' (1992) 66 *ALJ* 294; J Rowbotham, 'Company Law to get a New Reality' (1992) 14 *BRW* 22; R B S MacFarlan, 'Directors' Duties after the National Safety Council Case' (1992) 9 *ABR* 269; M I Steinberg, 'The Corporate Law Reform Act 1992: A View From Abroad' (1993) 3 *AJCL* 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 *ABLR* 111; S Woodward, 'Directors: to be Informed or Beware' (1993) 67 *LIJ* 274; C A Schipani, 'Defining the Corporate Directors' Duty of Care Standard in the United States and Australia' (1994) 4 *AJCL* 152.

[59] Explanatory Memorandum, Corporate Law Reform Bill 1992 (Cth), at 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. Australian 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), p 81, quoting House of Representatives Standing Committee on Legal and Constitutional Affairs, Corporate Practices and the Rights of Shareholders, *Directors' Duty of Care and Consequences of Breaches of Directors' Duties* (1991).

doubts about the general law business judgment principle's applicability.[60] While the New South Wales Court of Appeal in the *AWA Appeal* acknowledged directors'' responsibilities to 'display entrepreneurial flair', Clarke and Sheller JJ's failure to discuss the general law business judgment principle created some uncertainty about the standard of review's precise parameters.

In 1997, a new Commonwealth Government released the Corporate Law Economic Reform Program Papers recommending the introduction of a statutory business judgment rule.[61] The Government offered two primary justifications for the rule. First, the rule would codify and clarify the existing standard of review and rectify any uncertainty following the *AWA Appeal*. Second, it would encourage directors' entrepreneurial decision-making by providing them with superior protection.[62] The statutory business judgment rule was ultimately enacted in s 180(2) of the *Corporations Law 2001* (Cth) in March 2000.[63] 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:
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> (a) make the judgment in good faith for a proper purpose; and
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> (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.'[64]

Despite prominent concerns that s 180(2) would unduly grant directors' impunity for poor corporate decisions,[65] very few cases have actually considered — let alone applied — the statutory business judgment rule.[66] Next, we examine two such cases to evaluate the extent to which these fears are borne out in the case law.

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[60] See Corporate Law Economic Reform Program, Parliament of Australia, *Paper 3 – Directors' Duties and Corporate Governance* (1997); Tan, above n 1; Baxt, above n 1; J H Farrar, 'The Duty of Care of Company Directors in Australia and New Zealand' (1996) 6 *Cant LR* 228; Law, above n 1.

[61] Corporate Law Economic Reform Program, Parliament of Australia, *Paper 3 – Directors' Duties and Corporate Governance* (1997).

[62] Ibid, at 24.

[63] *Corporate Law Economic Reform Program Act 1999* (Cth) sch I, inserting the provision at s 180(2).

[64] Ibid, inserting the provision at 180(3).

[65] A Greenhow, 'The Statutory Business Judgment Rule: Putting Wind into Directors' Sails' (1999) 11(1) *Bond LR* 33.

[66] 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': see, eg, *Australian Securities and Investments Commission v Adler* (2002) 41 ACSR 72; *Gold Ribbon (Accountants) Pty Ltd v Sheers* [2006] QCA 335 at [247]–[248].

C *Analysis of Case Law*

1 *Decision Rule in Rich*

The scarcity 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* (2009) 236 FLR 1 ('*Rich*'). In *Rich*, the Australian Securities and Investments Commission ('ASIC') alleged that two of One.Tel Ltd ('One.Tel')'s directors — Rich and Silberman — breached their duty of care by failing to keep the board informed about the telecommunications company's true financial status, performance and prospects prior to its collapse in March 2001. The way ASIC framed their case required them to prove their allegations concerning One.Tel's financial circumstances during the relevant period with a vast amount of evidence. As a result, *Rich* earned the ignominious distinction of becoming one of the longest running civil trials in New South Wales' history.[67] Austin J strongly criticised the ASIC's pleadings, and ultimately held that ASIC failed to prove its case beyond the balance of probabilities.[68] In dismissing ASIC's case, his Honour held that the directors could have been protected by s 180(2) had they actually breached their duty of care. In the course of Austin J's mammoth judgment exceeding 3,000 pages, his Honour clarified several important aspects of the statutory business judgment rule's operation and its interaction with the existing legal framework.

First, 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'.[69] Austin J clarified the operation of this general law principle by stating that 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.'[70] In particular, Austin J held that it assists in distinguishing a lack of due 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. In other words, his Honour confirmed that the business judgment principle subsists as a standard of review. Second, Austin J clarified that the general law business judgment principle is also relevant to the application of the statutory duty of care under s 180(1) and not simply the general law duty of care.[71] Third, his Honour distinguished between the open-ended considerations required to invoke the general law rule, and the explicitly defined pre-conditions necessary for directors to invoke the statutory business judgment rule.[72] For this reason, Austin J concluded that 'it is at least theoretically possible' for the s 180(2) to apply in situations where the general law business judgment principle would not.[73] In doing so, his Honour noted that this would be contingent on courts' interpretation of the pre-conditions in subparagraphs 180(2)(a)–(d).[74] 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:

- the impugned conduct is a business judgment as defined;

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[67] SBS, 'Factbox: ASIC v One.Tel' (24 February 2015) < http://www.sbs.com.au/news/article/2009/11/19/factbox-asic-v-onetel>
[68] *Rich* at 32, [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.'
[69] Ibid, at 145.
[70] Ibid.
[71] Ibid.
[72] Ibid.
[73] Ibid.
[74] Ibid, at 146.

- the directors or officers are acting in good faith, for a proper purpose and without any material personal interest in the subject matter;
- 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;
- 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);
- they believe that their decision is in the best interests of the corporation; and
- 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.[75]

Austin J also clarified the procedure for applying the statutory defence.[76] First, the court must assess whether the relevant circumstances could amount to a breach of the duty of care according to whether the action or inaction is unreasonable in the sense of being more than a 'mere error of judgment'.[77] If the court finds the relevant action or inaction to be unreasonable, it must then ask whether the director/s made a 'business judgment' as defined in s 180(3).[78] Finally, the court must consider whether the directors satisfy each of the four preconditions in s 180(2)(a)–(d).[79]

Crucially, Austin J held that defendant directors bear the onus of establishing each of these preconditions.[80] Having noted that the statutory language is 'profoundly ambiguous', Austin J based his decision on two factors.[81] First, if the plaintiff bore the onus of proof, the enactment of the business judgment rule in s 180(2) would effectively add elements for the plaintiff to prove — contrary to the intention expressed in the Explanatory Memorandum and Secondary Reading speech that the rule would not reduce the standard of care.[82] Second, if the plaintiff was required to establish the absence of each pre-condition, this would effectively require it to demonstrate more serious infringements under the *Corporations Act 2001* (Cth) than are subsumed under the duty of care.[83]

In summary then, Austin J's suggested 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 made in *obiter*, their practical implications remained uncertain.

2 *Decision Rule in Mariner*

Mariner is occasionally characterised as the first case in which directors have successfully invoked s 180(2)'s protection in its 15-year existence.[84] But a closer reading reveals that, like *Rich*, the Federal Court's treatment of the rule was strictly in *obiter*.

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[75] Ibid, at 155.
[76] Ibid, at 141.
[77] Ibid, at 150.
[78] Ibid, at 150–2.
[79] Ibid, at 152–4.
[80] Ibid, at 149.
[81] Ibid, at 148.
[82] Ibid, at 149.
[83] Ibid, at 149–50.
[84] See, eg, Minter Ellison, 'Directors' Duties' (24 June 2015) <http://chqa.minterellison.com/blogcustom .aspx?entry=971>; D Jacobson, 'Case Note: Directors Successfully Rely on Business Judgment Rule' (9 July 2015) *Bright Law* <http://www.brightlaw.com.au/corporate-governance/case-note-directors-successfully-rely-on-business-judgment-rule/>; B Wood, 'ASIC v Mariner Corporation Limited' (27 October 2015) *McCullough Robertson* <http://thechairmansredblog.blogspot.com.au/2015/10/asic-v-mariner-corporation-limited.html>.

In *Mariner*, ASIC brought proceeding against Mariner Corporation Limited ('Mariner') —a public investment company engaged in small cap mergers and acquisitions — and its three directors.[85] The alleged breach of the directors' duties of care centred on Mariner's Australian Securities Exchange announcement of an off-market takeover bid for all of the issued capital of Austock Group Limited ('Austock') at 10.5 cents per share.[86] At the relevant time, Mariner did not itself have sufficient resources to satisfy its obligations under the bid had it been accepted.[87] The bid was announced at a price only slightly above market rate. Further, the directors believed that Austock's assets could be realised for around twice the price of the bid.[88] The directors placed numerous conditions on the bid, including a requirement that at least 50% of the shareholders accept the proposal.[89] Since the directors controlled approximately 36% of the shares, it was highly unlikely that this minimum acceptance condition would have been satisfied.[90] Ultimately, Mariner withdrew its bid because Austock agreed to sell its property and funds management business to another company.[91]

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, ASIC 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 Mariner would be able to perform its obligations under the bid if a substantial proportion of the offers were accepted.[92] In addition, ASIC alleged that Mariner contravened s 1041H since the announcement was misleading or deceptive because Mariner was not permitted to make a takeover bid for less than 11 cents per share.[93] Further, ASIC alleged that the directors contravened their statutory duty of care by causing Mariner to contravene ss 631(2)(b) and 1041H, or putting it at risk of such contravention.[94] ASIC also asserted that the directors had breached s 180(1) irrespective of whether Mariner had breached ss 631(2)(b) or 1041H.

Under the circumstances, Beach J held that none of the directors had breached their duty of care under s 180(1). In delivering his judgment, Beach J focused on the actions of Mr Olney-Fraser, with the liability of the other two directors largely continent on demonstrating reasonable reliance on Mr Olney-Fraser under s 189.[95] His Honour acknowledged that the role of a director necessarily involves risk-taking, stating:

> 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.[96]

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[85] *Mariner* at 346.
[86] Ibid, at 344.
[87] Ibid, at 403.
[88] Ibid, at 368.
[89] Ibid.
[90] Ibid, at 403.
[91] Ibid, at 372–3.
[92] Ibid, at 344.
[93] Ibid.
[94] 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 consider the regulatory constraints on Mainer acquiring more than certain percentages of shares in Austock. Ibid, at 344.
[95] Ibid, at 345.
[96] Ibid, at 433.

In this regard, Beach J emphasised that the foreseeable risk of harm to the corporation resulting from the conduct must be weighed against the potential benefits that directors could reasonably expect to accrue to the corporation.[97] His Honour found that Mariner could potentially benefit from realising the assets of Austock if the bid was successful and noted that the risks posed to the company were negligible due to the minimum acceptance conditions placed on the bid.[98] On balance, Beach J found that the potential benefits of the directors' conduct outweighed the risk of harm. His Honour accordingly held that the directors had not breached their statutory duty of care under s 180(1).[99]

In so holding, Beach J placed considerable emphasis on Mr Olney-Fraser's expertise in mergers, acquisitions and finance.[100] His Honour stressed that this was an important 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.'[101] This is entirely consistent with the approach taken by Austin J in *Rich* in relation to the general law business judgment principle. Further, it reaffirms the efficacy of the existing general law business judgment principle as these comments were made in context of the duty of care itself and not the statutory business judgment rule.

In addition to exculpating the directors under the duty of care, Beach J also stated that the directors would have been entitled to the protection of the statutory business judgment rule.[102] Considering the nature of Mariner's business, his Honour was satisfied that the directors' decision to announce a takeover bid was a 'business judgment' as defined in s 180(3).[103] Regarding 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 the profits Mariner could potentially have made from the transaction outweighed its risks.[104] Second, his Honour was satisfied the directors did not have a material personal interest in the transaction.[105] Third, Beach J deemed that Mr Olney-Fraser was reasonable informed in making the bid. This was largely due to the fact that Mr Olney-Fraser had gathered a substantial amount of information about the prospects of the on-sale of Austock assets through his discussions with third parties.[106] His Honour also stated that the other directors were entitled to rely on this information.[107] 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.[108]

Beach J's judgment demonstrates that courts' remain reticent to hold directors' liable for breach of their duty of care by hindsight merits review of directors' decisions. But, like *Rich*, it also demonstrates that courts' effectively insulate directors' from hindsight review under the general law business judgment principle. For this reason, the extent to which the statutory business judgment rule has fulfilled its intended purposes must be questioned.

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[97] Ibid.
[98] Ibid, at 404, 423, 424, 427.
[99] Ibid, at 424, 427.
[100] Ibid, at 426. Mr Olney-Fraser had practiced as a mergers and acquisitions lawyer for 15 years.
[101] Ibid, at 347.
[102] Ibid, at 430, 437, 438.
[103] Ibid, at 428, 436.
[104] Ibid, at 428, 437.
[105] This did not appear to be in contention. Ibid, at 428, 437.
[106] Ibid, at 350, 492.
[107] Ibid, at 435–8.
[108] Ibid, at 429, 437.

III Statutory Business Judgment Rule Critiqued

The judgments in *Rich* and *Mariner* provide valuable insight into the requirements the directors need to satisfy to enliven the statutory business judgment rule. They also confirm that the provision *can* be applied as a defence in certain circumstances. But 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.[109] Moreover, these decisions leave the question of whether the statutory business judgment rule actually modifies the liability of directors wide open. This is because courts have yet to apply the rule in a situation where the directors would otherwise not be protected under the general business judgment law principle. For this reason, 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 statutory business judgment rule has achieved its intended goal of promoting entrepreneurial decision-making by providing directors' greater protection for honest business decisions.

A *Greater Clarity or Greater Complexity?*

On its face, the statutory business judgment rule ought to intuitively provide directors with greater certainty compared to the pre-existing decision rule.[110] For a start, it lists certain pre-conditions with fixed outcomes, whereas the general law business judgment principle remains open-ended and flexible. Indeed, the 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 definitively 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, whether the statutory business rule has in fact provided directors with greater certainty regarding their liability is questionable. For a start, 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,[111] if Austin J — a renowned expert in commercial law — characterises the legislative drafting as 'ambiguous', 'confusing' and 'opaque', the provision can hardly provide greater certainty to those directors who seek to enliven it. These difficulties in interpretation may also have a profound effect on the efficacy of the rule, such that it may suffer from underuse and not be given the opportunity to alter the general law standard of review on a practical level.

Many of the difficulties faced in interpreting the statutory business judgment rule reflect the fact that it is a difficult legal transplant from the US.[112] Section 180(2) is strongly based on the American

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[109] *Rich* at 145.

[110] C F Santow, above 54, at 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*?

[111] J Varzaly, 'Protecting the Authority of Directors: An Empirical Analysis of the Statutory Business Judgment Rule' (2012) 12 *JCLS* 429, at 445–6.

[112] Farrar, above n 53, at 791.

Law Institute's ('ALI') model formulation in §4.01(a) of their Principles of Corporate Governance,[113] despite much of the discussion behind its implementation focusing on the Delaware equivalent.[114]

The Delaware business judgment rule is a common law principle with at least 150 years of case law expounding the doctrine.[115] The ALI formulation was drafted as part of a recommendation for the enactment of a statutory business judgment rule in the US.[116] Although it is persuasive, it remains unenacted in most US states.[117] As such, it arguably does not capture the true complexity or nuances of the common law business judgment rule as developed and applied in Delaware courts. By extension, the transplant of the ALI provision will not necessarily incorporate the intricacies of the rule that ensure it functions in the same way as the Delaware rule.[118] In this context, there are a number of points to note.

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, the Delaware business judgment rule reveals is arguably not a rule at all.[119] For a start, it does not mandate a standard of conduct for directors.[120] Instead, it imposes a standard of review under which directors are generally entitled to a powerful *presumption* in favour of directors who make honest business decisions.[121] As such, the rule provides directors a 'safe harbour' from liability unless the *plaintiff* demonstrates that the relevant preconditions are met.[122] Accordingly, the failure of the Commonwealth Parliament to explicitly specify that the onus of proof is placed on the plaintiff has precluded the Australian business judgment rule from operating as a general presumption in favour of directors as it does in Delaware.[123]

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[113] Section 4.01(a) of the American Law Institute, *Principles of Corporate Governance: Analysis and Recommendations — Volumes 1 and 2*, American Law Institute, 1994, provides:

> A director 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.

[114] Redmond, above n 11, p 457.

[115] B Keller, 'Australia's Proposed Statutory Business Judgment Rule: A Reversal of a Rising Standard of Corporate Governance' (1999) 4 *DLR* 125.

[116] Ibid, at 126–9.

[117] Ibid, at 125.

[118] Farrar, above n 53, at 791.

[119] See D M Branson, *Corporate Governance*, Lexis Law, Charlottesville, VA, 1993, at [7.01]–[7.20].

[120] D M Branson, 'A Business Judgment Rule for Incorporating Jurisdictions in Asia?' (2011) 23 *SAcLJ* 687, at 689.

[121] *Cede & Co Technicolor*, 634 A.2d 345 (Del. 1993), at 361 (emphasis added). See *Brehm v Eisner*, 746 A.2d 244 (Del. 2000), at 264: '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'.'

[122] Branson, above n 120, at 689.

[123] The word 'presumption' in the Explanatory Memorandum provides some indication that Parliament intended the plaintiff 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), at [6.1] (emphasis added). Nevertheless, courts have observed that the preceding phrase 'the substantive duties of directors will remain unchanged' negates such an intention, see *Rich* at 149.

The failure to specify the placement of the onus impacts both the certainty and efficacy of the business judgment rule. If the onus is placed on the defendant, it is significantly more challenging for a director to enliven the protection of the business judgment rule.[124]

First, if the defendant is required to prove that she or he has acted in good faith, for a proper purpose, and without a material personal interest, this essentially requires the defendant to prove the absence of more serious breaches of their directors' duties under the *Corporations Act 2001* (Cth) than the duty of care itself.[125] The onus places a significant evidential burden on directors to have sufficient evidence to prove satisfaction of its requirements.[126] 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.'[127] 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 honest business decisions. Although the statutory business judgment rule does encapsulate many of the same *considerations* as the common law business judgment principle, the courts' placement of the onus on the defendant means that courts are inevitably required to scrutinise directors' decisions 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 this respect.

Another difficulty of interpretation is created by the good faith and proper purpose pre-condition in s 180(2).[128] Directors' duties to act in good faith and for proper purposes derive from their fiduciary duties, and not their duty of care.[129] For this reason, the good faith and proper purposes preconditions in s 180(2) involve a certain degree of doctrinal commingling.[130] While doctrinal commingling itself is not necessarily problematic, the good faith and proper purpose pre-conditions in s 180 add a level of complexity causing difficulties in its application. Fridman notes:

> 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 harbour from personal liability in relation to honest, informed and rational business judgments incorporates the proper purpose rule by reference.[131]

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. It is difficult to see how the inclusion of the common law

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[124] *Rich* at 149. *Mariner* at 428. See also *Australian Securities and Investments Commission v Adler* (2002) 41 ACSR 72 at [410] (Santow J). See also, *Australian Securities and Investments Commission v Fortescue Metals Group Ltd* (2011) 190 FCR 364 at [197]; *Australian Securities and Investments Commission v Macdonald (No 11)* (2009) 230 FLR 1.

[125] 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). N Young, 'Has Directors Liability Gone Too Far or Not Far Enough? A Review of the Standard of Conduct Required of Directors' (2008) *C&SLJ* 216, at 223.

[126] A Findlay, 'CLERP: Non-Executive Directors' Duty of Care, Monitoring and the Business Judgment Rule' (1999) 27 *Aus Buis Law Rev* 98, at 111; A Lumsden, 'The Business Judgment Defence: Insights from ASIC v Rich' (2010) 28 *C&SLJ* 164, at 168.

[127] Findlay, above n 126.

[128] The 'proper purposes' requirement is absent in the US formulations.

[129] Santow, above n 54, at 349.

[130] See *Rich* at 149 (Austin J); *Australian Securities and Investments Commission v Adler* (2002) 168 FLR 253 at [410] (Santow J).

[131] S Fridman, 'An Analysis of the Proper Purposes Rule' (1998) 12 *Bond LR* 164, p 183.

doctrine as a pre-requisite to the application of the statutory rule in any way 'clarifies' the general law position when it simply incorporates it by reference.

Finally, the requirement in s 180(2)(d) that 'the director *rationally* believes that the judgment is in the best interests of the corporation' has proved difficult to construe. 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 wording has stirred 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)'.[132] On the other hand, Austin J was informed by the dictionary definition of rationality and stated that:

> [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'.[133]

To add further fuel to the discussion, 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'.[134] This debate will likely remain unresolved until it is considered at an appellate level.[135]

B *Broader 'Acoustic Separation'?*

In addition to the problems of interpretation posed by s 180(2), whether it has broadened the 'acoustic separation' between conduct rules and decisions rule in practice is doubtful.

Rich indicates that it is at least theoretically possible for s 180(2) to provide directors' superior protection by heightening the acoustic separation between conduct and decision rules. As Austin J acknowledged in *Rich*,[136] the general law business judgment is not a bright line test and the grounds on which the 'exception' may be invoked remain open-ended. By contrast, the statutory business judgment rule operates as a specific *defence* to a breach of directors' duty of care. 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 implied in *Rich*, whether this theoretical possibility can be manifested in practice is contingent on the extent to which the preconditions in s 180(2)(a)–(d) differ from the considerations under the general law business judgment principle.[137]

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

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[132] Young, above n 125, p 222.
[133] *Rich* at 152.
[134] See M Hooper, 'The Business Judgment Rule: (2011) ASIC v RICH and the reasonable-rational divide' *Bond Corp Gov eJnl* <http://epublications.bond.edu.au/cgej/22>.
[135] See *Rich* at 149.
[136] Ibid, at 145.
[137] Ibid, at 146.

rule. For instance, the fact that Mr Olney-Fraser acted in good faith, and on the basis that the potential benefits of his conduct outweighed the risk of harm, related both to the satisfaction 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.[138] 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.[139] 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).[140]

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.[141] If, as we contend, the general law principle provides for a flexible exception for business judgments made in good faith,[142] for a proper purpose,[143] in the absence of a material personal interest in the transaction,[144] and with a reasonable belief that the decision was in the best interests of the business corporation,[145] it is difficult to conceive of a situation where the statutory business judgment rule would offer directors additional protection in practice.[146]

One difference in the criteria that need to be satisfied is that none of the cases in which the general law principle has been considered have explicitly listed a requirement that the directors must be reasonably informed about the subject matter of their business decision. Nevertheless, the *AWA Appeal* indicates that a director must remain reasonable 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.[147] Another difference is the requirement under the proper purposes doctrine that the directors possess 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*. But, as we discussed above, the practical ramifications of this distinction remain uncertain.

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

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[138] *Mariner* at [453]–[482], [486], [487], [488], [544], [492].
[139] Ibid, at [9], [11]–[13], [441], [476], [486]–[487], [500], [558].
[140] Ibid, at [448], [489], [545].
[141] M Berkahn, 'A Statutory Business Judgment' (1999) 3 *SCULR* 215, at 226; LexisNexis, *Australian Corporations Law – Principles and Practice* (at 23 November 2015) [3.2A.0060].
[142] *Harlowe's Nominees* at 493.
[143] Ibid; *Whitehouse* at 292–3.
[144] *Harlowe's Nominees* at 493–4, quoting *Mills v Mills* (1938) 60 CLR 150 at 163; *Whitehouse* at 292–3. *Contra* Santow, above n 54, at 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]ne 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.

But as was argued above, the approach taken in *Harlowe's Nominees* suggests that a director' material personal interest in a transaction would preclude the 'proper purposes' doctrine from applying. See also Berkahn above n 141, at 226.
[145] Berkahn, above n 141, at 226; see also *Reid Murray Holdings Ltd (in liq) v David Murray Holdings Pty Ltd* (1972) 5 SASR 386 at 402, citing *Charterbridge Corp Ltd v Lloyds Bank Ltd* [1970] Ch 92. See also *Shuttleworth v Cox Bros and Co (Maidenhead) Ltd* [1927] 2 KB 9,at 23–4; *Wayde v New South Wales Rugby League Ltd* (1985) 61 ALR 225 at 232.
[146] See Santow, above 54, at 350–1; Redmond, above n 55.
[147] *AWA Appeal* at 656, citing *Hedley Byrne & Co Ltd v Heller & Partners Ltd* [1964] AC 465; Berkahn, above n 141, at 226.

business judgment rule 'would not change the substantive law at all',[148] a sentiment echoed by Redmond who stated that the general law principle 'in function, if not name,' embodies the statutory business judgment rule.[149] As the Australian Institute of Company Directors argued, the statutory 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.'[150] 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.[151]

The Second Reading speech provides further support for this interpretation and 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.[152]

Insofar as the statutory business judgment rule Parliament intended to encapsulate largely the same elements as the general law business judgment rule it might be deemed a success. But this reveals a crucial difficulty with the s 180(2) business judgment rule. If the statutory business judgment rule was to provide an effective defence to s 180(1), 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. 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).[153] For this reason, it appears that 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, any potential for the statutory business judgment rule to offer directors a practical 'defence', over and above that already provided at 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.

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[148] A Cameron, 'The Perspective of the Australian Securities Commission on the Enforcement of Directors' Duties and the Role of the Courts', in I M Ramsay (Ed), *Corporate Governance and the Duties of Company Directors* (Centre for Corporate Law and Securities Regulation, Melbourne, 1997, p 207.

[149] Redmond, above n 55, p 198.

[150] 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), at 32.

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

[152] Commonwealth, *Parliamentary Debates*, Senate, 3 December 1998, at 1286 (Joe Hockey).

[153] Redmond, above 55, p 203–4.

Understanding this tension is especially important, in light of various legislative proposals aiming to provide directors with superior protection without 'lowering the standards for directors',[154] or targeted at 'fulfilling Parliament's intention.'[155] While this article does not aim to critique these proposals, we caution that any future legislative interventions must appreciate the inherent tension underlying the current rule if they are to overcome its shortcomings.

In truth, the distinction between the clarity and protection provided by the rule is a false dichotomy when it comes to enhancing directors' protection for legitimate enterprise. Legal regulation of directors' can stifle their 'entrepreneurial flair' in two main ways. The first is if the legal standards for directors are overly proscriptive or prescriptive. Uncertainty abounds in business, and potential rewards are almost always counterbalanced by commensurate risks. For this reason, the legal expectations for directors must not be overly proscriptive or prescriptive in mandating what directors can and cannot do. Otherwise, legal rules would unduly inhibit directors' ability to seize commercial opportunities. Second, directors' capacity for enterprise can also be stifled if the legal standards are unduly ambiguous. Boards must balance competing responsibilities, often within limited timeframes and with imperfect information. If legal rules set ambiguous standards, this may require boards to allocate a disproportionate amount of time to ensuring legal compliance at the expense of formulating business strategy and policy. Ambiguous standards may also lead boards to err on the side of caution and act in an overly conservative matter to guarantee legal conformance.

In other words, legal regulation can inhibit enterprise in both a substantive and temporal sense. Although Parliament designed the statutory business judgment rule to facilitate commercial initiative by targeting these two core concerns, the case law to date casts doubts on its efficacy in achieving either of these goals.

IV Conclusion

In view of the above discussion, the following conclusions can be made. An analysis of the relevant case law reveals a fundamental tension between the express purposes behind the Federal Government's implementation of the statutory business judgment rule. Parliament's stated desire to confirm the existing general law standard of review has seemingly led the provision to be interpreted in way that it has not altered the existing 'acoustic separation' to enhance directors' protection for legitimate business judgments. Moreover, the difficulties courts have faced in construing the provision suggest that it has complicated the framework governing for directors' liability, rather than providing directors with greater clarity. For this reason, the ambiguity of its various pre-conditions also suggests the rule has so far failed to facilitate directors' ability for enterprise in a temporal sense.

If we take directors' concerns that boards are focusing too heavily on compliance and regulatory issues at the expense of strategy seriously, then we must also question the statutory business judgment rule's efficacy in remedying their fears. Of course, we cannot discount the possibility that directors' views are tainted by self-interest or that other stakeholders will not share their views. Nevertheless, *Rich* and *Mariner* do suggest that the statutory business rule has done very little to provide directors with superior protection for entrepreneurial decision-making. Even if we doubt the impartiality or veracity of directors' concerns about the duty of care's stringency, we must equally doubt that the judicial treatment of the statutory business judgment rule (or, perhaps more accurately, lack thereof)

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[154] Australian Institute of Company Directors, 'The Honest and Reasonable Director Defence: A Proposal for Reform' (7 August 2014) <http://www.companydirectors.com.au/director-resource-centre/policy-on-director-issues/policy-papers/2014/the-honest-and-reasonable-director-defence>.

[155] L Pelling, 'Fulfilling Parliament's Intention: A Business Judgment Rule to Stimulate Responsible Risk-Taking and Economic Growth' (2015) 67 *Governance Directions* 344.

will allow directors to allocate greater energy to strategic and entrepreneurial endeavours than previously.

None of this is to say that the statutory business judgment rule cannot get closer to clarifying and enhancing directors' protection for enterprise in the future. A theoretical distinction remains between the general law and statutory decision rule, even if it has not yet manifested in practice. The theoretical boundaries of the general law business judgment rule remain imprecise, and the statutory business judgment rule has not yet been considered at an appellate level. Indeed, as Austin J noted in *Rich*, crucial matters such as the onus of proof will eventually need to be resolved at the appellate level.[156] It might be that upon reaching this stage, courts will make great leaps regarding both the current acoustic separation and the clarity of s 180(2). Certainly, a judicial reconsideration of the onus's placement on the defendant could go a long way to the rule providing directors with more robust protection. But given the limited judicial attention the statutory business judgment rule has received in the past 15 years, it is unlikely that directors will take much comfort in any of this.

The apparent failure of the statutory business judgment rule to either clarify directors' liability for due care, or provide them with an effective safe harbour has again intensified the debate surrounding the appropriate level of directors' liability.[157] 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 principle. Moreover, the fundamental tension 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'.[158]

Given the role the general law business judgment 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 in our volatile economic environment. Legislative intervention might indeed prove to be the best method for achieving this clarity. But any clarification must be weighed against the undue rigidity it may pose over a flexible general law approach. Future developments must also adopt a measured approach, and it is questionable whether Australia should attempt to directly emulate the decision rule of Delaware — not least because of the evident difficulties legal transplants may face.[159] 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.

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[156] *Rich* at 149.

[157] See, Pelling, above n 155; J Fox, 'Honest and Reasonable Director Defence' (2015) (67) *Governance Directions* 218; M Broomhead, 'The Business Judgment Rule: A Case for Change to the AICD model' (2015) 67 *Governance Directions* 138; J Harris and A Hargovan, 'Revisiting the Business Judgment Rule' (2014) 66 *Governance Directions* 634; D Jordan and M Legg, 'The Australian Business Judgment Rule after ASIC v Rich: Balancing director authority and accountability (2013) 34 *Ad Law Rev* 403. Paatsch was particularly scathing about what he perceives to be the 'relentless, uninspiring, evidence-free campaign for the change to the business judgment rule': D Paatsch, 'The Business Judgment Rule; A Case for a 'Known Quantity' (2015) 67 *Governance Directions* 140.

[158] See Pelling, above n 155.

[159] See Fox, above n 157.