AUSTRALIA'S PROPOSED STATUTORY BUSINESS JUDGMENT RULE: A REVERSAL OF A RISING STANDARD IN CORPORATE GOVERNANCE?

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I INTRODUCTION

On 7 July 1998, the federal Treasurer, Mr Peter Costello, introduced the Corporate Law Economic Reform Bill 1998 (Cth) ('CLER') into the House of Representatives. This Bill was to have introduced into the *Corporations Law* new director's duties and corporate governance provisions. Due to the lapse of government in October 1998, however, the CLER was reintroduced in December 1998 as the Corporate Law Economic Reform Program Bill 1998 (Cth). Amongst a number of changes to a variety of corporate law aspects, the new CLERP Bill provided for a new statutory duty of care and diligence and a statutory business judgment rule ('BJR') in its proposed s 180(2). The Bill is now enacted as the *Corporate Law Economic Reform Program Act 1999* ('CLERP') but is not to be proclaimed until 13 March 2000.

The BJR has been a common law principle of corporate governance for at least 150 years in the US. The Rule, simply stated, is a 'presumption that in making a business decision, the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company.'[1] In effect, a BJR means that a court will not substitute its judgment for

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[1] *Smith v Van Gorkom*, 488 A 2d 858 at 872 (Del Supr, 1985).

that of a board of directors unless the evidence establishes that the directors' decision involved a breach of fiduciary duty.[2]

This paper argues against introducing a statutory BJR as a general principle for the following reasons: (i) it is unusual—other professions do not have the benefit of the same protection, and it may cause the watering down of the general duty of care by analogy in the future development of the common law; (ii) it is inappropriate—it will not deliver greater certainty in respect of director's liability in any form, but will produce substantially more uncertainty than is likely to be alleviated; (iii) it is unfortunate—directors' accountability will be reversed as it will likely lower the standard of care; and (iv) it is unnecessary—it merely reflects the current standard of care and diligence required of directors reflected by a combination of existing statutory provisions and general law principles.[3]

II ORIGIN AND DEVELOPMENT OF THE BJR

A *The Experience in the United States*

The BJR originated in the US. The earliest case which recognised that directors must exercise due care and diligence in the management of a business was *Percy v Millaudon* in 1829.[4] In those days, the appropriate minimum standard of care to which directors and officers had to conform ranged from gross negligence to the degree of care that an ordinarily prudent person would exercise in conducting personal business affairs.[5] This has now evolved to be a more middle ground standard which requires that directors and officers exercise the degree of care that an ordinary prudent person in a like position under similar circumstances would exercise.[6]

The BJR developed concurrently in cases that also articulated the duty of care. Some early decisions held that directors were liable only for business mistakes 'of so gross a kind that a man of common sense and ordinary attention would not have committed them.'[7] Many other cases held that directors were not liable for honest mistakes or errors of judgment.[8] Still others appeared to give directors even greater scope in exercising their powers:

[2] See John Farrar, 'Corporate Governance, Business Judgment and the Professionalism of Directors' (1993) 6 *Corporate and Business Law Journal* 1, 18.
[3] See Submission by the Law Council of Australia dated 3 April 1997 to the Business Law Division of the Commonwealth Department of Treasury, 8 ('Law Council Submission').
[4] 8 Mart (NS) 68, 74-5 (La 1829).
[5] See Marcia McMurray, 'An Historical Perspective on the Duty of Care, the Duty of Loyalty, and the Business Judgment Rule' (1987) 40 *Vanderbilt Law Review* 605, 607.
[6] Ibid 609.
[7] *Percy v Millaudon* 8 Mart (NS) 68, 78 (La 1829).
[8] *Smith v Prattville Mfg Co*, 29 Ala 503, 509 (1857); *Hodges v New England Screw Co*, 1 RI 312, 348 (1850).

> Questions of policy of management, expediency of contracts or action, adequacy of consideration, lawful appropriation of corporate funds to advance corporate interests, are left solely to their honest and unselfish decision, for their powers therein are without limitation and free from restraint, and the exercise of them for the common and general interests of the corporation may not be questioned, although the results show that what they did was unwise or inexpedient.[9]

In 1982, the American Law Institute ('ALI') suggested that a formal BJR be enacted and went on to produce a draft. Several drafts later, in 1999, it remains unlegislated but persuasive. Essentially, the US BJR provides that if certain prerequisites are met, the level of judicial review imposed on a directors' decision is very minimal. These prerequisites are that: a decision must be made; it must be made in good faith (ie the director must believe subjectively that the decision is in the best interests of the corporation and, the decision must not be knowingly illegal); the director must have reasonably informed him/herself concerning the decision; and the decision must not involve a conflict with the director's own interests. If these are met, the director will not be liable even if the decision is unreasonable, as long as it is not irrational.[10] The BJR has been most specifically invoked by boards meeting challenges to their defensive steps taken when facing a hostile takeover bid, although this has not been the sole operation of the BJR.[11]

B The BJR Doctrine in Australia

Australian common law initially relied upon United Kingdom authorities in respect of directors' duties of care and diligence. In the early case of *Turquand v Marshall*[12] it was held that provided the directors act intra vires of their powers, the court would not interfere in their exercise of discretion. This was so even where they had behaved carelessly, lacked the requisite skills or were negligent in carrying out their duties, because it was the misfortune or fault of the corporation for choosing such unwise directors. In *Re Denham and Co,*[13] notwithstanding that the director concerned was found guilty of considerable negligence in his failure to check the company's accounts and lack of attendance at board meetings, the court did not find he had breached his duty of care because the court did not expect him to realise the significance of certain information in the financial accounts. Other cases from that era showed that the common law imposed a remarkably low burden on company directors, requiring them simply to do the best they could.[14] Even the most extreme misconduct[15] did not equate with a gross negligence standard which would breach

[9] *Pollitz v Wabash Railroad Co*, 207 NY 113, 124 (1912).
[10] See Robert Austin, 'Interview—Eisenberg in Australia' (1992) 8(6) *Company Director* 22, 23.
[11] See Law Council Submission, above n 3, 3.
[12] (1869) LR 4 Ch App 376.
[13] (1884) 25 Ch D 752.
[14] See *Re City Equitable Fire Insurance Co Ltd* [1925] Ch 407.
[15] See *Re Brazillian Rubber Plantations and Estates Ltd* [1911] 1 Ch 425.

the requisite standard of care and diligence.[16] Indeed, a company director's position was said to be as onerous as having a nice warm bath because the law was prepared to tolerate an unreasonable amount of inactivity, absenteeism and incompetence.[17]

Then came the cases primarily decided on the 'proper purposes' doctrine. These authorities demonstrate a clear judicial policy of non-interference in the merits of directorial decision making. According to this doctrine, directors have a fiduciary duty to use their powers in good faith for the purpose they were conferred and not for any improper or irrelevant purpose. In order to establish whether the duty has been breached a court will enter into a two step inquiry process. First, it ascertains the nature of the power and the purpose for which it was conferred, which is a matter of law. This is followed by a factual inquiry which identifies the purpose for which the power was exercised, and a conclusion whether that purpose is outside the category of proper purposes.[18] The Privy Council stressed that this factual inquiry does not extend to the 'merits from management decisions ... nor will courts of law assume to act as a kind of supervisory board over decisions within the powers of management honestly arrived at.'[19] The High Court formulated a similar view by conceding to directors 'the right and the duty of deciding where the company's interests lie and ... their judgment, if exercised in good faith and not for irrelevant purposes, is not open to review in the courts.'[20] Both these judicial pronouncements are clearly consistent with the business judgment doctrine.

The more recent case of *PineVale Investments v McDonnell and East Ltd*[21] decided that a director exercising the power to raise equity capital, and purchasing another business in the face of an imminent takeover bid, was doing so for a proper purpose because it was commercially justifiable. On the objective evidence in the case, the directors decided to purchase the Piggot business because they genuinely believed that it was in the commercial interests of the company to acquire the business. Consequently, the directors had not breached their duty. This further demonstrates that Australian courts are reluctant to intervene in the internal affairs of companies by superimposing their judgment for that of the Board[22] and, according to Ford and Austin, just as separate US jurisdictions have developed a BJR, so England and Australia have allowed boards a wide freedom to make errors of judgment in business matters.[23]

There is a similar reluctance to intervene in the internal affairs of a company in oppression cases (such as *Wayde v NSW Rugby League Ltd*[24]) where s 246AA of the

[16] See *Lagunas Nitrate Co v Lagunas Syndicate* [1899] 2 Ch 392, 435 (Lindley MR.)
[17] Farrar, above n 2, 2
[18] See Harold A J Ford and Robert P Austin, *Ford's Principles of Corporations Law* (6th ed, 1992) 473-4.
[19] *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821, 832.
[20] *Harlowe's Nominees P/L v Woodside (Lakes Entrance) Oil CO NL* (1968) 121 CLR 483, 493.
[21] (1983) 8 ACLR 199.
[22] See Robert Baxt, '"Defeating Takeovers"—Business Judgment of Directors and Related Issues' (1984) 58 *Australian Law Journal* 290, 291.
[23] Ford and Austin, above n 18, 481.
[24] (1985) 61 ALR 225.

Corporations Law demonstrates a legislative intention to require courts to consider the merits of board decisions.[25]

C Other Jurisdictions: UK and Canada

Whilst there is no statutory BJR in the UK, courts there have always been reluctant to interfere with the business judgment of directors and have been slow to criticise the accuracy of directors' business foresight at the time their decision was made.[26] Thus, although UK company laws pay some attention to the business judgment doctrine, the courts generally prefer to talk about proper purpose.[27] Similarly in Canada, the courts talk about proper purpose rather than a BJR. Interestingly, the two main cases there, *Teck Corporation v Millar*[28] and *Exco Corp Ltd v Nova Scotia Savings and Loans*[29] are not consistent with each other.

D Impetus for an Australian Statutory BJR

In the late 1980s and early 1990s there was a comprehensive debate about whether to introduce a statutory BJR into Australia. The Companies and Securities Law Review Committee ('CSLRC')[30] and two parliamentary committees[31] recommended its introduction whilst the Companies and Securities Advisory Committee ('CASAC') in its report, 'Director's Duty of Care and Consequences of Breaches of Director's Duties', advised against doing so.[32]

When, in May 1992, the ALI included the idea of a BJR in its *Principles of Corporate Governance: Analysis and Recommendations*, there were renewed calls for its introduction, primarily originating from the Australian Institute of Company Directors. Recommendations from its Legal Committee resulted in CASAC again advising the Attorney-General (in August 1992) against the introduction of a BJR.[33] Whilst this view was accepted by the Government, CASAC's proposal to amend s 232(4) to ensure directors would be 'judged against a flexible objective standard',

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[25] See David Tan, 'Delivering the Judgment on a Statutory Business Judgment Rule in Australia' (1995) 5 *Australian Journal of Corporate Law* 442, 443.

[26] See Nigel G Maw, Lord Howe of Horsell and Sir Michael Cooper, *Maw on Corporate Governance* (1994) 15.

[27] See John Farrar, 'Business Judgment and Defensive Tactics in Hostile Takeover Bids' (1989) 15 *Canadian Business Law Journal* 15, 27.

[28] (1973) 33 DLR (3d) 288.

[29] (1987) 78 NSR (2d) 91.

[30] Companies and Securities Law Review Committee, *Company Directors and Officers: Indemnification, Relief and Insurance*, 1990.

[31] Commonwealth, *Company Director's Duties*, Parl Paper No 395 (1989); Commonwealth, *Corporate Practices and the Rights of Shareholders*, Parl Paper No 293 (1991).

[32] John Kluver, on behalf of the Legal Committee of the Companies & Securities Advisory Committee, 'Statutory Business Judgment Rule: The CLERP Proposals', October 1997, 1.

[33] Ibid.

was not endorsed. It was not until the 1998 CLER Bill that a BJR was seriously mooted by the Commonwealth.

There appear to be two limbs to the impetus for introducing a BJR into the CLERP Bill. First, the courts, in a number of recent cases, have refused to exercise their discretion, at general law or under s 1318 of the *Corporations Law*, to excuse directors from liability where they have acted fairly and honestly. Second, the New South Wales Court of Appeal decision of *Daniels v Anderson*[34] extended and made more uncertain the accountability and reliability of directors. Moreover, other decisions, both before and after *Daniels*, created a number of inconsistencies.[35] These reasons will be discussed further below.

III THE CURRENT LAW IN AUSTRALIA

The current s 232(4) of the *Corporations Law* came into force on 1 February 1993. It provides that 'in the exercise of his or her powers and the discharge of his or her duties, an officer of a corporation must exercise the degree of care and diligence a reasonable person in a like position in a corporation would exercise in the corporation's circumstances.' Although this does provide controls on a director's duty, it is different from a BJR. A number of issues, however, arise concerning the extent and scope of this statutory duty.

A *The Statutory Duty – Objective or Subjective?*

Section 232(4) had its genesis in s 107 of the *Companies Act 1958* (Vic) which was the paradigm for the later uniform companies legislation. Section 107 was intended to operate as an objective test of directors, as was clearly stated at the time by the Minister, PV Feltham:

> it would not be a defence for the director to say that he did not know that this type of activity was being practised. The director would have to satisfy a court that he had in fact used reasonable diligence. If he ought to have known what was happening, he will be deemed to have in fact known and to be responsible.[36]

Nevertheless, in interpreting the provision, the Full Court of the Supreme Court of Victoria later insisted on a measure of subjectivity.[37] The Court reasoned that as the word 'skill' had been omitted from the provision, Parliament demanded diligence only, and the requisite degree of diligence demanded was what could reasonably be

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[34] (1995) 13 Australian Company Law Cases 614 ('*Daniels*').
[35] Commonwealth, *Corporate Law Economic Reform Program: Director's Duties and Corporate Governance—Facilitating Innovation and Protecting Investors*, Paper No 3 (1997).
[36] Victoria, *Parliamentary Debates*, Legislative Council, 29 October 1958, 1299.
[37] Farrar, above n 2, 13.

expected of that director in the circumstances and no more.[38] This decision equated the common law standard of care and diligence with that of Romer J's holding in *Re City Equitable*.[39] It was in the aftermath of the corporate excesses of the eighties, however, that the common law approach 'was not sufficient to satisfy the director's duty of care ... directors must provide an independent inquiring mind.'[40]

Consequently, some time before the introduction of s 232(4) in 1993, the Tricontinental Royal Commission suggested that an increase in the requisite standard of care to a more objective one should be adopted, and this was followed by the decisions of *Commonwealth Bank of Australia v Friedrich*[41] and *AWA Ltd v Daniels*.[42] In turn both the Senate and House of Representatives Standing Committees on Legal and Constitutional Affairs recommended that an explicitly objective standard be formulated.[43]

This was not quite followed, but neither was it clarified. The 1993 *Corporations Law* came with an Explanatory Memorandum which stated that s 232(4) was not meant to change the law but merely confirmed the then existing position. At the same time, the Memorandum seemed to align the provision with decisions such as *Statewide Tobacco Services v Morley*[44] and *Friedrich* which clearly set an objective standard of care and diligence.[45] A number of commentators noted this discrepancy.[46]

Significantly, the Explanatory Memorandum adhered to the business judgment doctrine in two ways. First, it acknowledged corporate risk taking by specifically referring to the fact that directors or officers are not liable for honest errors of judgment.[47] Second, it endorsed the courts' reluctance in both reviewing business judgments made in good faith and exercising of discretion under s 1318 of the *Corporations Law* in excusing directors who have acted honestly and fairly.[48]

B Statutory and Common Law Duties—Same Standard?

As some cases have been decided on the common law duty whilst others have been decided on the statutory duty, the question needs to be considered whether the

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[38] See *Byrne v Baker* [1964] VR 443.
[39] *Re City Equitable Fire Insurance Co Ltd* [1952] Ch 407.
[40] *Final Report of the Royal Commission of Inquiry into the Tricontinental Group of Companies*, 1992, vol 2, c 19, [19.53-19.56].
[41] (1991) 9 Australian Company Law Cases 946 ('*Friedrich*').
[42] (1992) 7 ACSR 759.
[43] See John Farrar, 'Report on Modernising Australian Corporations Law' (1992) 89 *Company Director* 13, 15.
[44] (1990) 8 ACLC 827 ('*Morley*').
[45] Corporate Law Reform Bill 1992 (Cth) Explanatory Memorandum [83].
[46] See: Tan, above n 25, 444; Sue Woodward, 'Directors—Be Informed or Beware!' (1993) 67 *Law Institute Journal* 274; Julie Cassidy, 'An Evaluation of s 232(4) *Corporations Law* and the Director's Duty of Due Care, Skill and Diligence' (1995) 23 *Australian Business Law Review* 184, 190; Farrar, above n 43, 17.
[47] Corporate Law Reform Bill 1992 (Cth) Explanatory Memorandum [88].
[48] Ibid [89].

duties of care and diligence at common law and under s 232(4) have merged or are parallel. It is noted that the proposed BJR provides that if a director or officer meets the BJR provision's requirements he or she is taken to have met both the statutory and 'equivalent general law duty' of care and diligence.[49]

Arguably, the cases suggest that the two duties are substantially the same. Firstly, Malcolm CJ in *Vrisakis v ASC*[50] stated that the statutory policy imposed by s 232(4) 'reflect[s] the general concept of negligence at common law'.[51] Secondly, in *Daniels* (a case that dealt with the common law duty of care and diligence), the majority expounded:

> We are of the opinion that a director owes to the company a duty to take reasonable care in the performance of the office. 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. ... The duty is a common law duty to take reasonable care.[52]

Thirdly, Lockhart J observed in *Australian Innovation Ltd v Petrovsky*[53] that '[a]part from the statutory duty imposed upon directors by s 232(4) to act with due care and diligence, duties of the same kind are owed under the general law.'[54]

On the other hand, it has also been argued that the common law and statutory duties of care and diligence are not the same because the common law duty exceeds the s 232(4) requirements by virtue of the majority judgment in *Daniels.*[55] The majority held that the law of negligence applies to both executive and non-executive directors alike in requiring them to bring an informed, independent and active discretion to their positions within the corporation.[56]

There are several reasons why there has not been any detailed judicial consideration of the statutory provision as the common law duty of care seems to have surpassed its statutory equivalent.[57] Firstly, it is argued that some parts of the statutory provision, such as the phrase 'in a like position', may facilitate adherence to a subjective duty of care.[58] Secondly, the Explanatory Memorandum attached to s 232(4) stated

[49] The CLERP Bill goes even further by providing that the statutory duty of care and diligence is equivalent to not only the common law duty, but also to the equitable duty. Are the legislators suggesting that the statutory and common law duties of care and diligence have merged with a directors fiduciary obigations to his or her company?
[50] (1993) 11 ACSR 162.
[51] Ibid, 165.
[52] *Daniels* (1995) 13 Australian Company Law Cases 614, 665-6 (emphasis added).
[53] (1996) 14 Australian Company Law Cases 1357.
[54] Ibid, 1361.
[55] See Julie Cassidy, 'Has the "Sleeping" Director Finally Been Laid to Rest?' (1997) 25 *Australian Business Law Review* 102, 103; Larelle Law, 'The Business Judgment Rule in Australia: A Reappraisal Since the AWA Case' (1997) 15 *Company and Securities Law Journal* 174, 183.
[56] *Daniels* (1995) 13 Australian Company Law Cases 614, 662-5.
[57] See Cassidy, above n 55.
[58] Ibid 115.

that the provision does not change the law, but merely confirms the state of the law given by Rogers CJ's judgment in *Daniels*. As His Honour clearly distinguished between the standard of care required from executive and non-executive directors by holding that the latter only need abide by a subjective standard, the provision is open to an interpretation that there is a subjective standard of care.[59] This, according to Cassidy, is supported by Derrington J in *Re Property Consultancy P/L*[60] who observed that s 232(4) requires only the subjective elements of care and diligence. However, Cassidy does not agree with that conclusion because the legislators' intention to have s 232(4) operate as an objective standard is evident from the Explanatory Memorandum itself.[61] It states that the phrase 'in a like position' will allow the courts to impose a more objective test and ensure that our courts have complete freedom to take into account all relevant considerations in applying the test.[62] Cassidy's observations are powerful, and even though the statutory duty and common law duty may not be applied in the same (objective) manner, there is no difference in their respective underlying policies.

Given that the current state of the law is somewhat unclear, it is necessary to examine whether a newly created statutory BJR will improve upon this position.

IV A STATUTORY BJR: IMPROVED ACCOUNTABILITY AND CERTAINTY?

Having concluded that, at least theoretically, both the statutory and common law duties of care and diligence require an objective standard, it is possible to reexamine the decided cases on the duty of care and diligence of directors from the viewpoint of whether a statutory BJR will reduce a director's present level of accountability in respect of negligent business decisions and whether it is necessary in order to achieve greater certainty in respect of a director's potential liabilities.

There is no doubt that since the time of the case of the Marquis of Bute[63] and *Re City Equitable Fire Insurance Co Ltd*[64] the standard of care expected by the community from corporate directors and officers has increased. A clear demonstration of such higher standard can be seen in the area of insolvent trading. Here, Parliament and the courts were prepared to pierce the corporate veil if the directors had allowed the company to trade whilst insolvent: good examples are s 588G of the *Corporations Law*[65] and recent insolvent trading decisions such as *Morley* and

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[59] Ibid.
[60] (1995) 95 ATC 1051.
[61] Cassidy, above n 55, 116.
[62] Corporate Law Reform Bill 1992 (Cth) Explanatory Memorandum [39].
[63] In *Re Cardiff Savings Bank* [1892] 2 Ch 100, the marquis was held not to be in breach of his duty of diligence despite only having attended one board meeting in 17 years.
[64] [1925] 1 Ch 407.
[65] For all debts incurred prior to 23 June 1993 the applicable provision is s 592 whilst s 588G applies to debt incurred after that date.

Friedrich. The relationship between sections 232(4) and 588G(1) is that the standard attributable to a director who is the subject of an insolvent trading offence is to be consistent with the general test of care and diligence in s 232(4).[66] The leading case in this area is *AWA Ltd v Daniels*, of which both its trial and subsequent appeal (*Daniels v Anderson*) are worth examining.

A AWA Ltd v Daniels: *The Trial Decision*

AWA's business was manufacturing, importing and exporting electrical goods. To overcome its exposure to currency fluctuations it employed a currency dealer, Koval, to trade on the foreign exchange market under general policy guidelines laid down by the Board. Over the ensuing period, Koval produced figures which showed the foreign exchange operation was very profitable whilst, in truth, there were substantial losses which had been hidden by Koval through unauthorised lines of credit from various banks. Two audits conducted by AWA's external auditors, and financial statements supplied to the board, failed to show the operation's true status. One of the audit partners, however, was aware that the company's internal controls had serious defects. Once AWA's board became aware of the foreign exchange operation's true position, it sued its auditors for negligence. The auditors counterclaimed against AWA's directors for contributory negligence.

Rogers CJ distinguished between the functions and the liabilities of executive and non-executive directors. This same analysis will therefore be employed in examining the case in relation to the proposed BJR.

1 *Non-Executive Directors*

AWA Ltd v Daniels moved away from the reasoning employed in *Morley*. In *Morley*, Ormiston J found against the director Mrs Morley because she was too passive, breaching her positive duty to monitor the company's financial affairs. This was not the case here. Moreover, Rogers CJ in *AWA Ltd v Daniels* expressly acknowledged that the directors appeared to be of a high calibre. They were all experienced businessmen who served on the boards of some of the most prominent and successful Australian corporations.[67]

His Honour found that the duty of care for non-executive directors is to be measured subjectively, taking into account their actual knowledge and experience, the nature and extent of the corporation's business, and the distribution of responsibilities in the particular corporation.[68] This subjective standard, however, still required directors to take reasonable steps to place themselves in a position to guide and monitor the management of the company. Thus, Rogers CJ noted the importance of determining the proper division of functions between the board and management.

[66] Butterworths, *Australian Corporations Law, Principles and Practice*, vol 1, [3.2.0645].
[67] *AWA Ltd v Daniels* (1992) 7 ACSR 759, 772.
[68] Ibid 864.

This is so notwithstanding the statutory duty does not differentiate between the board and management (non-executive and executive directors).[69]

So what should non-executive directors (in a company the size of AWA especially) be doing in order to fulfil their duty? According to Rogers CJ, they are to: set corporate goals; appoint the chief executive officer; oversee the plans of managers for the acquisition and organisation of financial and human resources towards attainment of the company's goals; and, review, at reasonable intervals, the corporation's progress towards attaining its goals.[70] In setting these standards, Rogers CJ was guided by decisions involving insolvent trading companies.[71]

Had AWA's non-executive directors been negligent in the performance of their duty of care and diligence? On the objective evidence they had not, as they had made policy decisions to set up a system of internal controls and had laid down the basic principles of the policy to be implemented by management. There was no evidence to suggest to these directors that the policy was not being implemented, thereby putting them on inquiry. Had they been put on notice of serious defects in the management of the company, they would be expected to pursue those matters with a greater degree of diligence and stubbornness than others.[72] As the auditors' report confirmed that the policy was being adhered to, the claim for contributory negligence against the non-executive directors was dismissed.

On the facts of this case the non-executive directors were not negligent, therefore application of the proposed BJR would not have made any difference to the result and to the level of their accountability.

2 *Executive Directors*

Rogers CJ noted that Anthony Hooke was both AWA's chairman of the board and its chief executive officer. Thus he was an executive director. These positions are usually covered by a service contract which incorporates an express or implied condition that the incumbent will exercise the care and skill to be expected of a person in that position. Unlike the requisite standard of care for a non-executive director, the standard of care of an executive director is measured objectively.

What then were Hooke's responsibilities? He was required to formulate board policy; communicate between the board and management in both directions; and be fully informed on management activities. Did he fulfil these duties to the required standard? The Court found that he failed to pass on information (warning signs) received from the auditors to other board members; he did not fully inform himself of Koval's activities and consequently, failed to pass this information to the board; he failed to take the possible risks of Koval's foreign exchange activities into ac-

[69] Ibid 864-5.
[70] Ibid 865-6.
[71] For example, *Morley* (1990) 2 ACSR 405 and *Friedrich* (1991) 5 ACSR 115.
[72] See Robert Baxt, 'The AWA Case' (1992) 10 *Company and Securities Law Journal* 416, 417.

count; and, he made no attempt to decide this problem on a rational business basis. As a result of these findings, Rogers CJ held Hooke had been contributory negligent.[73]

The question then becomes, would the application of the proposed BJR have made Hooke any less accountable for his negligence? In the case, Rogers CJ considered that had Hooke examined and decided the foreign exchange problem on a rational business basis, the protection of a BJR or relief under s 1318 would have been appropriate.[74] Thus, Hooke was not entitled to the protection of the BJR because he failed to meet all of its prerequisites. He did not act in good faith because he failed to pass important information on Koval's foreign exchange operations to the board. He failed to adequately inform himself. Consequently, any belief he may have formed could not have had any rational basis. Therefore, whether the proposed BJR is adopted is immaterial to the resolution of Hooke's liability in this case. He would have been equally liable under the proposed CLERP BJR as he was under the existing legislation.

B AWA Ltd v Daniels *and a BJR's Greater Certainty*

1 *Non-executive Directors*

As the non-executive directors in *AWA Ltd v Daniels* were not negligent, the protection of a BJR was not required. They were not liable because they had behaved within the requisite standard of care and diligence. A BJR's safe harbour from negligence would be irrelevant; whether it was applied to their behaviour or not would not have made them any more or less certain of their potential liability.

Alternatively, it is arguable that Rogers CJ recognised and applied the BJR without expressly referring to it. He acknowledged that directors' decision making is often difficult because the law insists that they 'accept more and more responsibility for the oversight of a company's affairs at the same time as the affairs of companies become more and more complex and diverse.'[75] On this basis his Honour applied the BJR and found compliance with all its elements. Consequently, the non-executive directors enjoyed the benefit of the protective presumption of the BJR. On this analysis as well, statutory adoption of the BJR will not increase a director's certainty in respect of his or her potential liability.

2 *Executive Directors*

Rogers CJ found that Hooke had been negligent and therefore could neither claim the protection of the BJR nor be excused from liability under s 1318 of the *Corpo-*

[73] See Sally Sievers, 'Farewell to the Sleeping Director—The Modern Judicial and Legislative Approach to Director's Duties of Care, Skill and Diligence' (1993) 21 *Australian Business Law Review* 111, 139.
[74] *AWA Ltd v Daniels* (1992) 7 ACSR 759, 878.
[75] Ibid 865.

rations Law.[76] Whether the BJR is part of the common law or in legislative form would not have made any difference to Hooke's knowledge of his potential liability for his acts and omissions. This view has been implicitly supported by the Commonwealth government when it decided, in 1992, that the development of the business judgment doctrine is better left to the courts.[77] The only way Hooke could have been more certain about his potential liability is by obtaining legal advice on the consequences of these acts and omissions before they occurred.

C Daniels v Anderson: *The Appeal*

Not surprisingly, the decision at first instance was appealed. In the rehearing, the majority of the New South Wales Court of Appeal (Clarke and Sheller JJA, Powell JA dissenting) held that directors owe a common law duty to their company to take reasonable care in the performance of their office, actionable by suit in negligence by the company.[78] This duty is to be measured objectively, is not limited by the particular director's knowledge and experience or ignorance or inaction,[79] and is the same test as the one applicable in the law of negligence. Importantly, the test does not draw a distinction between executive and non-executive directors because, according to Clarke JA, such a formal divergence in the standard of care is unnecessary.[80] Instead, the concept of negligence is adaptable to the facts of a particular case. This includes the question whether the director holds his or her office in a non-executive or executive capacity.[81]

Notwithstanding that the court rejected a different standard of care for non-executive and executive directors, it nevertheless recognised that subjective aspects can form part of a director's objective duty of care and diligence. These variable subjective factors include the size and business of the particular company and the director's skills and experience.[82]

The appellate decision is specifically referred to in the CLERP Paper as 'having extended and made more uncertain the accountability and liability of directors.'[83] This is confirmed by Professor Paul Redmond who attributes renewed advocacy for a BJR to concerns about the general law duty of care expressed in the majority judgment.[84]

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[76] Ibid 868.
[77] See Corporate Law Reform Bill 1992 (Cth) Explanatory Memorandum [89].
[78] *Daniels* (1995) 13 Australian Company Law Cases 614, 665-6.
[79] Ibid 666.
[80] Ibid 665.
[81] Ibid 663. Also see, for example, *Cook v Cook* (1986) 162 CLR 376 which held that duty owed by the learner driver to the passenger was to take the same level of care that would be taken by a reasonable learner driver.
[82] *Daniels* (1995) 13 Australian Company Law Cases 614, 665.
[83] Commonwealth, above n 35, 22.
[84] See Paul Redmond, 'Safe Harbours or Sleepy Hollows: Does Australia Need a Statutory Business Judgement Rule?' in Ian Ramsay (ed), *Corporate Governance and the Duties of Company Directors* (1997) 189.

What then, according to the majority, does the law require of directors? In their finding, their Honours relied substantially on US case law and Australian insolvent trading decisions. They held that directors are obliged to: inform themselves continually about, and understand the business of the corporation; supervise managers and practices to determine whether business methods were safe and proper; not shut their eyes to corporate misconduct; generally monitor corporate affairs and policies; attend board meetings regularly; maintain familiarity with the financial status of the corporation by regular reviews of financial statements; and object and, if necessary, resign if the corporation does not, upon discovery of an illegal course of action, correct the conduct.[85]

Even though the majority set a higher standard of care than was the case at first instance, both decisions exonerated the non-executive directors from liability. Likewise, both held Hooke to be negligent. Therefore, on those points, the majority decision was consistent with that of the court below. Also, the proposed statutory BJR and the majority's requirements from directors are substantially consistent with each other. This means that the existence of a statutory BJR would not have enhanced the defences of any of AWA's directors.[86]

The first requirement of the proposed BJR is that decisions are made in good faith for a proper purpose. But decisions cannot be made in good faith unless they are made once the decision maker has attended to all of the requirements set out by the majority in *Daniels*. Secondly, the proposed BJR requires directors not to have a material personal interest in the subject matter of the decision. Whilst the majority does not expressly state this requirement, it does, however, imply that a director is bound to avoid conflicts of the company's interests with that of his or her own. This is so because the court requires directors not to shut their eyes to corporate misconduct. Obviously this includes their own conduct—to have a conflict of interest constitutes misconduct. Thirdly, the proposed BJR requires directors to adequately inform themselves about the subject matter of the decision. Clearly, the first six items mentioned by their honours[87] impose a positive duty on directors to be informed on a range of important corporate governance matters. The final limb of the BJR requires a rational belief that the decision is in the best interests of the company. But unless the belief is based upon directors adequately informing themselves, it cannot be rational. Thus, unless they know the financial status of the company, understand its business, supervise managers and practices, monitor corporate affairs and attend board meetings regularly, there is every chance that a belief that the decision is in the best interests of the company is not rational, as the directors will have no idea of what are the best interests of the company.

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[85] *Daniels* (1995) 13 Australian Company Law Cases 614, 664-5 quoting Pollock J in *Francis v United Jersey Bank* 432 A 2d (1981). See also *Milpurrurru v Indofurn P/L* (1995) AIPC 91-116 39051, 39074 where, had the directors made inquiries when put on notice, infringement of copyright of paintings would have been avoided.

[86] See also Ken Martin, 'The Duty of Care Owed to a Company by its Directors' unpublished paper dated 22 September 1997 on file with the author, 26.

[87] See above n 85 and accompanying text.

On this basis, it is difficult to see why the *Daniels* appeal judgment extended and made more uncertain the accountability and liability of directors.[88] However, there are other aspects in the majority judgment which do place doubts on this. Firstly, the majority, in distinguishing the director from a trustee, referred to the duty of a director as including 'display[ing] entrepreneurial flair and accept[ing] commercial risks to produce a sufficient return on the capital invested.'[89] Secondly, in what has been referred to as a common theme throughout the joint judgment, one of the duties of directors is to make business judgments and business decisions in a spirit of enterprise, and to take commercial risks in the hope of commensurate rewards.[90] According to Larell Law, these statements can be construed in a positive light by company directors in Australia as the court is indicating some protection from negligence for genuine commercial risk taking behaviour.[91]

In its argument for the introduction of a statutory BJR, the CLERP Paper also contends that uncertainty in accountability and liability does not exist simply because of *Daniels*, but is apparent in decisions rendered both before and after the *Daniels* appeal. These decisions are apparently inconsistent with the Court of Appeal decision and with each other.[92] The cases cited are mainly those that were decided by the Full Court of the Western Australian Supreme Court.[93] Essentially, these cases hold that the test whether a director has breached his or her duty of care and diligence is subjective, that is, consistent with the holding of Rogers CJ in *Daniels* at first instance in respect of non-executive directors. If this is so, there is no need to introduce a statutory BJR as the 1993 Explanatory Memorandum claimed that the Government had decided not to introduce one on the strength of the *AWA Ltd v Daniels* decision.

In any event, the business judgment doctrine was also acknowledged in some of the Western Australian cases. According to Ipp J:

> The management and direction of companies involve taking decisions and embarking upon actions which may promise much, on the one hand, but which are, at the same time, fraught with risk on the other. That is inherent in the life of industry and commerce. The legislature undoubtedly did not intend by s 229(2) [now s 232(4)] to dampen business enterprise and penalise legitimate but unsuccessful entrepreneurial activity. Accordingly, the question

[88] See Commonwealth, above n 35.
[89] *Daniels* (1995) 16 ACSR 607, 658.
[90] See Law, above n 55, 183. See also *Australian Innovation Limited v Petrovsky* (1996) 14 Australian Company Law Cases 1357, 1361: 'It is important that the courts do not impose burdens upon directors which make their task so onerous that capable people would be deterred from serving as directors' (Lockhart J).
[91] See Larelle Law, 'Company Directors: Duty to Take Risks?' [1996] *Current Commercial Law* 89.
[92] See Commonwealth, above n 35.
[93] See, eg, *Re Property Force Consultants P/L* (1995) 13 Australian Company Law Cases 1051; *Dempster v Mallina Holdings Ltd* (1994) 13 WAR 12; *Permanent Building Society v Wheeler* (1994) 14 ACSR 109; *Vrisakis v ASC* (1993) 16 ACSR 607.

> whether a director has exercised a degree of care and diligence can only be answered by balancing the foreseeable risk of harm against the potential benefits that could reasonably have been expected to accrue to the company from the conduct in question.[94]

The test of 'balancing the foreseeable risk of harm against the potential benefits' was again applied by Ipp J in *Permanent Building Society v Wheeler* and Carr J in *Gamble v Hoffman.*[95]

Although this test has received worthy criticism on the one hand,[96] it is useful insofar as it exempts from judicial scrutiny any legitimate but unsuccessful entrepreneurial activity. Thus its effect and the objectives of the BJR are consistent. This is adequately demonstrated by Law's application of the four components of the BJR to *Vrisakis.*[97]

In light of the above, it is unlikely that the introduction of a statutory BJR will have the desired effect of reducing a director's accountability in respect of negligent business decisions. Further, a statutory BJR will not achieve greater certainty in respect of a director's potential liability for decisions negligently made, as will be discussed next.

V THE RATIONALE UNDERLYING INTRODUCTION OF THE BJR

According to the CLERP Paper, the fundamental purpose of a BJR is to protect the authority of directors in the exercise of their duties, so as to encourage competent individuals to assume directorships.[98] Indeed, the federal treasurer, Peter Costello, has confirmed this sentiment by expressing the view that the rationale of the BJR is economically based. It will assist in achieving the economic objective of the corporation, which after all, is to limit liability, and thereby promote investment and endeavours which would otherwise not occur.[99] A statutory BJR will promote innovation by providing the 'right balance between the competing interests of, commercial risk taking by directors and, on the other hand, their accountability.'[100] The statutory BJR will provide legal certainty on the question of director's potential liability, which is an important goal.[101]

It is not certain, however, that introducing any form of statutory BJR will achieve greater certainty. Further, a BJR will not strike the appropriate balance between risk taking and accountability. Indeed, the introduction of a BJR will make the law

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[94] *Vrisakis v ASC* (1993) 11 ACSR 162, 212.
[95] (1997) 24 ACSR 369.
[96] See Julie Cassidy, *Company Directors* (1998) vol 2, 9-10.
[97] See Law, above n 55, 185.
[98] See Commonwealth, above n 35, 23. See also *Briggs v Spaulding,* 141 US 132, 149 (1891).
[99] Peter Costello, 'A Step in the Right Direction' (1996) 12(6) *Company Director* 27, 27-8.
[100] Commonwealth, above n 35, 23.
[101] Costello, above n 99, 28.

regarding directors' liability more uncertain, which will have an effect on accountability of directors. It is argued that this is so in respect of both the general concept of a BJR and the proposed version as contained in s 180(2) of the CLERP Bill. Consequently, it is necessary to consider the resultant uncertainties flowing from the introduction of a statutory BJR based on the standard arguments relied upon for its enactment.

A *Encouraging Risk Taking*

Encouraging risk is the traditional rationale used in the US for having a BJR. Its existence is said to provide a stimulus to risk taking, innovation and other entrepreneurial activities.[102] Some would argue such a stimulus is especially important in the business context because deterring risk taking creates greater harm. But while risk taking is important in business, it is equally so in medicine, law and other disciplines as decisions necessarily involve a balancing of risks.[103]

The CSLRC also was of the view that a statutory BJR would be a catalyst to business endeavours because it would provide a safeguard or certainty against personal liability for business decisions taken honestly. This is so because the BJR ensures that a tribunal would not review the merits of such decisions.[104] Advocating for a BJR on this ground is suspect because there is no clear authority supporting judicial review of business decisions on their merits.[105] In fact there is considerable authority for the opposite proposition.[106] Additionally, s 1318 and the common law already allow the court to excuse a director from liability where he or she has acted honestly and ought fairly to be excused.[107] Thus, there is no point in introducing a statutory BJR which simply serves to confirm the position at common law. Moreover, it is surprising that bodies of professionals such as the Australian Institute of Company Directors (AICD) and the Business Council believe that the introduction of a BJR into the *Corporations Law* will reduce uncertainty for directors when making decisions. Surely, uncertainty is the very nature of commercial life—demands for higher levels of certainty are unrealistic.[108]

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[102] See American Law Institute, *Principles of Corporate Governance: Analysis and Recommendations—Proposed Final Draft* (1992) 24-5.
[103] See Franklin Gevurtz, 'The Business Judgement Rule: Meaningless Verbiage or Misguided Notion?' (1994) 67 *South Californian Law Review* 287, 311.
[104] See Companies and Securities Law Review Committee, *Company Directors and Officers; Indemnification, Relief and Insurance*, Report No 10 (1990) [76].
[105] See Redmond, above n 84, 199.
[106] See *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821, 823; *Harlowe's Nominees P/L v Woodside (Lakes Entrance) Oil Co N/L* (1968) 121 CLR 483, 493.
[107] For an actual example, see *Re Claridge's Patent Asphalte Co Ltd* [1921] 1 Ch 543.
[108] See Submission by John Lightowlers to the Business Law Division of the Commonwealth Department of Treasury, 2 December 1997, 2.

B Protecting Business Decisions

It is argued that a BJR is necessary to ensure that, provided its prerequisites are met, directors' decisions will be unassailable. The BJR will operate so as to provide a 'safe harbour' allowing commercial decision making on its true merits.[109]

This contention is fallacious on a number of grounds. Firstly, decisions will still be subject to the statutory standard of care if a plaintiff can show that on the objective evidence, the decision has not met one or more of the BJR's preconditions. Thus the BJR's protection is not absolute.[110] A clear demonstration of this can be seen in the decision of *Smith v Van Gorkom*.[111] There the Delaware Supreme Court held that the directors did not adequately inform themselves as to Van Gorkom's role in forcing the 'sale' of the company and were grossly negligent in approving the sale upon two hours consideration. This was so notwithstanding that the price per share obtained by this deal increased shareholder's wealth by 50 per cent over market value, and that the company's directors were experienced, well-informed and sophisticated. Further, the transaction negotiated by Van Gorkom, who himself was a substantial shareholder, was at arm's length. Thus, the better the price, the more Van Gorkom received. It is worth noting that this decision was made in a jurisdiction in which the BJR has been 'protecting' directorial decisions for over 150 years.

Secondly, on the specific form of the proposed BJR, there are what have been referred to as 'conflict concerns'.[112] Assuming, for the purpose of this argument, that the 'note' accompanying the proposed BJR is effective in restricting the BJR's application to the statutory and common law duty of care and diligence. This would mean that the BJR will not operate to protect decisions concerning, for example, the issuing of prospectuses or insolvent trading. However, it is clearly possible to challenge a director's decision, protected by the BJR, under s 52 of the *Trade Practices Act 1974* (Cth) ('TPA'). On this basis, a director's decision may be challenged, or duty may be enforced, under the TPA because the *Corporations Law* in its application to the various states, is State legislation. As the TPA is a Commonwealth Act, s 109 of the *Constitution* will resolve a conflict between the two acts in favour of the TPA.[113]

There are other examples of overlap between the duty of care proffered in the BJR and other provisions which impose duties (and/or liabilities) on directors and their

[109] See Australian Institute of Company Directors, *Submission to the A-G of the Commonwealth of Australia on the Exposure Draft (February 1992) of the Corporate Law Reform Bill 1992* (May 1992), 24-5.
[110] See Redmond, above n 84, 200. See also *Corporate Governance and the Duties of Company Directors*, Centre for Corporate Law and Securities Regulation, University of Melbourne, Melbourne, 200; Law Council Submission, above n 3, 5.
[111] 488 A 2d 858 (Del, 1995).
[112] See Law Council Submission, above n 3, 9.
[113] Ibid. See also Michael Gillooly, 'Misleading or Deceptive Conduct Under Section 995 of the Corporations Law' in Colin Lockhart (ed), *Misleading or Deceptive Conduct: Issues and Trends* (1996) 43.

decision making. These occur both outside[114] and within the *Corporations Law*. In the latter category, where there is continuing negligent conduct by a director which amounts to a breach of the *Corporations Law*, a shareholder (or any person whose interests have been affected by that conduct, or decision to engage in that conduct) may obtain an injunction to restrain the conduct and an award of damages.[115] This contention is also supported by Einfeld J in *Air Peak P/L v Jetstream Aircraft Ltd.*[116] Thus, it appears that the court's power to grant an injunction or award damages against a director for a negligent business decision may clash with the proposed statutory BJR. On the one hand, directors will have a safe harbour from their negligent decisions or business judgments, whilst on the other hand, a court may for the same decision or judgment, issue an injunction or award damages, thereby creating uncertainty. A similar contention is made by Warnich in respect of s 260 where a director's decision may be challenged for conduct contrary to the interests of the members as a whole, and s 598 where 'eligible applicants'[117] may bring an action against a person who is guilty of negligence.[118] Also, in both of these instances the 'protection' provided on the one hand by the statutory BJR could disappear by operation of one or the other of these provisions.

In any event, the general law and s 164(3)(f) of the *Corporations Law* already presume the validity of directors' decisions. Judicial policies of non-intervention in the merits of directorial decisions have demonstrated a proper balance between risk taking and accountability. A recent demonstration of this balance is Perry J's remarks in *State of South Australia v Marcus Clark*[119] where he stated:

> Although the administration of the bank's affairs was to be 'in accordance with accepted principles of financial management and with a view of achieving a profit', this did not mean that in its pursuit of profit either the board or the chief executive officer could properly expose the bank to unnecessary risk.[120]

No decisions have subjected directors to either inappropriate hindsight review or merits review of their business judgments.[121]

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[114] See, eg, the Submission from Nehmer McKee dated 18 November 1997 to Mr P Lindsay MHR referring to s 222AOC of the *Income Tax Assessment Act 1936* (Cth).
[115] See s 1324(10). See also L Warnich, 'The Liabilities of the Inattentive Company Officer' (1988) 18 *University of Western Australia Law Review* 91, 98; see also Bob Baxt, 'On Company Money' (1997) 68(8) *Charter* 52, 53.
[116] (1997) 15 Australian Company Law Cases 715, 720-1.
[117] As defined in s 9 of the *Corporations Law*.
[118] See Warnich, above n 115, 99, 103.
[119] (1996) 19 ACSR 606.
[120] Ibid 629.
[121] See Redmond, above n 84. See also Law Council Submission, above n 3, 5.

C Fairness and Expediency

John Farrar argues that the BJR's special protection is justified on the twin bases of fairness and expediency.[122] The fairness justification is premised upon the notion that whilst all professionals are liable for bad decisions (as distinct from good decisions which turn out to be bad), directors ought be protected by the BJR. This is so because, unlike other groups of professionals, there exists no body of practice or norms against which acceptable conduct can be measured and most directorial decision making is founded upon incomplete information and necessarily involves risk. Thus, it is argued, these qualities both undermine the accuracy of after the fact review and are not true of other disciplines or professions.

The contention that no norms guide business decisions is wrong. As in other professions, there exists formal business education. Other professions also undertake actions in unique situations based upon intuition and experience without being able to articulate the exact reasons for the course of action. Thus, business decisions are no less inappropriate for judicial review than those of other professionals.[123] The Law Council of Australia agrees with this, arguing that finance and investment professionals make complex decisions based on incomplete information, which necessarily involve risk.[124] Yet this group is exposed to liability without the protection of a BJR. Other expert commentators point out that the BJR provides the negligent director with a safe harbour, whilst hindsight bias (or review) is applied to medical practice.[125] In any case, why should there be a special enclave for corporate directors and officers, when the requisite standard of care at both common law and under the *Corporations Law* provide adequate protection for the particular nature of the director's office?[126]

From the view of expediency, shareholders' welfare will be advanced by encouraging rather than restricting risk taking. Thus, making directors liable for mere errors of judgment will stifle economic activity.[127] A director's duty of care and diligence does not make directors liable for mere errors of judgment. At common law and under s 232(4) of the *Corporations Law*, no such liability arises. The duty of care requires directors to monitor or oversee the conduct of the corporation's business, to make further inquiries on information received which reasonably gives cause for concern, and to use reasonable care in making decisions.[128] According to Paul Redmond and the Law Council of Australia, the real reason underlying the

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[122] See Farrar, above n 2, 23-4; Farrar, above n 43, 17-18.

[123] See Gevurtz, above n 103, 308-9.

[124] Law Council Submission, above n 3, 9.

[125] See Hal Arkes and Cyndy Schipani,'Medical Malpractice v. the BJR: Differences in Hindsight Bias' (1994) 73 *Oregon Law Review* 587, 610.

[126] Section 232(4) of the *Corporations Law* requires the degree of care and diligence that a reasonable person *in a like position* in a corporation would exercise *in the corporation's circumstances* (emphasis added). See also *Daniels* (1995) 13 Australian Company Law Cases 614, 663.

[127] See Farrar, above n 2, 23-4; Farrar, above n 43, 17-18.

[128] See Deborah DeMott, 'Director's Duty of Care and the Business Judgment Rule: American Precedents and Australian Choices' (1992) 4 *Bond Law Review* 133, 133-4.

expediency argument is that shareholders' interests will be better served by the absence of legal accountability for director's decisions.[129] There is no evidence to support this assertion.

D Importation of US Liability Standards

The majority judgment in *Daniels* has arguably adopted a tougher standard of care for directors, akin to that imposed on US directors (by adopting the *Francis v United Jersey Bank*[130] test). The majority quoted extensively from this case and found that what the Supreme Court of New Jersey required from directors has become the same as what Australian law requires of its directors. On this basis it would be somewhat unfair to Australian directors not to also import the protections available to American directors.[131] Whilst Redmond and the Law Council agree that this argument has some force, they warn that the US's BJR is not purely a complement to its duty of care, as is intended with the proposed statutory BJR. In those US jurisdictions, the BJR also serves as a response to, inter alia, contingent fee practices and the relative ease in which shareholders' derivative suits are brought. Neither of these exist here.[132] On this argument, then, the proposed statutory BJR is not required.

Importing norms from a foreign system requires caution and sophistication. The US jurisprudence on the BJR has features and consequences that are at odds with policy choices in Australian corporation law.[133] Those arguing in favour of the BJR's importation into Australia need to realise that the BJR in the US has not been statutorily adopted. Therefore in both Australia and the US, the BJR is part of the common law. It has already been demonstrated that the Australian authorities have adequately recognised the BJR doctrine, so that in effect, its protection exists.

E Adequate Protection at General Law

Some have argued that there is something to be gained from a statutory BJR's comprehensive statutory restatement. The argument is that the benefit to be gained by a director is clarification of the steps to take in making a business judgment in order to be protected should a decision not turn out well. It would also provide the courts with guidance as to the appropriate application of the BJR.[134] This argument was given in the context of a recently introduced s 232(4).[135] Even if that contention was accepted (and it is not), it should be noted that the proposed statutory BJR is accompanied by a new statutory duty of care and diligence which is clearly regres-

[129] Redmond, above n 84, 200; Law Council Submission, above n 3, 9.
[130] 432 A 2d 814 (NJ, 1981).
[131] See Martin, above n 86, 26.
[132] See Andre Tunc, 'The Judge and the Businessman' (1986) 102 *Law Quarterly Journal* 549, 560; Redmond, above n 84, 201; Law Council Submission, above n 3, 10.
[133] See DeMott, above n 128, 141-4.
[134] See Tan, above n 25, 452.
[135] Ibid, 442-3.

sive as far as the requisite standard of care is concerned, because it seeks to return to the low subjective standard of *Re City Equitable Insurance* by introducing additional subjective elements into the statutory duty. This means that the need to balance the objective duty of care with a statutory BJR will either no longer exist or will be substantially lessened.

Tan offers an additional reason for a statutory BJR. He argues that US courts have misapplied the BJR where it is a rule of common law. Therefore, for it to be properly applied as the equilibrium between the competing interests of commercial risk taking and accountability, it must be legislatively adopted.[136] Granted, there are US cases which tend to show some misapplication[137] but is this a reason for adopting a legislative BJR? There are many examples of courts interpreting statutes in different ways. Surely the interpretation and application of a statutory provision or a rule of law is dependent upon the facts of a particular case. Therefore, not only is there nothing to be gained by a legislative restatement of the BJR, but also the flexibility assured by reliance upon the courts for the development of legal principle would be lost.[138] In the US there have been substantial difficulties in the BJR's codification. The ALI draft has taken over a decade to complete and it still has not been legislatively adopted. Additionally, the American Bar Association has simply abandoned the codification project after 'ten drafts and hundreds of man-hours of struggle', concluding that there were 'too many imponderables which might arise in future cases'.[139] The development of such principles is 'better left to the courts'.[140]

F Reality of Shareholder Litigation

It is telling to note that there are only a few recently reported decisions in which a solvent company has sued its directors for breach of the general law or statutory duty of diligence. There are two possible reasons for this. Firstly, the threat of litigation faced by directors for breach of this duty is illusory. Secondly, there is the curious paradox whereby the potential defendants are responsible for their own enforcement. Both these reasons make the need for a statutory BJR unwarranted. This is because it is generally directors who consider whether to pursue an action against other directors for breach of their common law or statutory duties. The shareholder's derivative action is taken on behalf of the company but is largely inadequate because at common law the 'proper plaintiff' rule[141] is restrictive, and at both common law and under statute, the remedies are inadequate and the cost consequences to the shareholder concerned, inappropriate.

In this context the Government proposed to make it less cumbersome for shareholders to initiate derivative actions by introducing appropriate legislative provisions

[136] Ibid, 446-7.
[137] See, for eg, the cases referred to by Tan, above n 25, 447.
[138] See Redmond, above n 84, 202; Law Council Submission, above n 3, 10.
[139] See D Block, N E Barton and S J Radin, *The Business Judgment Rule* (1987) 24-5.
[140] See Corporate Law Reform Bill 1992 (Cth) Explanatory Memorandum [89].
[141] See *Foss v Harbottle* (1843) 67 ER 189.

simultaneously with the proposed BJR.[142] Whilst on the one hand the Government intends to correct the inadequate state of shareholder remedies for enforcement of director's duties, it seems, on the other hand, that it is nullifying this correction by introducing a statutory BJR. The effect of these legislative changes may make it easier, therefore, for shareholders to take such actions, but more difficult for these actions to be successful. The result: much ado about nothing.

VI A STATUTORY BJR AND THE CONTENT OF THE DUTY OF CARE

In 1992, the Secretary of the A-G's Department reasoned that a statutory BJR is either unnecessary (because it merely reflects the current requisite standard of care and diligence required of directors) or it is designed to lower that standard (in which case it is undesirable).[143] This paper has argued that the BJR will not deliver certainty with respect to potential liability. Even if it did, is a legally ordained right to such certainty, a fair and equitable outcome given the comparison with other professional groups? If such a right was to exist for corporate officers, it would only be a matter of time before the standard of care of other professions would be lowered by analogy. On this basis, the statutory BJR's introduction is not only unnecessary, but also counter-productive.

The Australian Institute of Company Directors has argued that a BJR 'does not merely reflect the current standard of care...[it] does not lower the standard of care but qualifies the duty ... [and] lower[s] the risk of liability'.[144] But this is really just hair-splitting. The desired effect of a BJR, both in its general principle and in its specific s 180(2) proposed statutory form, is to lower the standard of care for corporate officers by suspending the operation of the duty of care, thereby compromising its function in establishing standards of director conduct equal to that of other professionals. There is no other way the BJR can operate.[145]

How does the BJR lower the standard of care? Consider that both the ALI draft and the proposed statutory BJR allow a director to have a 'rational belief' that the decision is in the best interests of the corporation. This, according to the ALI commentary, is intended to permit a significantly wider range of discretion than 'reasonable', and to give corporate officers a safe harbour from liability from business judgments that might arguably fall outside the term 'reasonable'. Thus, a businessperson is entitled to make unreasonable or even stupid decisions as long as a judgment is not wholly irrational.[146] This is confirmed by a number of expert US commentators who conclude that the BJR essentially absolves directors of liability

[142] See generally, Commonwealth, above n 35, [5.3.1-5.4].
[143] See Andrew Rose, 'Directors Duties' (Paper presented at National Practitioners Forum on the Corporate Reform Bill 1992, April 1992, on file with author).
[144] See Australian Institute of Company Directors, above n 109, 32.
[145] See Redmond, above n 84, 204; Law Council Submission, above n 3, 12-13.
[146] See Tunc, above n 132, 560.

for acts short of gross negligence or egregious cases of misconduct;[147] retracts or nullifies the duty of care;[148] or condones an absolute neglect of corporate affairs.[149]

Thus, if it is unfair to other professionals that directors may enjoy a legally ordained right to certainty of liability, then it is equally inequitable for other professionals to be subject to a negligence standard whilst directors are not. The resulting inequity makes the BJR's introduction undesirable on two counts. First, other professionals also must make difficult decisions or render advice with uncertain outcomes that can be attacked by hindsight bias. Yet these professionals may be held liable for mere negligence.[150] Second, there is a danger that the objective standard of care currently required from our corporate directors and officers will be diluted by the case law, once courts have to interpret the requisite standard of care with the juxtaposition of a statutory BJR. This, if nothing else, ought to be drawn from the US experience.

VII THE EFFECT OF INTRODUCING A STATUTORY BJR

After changing the law, what benefits or adverse effects, if any, will flow? It has already been shown that in all likelihood a BJR would not make any difference to existing judicial decisions. This is because both the *Corporations Law* and the general law sufficiently recognise the necessity to maintain the delicate balance between the needs of encouraging endeavour and accountability. Further, it has been argued that certainty as to potential liability will not be attained; instead, in some aspects the BJR will present substantial new uncertainty.

Nevertheless, it is likely that the Government will persist in adopting a statutory BJR. This raises the question whether its introduction will have any adverse affects on accountability standards. The US experience informs us that whilst there may not be a direct or immediate impact on corporate governance or accountability, it will certainly have some impact. The BJR's underlying rationale is to induce entrepreneurial risk taking, but its application at times has gone beyond its objectives.[151] US courts have resorted to it as a basis for dismissing shareholders' derivative suits without any judicial scrutiny of the underlying suspect transaction.[152] Similarly, its application has had the effect of affirming target board action to stop shareholders selling their shares to a reputable bidder at a substantial premium over the prevail-

[147] See McMurray, above n 5, 614-15; Joseph Bishop, 'Sitting Ducks and Decoy Ducks: New Trends in the Indemnification of Corporate Directors and Officers' (1968) 77 *Yale Law Journal* 1078, 1095.

[148] See Harvey Goldshmid and Phillip Sorensen, 'Conference Panel Discussion: The Business Judgement Rule' (1984) 45 *Ohio State Law Journal* 629, 634, 639-40.

[149] See Cindy Schipani, 'Duty of Care: The US Experience' (1995) 47 *Australian Company Secretary* 345, 348.

[150] See Marc Steinberg, 'The Corporate Law Reform Act 1992: A View From Abroad' (1993) 3 *Australian Journal of Corporate Law* 154, 164.

[151] Ibid 164.

[152] See, eg, *Zapata Corporation v Maldonado* 430 A2d 779 (Del, 1981).

ing market price.[153] Such applications appear to be contrary to the 'proper purposes' doctrine and have been referred to as an affront to corporate accountability and governance.[154]

A further disturbing development in the US is the unduly broad interpretation given to 'disinterested' as it is applied in their BJR. In this context, 'disinterested' means that the director concerned does not have a personal interest in a given business decision or judgment. US courts have held that a director whose law firm earns large fees from representing the corporation is disinterested.[155] The proposed stautory BJR does not use the term 'disinterested', instead employing the phrase 'material personal interest'. But both 'material personal interest' and being interested (a word whose direct opposite is disinterested) in a transaction are closely related. As 'material personal interest' is not defined, interpretation of this phrase will be left entirely to our courts. Based on past practices, it is likely that in the absence of Australian decisions to the contrary, US law will be considered and followed, thereby giving directors too much latitude.

VIII CONCLUSION

No one has suggested that introducing a statutory BJR will return corporate governance to the days when the office of director was considered a 'pleasant employment without ... incurring any responsibility.'[156] What is disturbing, however, is that the introduction of the proposed BJR together with a revamped statutory duty, will not deliver the certainty which has been promised by its proponents. Indeed, its introduction may have the effect of lowering the standard of care and diligence required from directors and corporate officers without delivering any compensatory benefits.

The original s 232(4) of the *Corporations Law* did not include a statutory BJR because it was thought that it would be better left to the courts to develop. The Commonwealth government, however, has reversed its position on this as a result of the *Daniels* appeal. *Daniels* clearly acknowledged the need for corporate risk taking by recognising that 'directors must be allowed to make business judgments ... in a spirit of enterprise untrammelled by the concerns of a conservative investment trustee.'[157]

At the end of the day, a legislative and judicial framework that promotes accountability without unduly impeding entrepreneurial risk taking is the defining tension in corporate governance. On the one hand, there is the deference to directors' decisions; on the other hand the scope of judicial review. The courts have shown that

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[153] See, eg, *Panter v Marshall Field and Co* 646 F 2d 271 (7th Cir, 1981) and *Unocal Corp v Mesa Petroleum Co* 493 A 2d 946 (Del Supr, 1985).
[154] See Steinberg, above n 150, 164.
[155] See *Maldonado v Flynn* 597 F 2d 789, 794 (2nd Cir, 1979). For other examples see Steinberg, above n 150, 165.
[156] See *Re Brazilian Rubber Plantations and Estates Ltd* [1911] 1 Ch 425, 427.
[157] *Daniels* (1995) 13 Australian Company Law Cases 614, 662-3.

this balance is achievable without going down the path of becoming a 'supervisory board'. The richness of the common law has shown repeatedly that it is capable of managing this balance. As such, there is no need for a statutory BJR. Our legislators should not give in to ill-founded hysteria arising from certain sectors of the business community.