



Articles

Defences and relief from liability for company directors: Widening protection to stimulate innovation*

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Directors' concerns about personal liability exposure in Australia have occupied the minds of academics, professionals and government institutions for many years. The introduction of the statutory business judgment rule in s 180(2) of the Corporations Act 2001 (Cth) was welcomed widely and with enthusiasm. However, a closer look at this statutory rule and the few cases where it was used as a defence, reveal that the actual protection it provided for directors against personal liability is negligible. This paper will discuss the various proposals for reform made by academics, government organisations and industry bodies. It will also argue that the current state of affairs in Australia regarding the statutory business judgment rule is one of uncertainty, and that the protection directors hoped would be provided by the safe harbour provision in s 180(2) is illusory. Wider protection for directors against personal liability is proposed in this paper. It is proposed that s 180(2) and (3) are repealed and a new section inserted in Ch 9 (Miscellaneous) of the Corporations Act 2001 (Cth). The new section would provide protection against personal liability beyond mere 'business judgments' as currently defined in s 180(3). This means the protection will also be available for alleged breaches and contraventions of other provisions of the Corporations Act 2001 (Cth), thus overcoming one of the most serious limitations of the current statutory business judgment rule — it only provided protection when directors are sued for a breach of their duty of care and diligence under s 180(1). The new proposal is based partly on other proposals already suggested in Australia, but this new proposal is also informed by international perspectives.

I Introduction

Directors today are exposed to increased liability and penalties.¹ This increased exposure to personal liability has caused anxiety and concern, and

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¹ M Legg and D Jordon, 'The Australian Business Judgment Rule After *ASIC V Rich*: Balancing Director Authority and Accountability' (2014) 34 *ALR* 403 at 403–26.

has resulted in several proposals for wider protection against and relief from personal liability for company directors in Australia. A particular focus has been the statutory business judgment rule contained in s 180(2) and (3) of the Australian Corporations Act 2001 (Cth) (Corporations Act).² Other proposals for law reform were made by the Australian Institute of Company Directors (AICD)³ and by Dr Robert Austin.⁴

In Part IIA of this paper the focus is on the common law and statutory business judgment rules. In Part IIB the AICD's 'Honest and Reasonable Director Defence' is analysed and comment on, while in Part IIC the focus is on Austin's 'New Business Judgment Rule Proposal'. Some earlier initiatives, particularly a proposal by Treasury regarding wider defences for directors, are dealt with in Part IID. In Part III, a new proposal for a wider defence, 'The All-inclusive Directors and Other Officers Decisions Defence', is suggested.

In Part IV it is argued that 'The All-inclusive Directors and Other Officers Decisions Defence' will remove the need for more drastic and radical reforms proposed by others. In Part V the power of a court to grant relief from liability to directors is considered: this is not a defence, but relief a director may seek from the court after being held in breach of their duties. In Part VI concluding observations and recommendations are provided.

II Current and proposed defences for company directors

A The common law and statutory business judgment rules

1 Australian common law and statutory business judgment rules

The background to and origins of the statutory duty of care and the statutory business judgment rule have been dealt with in some detail in previous publications.⁵ The 'common law business judgment rule' in jurisdictions other than the United States is and always has been a poorly developed rule. Cases such as *Overend Gurney & Co v Gibb*,⁶ *Re Smith & Fawcett Ltd*⁷ and

2 A Hargovan and J du Plessis, 'Re-assessment of the Statutory Business Judgment Rule in Australia — The Case for Law Reform', *Corporate Law Teachers Association — Briefing Parliamentary Joint Committee on Corporations and Financial Services*, 27 October 2014; J Harris and A Hargovan, 'Revisiting the Business Judgment Rule' (2014) 66 *Governance Directions* 634.

3 Australian Institute of Company Directors, *A Proposal for Law Reform: The Honest and Reasonable Director Defence*, August 2014, at <<http://www.companydirectors.com.au/Director-Resource-Centre/Policy-on-director-issues/Policy-Papers/2014/The-Honest-and-Reasonable-Director-Defence>> (accessed 3 February 2017).

4 R Austin, 'Boards that Lead Need Better Protection', *Australian Financial Review*, 21 March 2014, at <<http://www.afr.com/business/legal/boards-that-lead-need-better-protection-20140320-ixc9g>> (accessed 3 February 2017).

5 See J J du Plessis, 'Open Sea or Safe Harbour? American, Australian and South African Business Judgment Rules Compared — Part 1' (2011) 32 *Comp L* 347 at 347–52; J J du Plessis, 'Open Sea or Safe Harbour? American, Australian and South African Business Judgment Rules Compared — Part 2' (2011) 32 *Comp L* 377 at 377–83.

6 (1872) LR 5 HL 480.

7 [1942] Ch 304; [1942] 1 All ER 542.

*Harlowe's Nominees Pty Ltd v Woodside (Lakes Entrance) Oil Co NL*⁸ have been used to justify the existence of a 'common law business judgment rule' in Australia and South Africa.⁹ In none of these cases has the term 'business judgment rule' been used and all of them have merely reflected the unwillingness of courts to interfere with internal decisions of directors generally if the powers used had been used for a proper purpose.¹⁰ It was correctly pointed out that since the proper purpose doctrine does not 'protect directors' as does a business judgment rule (safe harbour rule), as it is used in US jurisprudence, it is not correct to equate the Australian common law 'proper purpose doctrine' or 'business judgment doctrine' with the US 'business judgment rule'.¹¹

As illustration of the stark contrast between the so-called 'business judgment rule' in non-American jurisdictions and the American 'business judgment rule', the approach in the United States and the Delaware common law business judgment rule will be dealt with briefly.

2 Model US statutory business judgment rule and the Delaware common law and statutory business judgment rules

A proposed statutory expression of the 'business judgement rule' is contained in § 8.31(a)(2) of the Model Business Corporations Act (MBCA) and in § 4.01(c) of the American Law Institute's (ALI's) *Principles of Corporate Governance: Analysis and Recommendations*. In the Delaware General Corporation Law (Title 8, Ch 1 of the Delaware Code) (DGCL), however, there is no statutory business judgment rule. The Delaware courts have developed a common law business judgment rule based on the wording of § 141(a) of the DGCL, namely that '[t]he business and affairs of every corporation ... shall be managed by or under the direction of a board of directors'. It was concluded that, as a 'fundamental principle of the Delaware General Corporation Law', the legislature has empowered the board of directors to directly or indirectly 'manage the business of the corporation'. Thus there is no general scope for the courts to interfere with their business judgments: they have 'managerial freedom'.¹² Or, as it has been put in the well-known case of *Smith v Van Gorkom*:

Under Delaware law, the business judgment rule is the offspring of the fundamental principle, codified in Del C § 141(a), that the business affairs of a Delaware corporation are managed by or under its board of directors ... In carrying out their

8 (1968) 121 CLR 483; BC6800800. See also D Tan, 'Delivering the Judgment on a Statutory Business Judgment Rule in Australia' (1995) 5 *Aust Jnl Corp Law* 442 at 444–5.

9 See P Redmond, 'The Reform of Directors' Duties' (1992) 15 *UNSWLJ* 86 at 113; P Redmond, 'Safe Harbours or Sleepy Hollows: Does Australia Need a Statutory Business Judgment Rule?' in *Corporate Governance and the Duties of Company Directors*, I M Ramsay (Ed), Centre for Corporate Law and Securities Regulation, 1997, pp 198–9.

10 See generally M J Whincop, 'Directors' Statutory Duties of Honesty and Propriety' in *Corporate Governance and the Duties of Company Directors*, *ibid*, pp 125, 146; and M Berkahn, 'A Statutory Business Judgment' (1999) 3 *SCULR* 215 at 225.

11 See L Law, 'The Business Judgment Rule in Australia: A Reappraisal since the AWA Case' (1997) 15 *CSLJ* 174 at 180; J H Farrar, 'Business Judgment and Defensive Tactics in Hostile Takeover Bids' (1989) 15 *CBLJ* 15 at 19; J H Farrar, 'Towards a Statutory Business Judgment Rule in Australia' (1998) 8 *Aust Jnl Corp Law* 237.

12 See *Stone v Ritter* (2006) 911 A 2d 362.

managerial roles, directors are charged with an unyielding fiduciary duty to the corporation and its shareholders ... The business judgment rule exists to protect and promote the full free exercise of the managerial power granted to Delaware directors ... The rule itself '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'. Thus, the party attacking a board decision as uninformed must rebut the presumption that its business judgment was an informed one.¹³

As part of directors' fiduciary duties under US law, directors are under a duty of care. However, unlike the MBCA (§ 8.30(b) and ALI's *Analysis and Recommendations* (§ 4.01(a)), the directors' duty of care under Delaware corporations law has also been developed by the courts as a common law duty, and as part of directors' 'unyielding fiduciary duty to the corporations and its shareholders'.¹⁴

There is no doubt that the Delaware business judgment rule has been very effective in protecting directors of companies incorporated in Delaware in relation to their business judgments.¹⁵ One must, however, not be misled by that apparently straightforward statement. The Delaware law of fiduciary duty, including the duty of care and the application of the business judgment rule, is in fact very complex. There have been many cases that have set precedents, and many of those have been interpreted differently over the years. This complexity, plus the sheer number of cases and the diverging academic opinions on the scope of the business judgment rule, offers considerable scope to support the underlying aim of the business judgment rule, namely that directors' business judgments should not be second-guessed by the courts.

An excellent expression of the practical reality under Delaware corporations law is found in the following concluding comments by the Court of Chancery of Delaware Litigation:

Citigroup has suffered staggering losses, in part, as a result of the recent problems in the United States economy, particularly those in the subprime mortgage market. It is understandable that investors, and others, want to find someone to hold responsible for these losses, and it is often difficult to distinguish between a desire to blame *someone* and a desire to force those responsible to account for their wrongdoing. Our law, fortunately, provides guidance for precisely these situations in the form of doctrines governing the duties owed by officers and directors of Delaware corporations. This law has been refined over hundreds of years, which no doubt included many crises, and we must not let our desire to blame someone for our losses make us lose sight of the purpose of our law. Ultimately, the discretion granted directors and managers allows them to maximize shareholder value in the long term by taking risks without the debilitating fear that they will be held personally liable if the company experiences losses. This doctrine also means, however, that when the company suffers losses, shareholders may not be able to hold the directors personally liable.¹⁶ (emphasis in original)

13 *Smith v Van Gorkom* (1985) 488 A 2d 858.

14 *Ibid*, at 872. See further J G Hill, 'Centro and the Monitoring Board — Legal Duties versus Aspirational Ideals in Corporate Governance' (2012) 35 *UNSWLJ* 341 at 347–53.

15 See comment by the Australian Institute of Company Directors, above n 3, p 24.

16 (2009) 964 A 2d 106 at 130.

Because of space it is impossible to provide a detailed analysis of directors' duties under Delaware law and the exact nature of the protection provided by the Delaware common law business judgment rule, but it is reasonably safe to state that before a Delaware court would be prepared to grant leave for a case against directors to proceed, the plaintiffs have to provide the court with clear indications of gross negligence; blatant dishonesty; blatant improper use of powers; acting in bad faith; or sustained or systematic failure of duties. Each of these is a formidable obstacle to overcome.¹⁷ Directors in several states have additional protection because Delaware, and then several other states, inserted provisions into their Corporations Acts to allow companies to include provisions in their certificate of incorporation 'eliminating or limiting the personal liability of a director to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a directors'.¹⁸ There are limits to these protective provisions,¹⁹ but the basic aim — to eliminate or limit personal liability — ensures that only in exceptional circumstances will directors 'feel it in their pockets' even if they have been held personally liable for a breach of duties.

The position in Australia is exactly the opposite: a company or a related body corporate is prohibited from 'exempt[ing] a person (whether directly or through an interposed entity) from a liability to the company incurred as an officer or auditor of the company'.²⁰ The prohibitions are detailed and the exceptions limited to payment of legal costs; even the premiums of director and officer insurance may not be paid by the corporation to insure against certain serious contraventions of the Corporations Act.²¹

17 See D M Branson, 'The American Law Institute Principles of Corporate Governance and the Derivative Action: A View from the other Side' (1986) 43 *WLLR* 399 at 405–7, describing what a formidable task it is for plaintiffs' counsel to get a case regarding 'business judgment' heard by US Courts, quoting (at 406) *Cramer v General Telephone & Electronics Corporation* (1978) 582 F 2d 259 at 274: 'Absent bad faith or some other corrupt motive, directors are normally not liable to the corporation for mistakes of judgment'. See also *Auerbach v Bennett* (1979) 393 N E 2d 994: 'It appears to us that the business judgment doctrine, at least in part, is grounded in the prudent recognition that courts are ill-equipped and infrequently called on to evaluate what are and must be essentially business judgments. The authority and responsibilities vested in corporate directors both by statute and decisional law proceed on the assumption that inescapably there can be no available objective standard by which the correctness of every corporate decision may be measured, by the courts or otherwise. Even if that were not the case, by definition the responsibility for business judgments must rest with the corporate directors; their individual capabilities and experience peculiarly qualify them for the discharge of that responsibility. Thus, absent evidence of bad faith or fraud (of which there is none here) the courts must and properly should respect their determinations'.

18 DGCL § 102(b)(7).

19 The provision cannot eliminate or limit the liability of a director '(i) For any breach of the director's duty of loyalty to the corporation or its stockholders; (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law; (iii) under § 174 [Liability of directors for unlawful payment of dividend or unlawful stock purchase or redemption; exoneration from liability; contribution among directors; subrogation] of this title; or (iv) for any transaction from which the director derived an improper personal benefit' — *ibid*.

20 Corporations Act 2001 (Cth) s 199A(1) and (2).

21 *Ibid*, ss 199A(2) and (3), 199B and 199C. For further background to the statutory provisions, see Companies and Securities Law Review Committee, *Company Directors and Officers: Indemnification, Relief and Insurance*, Discussion Paper No 9, April 1989, Ch 2 (statutory

In conclusion, the ‘American business judgment rule’²² is highly developed, with many nuances (even applying in a special way in specific areas, such as take-overs,²³ ‘within the vicinity of insolvency’,²⁴ and in other situations)²⁵ and with a massive body of case law and academic literature informing it.²⁶

3 Aim with the statutory business judgment rule: Protecting directors against personal liability

It cannot be emphasised enough that since some of the earliest official reflections on whether or not a statutory business judgment rule should be included in Australian corporations legislation, the predominant aim with the rule was identified as protecting directors against personal liability when they have taken innovative business decisions or displayed ‘entrepreneurial flair’²⁷ — they should be protected against mere errors of judgment.²⁸

In November 1989, the Companies and Securities Law Review Committee (Chaired by Senator Barney Cooney) released a discussion paper with the aim of encouraging innovative business decisions. The paper explained, with reference to one of the earlier drafts of the ALI’s comprehensive corporate governance project, which itself stretched over more than a decade:

In the U.S.A. the American Law Institute in its Principles of Corporate Governance and Structure: Restatement and Recommendations (1982) page 143 noted the existence in American law of a ‘business judgment’ gloss on the director’s duty of care and diligence which had been developed by the courts ‘because of a desire to protect honest directors and officers from the risks inherent in hindsight reviews of their unsuccessful decisions, and because of a desire to refrain from stifling innovation and venturesome business activity’.²⁹

limits on indemnification), at <http://www.takeovers.gov.au/content/Resources/cs/09_company_directors_and_officers.pdf> (accessed 3 February 2017).

- 22 Du Plessis, ‘Open Sea or Safe Harbour? American, Australian and South African Business Judgment Rules Compared — Part 1’, above n 5, at 349.
- 23 J H Farrar, ‘Business Judgment and Defensive Tactics in Hostile Takeover Bids’ in *Essays on Comparative Commercial and Consumer Law*, D B King (Ed), Fred B Rothman & Co, 1992, pp 173–206.
- 24 D A DeMott, ‘Directors’ Duty of Care and the Business Judgment Rule: American Precedents and Australian Choices’ (1992) 5 *Bond LR* 133 at 138; M Roth, ‘Outside Director Liability: German Stock Corporations Law in Transatlantic Perspective’ (2008) 8 *J Corp L Stud* 337 at 361–4.
- 25 See M I Steinberg, ‘The Corporate Law Reform Act 1992: A View from Abroad’ (1993) 3 *Aust Jnl Corp Law* 154 at 164; and Farrar, ‘Business Judgment and Defensive Tactics in Hostile Takeover Bids’, above n 22, pp 178–9.
- 26 See S A Radin, *The Business Judgment Rule: Fiduciary Duties of Corporate Directors*, 6th ed, Aspin Publishers, 2009, pp 26–8.
- 27 A Greenhow, ‘The Statutory Business Judgment Rule: Putting the Wind into Directors’ Sails’ (1999) 11 *Bond LR* 33 at 34. See further B W Bainbridge and T Connor, ‘Another way Forward? The Scope for an Appellate Court to Reinterpret the Statutory Business Judgment Rule’ (2016) 34 *CSLJ* 415 at 434–6.
- 28 See M S Blackman, ‘Companies’ in *The Law of South Africa (LAWSA): Volume 4 — Part 2*, W A Joubert (Ed), Butterworths, 1996, p 232, at [138].
- 29 Companies and Securities Law Review Committee, above n 21, at [36].

The discussion paper also refers to some typical functions of boards of directors in directing companies as identified by the British Institute of Directors,³⁰ but then refers to the diversity of business activities:

But such is the diversity of business activity that rules cannot be laid down as to the way a board should go in making a decision on many matters of business judgment: a decision to site a plant in a particular place; a decision to acquire an interest in another company. There may even be no consensus as to the six functions (of the board identified by the British Institute of Directors) referred to above.³¹

Later in the discussion paper it is again emphasised that an important policy consideration for introducing a statutory business judgment rule would be ‘facilitating the taking of risks’.³²

In 1989, the Companies and Securities Law Review Committee recommended the introduction of a statutory business judgment rule based on two notions: that ‘informed business judgments should be encouraged in order to stimulate innovation and risk-taking’ and ‘to limit judicial intrusiveness in private sector decision making’.³³ Despite another similar recommendation, in the 1991 Lavarch Report,³⁴ the introduction of the statutory business judgment rule in Australia had to wait for almost another decade to be introduced only in 1999.

Recent government campaigns³⁵ again indicate the need to encourage entrepreneurship and risk-taking as we enter uncharted waters at the close of the mining boom in Australia.³⁶ Indeed, the banking sector feels that the ‘cautious approach [of directors is] undermin[ing] the overall efficiency and dynamism of the economy’.³⁷ The Treasury too has emphasised the need for regulation that does not ‘have a freezing effect on responsible risk taking and commercial decision making’.³⁸

It is hard to better illustrate the serious intention of the Australian legislature to provide protection to Australian directors with the business judgment rule

30 Ibid, at [33].

31 Ibid, at [110].

32 Ibid, at [34].

33 Senate Standing Committee on Legal and Constitutional Affairs, *Company Directors’ Duties: Report on the Social and Fiduciary Duties and Obligations of Company Directors*, Cooney Report, Parliament of Australia, Canberra, 1989, at [3.32], <http://www.takeovers.gov.au/content/Resources/parliamentary_reports/downloads/social_fuduciary_duties_obligations.pdf> (accessed 3 February 2017).

34 House of Representatives Standing Committee on Legal and Constitutional Affairs, *Report on Corporate Practices and the Rights of Shareholders*, Lavarch Report, Parliament of Australia, Canberra, 1991, at [5.4.26], [5.4.29]–[5.4.30], [5.4.42], <http://www.aph.gov.au/Parliamentary_Business/Committees/House_of_Representatives_committees?url=reports/1991/1991_pp293report.htm> (accessed 3 February 2017).

35 Department of Employment, *Building Australia’s Future Workforce (BAFW) Evaluation*, Australian Government, 13 June 2014, at <<https://employment.gov.au/building-australia-s-future-workforce-bafw-evaluation>> (accessed 3 February 2017).

36 R Green, ‘After the Boom: Where will Growth Come from?’, *The Conversation* (online), 23 August 2013, at <<http://theconversation.com/after-the-boom-where-will-growth-come-from-17358>> (accessed 3 February 2017).

37 Treasury, *Rethinking Regulation: Report of the Taskforce on Reducing Regulatory Burdens on Business*, Australian Government, Canberra, 15 August 2006, at <<http://archive.treasury.gov.au/contentitem.asp?ContentID=1141>> (accessed 3 February 2017).

38 J J du Plessis et al, *Principles of Contemporary Corporate Governance*, 3rd ed, Cambridge University Press, 2015, p 9.

than by quoting from the Explanatory Memorandum that accompanied the 1998 Bill:

- 6.9 Provided directors or other officers fulfil the requirements of proposed subsection 180(2) paragraphs (a) to (d):
- *such directors have an explicit safe harbour, being effectively shielded from liability for any breach of their duty of care and diligence* (emphasis added); and
 - *the merits of directors' business judgments are not subject to review by the Courts* (emphasis added).
- 6.10 Proposed subsection 180(2) *acts as a rebuttable presumption in favour of directors which, if rebutted by a plaintiff, would mean the plaintiff would then still have to establish that the officer had breached their duty of care and diligence.*³⁹ (emphasis added)

The business judgment rule is currently contained in s 180(2) and (3) of the Corporations Act:

Business judgment rule

180(2) A director or other officer of a corporation who makes a business judgment is taken to meet the requirements of subsection (1), and their equivalent duties at common law and in equity, in respect of the judgment, if they:

- (a) make the judgment in good faith for a proper purpose; and
- (b) do not have a material personal interest in the subject matter of the judgment; and
- (c) inform themselves about the subject matter of the judgment to the extent they reasonably believe to be appropriate; and
- (d) rationally believe 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.

Note ... [quoted below]

180(3) In this section:

business judgment means any decision to take or not take action in respect of a matter relevant to the business operations of the corporation.

Senator Hill, during his Second Reading speech supporting the Corporate Law Reform Bill (No 2) 1992, said it 'provides certainty for directors' and 'stimulates risk taking and innovation ... to give directors the confidence to make commercial decisions on their true merits'.⁴⁰ Sadly, the certainty Senator Hill spoke of is lacking under the statutory business judgment rule. An

³⁹ Explanatory Memorandum, Corporate Law Economic Reform Program Bill 1998, Parliament of Australia, Canberra, at <<https://www.legislation.gov.au/Details/C2004B00269/Explanatory%20Memorandum/Text>> (accessed 3 February 2017).

⁴⁰ Commonwealth, Parliamentary Debates, Senate, 17 December 1992, p 5297 (Robert Hill), <http://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;adv=yes;db=CHAMBER;id=chamber%2Fhansards%2F1992-12-17%2F0064;orderBy=_fragment_number.doc_date-rev;query=Dataset%3Ahansards.hansards80%20Decade%3A%221990s%22%20Year%3A%221992%22;rec=0;resCount=Default> (accessed 3 February 2017).

empirical survey revealed that only two of 21 cases up to 2009 had successfully raised the business judgment rule.⁴¹ It appears that the rule exists purely as an enthusiastic ideal.

Although the rule ‘has been considered in a number of significant cases’,⁴² the application of it has either been rejected outright because of a clear conflict of interest for the defendant director⁴³ or because the act of the director or decision the director made was not considered to be a ‘business judgment’⁴⁴ or judgments ‘in respect of a matter relevant to the business *operations* of the corporation’ (emphasis added). In most of the cases where the statutory business judgment rule was mentioned, there was no in-depth consideration of the scope of its application.⁴⁵ There are a few exceptions.

4 Analyses of leading cases on the business judgment rule

*Deangrove Pty Ltd (recs and mgrs apptd) v Bucky*⁴⁶ was the first case to consider the business judgment rule after its enactment in 2001. It did so in the context of receiver duties and found a business judgment had been made (s 180(3)) satisfying the preconditions of s 180(2)(a)–(d) of the Corporations Act. This case was interesting because Branson J simply applied the provisions and did not make any further comment on the duty of care and diligence or the business judgment rule. The case confirmed the court’s reluctance to review business decisions made in good faith.⁴⁷

As noted, judges have very rarely applied or considered applying the business judgment rule,⁴⁸ even though there were high expectations that the rule would ‘put the wind into ... directors[’] sails’.⁴⁹ Austin J provided the first

41 S A G Ricci and J Miyairi, ‘From Enactment to Mariner: Does the Statutory Business Judgment Rule Change the “Acoustic Separation” Between Conduct Rules and Decision Rules in Australia?’, 2015, p 29, at <https://www.business.unsw.edu.au/About-Site/Schools-Site/Taxation-Business-Law-Site/Documents/Gramitto-Ricci-Miyairi_CLTA-Conference-Paper.pdf> (accessed 3 February 2017).

42 R Baxt, E Finnane and J Harris, *Annotations: Corporations Legislation 2014*, 13th ed, Thomson Reuters, 2014, p 205.

43 See *Australian Securities and Investments Commission v Adler* (2002) 41 ACSR 72; 168 FLR 253; [2002] NSWSC 171; BC200200827 (*Adler*); *Australian Securities and Investments Commission v Fortescue Metals Group Ltd* (2011) 190 FCR 364; 81 ACSR 563; [2011] FCAFC 19; BC201100543 (*Fortescue Metals*).

44 *Australian Securities and Investments Commission v Fortescue Metals Group Ltd*, *ibid*; *Gold Ribbon (Accountants) Pty Ltd (in liq) v Sheers* [2006] QCA 335; BC200606852 (*Sheers*).

45 See also other cases referred to, and also *Deangrove Pty Ltd v Buckby* (2006) 56 ACSR 630; 24 ACLC 414; [2006] FCA 212; BC200601192 (*Deangrove*); *MacDonald v Australian Securities and Investments Commission* (2007) 73 NSWLR 612; 65 ACSR 299; [2007] NSWCA 304; BC200709160 at [14] (*MacDonald*); *Ingot Capital Investments Pty Ltd v Macquarie Equity Capital Markets (No 6)* (2007) 63 ACSR 1; [2007] NSWSC 124; BC200702746 at [1426]–[1437]; and *Hall v Poolman* (2007) 65 ACSR 123; 215 FLR 243; [2007] NSWSC 1330; BC200710202.

46 *Deangrove*, *ibid*.

47 See J Varzaly, ‘Protecting the Authority of Directors: An Empirical Analysis of the Statutory Business Judgment Rule’ (2012) 12(2) *J Corp L Stud* 429 at 449.

48 See *Adler* (2002) 41 ACSR 72; 168 FLR 253; [2002] NSWSC 171; BC200200827 and *Sheers* [2006] QCA 335; BC200606852. In both decisions the court battled with whether or not a director’s actions or inactions could be considered to satisfy the definition of a ‘business judgement’.

49 Greenhow, above n 27.

detailed examination of the rule in *Australian Securities and Investments Commission v Rich*,⁵⁰ where it was acknowledged that a broader business judgment principle survived the enactment of s 180(2), and the procedure for a director to satisfy the preconditions and successfully rebut a breach of duty under s 180(2) was thoroughly examined. In commentary on this case it has been argued that the:

obiter [remarks of] Austin J's judgment gave a strong indication that, theoretically at least, the statutory business judgment rule has broadened the 'acoustic separation' between conduct rules and decisions rules by potentially protecting a defendant from liability when s 180(1) — and the general law business judgment rule subsumed within it — would otherwise be breached.⁵¹

It has been further argued that the 'practical implications [of Austin J's remarks] remained uncertain'⁵² until the business judgment rule was invoked 'unequivocally'⁵³ in a decision of the Federal Court, namely *Australian Securities and Investments Commission v Mariner Corporation Ltd*.⁵⁴

Indeed, the decision in *Mariner* emphasised the importance of a director being able to take justifiably necessary 'calculated' risks with the aim of carrying out a 'commercial activity', such as announcing a takeover bid without securing appropriate funding (in that case).⁵⁵ In short, Beach J dismissed an application by ASIC alleging contravention of s 180(1) on the basis that each of the three directors (Mr Olney-Fraser, Mr Christie and Mr Fletcher) had failed to act with due care and diligence in announcing the takeover bid. Notably, Justice Beach rejected the argument that a breach of a statutory provision proven against a corporation automatically should be interpreted as a breach of directors' duty of care and diligence.⁵⁶ Beach J considered whether or not Mr Christie and Mr Fletcher could demonstrate reasonable reliance on the actions of Mr Olney-Fraser in accordance with s 189 of the Corporations Act.⁵⁷ It was held 'that the directors had not breached their duty of care under s 180(1) ... [and] in any case [were] entitled to the protection of the s 180(2) business judgment rule'.⁵⁸ His Honour's analysis of the conduct of Mr Olney-Fraser is significant.

First, 'there must be a "business judgment"'.⁵⁹ His Honour was satisfied that the initiation of the takeover bid was, having regard to the nature of Mariner's business and the benefits that could accrue from a successful takeover bid, a business judgment within the meaning of s 180(3).⁶⁰ His Honour further emphasised that Mr Olney-Fraser had 'substantial and relevant

50 (2009) 75 ACSR 1; 236 FLR 1; [2009] NSWSC 1229; BC200910410 (*Rich*).

51 Ricci and Miyairi, above n 41, p 24.

52 Ibid. See also Bainbridge and Connor, above n 27, at 421–6.

53 Ibid 1.

54 (2015) 241 FCR 502; 327 ALR 95; [2015] FCA 589; BC201505423 (*Mariner*).

55 Ibid, at [452].

56 D Jacobson, 'Case note: Directors successfully rely on business judgment rule', *Bright Law*, 9 July 2015, at <<http://www.brightlaw.com.au/corporate-governance/case-note-directors-successfully-rely-on-business-judgment-rule/>> (accessed 3 February 2017).

57 Ibid.

58 Ricci and Miyairi, above n 41, p 26.

59 Ibid.

60 *Mariner* (2015) 241 FCR 502; 327 ALR 95; [2015] FCA 589; BC201505423 at [486]–[487], [543].

experience' in mergers and acquisitions.⁶¹ Second, considering the preconditions of s 180(2)(a)–(d), 'the [directors acted in] good faith and for a proper purpose ... because of the potential for Mariner to make a significant profit ... in the best interests of Mariner',⁶² thereby satisfying his Honour that the directors met the third requirement, namely 'that [the directors had] no material personal interest in the subject matter of the judgment'.⁶³ Beach J, in referring to the fourth requirement, determined that the directors collectively,⁶⁴ through Mr Olney-Fraser, had 'inform[ed] themselves of the subject matter of the judgment ... to the extent they reasonably believe[d] to be appropriate'⁶⁵ to make a decision.⁶⁶ His Honour referred to:

[Australian Securities Investment Commission's ('ASIC's')] submission ... that the reasonableness of the belief should be assessed by reference to ... the importance of the business judgment to be made; the time available for obtaining information; the costs related to obtaining information; the director or officer's confidence in those exploring the matter; the state of the company's business at that time and the nature of competing demands on the board's attention ... and whether or not material information is reasonably available to the director.⁶⁷

Accordingly, the directors were held to satisfy the final requirement of 'rational belief',⁶⁸ thereby satisfying 'the requisite elements of the business judgment rule', and therefore were 'entitled to its exculpatory operation'.⁶⁹

5 Complexity and uncertainty regarding the Australian statutory business judgment rule

The scope and application of the statutory business judgment rule is uncertain because of the very narrow operation of the rule.⁷⁰ *First*, its protection is strictly limited to directors' duty of care and diligence.⁷¹ The protection of s 180(2) is limited to s 180 only, as was made clear in the Explanatory Memorandum that accompanied the 1998 CLERP Bill hence the protection of the business judgment rule was not to extend to — insolvent trading. That intention is confirmed in the note accompanying s 180(2):

Note: This subsection only operates in relation to duties under this section and their equivalent duties at common law or in equity (including the duty of care that arises

61 *Ibid*, at [476].

62 *Ibid*, at [488], [544].

63 *Ibid*, at [489], [545].

64 *Ibid*, at [533], [539], [549].

65 Corporations Act (Cth) 2001 s 180(2)(c) requirement.

66 *Mariner* (2015) 241 FCR 502; 327 ALR 95; [2015] FCA 589; BC201505423 at [33], [491]–[492].

67 *Rich* (2009) 75 ACSR 1; 236 FLR 1; [2009] NSWSC 1229; BC200910410 at [7283]–[7284], citing Austin J.

68 Corporations Act (Cth) 2001 s 180(2)(d) requirement.

69 *Mariner* (2015) 241 FCR 502; 327 ALR 95; [2015] FCA 589; BC201505423 at [494], [548], [551].

70 Australian Institute of Company Directors, above n 3, p 6.

71 See again note to s 180(2) quoted in the text above. See further J J du Plessis, 'Company Law Developments in South Africa: Modernisation and Some Salient Features of the Companies Act 71 of 2008' (2012) 27 *Aust Jnl of Corp Law* 46 at 68.

under the common law principles governing liability for negligence) — it does not operate in relation to duties under any other provision of this Act or under any other laws.

Based on this note, it has been pointed out that the business judgment rule as a defence (safe harbour) would not be available to directors for breaches of statutory duties regarding, for instance, continuous disclosure, financial reporting or insolvent trading.⁷² Directors are also deprived of the protection of the statutory business judgment rule if a breach of their duty of care and diligence towards the company under s 180(1) of the Corporations Act is proven by other provisions of the Act having been contravened.

Herzberg and Anderson⁷³ call this the ‘stepping stone approach’ and then discuss several ‘stepping stone cases’.⁷⁴ The ‘first stepping stone’ is for ASIC to prove a contravention by a corporation of provisions other than s 180(1) and use that to hold directors liable for a breach of their duty of care and diligence. In the *Citrofresh* litigation it was proven that Citrofresh International Ltd contravened s 1041H. However, as the directors did not ensure that s 1041H was not contravened, and did owe duties towards the company as a separate legal entity, they were thus held in breach of their duty of care and diligence (s 180(1)).⁷⁵ The ‘stepping stone approach’ was considered in *Australian Securities and Investments Commission v Cassimatis*.⁷⁶ In this case, ASIC used the fact that the company (Storm Financial) contravened a provision of the Corporations Act, as ‘stepping stone’⁷⁷ to allege that the directors (Mr and Mrs Cassimatis) were automatically in breach of their duty of care and diligence under s 180 of the Corporations Act. Edelman J raised ‘serious doubt as to whether this assumption is correct’⁷⁸ and accepted the submission of the directors (Mr and Mrs Cassimatis) ‘that s180 “cannot be used to create liability in directors merely because their companies have contravened other provisions of the [Corporations Act]”’⁷⁹ and affirmed the decision in *Mariner*.⁸⁰ In *Mariner*, Beach J held that ‘the duty owed under s 180 does not impose a wide-ranging obligation on directors to ensure that the affairs of a company are conducted in accordance with law. It is not to be used as a

72 Australian Institute of Company Directors, above n 3, pp 6, 17; J J du Plessis and A Rühmkorf, ‘New Trends Regarding Sustainability and Integrated Reporting for Companies: What Protection do Directors have?’ (2015) 36 *Comp L* 49 at 57–8; J J du Plessis and I Meaney, ‘Directors’ Liability for Approving Financial Statements Containing Blatant Incorrect Items: Lessons from Australia for All Directors in All Jurisdictions’ (2012) 33 *Comp L* 273 at 277; R T Langford, ‘The New Statutory Business Judgment Rule: Should it Apply to the Duty to Prevent Insolvent Trading?’ (1998) 16 *CSLJ* 533.

73 A Herzberg and H Anderson, ‘Stepping Stones — From Corporate Fault to Director’s Personal Civil Liability’ (2012) 40 *FLR* 181.

74 *Ibid.*, at 182–4.

75 *Australian Securities and Investments Commission v Citrofresh International Ltd (No 2)* (2010) 77 ACSR 69; [2010] FCA 27; BC201000263 at [3], [6], [47]–[51]; and *Australian Securities and Investments Commission v Citrofresh International Ltd (No 3)* (2010) 268 ALR 303; 77 ACSR 392; [2010] FCA 292; BC201001719 at [52].

76 (2016) 336 ALR 209; [2016] FCA 1023; BC201607349 (*Cassimatis*).

77 See *ibid.*, at [4], [679], [834].

78 *Ibid.*, at [834].

79 *Ibid.*, at [526].

80 (2015) 241 FCR 502; 327 ALR 95; [2015] FCA 589; BC201505423 at [447].

back-door means for visiting accessorial liability on directors'.⁸¹ Edelman J held, however, that the directors in fact breached s 180(1) 'by exercising their powers in a way which caused or "permitted" (by omission to prevent) inappropriate advice to be given to the relevant investors'.⁸² We agree with the approach in the *Mariner* and *Cassimatis* cases, but in fact they illustrate the complexity and uncertainty regarding the Australian statutory business judgment rule. In both these cases the primary corporate regulator, ASIC, relied on a rather strict interpretation of the Corporations Act in an attempt to deny directors the protection of the statutory business judgment rule.

The second reason why we submit that the scope and application of the statutory business judgment rule is complex and uncertain, is because a 'business judgment' is narrowly defined as only applying to 'the business operations of the corporation' (emphasis added),⁸³ which has resulted in a narrow and technical interpretation of 'business judgments'.⁸⁴ There is no denial that many decisions of boards of directors can be highly complex,⁸⁵ and directors can face additional anxiety if there is uncertainty as to whether a particular decision is indeed a 'business judgment', protected by the business judgment rule, or a 'non-business judgment', for which they will have to rely on other defences⁸⁶ or forms of relief.⁸⁷ The complexity of the Australian law regarding personal liability was explained well by the AICD:

[W]e have the possible absurd luxury in Australia of three separate approaches to the duty of care of directors, each with its own remedial consequences — equity, common law and statute. No other system in the world is so complex.⁸⁸

It was for all these reasons that in 2014 the AICD published *A Proposal for Reform: The Honest and Reasonable Director Defence* (AICD Proposal).⁸⁹

B AICD: 'The Honest and Reasonable Director Defence'

1 Motivation for the broader defence

A more detailed discussion of why Australian directors need a defence that is broader than the business judgment rule is contained in the AICD Proposal's 'Introduction' and 'Part 1: The Need for Change'.⁹⁰ The fact that fear of 'personal liability' is the driving force for the AICD proposal is clear.

81 Ibid, at [444].

82 *Cassimatis* (2016) 336 ALR 209; [2016] FCA 1023; BC201607349 at [833].

83 Corporations Act 2001 (Cth) s 180(3). See Explanatory Memorandum, Corporate Law Economic Reform Program Bill 1998, Parliament of Australia, Canberra, at [6.8], <<https://www.legislation.gov.au/Details/C2004B00269/Explanatory%20Memorandum/Text>> (accessed 3 February 2017).

84 See, for instance, *Fortescue Metals* (2011) 190 FCR 364; 274 ALR 731; 81 ACSR 563; [2011] FCAFC 19 at [198].

85 For an excellent example of the complexity of directors' continuous disclosure duties see Australian Institute of Company Directors, above n 3, pp 9–10.

86 Ibid, pp 8–10, referring to 'the stepping stone approach'.

87 Corporations Act 2001 (Cth) ss 1317S and 1318 and discussion below.

88 Australian Institute of Company Directors, *Duty of Care and the Business Judgement Rule*, Submission to the Department of Treasury, June 1997, at <<http://www.companydirectors.com.au/director-resource-centre/policy-on-director-issues/policy-submissions/1997/duty-of-care-and-the-business-judgement-rule>> (accessed 3 February 2017).

89 Australian Institute of Company Directors, above n 3, p 1.

90 Ibid, p 30.

However, the broader context and motivation for change concerns ‘increased regulation and red tape’.⁹¹ It is argued, albeit by way of inference at times, that having a broader defence such as ‘The Honest and Reasonable Director Defence’ available to Australian company directors will ‘encourage the entrepreneurial spirit of Australian directors and businesses’, will increase ‘international competitiveness and productivity’,⁹² will encourage Australian directors ‘to pursue and harness new opportunities, drive performance and create jobs’, and will even lead ‘to more effective corporate governance’.⁹³

2 The defence

The AICD makes it clear that the proposed defence is not intended to alter the primary duties and obligations imposed on directors by the law and should apply in addition to the specific statutory defences in the Corporations Act. It is proposed that the defence be inserted into Ch 9 (Miscellaneous) of the Australian Corporations Act.⁹⁴

The proposal is that the defence should read as follows:

[section number] — Honest and reasonable director defence

Notwithstanding any other provision of this Act or the ASIC Act, if a director acts (or does not act) and does so honestly, for a proper purpose and with the degree of care and diligence that the director rationally believes to be reasonable in all the circumstances, then the director will not be liable under or in connection with any provision (including any strict liability offence) of the Corporations Act or the ASIC Act (or any equivalent grounds of liability in common law or in equity) applying to the director in his or her capacity as a director.⁹⁵

First, it is worth noting that the defence would provide ‘an overarching’ defence for all types of directors’ acts and judgments, not just ‘business judgments’, as is currently the case with s 180(2) of the Corporations Act. It would even apply to criminal offences, but as the requirement of the defence is ‘honesty’, it would not trump the ‘dishonest’ provisions of the Corporations Act.⁹⁶

Second, the burden of proving ‘honesty and reasonableness’ would be on the directors and the burden of proof would be the ordinary civil burden of proof, namely ‘proof on the balance of probabilities’.⁹⁷

Third, the defence would apply to positive acts as well as omissions. Omissions would be protected only if the directors ‘honestly and reasonably’ did not take any particular positive steps (in other words, did nothing). As it is put, a director would then be protected when he or she ‘omitted to do something, has not turned their mind to an issue or has failed to act in a particular way’.⁹⁸

91 Ibid.

92 Ibid.

93 Ibid.

94 Ibid, p 23.

95 Ibid.

96 Ibid, p 24.

97 Ibid, pp 23–4.

98 Ibid, pp 24–5.

3 Evaluation

As the presumption in the business judgment rule is that directors take business decisions in good faith, there should be no reason for a much wider form of protection such as the AICD proposal.

As far as the ‘honest’ part of the proposed defence is concerned, the AICD points out that the term ‘honestly’ has been interpreted by the Australian courts.⁹⁹ However, these interpretations make it clear that it is not possible to determine a clear standard against which ‘honesty’ can be judged. It is a state of mind and a moral obligation, and these do not lend themselves to exact and objective evaluation.¹⁰⁰

It should not be forgotten that in 1992 the civil standards of care and diligence were amended and the word ‘honesty’ was removed.¹⁰¹ The problem was that proving that a director did not act ‘honestly’ in fact required proof of ‘dishonesty’, as it is very difficult to determine shades of ‘honesty’ or ‘dishonesty’: if ‘honesty’ is on the one end of the scale and ‘dishonesty’ is on the other, will a director be in breach of this duty if the director was just not 100% honest or just slightly ‘dishonest’?

When the ‘honest’ part of the duty of care and diligence was removed from the statutory duty of care and diligence in 1992, ‘dishonesty’ was included in another section as a yardstick to determine whether directors had committed a criminal offence by acting ‘dishonestly’.¹⁰² This was done to ensure that the basic statutory duty of care and diligence was completely decriminalised, and that a breach of it would be a breach of a civil penalty provision.¹⁰³

As far as the ‘reasonable’ requirement of the AICD proposal is concerned, it has been argued¹⁰⁴ that the requirement has an objective tone to it, but it would mean that directors only need to perform to a standard of care and diligence that they ‘rationally believe’ to be reasonable, which renders it a subjective assessment. This would take the law back to the time of *Re City Equitable Fire Insurance Co*,¹⁰⁵ when directors (particularly non-executive directors) were recognised as owing only intermittent obligations to the company. Based on higher community expectations of standards of conduct required of directors now, we ought not revert to the past.¹⁰⁶

In short, because the ‘The Honest and Reasonable Director Defence’ proposed by the AICD contains subjective elements, the adoption of it would be a radical departure from the current Australian law.¹⁰⁷ Its reliance on

⁹⁹ Ibid, pp 25–6.

¹⁰⁰ See further J J du Plessis, ‘Revisiting the Judge-Made Rule of Non-Interference in Internal Company Matters’ (2010) 127 *SALJ* 304 at 324–5.

¹⁰¹ Corporate Law Reform Act 1992 (Cth) s 11, amending s 232(4) to read as follows: ‘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 that a reasonable person in a like position in a corporation would exercise in the corporation’s circumstances’.

¹⁰² See Corporations Act 2001 (Cth) s 184(2) and (3). See generally G F K Kim Santow, ‘Codification of Directors’ Duties’ (1999) 73 *ALJ* 336 at 346 regarding the implication for codification of criminal sanctions.

¹⁰³ Ibid, at 336.

¹⁰⁴ Hargovan and Du Plessis, above n 2, p 6.

¹⁰⁵ [1925] Ch 407; [1924] All ER Rep 485.

¹⁰⁶ Hargovan and Du Plessis, above n 2, p 6.

¹⁰⁷ Ibid, pp 6–7.

subjective elements, including a director's belief that he or she is exercising reasonable care and diligence, has led to one commentator labelling it an 'honest idiot's defence'.¹⁰⁸

4 Perspective

As will be seen from the discussion in Part III, it is not argued that wider protection against personal liability should not be provided to directors, only that the AICD proposal goes too far.

C Austin's proposal — 'The New Business Judgment Rule Proposal'¹⁰⁹

Austin's proposal¹¹⁰ is a 'broader based defence'¹¹¹ that extends the current personal liability defence of directors in two ways. It would extend beyond the Corporations Act, the ASIC Act and common law or equity — to any Act.¹¹² Minter Ellison Senior Associate Lysarne Pelling outlines the key features of the proposal:

A director is protected from any liability and penalty, unless the party alleging breach of duty or exposure to liability proves:

- there was no business judgment; or
- there was a business judgment, but:
 - the director was dishonest;
 - the director had an undisclosed material personal interest; or
 - the business judgment was one that no reasonable person in the director's position could have made.¹¹³

Pelling goes on to highlight a number of important features. First, Austin's proposal would only protect directors in their exercising of their director's capacity to make business decisions.¹¹⁴ This means that executive directors and directors acting in a personal capacity, including non-director officers, are excluded from the proposal's exculpatory intention.¹¹⁵ A problem that remains is the exposure of corporate officers to liability arising from decisions made without that authority: as Pelling puts it, 'outside their sphere of responsibility'.¹¹⁶

Second, Austin takes the term 'business judgment' further by broadening the definition to include 'any decision to take or not take action in respect of a matter relevant to the business operations of the company'.¹¹⁷ To put the

108 D Paatsch, 'The Business Judgment Rule: A Case for the "Known Quantity"' (2015) 67 *Governance Directions* 140.

109 L Pelling, 'Fulfilling parliament's intention: A business judgment rule to stimulate responsible risk-taking and economic growth' (2015) 67 *Governance Directions* 344. See also Harris and Hargovan, 'Revisiting the Business Judgment Rule', above n 2, at 634.

110 Austin, above n 4.

111 Hargovan and Du Plessis, above n 2, p 7; Harris and Hargovan, 'Revisiting the Business Judgment Rule', above n 2, at 636.

112 Harris and Hargovan, *ibid.*

113 Pelling, above n 109, at 345.

114 *Ibid.*

115 *Ibid.*

116 *Ibid.*

117 *Ibid.*

AICD proposal into perspective here, the AICD puts no limit on the type of decision or act taken by the directors. It has been argued that it is ‘erroneous because it abandons the policy basis [accepted by the Australian Parliament in 1998] of protecting business judgments’.¹¹⁸ However, extending — protection wider than ‘business judgments’ should not be seen as making the protection for directors too wide. Directors will have the defence available if they make ‘business judgments’ as long as they meet the four requirements currently listed in s 180(2) are present. However, there is no good reason why directors should not also have a defence available if the four requirements are met when they made other judgments or take other decisions as company directors.

Pelling discusses a third feature, namely the reversal of the onus of proof discussed by Harris and Hargovan, who argue that Austin’s proposal for a new provision would reverse the current onus of proof, a result they approve of.¹¹⁹

The Austin recommendation, by reversing the onus of proof, protects directors beyond the exercise of business judgments¹²⁰ and is intended to permit directors to act without fear of personal liability.¹²¹ It consequently maintains the original intention of Parliament and addresses the anxieties faced by directors — costs and loss of reputation.¹²²

A fourth feature of Austin’s proposal is its aim to extend the application of the business judgment rule to ‘any Australian statute’ by amending Commonwealth, state and territory interpretation legislation.¹²³ This means that directors would be protected from personal liability for decisions that are made ‘in connection with a business judgment’ without limitation across all areas of law ‘unless expressly excluded’.¹²⁴ Some commentators have criticised the proposal because of the difficulty of generating support for the adoption of Commonwealth legislation.¹²⁵ Austin’s proposal without question provides a ‘safe harbour’, but we are of the opinion that a broader protection, based on the current s 180(2), would provide a better solution.

D The 2007 Treasury Review of Sanctions in Corporate Law

Directors, whether they like it or not, have long carried the burden and threat of personal liability when exercising ‘their ability or desire to engage in appropriate and commercial risk taking’.¹²⁶ In 2006, a ‘general defence’ was proposed by the Treasury to discharge director liability for decisions made:

- in a bona fide manner;
- within the scope of the corporation’s business;
- reasonably and incidentally to the corporation’s business; and

118 Ibid.

119 Harris and Hargovan, above n 2, ‘Revisiting the Business Judgment Rule’, at 636.

120 Hargovan and Du Plessis, above n 2, p 10.

121 Austin, above n 4.

122 Pelling, above n 109, at 345. See further Bainbridge and Connor, above n 27, at 415–37.

123 Pelling, *ibid*, at 346.

124 *Ibid*.

125 Paatsch, above n 108, at 142; and M Broomhead, ‘The Business Judgment Rule: A Case for Change to the AICD Model’ (2015) 67 *Governance Directions* 138 at 139.

126 M Byrne, ‘Directors to Hide From a Sea of Liabilities in a New Safe Harbour’ (2008) 22 *Aust Jnl of Corp Law* 255 at 256.

- for the corporation's benefit.¹²⁷

The proposal for a 'general defence' was heavily supported by 'the majority of submissions'¹²⁸ to the 2006 Treasury Discussion Paper.¹²⁹ However, the 'Summary of Submissions' made in response to the June 2007 'Review of Sanctions in Corporate Law' (Sanctions Review) concluded that the proposed reforms are 'insufficiently distinct and specific to the point of becoming a potential source of uncertainty'.¹³⁰ Hence, the proposed 'general defence' was abandoned. Indeed, a submission from the collective Corporate Law Academics of the University of Western Sydney argued that the proposed 'general defence' was 'not really coherent [and was] absurd'.¹³¹ They argued that 'there is no need to create a new defence' and that the 'only thing that is needed is improving the business judgement rule and expanding it to apply to all breaches of directors' duties'.¹³²

The Treasury's sanctions review discussed corporate law sanctions that influenced business decisions in an 'unintended and inefficient' way.¹³³ Fundamentally, the sanctions review was concerned with 'striking [a] ... balance between promoting good behaviour and ensuring directors are willing to take sensible commercial risks'.¹³⁴ It was pointed out that '[t]his issue goes to the necessity, nature and scope of any reform in this area'.¹³⁵

The Treasury proposed two types of reform: the expansion of impossible sanctions and the refinement of 'underlying offence provisions' to facilitate the transparent identification of circumstances that give rise to a sanction. The sanctions review examined three options in relation to the latter of these proposals:

- no change to the current regulatory regime;
- the introduction of a general defence; and
- reform of specific directors' duties.¹³⁶

Notably, the sanctions review focused on the overwhelming support for the formulation of a general defence proposed in the 2006 Discussion Paper. In doing so, while it too found that 'there was no consensus view as to its

127 Treasury, *Corporate and Financial Services Regulation Review*, Discussion Paper, Australian Government, Canberra, 2006, p 38.

128 R Purslove, 'Decisions in the Twilight Zone of Insolvency — Should Directors be Afforded a New Safe Harbour?' (2011) 13 *U Notre Dame Austl L Rev* 113 at 136. See Treasury, *ibid*.

129 Treasury, *Review of Sanctions in Corporate Law*, Discussion Paper, Australian Government, Canberra, 2007.

130 Treasury, *Review of Sanctions in Corporate Law*, Discussion Paper, Summary of Submissions, Australian Government, Canberra, August 2007, p 7.

131 University of Western Sydney, *Review of Sanctions in Corporate Law*, Submission to the Commonwealth Treasury, Consultation Paper, p 18, at <<http://archive.treasury.gov.au/contentitem.asp?ContentID=1285>> (accessed 3 February 2017).

132 *Ibid*, p 19.

133 Treasury, *Review of Sanctions in Corporate Law*, Roundtable Paper 1, Australian Government, Canberra, August 2007, p 3. These review proposals were never published, but participants in the roundtable discussions were provided with copies, which could be made available by the first author on request (email: jean.duplessis@deakin.edu.au) as they were not marked as 'confidential'.

134 *Ibid*.

135 *Ibid*.

136 *Ibid*.

elements', it did find that there was a set of themes that could strengthen a general defence: namely 'good faith, reasonableness, best interests of the company, lack of material personal interest and informing oneself'.¹³⁷ More importantly, as an alternative to the introduction of a 'general defence', three options for the specific reform of the business judgment rule were considered: (1) clarify the onus of proof; (2) clarify or change the standard of review, specifically from rationality to reasonableness; and (3) investigate the operation of the business judgment rule in other jurisdictions.¹³⁸ This initiative for reviewing the sanctions in corporate law never progressed further, most probably because the Liberal Government was replaced by the Labor Government in 2007.

E South Africa — 'The All-Decisions Defence'

South Africa's Companies Act 2008 (Companies Act) came into effect on 1 May 2011. This Act is not based on any particular company law model, but most of the provisions and underlying principles can be traced back to legislation in Australia, Canada, the United Kingdom and the United States. However, there is currently a significant part of the Companies Act that can be described as unique and innovative.¹³⁹ A much wider defence than the business judgment defence was adopted. Elements of it are similar to the s 180(2) of the Australian Corporations Act, but there are some significant differences as well.

Section 76(4) of the 2008 Act provides as follows:

- 76(4) In respect of any particular matter arising in the exercise of the powers or the performance of the functions of director, a particular director of a company —
- (a) will have satisfied the obligations of subsection (3)(b) [acting in the best interests of the company] and (c) [acting with the required care, skill and diligence] if —
 - (i) the director has taken reasonably diligent steps to become informed about the matter;
 - (ii) either —
 - (AA) the director had no material personal financial interest in the subject matter of the decision, and had no reasonable basis to know that any related person had a personal financial interest in the matter; or
 - (BB) the director complied with the requirements of section 75 [liability of directors and prescribed officers] with respect to any interest contemplated in subparagraph (aa); and
 - (iii) the director made a decision, or supported the decision of a committee or the board, with regard to that matter, and the director had a rational basis for believing, and did believe, that the decision was in the best interests of the company.

Clearly, the protection of this provision is considerably wider than the Australian statutory 'business judgment rule'. First, it does not only apply to the duty of care and diligence, but to all the directors' duties including when

¹³⁷ Ibid.

¹³⁸ Ibid.

¹³⁹ See generally P Delpont, *New Entrepreneurial Law*, LexisNexis, 2015.

directors exercise any power or perform any functions of a director. Second, there is no narrow definition referring to business judgments as relating to the 'business operation' of a corporation. Third, the defence is potentially available for directors if a breach of any provision of the 2008 Act is alleged, as long as the listed requirements are met. Although, as in Australia, it was intended that there be a rebuttable presumption in favour of directors, the wording of the section in fact suggests that the director will carry the burden of proof to show that the requirements were met before he or she can rely on the defence.

III A new proposal: 'The All-inclusive Directors and Other Officers Decisions Defence'

Proposals for a radical departure from the current Australian law in this area are not accepted, particularly where subjective elements are the focus of the proposal (as with the AICD proposal). Indeed, it has been correctly pointed out that the AICD defence will 'dilute ... the strength of the objective standard which currently underpins s 180(1) and 180(2) of the [Corporations] Act'.¹⁴⁰ We do not support the diluting of the s 180(1) objective test in its present form.¹⁴¹

Austin's proposal limits the protection to 'business judgments'. However, it is submitted that the protection should not be limited to 'business judgments'. It should be available to directors when exercising any judgment 'in respect of any particular matter in the exercise of powers or the performance of functions of directors'.¹⁴² The protection provided should also not only be available to directors when they were sued for a breach of their duty of care and diligence (s 180(1) of the Australian Corporations Act), as is currently the case. The defence should be available when directors are sued for any breach of any duty or for a breach of any other provision of the Corporations Act.

Another aspect of Austin's proposal that stands out is that it does not retain all four requirements currently contained in s 180(2). It is suggested that Austin moves away from the four requirements in s 180(2), because his proposal is premised on a reversal of the onus of proof. In his proposal, it is up to *the plaintiff* to prove (reversal of normal onus of proof) that:

- (a) there was no business judgment; or
- (b) there was a business judgment, but:
 - a. the director was dishonest;
 - b. the director had an undisclosed material personal interest; or
 - c. the business judgment was one that no reasonable person in the director's position could have made.

The new proposal made in this paper retains the four requirements in s 180(2), but the new proposal clearly places the onus of proving the four requirements

¹⁴⁰ A Huggins, R Simnett and A Hargovan, 'Integrated Reporting and Directors' Concerns about Personal Liability Exposure: Law Reform Options' (2015) 33 *CSLJ* 176 at 193.

¹⁴¹ Huggins, Simnett and Hargovan (*ibid*) point out that because of the subjective nature of the AICD's defence, it might be reassuring to directors, but it would 'be the most difficult statutory amendment to have passed into law'.

¹⁴² This is similar to s 76(4) of South Africa's 2008 Act.

on the director(s) who is (are) sued. This reflects the current position in *Rich*;¹⁴³ Austin J held that although the wording is ‘profoundly ambiguous’ the directors carry the burden of proof to prove the four requirements in order to be protected by the statutory business judgment rule.¹⁴⁴ It would not be possible, without considerable disruption to a company, to expect ASIC or the shareholders to prove (a) that a decision or judgment was made in good faith for a proper purpose; (b) that the director(s) did not have a material personal interest in the subject matter of the decision or judgment; (c) that the director(s) informed themselves about the subject matter of the judgment to the extent they reasonably believed to be appropriate; and (d) that the director(s) ‘rationally believe’ that the judgment was in the best interests of the corporation.

In particular, (c) and (d) would be very difficult for the plaintiff to establish. In addition, it would be very difficult for the plaintiff to prove that ‘[t]he 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’.¹⁴⁵

The proposal, ‘The All-inclusive Directors and Other Officers Decisions Defence’, provides a solution. Strictly speaking, it is unnecessary to refer to ‘directors and other officers’, as the definition of ‘officer’ includes directors, de facto directors and shadow directors.¹⁴⁶ However, given that ss 180, 181 and 184 use ‘directors and other officers’, the same words are adopted as a manner of form to be consistent with the current wording in these sections. ‘The All-inclusive Directors and Other Officers Decisions Defence’ will require repealing s 180(2) and (3) and inserting a new section into Ch 9 (Miscellaneous) of the Corporations Act 2001 (Cth):

[section number] — Director and officer defence

- (1) In respect of any particular matter arising in the exercise of the powers or the performance of the functions of director or officer, they will not be in breach of any duties at common law or in equity (including the duty of care that arises under the common law principles governing liability for negligence) or in breach of any statutory provision under this Act or any other Act if it is proven that:
 - (a) they acted in good faith for a proper purpose; and
 - (b) they did not have a material personal interest in the subject matter when they acted; and
 - (c) they informed themselves about the subject matter when they acted to the extent they reasonably believed to be appropriate; and
 - (d) they rationally believed that the act was in the best interests of the corporation.
- (2) A director’s or officer’s belief that the act 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.

143 (2009) 75 ACSR 1; 236 FLR 1; [2009] NSWSC 1229; BC200910410. For a more comprehensive discussion of the case, also providing the factual background, see Du Plessis et al, above n 38, pp 323–8.

144 *Rich* (2009) 75 ACSR 1; 236 FLR 1; [2009] NSWSC 1229; BC200910410 at [7269]–[7270].

145 Corporations Act 2001 (Cth) s 180(2).

146 *Ibid*, s 9 (definition of officer).

- (3) This section also applies when directors or officers refrain from acting, which would otherwise be in breach of any duties at common law or in equity (including the duty of care that arises under the common law principles governing liability for negligence) or in breach of any statutory provision under this Act or any other Act.

Subsection (1) is clearly based on the current s 180(2), but it moves away from ‘business judgment’, which is rather narrowly defined in s 180(3). Subsection (2) replicates the concluding paragraph under the current s 180(2), but the word ‘judgment’ is replaced by ‘act’. Subsection (3) covers breaches of any duty or any statutory provision by omissions or inaction.

It will be clear that the new proposal retains the objective review of the standard of care and diligence contained in s 180(1) of the Corporations Act.

The next section will discuss specific statutory defences in the Corporations Act to determine whether or not some of these defences should be repealed. In other words, is the proposed new defence broad enough to make the other defences superfluous?

IV Specific statutory defences

A Reasonable reliance: Section 189

Section 189 of the Corporations Act provides protection when directors, in good faith, rely on advice or information provided by others (including board committees) without having any reasonable suspicion that the advice was in fact incorrect or provided negligently. There is a requirement that each director must make ‘an independent assessment of the information, having regard to the director’s knowledge of the corporation and the complexity of the structure and operations of the corporation’.¹⁴⁷ It is argued in *Ford, Austin and Ramsay’s Principles of Corporations Law* that it does not mean that external advice should not be obtained, but it does mean that a director with special knowledge, such as a finance director, will probably be required to scrutinise advice and information within their expertise particularly carefully.¹⁴⁸ If the requirements are met there is a rebuttable presumption that reliance on the information or advice was reasonable. The burden of proof, however, remains on the directors to establish that it was reasonable for them to rely on the advice or information.¹⁴⁹

Is the defence in s 189 superfluous if the ‘The All-inclusive Directors and Other Officers Decisions Defence’ broader statutory protection provision is adopted? The answer is ‘no’ as it is submitted that directors should have a choice as to which defence they want to rely on. There will be an overlap

¹⁴⁷ Ibid, s 189(b)(ii).

¹⁴⁸ R P Austin and I M Ramsay, *Ford, Austin and Ramsay’s Principles of Corporations Law*, 16th ed, LexisNexis Butterworths, 2014, pp 294–5.

¹⁴⁹ *Re AWB Ltd* (2008) 21 VR 252; 252 ALR 566; [2008] VSC 473; BC200809901 at [51]; *Macdonald v ASIC* (2007) 73 NSWLR 612; 65 ACSR 299; [2007] NSWCA 304; BC200709160 at [16] — in the subsequent civil penalty case, *Australian Securities and Investments Commission v Macdonald (No 11)* (2009) 256 ALR 199; 71 ACSR 368; [2009] NSWSC 287; BC200903649 at [546], the defendant’s reliance on s 189 as a defence failed because the court held that there was no evidence that the defendant actually relied upon the advice provided (which was that certain information should have been disclosed).

between the new proposed defence and relying on s 189, which could be illustrated as follows: all directors who are relying on advice or information provided by others currently need to pass the good faith test, which is the first requirement in s 189(b)(i). It is expected that directors will act for a proper purpose when relying on information or advice provided by others, even though ‘proper purpose’ is not used in s 189. In other words, the fact that proper purpose is included in ‘The All-inclusive Directors and Other Officers Decisions Defence’ is one more safeguard to ensure that directors are conscious of this requirement when they rely on information or advice provided by others.

The second requirement, that they should not have a material personal interest in the relevant subject matter when relying on information or advice provided by others, should be a relevant consideration for directors so relying.

The third requirement, that in relying on advice or information provided by others they inform themselves to a reasonable degree, is in fact just another way of expressing what is currently the ‘independent assessment’ requirement in the reasonable reliance defence (s 189(b)(ii)). As far as the fourth requirement is concerned, when relying on such information or advice, it is not unreasonable to expect directors to ‘rationally believe’ that the reliance is in the best interests of the corporation.

The new subs (2), as is the case currently under s 180(2) (concluding sentence)), qualifies ‘rational belief’ and in fact protects the directors by providing that a director’s or officer’s belief that the act 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*. It will be obvious that this is not a simple objective measure. A comparable requirement forms part of s 189(b), requiring the director’s knowledge of the corporation and the complexity of the structure and operations of the corporation to be taken into consideration to determine whether or not the director has made an independent assessment. Why should the directors make different judgments every time they exercise their powers or perform functions as directors or officers? ‘The All-inclusive Directors and Other Officers Decisions Defence’ maintains a consistent approach and would ensure that directors aim to take the same things into consideration whenever they need to act or take decisions as directors. They would do so because they would be conscious that the wider defence would then protect them against liability should they be sued for a breach of any duty or any statutory provision.

It should be pointed out that s 189 has not been the subject of in-depth judicial scrutiny, not even in the *Centro* case¹⁵⁰ where the non-executive directors relied on information provided by the audit committee and the auditors. This is probably an indication that the section does not serve its purpose: that directors should not adopt an overly cautious approach when relying on information or advice provided by others. It was also pointed out

¹⁵⁰ Litigation in *Australian Securities and Investments Commission v Healey* (2011) 196 FCR 291; 278 ALR 618; [2011] FCA 717; BC201104526 and *Australian Securities and Investments Commission v Healey* (2011) 196 FCR 430; 284 ALR 734; [2011] FCA 1003; BC201106546, generally referred to as the *Centro* case, indicating that it involved the Centro group of companies — see Du Plessis and Meaney, above n 72, at 287. See also Hill, above n 14, at 341.

in the Explanatory Memorandum to the CLERP Bill 1998 that this reasonable reliance would be ‘conducive to the development of sound corporate governance practices such as putting in place appropriate board committee systems’.¹⁵¹

B Continuous disclosure: Section 674(2A)

Two sources regulate continuous disclosure in Australia: Ch 6CA of the Corporations Act and Ch 3 of the Australian Securities Exchange (ASX) Listing Rules. Section 674(2) of the Corporations Act supports ASX Listing r 3.1 by way of ‘statutory reinforcement’,¹⁵² ensuring that listing companies and other entities disclose ‘price-sensitive information’ to the market. ASIC enforces instances of contravention under s 674(2) and considers an obligation to continuously disclose as ‘fundamental to market integrity’ and maintaining a fair and efficient market¹⁵³ — ‘a well-informed market maintains market integrity and leads to greater investor confidence to invest in Australian business[es]’.¹⁵⁴

Listing r 3.1 requires a company that is aware¹⁵⁵ of information¹⁵⁶ that a reasonable person would expect to be generally available, due to the material effect it is likely to have on the price or value of the company’s securities¹⁵⁷ if not disclosed, be disclosed immediately¹⁵⁸ to the ASX.¹⁵⁹ ASX Listing r 3.1(A) provides exceptions related to the disclosure of price-sensitive information under Listing r 3.1 where the information falls into one or more of the following categories

[it] would be a breach of a law to disclose the information; [t]he information concerns an incomplete proposal or negotiation; [t]he information comprises matters

151 Explanatory Memorandum, Corporate Law Economic Reform Program Bill 1998, Parliament of Australia, Canberra, at [6.22], <<https://www.legislation.gov.au/Details/C2004B00269/Explanatory%20Memorandum/Text>> (accessed 3 February 2017).

152 M Bloch, J Weatherhead and J Webster, ‘The Development and Enforcement of Australia’s Continuous Disclosure Regime’ (2011) 29 *CSLJ* 253 at 253–7. See also D McFarlane, ‘Significant judicial guidance on the application of the continuous disclosure obligations’ (2015) 33 *CSL* 287 at 288.

153 B Gibson and J Price, ‘Continuous Disclosure: Guidance Note 8 Rewrite’, speech delivered to the *ASX Forum*, 22, 29 April 2013, p 2, at <<http://asic.gov.au/about-asic/media-centre/speeches/continuous-disclosure-asic-guidance-note-8-rewrite>> (accessed 3 February 2017); Australian Securities Exchange, *The Role of the ASX and its Listing Rules*, Discussion Paper, October 1990, p 22.

154 Commonwealth, *Second Reading Speech*, Corporate Law Reform Bill (No 2) 1992, Senate, 26 November 1992 (Nick Bolkus).

155 Australian Securities Exchange, *Listing Rules*, 2014, r 19.12 (definition of aware).

156 *Ibid*, definition of ‘information’.

157 Corporations Act 2001 (Cth) s 92(3) (eg, securities). Perram J held that in this context this definition can be narrowed to mean ‘listed securities’. See *Grant-Taylor v Babcock & Brown Ltd (in liq)* (2015) 322 ALR 723; 104 ACSR 195; [2015] FCA 149; BC201501320 at [70].

158 Australian Securities Exchange, *ASX Listing Rules Guidance Note 8 Continuous Disclosure: Listing Rules 3.1–3.1B*, 2014, p 13.

159 *Ibid*.

of supposition or is insufficiently definite to warrant disclosure; [t]he information is generated for the internal management purposes of the entity; or the information is a trade secret.¹⁶⁰

Section 674(2B) provides a defence to a contravention of s 674(2A) where it can be proved that ‘all steps (if any) that were reasonable’ were taken to comply with its obligations.

The ‘continuous disclosure regime’ and the personal liability of directors under it were mentioned in the 2014 AICD proposal as of particular concern to directors.¹⁶¹ It is submitted that directors should be protected against liability when making a disclosure (or not making a disclosure) if they meet the requirements of the broader defence proposed in this paper. Furthermore, the current defences, although rarely relied upon, should remain. The defendant director should have the right to choose the most appropriate defence available, but unlike under the current statutory business judgment rule, ‘The All-inclusive Directors and Other Officers Decisions Defence’ would provide protection against all possible contraventions, as long as the requirements in the proposed new section are met.

C Prospectus liability: Sections 728, 729 and 731

The development of financial markets is considered to be dependent upon ‘safeguarding the interests of investors’.¹⁶² Thus it is evident that ‘confidence ... is at the root of [the] market economy’.¹⁶³ It should be no surprise that s 728(1) of the Corporations Act provides that a person commits an offence if a ‘disclosure document’¹⁶⁴ includes misleading or deceptive statements or omits specified information.¹⁶⁵ A person making an offer must do so in the prescribed form:¹⁶⁶ a prospectus, offer information statement¹⁶⁷ or profile statement.¹⁶⁸ A prospectus must contain all the relevant information needed to pass the general disclosure test,¹⁶⁹ and set out the terms and conditions of the offer¹⁷⁰ (including any material lodged with ASIC in short form

160 Australian Securities Exchange, *ASX Listing Rules Chapter 3 Continuous Disclosure*, 14 April 2014, p 302.

161 Australian Institute of Company Directors, above n 3, p 15.

162 M N Houque et al, ‘The Effect of IFRS Adoption and Investor Protection on Earnings Quality around the World’ (2012) 47 *International Journal of Accounting* 333 at 337. See also Organisation for Economic Co-operation and Development (OECD), *Corporate Governance, Value Creation and Growth: The Bridge between Finance and Enterprise*, OECD Publishing, 2012, pp 3–4.

163 L B Smaghi, ‘Restoring Confidence’, speech delivered at the *Society, State, Market: A European Answer International Forum Economica*, University Carlos III de Madrid, Madrid, 25 November 2008, at <https://www.ecb.europa.eu/press/key/date/2008/html/sp081125_1.en.html> (accessed 3 February 2017).

164 See Corporations Act 2001 (Cth) Pt 6D.2 Div 3. A disclosure document includes prospectuses (in any form) and other statements.

165 This is information required by the Corporations Act, *ibid*, ss 710–715, depending on the type of disclosure document.

166 *Ibid*, s 710.

167 *Ibid*, s 709(4) provides that the offer information statement can be used where the capital raised is below \$10 million.

168 *Ibid*, s 709(2).

169 *Ibid*, s 710.

170 *Ibid*, s 711.

prospectuses).¹⁷¹ Section 729 provides a right of compensation to recover losses or damages from a person arising from a contravention of s 728(1). Furthermore, s 729(1) lists such persons as including the person making the offer; directors; proposed directors; underwriters; persons named in the disclosure document; and other persons who contravene or are involved in a contravention of s 728(1).¹⁷² Accordingly, a person can bring an action against a person under s 728(1) where the defences in ss 730–733 are not made out. Of particular importance is the defence of due diligence in s 733, which provides as follows:

A person does not commit an offence against subsection 728(3), and is not liable under section 729 for a contravention of subsection 728(1), because of a misleading or deceptive statement in a prospectus if the person proves that they:

- made all inquiries (if any) that were reasonable in the circumstances; and
- after doing so, believed on reasonable grounds that the statement was not misleading or deceptive.

A person does not commit an offence against subsection 728(3), and is not liable under section 729 for a contravention of subsection 728(1), because of an omission from a prospectus in relation to a particular matter if the person proves that they:

- made all inquiries (if any) that were reasonable in the circumstances; and
- after doing so, believed on reasonable grounds that there was no omission from the prospectus in relation to that matter.

It is submitted that the broader new defence proposed in this paper will protect directors if they are sued for a breach of any of the prospectus liability provisions, as long as they can prove that the four requirements in subs (1) of the proposed new section are met.

D Insolvent trading: Section 588H

1 The statutory provisions and concerns

It is well-known that there are considerable risks for directors to be held liable personally under s 588G (the insolvent trading provisions) of the Corporations Act. The defences to a s 588G breach, which appear in s 588H, are very specific. A person will have a defence under s 588H(2) if he or she can prove that at the time when the debt was incurred, the person had reasonable grounds to expect, and did expect, that the company was solvent at that time and would remain solvent even if it incurred that debt and any other debts that it incurred at that time or came to that belief based upon a reasonable reliance on the advice and opinions of others (s 588H(3)). Section 588H(4) provides a defence if the person can prove that he or she was ill or some other good reason exists why he or she did not take part in the relevant decision. It is also a defence under s 588H(5) if the person can prove that he or she took all reasonable steps to prevent the company from incurring the debt.

As pointed out above, even if directors make a ‘business judgment’

¹⁷¹ Ibid, s 712.

¹⁷² Purchasers are entitled to a refund; if not forthcoming, directors are personally liable: *ibid*, s 737(3). Also, there are criminal penalties under the s 1311 and in Sch 3.

regarding insolvency or potential insolvent trading and can prove that they met all the requirements in s 180(2), they will not be protected by the business judgment rule as that protection does not apply to the insolvent trading regime regulated under s 588G — the protection of the business judgment rule is limited to business judgments regarding the business operations of corporations and is currently, and more accurately only a defence for a breach of directors' duty of care and diligence (s 180(1)).

Thus there are considerable risks regarding personal liability and disqualification¹⁷³ for directors, as the circumstances under which directors could be held liable under s 588G are wide and the defences under s 588H are limited and specific. In fact, s 588G limits the likelihood of a director taking necessary measures to revive the company.

For directors, the current lack of protection and legal complexity and uncertainty is very much like 'walk[ing] a legal tightrope'.¹⁷⁴ It is clear that directors can — and do — simply hand a company over to an administrator or liquidator to avoid being personally liable for subsequent insolvent trading. The limitation presented by s 180(2) has dramatic consequences for directors, particularly when faced with 'necessary measures' to revive a company, which may result in insolvent trading. It may well serve the best interests of the corporation, and thus serve a proper purpose, to try to save the company, but at what cost? Directors are not protected by the very provisions that were drafted to provide a 'safe harbour'.

The Commonwealth Treasury explored a 'safe harbour' defence in a 2010 review of the insolvent trading regime aimed at extending the business judgment rule to insolvent trading.¹⁷⁵ However, no action has been taken as a result of this paper.

Interestingly, one commentator has suggested that Australia 'look to the softer view taken by UK law [regarding insolvent trading] ... which allows directors to restructure without ... [generating] negative publicity'.¹⁷⁶ Indeed, a closer examination of s 214 of the Insolvency Act 1986 c 45 (UK) reveals a 'substantially relaxed'¹⁷⁷ regime that allows an otherwise insolvent company to 'attempt to trade out of its difficulties without the directors necessarily

¹⁷³ Ibid, Pt 9.4B ss 1317E(1)(e), 1317G and 1317H.

¹⁷⁴ S Butler, *Insolvent Trading — The Harsh Reality* (2009) 2 *Journal of the Law Society Northern Territory* 40 at 40, <<http://www.austlii.edu.au/au/journals/BalJINTLawSoc/2009/25.html>> (accessed 20 February 2017). See generally M Quinlan and C Zahra, *Latest Developments in Insolvent Trading*, Allens Arthur Robinson, 25 May 2009, at <<https://www.allens.com.au/pubs/pdf/insol/pap27may09.pdf>> (accessed 3 February 2017); they analyse the insolvent trading provisions in New Zealand and the United Kingdom.

¹⁷⁵ Treasury, *Insolvent Trading: A Safe Harbour for Reorganisation Attempts Outside of External Administration*, Australian Government, Canberra, January 2010, at <http://archive.treasury.gov.au/documents/1713/PDF/Insolvent_Trading_Safe_Harbour_DP.pdf> (accessed 3 February 2017).

¹⁷⁶ S Parbery, 'Loosen Rules to Save Firms', *Australian Financial Review*, 8 August 2008, p 55, cited in K Neilson, *Weathering the Storm: Reforming Australia's Corporate Insolvency Laws for the Global Financial Crisis*, Honours thesis, Australian National University, 2009, at <http://archive.treasury.gov.au/documents/1748/PDF/Kathryn_Neilson.pdf> (accessed 3 February 2017).

¹⁷⁷ Ibid.

being liable should it fail to do so'.¹⁷⁸

It has been pointed out that the complex nature of insolvency laws in Australia and the United Kingdom, and directors' exposure to personal liability as a consequence, has 'created uncertainty; ... deterred talented people; ... prevented directors taking sensible risks; [and] discouraged the development of business and enterprise'.¹⁷⁹ Similar concerns were expressed in the Productivity Commission's *Business Set-Up, Transfer and Closure*,¹⁸⁰ as well as in the Australian Government's National Innovation and Science Agenda (Agenda) released on 7 December 2015.¹⁸¹ The Agenda outlined the government's intentions to adopt the recommendations of the Productivity Commission in three areas:

- (1) a reduction of the bankruptcy period from 3 years to 1 year;
- (2) the introduction of a 'safe harbour' to absolve and protect directors from the insolvent trading provisions of s 588G of the Corporations Act when implementing a 'restructuring plan' in good faith; and
- (3) an express prohibition on the enforcement of 'ipso facto' clauses in contracts when a firm is attempting to restructure.

On 29 April 2016, the government released *Improving Bankruptcy and Insolvency Laws*, which discusses the three proposals in detail, for public consultation.¹⁸² The focus, for current purposes, is on the second of the three reform proposals of the Agenda: a safe harbour defence (Model A) and a statutory carve out (Model B).¹⁸³

2 Safe harbour (Model A): Defence from insolvent trading liability¹⁸⁴

To alleviate uncertainty and restore and 'preserve enterprise value'¹⁸⁵ through entrepreneurship, the proposed 'Model A Safe Harbour' defence is centred upon the appointment of a restructuring advisor. This would provide directors with valuable time to rescue a company from the jaws of lost battles as long as the director(s) take all reasonable and necessary steps. Of course such a plan would require the company to maintain its records in line with the current

178 J Payne and D Prentice, 'Civil Liability of Directors for Company Debts under English Law', *Company Directors' Liability for Insolvent Trading*, I Ramsay (Ed), 2000, pp 190, 206.

179 Quinlan and Zahra, above n 174.

180 Productivity Commission, *Business Set-Up, Transfer and Closure*, Final Report No 75, Australian Government, Canberra, 30 September 2015.

181 Prime Minister M Turnbull, 'Launch of the National Innovation and Science Agenda', speech delivered at the *Commonwealth Scientific and Industrial Research Organisation*, Canberra, 7 December 2015, at <<https://www.pm.gov.au/media/2015-12-07/launch-national-innovation-and-science-agenda>> (accessed 3 February 2017).

182 Australian Government, *Improving bankruptcy and insolvency laws*, Proposals Paper, April 2016.

183 Productivity Commission, above n 180, p 10.

184 For an excellent summary of the current law regarding insolvent trading, the risk for directors and the proposed models, see Ashurst, *The journey to director safe harbour: Are we there yet?*, 9 May 2016, at <<http://www.ashurst.com/financehub/the-journey-to-director-safe-harbour-are-we-there-yet/>> (accessed 3 February 2017).

185 Australian Government, above n 182, p 10.

ss 286 and 588E provisions. It also requires the director(s) to continue to make the company's business decisions.¹⁸⁶ To do this, the proposal, 'a defence to s 588G', would require the appointment of 'an appropriately experienced, qualified and informed restructuring advisor'.¹⁸⁷ The director(s) can invoke the defence by 'appoint[ing] a restructuring advisor who can assess the company's viability against books and records within a reasonable period of ... appointment'.¹⁸⁸ The restructuring advisor '[must] exercise their powers and discharge their duties in good faith in the best interests of the company and ... inform ASIC of any misconduct they identify'.¹⁸⁹ A restructuring advisor will owe their duty to the company and will not be held to ransom by third parties for decisions made within reason and honestly, regardless of how erroneous the decisions turn out to be. Furthermore, the restructuring advisor will be restrained from further appointments to insolvency matters under the Corporations Act without leave of the court, and a definition of 'restructuring advisor' will be added to existing definitions of director.

It is submitted that the 'The All-inclusive Directors and Other Officers Decisions Defence' will be conducive to a more streamlined implementation. The reason is that the new proposal will result in all decisions taken by directors, including decisions to incur a debt that might render the corporation insolvent, are guided by the same considerations as contained in the proposed new section. This will lead to certainty and a consistent approach for directors whenever they act or take decisions on behalf of companies.

3 Safe harbour (Model B): Statutory carve out¹⁹⁰

When faced with financial uncertainty under s 588G, directors are likely to exercise a great deal of caution, regardless of the likelihood of successfully trading out of financial difficulty. This is due to the legislation's tendency to require the immediate winding up of companies when a company incurs a debt that puts the company as a whole into debt; this often provides, in itself, reasonable grounds for suspecting insolvency. This proposal offers directors 'who are acting in the best interests of the company and its creditors as a whole ... a safe harbour within which they may attempt to return the company to profitability'.¹⁹¹ The proposal attempts to instil confidence by relieving directors of liability for decisions under s 588G in the following circumstances:

- (a) the debt was incurred as part of reasonable steps to maintain or return the company to solvency within a reasonable period of time; and
- (b) the person held an honest and reasonable belief that incurring the debt was in the best interests of the company and its creditors as a whole; and

¹⁸⁶ Ibid, p 11.

¹⁸⁷ Ibid.

¹⁸⁸ Ibid.

¹⁸⁹ Ibid.

¹⁹⁰ Ibid, p 15: 'This model contemplates safe harbour as a carve out, rather than a defence, and thus the burden of proof would lie on any liquidator bringing a claim to show that a director had breached any one of the three limbs of the provision'.

¹⁹¹ Ibid.

(c) incurring the debt does not materially increase the risk of serious loss to creditors.¹⁹²

We take the view that such a proposal leaves directors open to personal liability because the statutory carve out is based on the assumption that the director will take 'reasonable steps' and the company will return to solvency within a 'reasonable time'.¹⁹³ Additionally, directors may still be held liable for other breaches that arise from trading out of insolvency despite the protections offered by s 588G.¹⁹⁴

V Relief from liability: Sections 1317S(1) and 1318(1)

The earlier history of the current relief provisions contained in ss 1317S in 1318 is dealt with in detail in a discussion paper released by the Companies and Securities Law Review Committee in 1989.¹⁹⁵ In 1989 the equivalent provision was s 535(1) of the Companies Act 1981 (Cth).¹⁹⁶ It read as follows:

535 Power to grant relief

535(1) If, in any civil proceeding against a person to whom this section applies for negligence, default, breach of trust or breach of duty in a capacity by virtue of which he is such a person, it appears to the Court before which the proceedings are taken that the person is or may be liable in respect of the negligence, default, or breach but that he has acted honestly and that, having regard to all the circumstances of the case, including those connected with his appointment, he ought fairly to be excused for the negligence, default or breach, the Court may relieve him either wholly or partly from his liability on such terms as the Court thinks fit.

This became s 1318(1) of the Companies Act 1989 (Cth), with only a minor amendment to deal with the gender-specific references, replacing 'he/him/his' with 'the person', and the wording has been unchanged in ss 1317S(1) and 1318(1) of the Corporations Act. The only reason for two almost identical relief provisions under the current Corporations Act is that s 1317S(1) applies to relief from 'civil penalty provisions', while s 1318(1) covers relief from all other provisions, as was the case before the 'civil penalty regime' became part of Australian corporations law.

The Australian provision can, in turn be traced back to recommendations made in the United Kingdom's Reid Report of 1906.¹⁹⁷ Based on these recommendations, s 32 of the UK Companies Act 1907 was enacted (it then became s 279 of the UK Companies Act 1908):

If in any proceedings against a director of a company for negligence or breach of trust it appears to a court that the director is or may be liable in respect of the negligence or breach of trust, but has acted honestly and reasonably, and ought fairly

¹⁹² Ibid.

¹⁹³ Ibid, pp 11 (Proposal 2.2), 16.

¹⁹⁴ J Harris and A Hargovan, 'Productivity Commission Safe Harbour Proposal for Insolvent Trading' (2016) 68 *Governance Direction* 9.

¹⁹⁵ Companies and Securities Law Review Committee, above n 21, at [94]–[100].

¹⁹⁶ Ibid, at [93]. See also Companies Act 1981 (Cth).

¹⁹⁷ *Report of the Company Law Amendment Committee*, Reid Report, Cd 305, Her Majesty's Stationery Office, 1906.

to be excused for the negligence or breach of trust, the court may relieve him, either wholly or partly, from his liability on such terms as the court may think proper.¹⁹⁸

What stands out is that the source legislation required ‘honesty and reasonableness’, while the Australian counterpart required only ‘honesty’. There is no discussion of this omission in the 1989 Discussion Paper of the Companies and Securities Law Review Committee, but in that discussion paper the history of this requirement is traced back to earlier legislation dealing with trustees:

The legislation that was enacted adopted the language of the Judicial Trustees Act 1896 section 3(1)(a) to provide the criteria by which the Court should be guided. It had to appear to the Court that the director or officer had acted honestly and reasonably and that, having regard to all the circumstances of the case, he ought fairly to be excused for the negligence or breach of trust.¹⁹⁹

The biggest problem is that if it is necessary for directors to rely on the relief provision, they have already been held to be in breach of their common law or statutory duties²⁰⁰ — they have already suffered reputation damage and any relief granted by the court will be a poor consolation.

It is submitted that ss 1317S and 1318 remain. Even though it is no defence, it has provided a final remedy for directors over many years. The requirements, before a court will relieve a director for a breach of a duty already proven, are not easy to overcome and that is why it is an acceptable final remedy. The courts rarely grant directors relief from liability, as will be obvious from the *Centro* case.²⁰¹

VI Conclusions

The AICD proposal — for an honest and reasonable person defence — will revive difficulties the courts have historically experienced in interpreting the standard of conduct expected of directors and the standards of review the courts need to use to determine whether or not there was a breach of a duty. The AICD proposal also includes subjective elements, which means its adoption would constitute a radical departure from current Australian law in this area. Austin’s proposal, aimed at reversing the onus of proof, is not desirable if the current four requirements in s 180(2) are kept in a new section providing protection to directors for other decisions and judgments which are not considered to be ‘business judgments’.

‘The All-inclusive Directors and Other Officers Decisions Defence’ provides a broader and wider defence that would apply to all decisions where the director can satisfy the four requirements, thereby avoiding any need for radical reforms. The standards of review remain and the onus of proof is on the defendant that their action or decision met the four requirements, which

198 See Companies and Securities Law Review Committee, above n 21, at [95]–[96].

199 Ibid, at [105].

200 Ibid, at [109].

201 *Australian Securities and Investments Commission v Healey* (2011) 196 FCR 291; 278 ALR 618; [2011] FCA 717; BC201104526 at [8]; *Australian Securities and Investments Commission v Healey* (2011) 196 FCR 430; 284 ALR 734; [2011] FCA 1003; BC201106546 at [13], [88]. See further Du Plessis and Meaney, above n 72, at 281–2.

means there are proper checks and balances to ensure that the protection is not unduly wide. This reflects the current position as was held by Austin J in *Rich*.

It has been argued that the current business judgment rule should be available if directors make forward-looking statements in their reporting on and disclosure of non-financial matters.²⁰² However, it has been correctly pointed out that under the current law the business judgment rule is not a defence if directors are sued under other statutory provisions, such as misleading and deceptive conduct.²⁰³ If 'The All-inclusive Directors and Officers Decisions Defence' is accepted, it would bring an end to this uncertainty as this wider defence will protect directors if they take decisions to report on and disclose non-financial information that includes forward-looking statements, as long as the four requirements are met.

It is understandable that directors would prefer an even wider form of protection, but high community expectations, evidenced in the already high standards of conduct required of directors, indicate that a wider form of protection for them is not in the best interests of the public, including creditors, shareholders and other investors. With the existing statutory defences remaining,²⁰⁴ and as long as directors in Australia ensure that the four requirements of the proposed wider defence are met, they should be protected against personal liability in respect of any particular matter arising in the exercise of the powers or the performance of the functions of director or officer.

202 Du Plessis and Rühmkorf, above n 72, at 49.

203 Australian Institute of Company Directors, above n 3, pp 11–17.

204 Except for the statutory business judgment rule, which would be repealed as part of 'The All-inclusive Directors and Officers Decisions Defence' proposed in this paper.