CORPORATE LAW DEVELOPMENTS AND REFORM

Corporations Law Reform – The Business Judgment Rule

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INTRODUCTION

Over the last decade there has been much debate in Australia about the need for a statutory business judgment rule, frequently referred to as a "safe harbour" for directors and other officers where they have made honest, informed and rational business decisions.

In 1997, as part of the Corporate Law Economic Reform Program (CLERP), the Treasurer announced proposals to reform the officer provisions of the Corporations Law, including the recommendation that a business judgment rule be introduced into the Corporations Law.[1] Draft legislation has now been released, called the Corporate Law Economic Reform Bill 1998 (the Bill). At the time of writing, the Federal Government intends introducing the Bill in the current Budget session of Parliament (12 May to 2 July 1998). In that regard the comments in this paper are qualified by the fact that they are based on the formulation of the business judgment rule set out in the exposure draft of the Bill released on 9 April 1998. It is recommended that this paper be read concurrently with the Bill.

In essence, the proposed formulation of the business judgment rule provides that directors and other officers will have met the requirements of their statutory duty of care and diligence and the equivalent general law duty, in respect of a business decision made by them, if the decision was made:

- in good faith for a proper purpose;
- without a material personal interest in the subject matter of the decision;
- on a properly informed basis; and
- in what they rationally believe to be in the best interests of the corporation.

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1 Corporate Law Economic Reform Program: *Directors' Duties and Corporate Governance*, Paper No 3 (1997).

This paper seeks to outline the main elements of the proposed statutory business judgment rule, discuss where it has come from (including discussion of the push for reform and a comparison of the main features of the US model), consider whether there is already a common law version of the rule under Australian law, and discuss some of the early reactions to the draft formulation. In view of the recent release of the draft legislation, reference to the arguments concerning whether a statutory version of the rule is needed, which have been so effectively canvassed by academic and other commentators in the last few years, will be limited.[2]

In addressing this topic it is appropriate to note the recent comments of corporate law expert Henry Bosch who, whilst applauding the proposed legislative reform on the basis that it clarifies, but is consistent with, the current position under Australian law, noted:

> "... our eulogy should be short: already too much attention has been paid to this minor amendment."[3]

At the risk then of contributing to a debate which is viewed by some as past its use by date, this paper hopes to brings some clarity to the elements and likely interpretation of the business judgment rule in the context of the draft legislation.

THE STATUTORY BUSINESS JUDGMENT RULE

Formulation of the Proposed Rule under the Corporate Law Economic Reform Bill 1998

To understand the context of the business judgment rule regard must be had to the reformulation of subsection 232(4) of the Corporations Law. Part 2D.1 subclause 2(1) of the Bill says:

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

In that regard it is important to note proposed changes to the statutory standard of care required of directors and other officers under subclause 2(1), which will (1) qualify the objective test currently contained in subsection 232(4) of the Corporations Law; and (2) provide that a breach of the duty will give rise to civil sanctions only; that is, it will no longer provide a basis for an offence under the Corporations Law.

The question of whether a director or other officer has exercised their powers and discharged their duties with the requisite degree of care and diligence will, in the context of subclause 2(1) of

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2 For further reading, see: R Baxt: "Do We Now Need a Business Judgment Rule for Company Directors?" (1995) 69 *ALJ* 571; R Baxt: "The Duty of Care of Directors – Does it Depend on the Swing of the Pendulum?" in *Corporate Governance and the Duties of Company Directors*, (1997) Ian Ramsay (ed), Centre for Corporate Law and Securities Regulation, The University of Melbourne; L Law: "The Business Judgment Rule in Australia: A Reappraisal Since the *AWA* Case" (1997) 15 *CSLJ* 174; P Redmond: "Safe Harbours or Sleepy Hollows: Does Australia Need a Statutory Business Judgment Rule?" in *Corporate Governance and the Duties of Company Directors*; D Tan: "Delivering the Judgment on a Statutory Business Judgment Rule in Australia" 5 (1995) *AJCL* 442 at 445.

3 Henry Bosch: "Two cheers for reform", *Shares* (May 1998) at pp 58-59.

the Bill, be assessed by reference to the particular circumstances of the director or officer in question. The Commentary on the New Provisions indicates this will allow the courts to have regard to the circumstances of the particular officer (ie their skills and experience, including their special background, qualifications and management responsibilities), as well as their position in the corporation, in evaluating their compliance with the requisite standard of care.[4]

The Bill's proposed formulation of the business judgment rule,[5] a mixture of the American Law Institute's 1994 draft model provision and the model put forward by the Companies and Securities Law Review Committee, provides as follows:

> "A director or other officer of a corporation who makes a business decision is taken to meet the requirements of subsection (1) [ie subclause 2(1) above] and their equivalent general law duty, in respect of the decision if they:
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> (a) make the decision in good faith and for a proper purpose; and
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> (b) do not have a material personal interest in the subject matter of the decision; and
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> (c) inform themselves about the subject matter of the decision to the extent they reasonably believe to be appropriate; and
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> (d) rationally believe that the decision is in the best interests of the corporation.
>
> The director's or officer's belief that the decision 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: This subsection only operates in relation to duties under this section and their general law equivalents – it does not operate in relation to their duties under any other provisions of this Law or under any other laws."

"Business decision" is defined as "... any decision to take or not take action in respect of a matter relevant to the business operations of the corporation."[6] Importantly, the rule is confined to instances involving business decisions made about the ordinary operations of the corporation and does not, for example, apply to decisions made in the context of insolvent trading or in relation to misstatements in a prospectus or takeover document.

"Officer" in the context of clause 2 includes directors, secretaries, receivers, administrators and liquidators, or former officers of the company.

Accordingly, the business judgment rule will apply in the context of the statutory duty of directors and other officers to exercise their powers and discharge their duties with care and diligence *and* the common law duty of care.

The "fundamental purpose of the rule is to protect the authority of directors in the exercise of their duties, not to insulate directors from liability,"[7] and in so doing to encourage directors to take advantage of business opportunities by undertaking responsible risk taking. The focus of the business judgment rule is on the process of decision-making, not on its results. The rule will act as a presumption in favour of directors and other officers where they have made bona fide business decisions. If the presumption is rebutted, that is, if there is evidence that, in making a

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4 Part 2 – Commentary on New Directors' Duties and Corporate Governance Provisions at p 41.

5 Subclause 2(2) of Chapter 2D.1 of the Bill (under Schedule 1 – New Directors' Duties and Corporate Governance Provisions).

6 Subclause 2(3). Ibid.

7 Op cit n 4 at p 41.

business decision, an officer failed to act in good faith or for a proper purposes, or without material personal interest, or on an informed basis, or in the honest belief that the decision was taken in the best interests of the corporation, the plaintiff will still have to establish that the officer breached their duty of care and diligence. These elements will be discussed later in this paper.

THE PUSH FOR REFORM

Events of the 1980s galvanised debate within Australia about standards of corporate governance, with a number of major law reform reports of the late 80s and early 90s recommending the introduction of a business judgment rule into Australian corporate law.[8] These reports were generally critical of the low standard of care required of company directors, and saw the "strengthening" of the duty of care and creation of a statutory business judgment rule as a way of increasing the effectiveness of the law.[9] Adoption of a business judgment rule into the Corporations Law was seen as one way to introduce clear guidelines on how the courts should interpret the duty of care and diligence in the Corporations Law.

However the 1992 decision of Rogers CJ in *AWA Ltd v Daniels (t/a Deloitte Haskins & Sells)* (1992) (the *AWA* case)[10] countered much of the debate in favour of a statutory business judgment rule and is understood to have triggered the decision of the then Attorney-General to resist moves to introduce a business judgment rule into the Corporations Law.[11] Although section 232 of the Corporations Law was amended by reinforcing the objectivity of the duty of care owed by a director or officer of a corporation,[12] the government at that time found it unnecessary to enact a business judgment rule in Australian corporate law, choosing instead to leave the development of such a rule to the courts.

The Explanatory Memorandum to the Corporate Law Reform Bill 1992 noted:

> "... no attempt has been made in the Bill to enact a US style of Business Judgment Rule since no state in the USA has adopted a legislative statement of the Rule. Instead the matter has been left to the courts to develop. Similarly the Government considers that the development of similar principles in Australia is better left to the courts", on the basis that "Australian courts had already developed principles that provide protection for the informed business decisions of directors ...."

Australian courts have developed a version of the business judgment rule, insofar as they have been reluctant to undertake judicial hindsight review of directors' business judgments taken honestly and in good faith. For example, the Australian High Court applied an unsophisticated version of the rule as early as 1968, when it noted:

> "Directors in whom are vested the right and duty of deciding where the company's interests lie and how they are to be served may be concerned with a wide range of practical

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8 Companies and Securities Law Reform Commission: *Company Directors and Officers: Indemnification, Relief and Insurance*, Discussion Paper No 9, April 1989 (at para 112); Senate Standing Committee on Legal and Constitutional Affairs: *Company Directors Duties – Report on the Social and Fiduciary Duties and Obligations of Company Directors* (the Cooney Report, AGPS, 1989) (at para 3.35); and the House of Representatives Standing Committee on Legal and Constitutional Affairs: *Corporate Practices and the Rights of Shareholders* (the Lavarch Report, AGPS, 1991) (at para 5.4.30).

9 L Law: op cit n 2 at p 175.

10 7 ACSR 749; 10 ACLC 933 (discussed further below).

11 R Baxt: "Do We Now Need A Statutory Business Judgement Rule?" op cit n 2 at p 571.

12 Subsections 232(3) and (4) were repealed and substituted by the new subsection 232(4) under the Corporate Law Reform Act 1992, which came into force on 1 February 1993.

considerations and their judgment if exercised in good faith and not for irrelevant purposes is not open to review by the court."[13]

Since then, various decisions can be construed as supporting the concept of risk-taking and evidencing some protection for company directors including, for example, statements in the *AWA* case, such as Clarke and Sheller JJA's comments distinguishing the role of directors from that of a trustee (at 658 and 664-665):

> "While the duty of a trustee is to exercise a degree of restraint and conservatism in investment judgments, the duty of care of a director may be to display entrepreneurial flair and accept commercial risks to produce a sufficient return on the capital invested ...," and
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> "Directors must be allowed to make business judgments and business decisions in a spirit of enterprise untrammelled by the concerns of a conservative investment trustee ... Great risks may be taken in the hope of commensurate rewards. If such ventures fail, how is the undertaking of it to be judged against an allegation of negligence by the entrepreneur?"[14]

As Redmond argues, "(j)udicial development of directors' duties has created a body of caselaw principle which in function, if not name, embodies such a business judgment rule" and "(s)imilar statements may be found with respect to the directors' duty of care, evidencing a judicial reluctance to 'second guess' business judgment taken without suggestion of bad faith and, indeed, a judicial deference to such judgments."[15] As noted above, the Explanatory Memorandum to the Corporate Law Reform Bill 1992, in rejecting earlier calls for a statutory business judgment rule, took the view that the general law provided adequate protection to directors against hindsight review by the courts. The Commentary on the New Provisions supports the view that there is already such a doctrine under general law, arguing that the proposed rule will simply "clarify and confirm the common law position that the Courts will rarely review bona fide business decisions."[16]

Following the decision in the *AWA* case renewed calls for reform were prompted by alleged inconsistencies in subsequent judicial decisions relating to directors' duties, or perceived inadequacies in the protection afforded to and accountabilities of directors under the existing law.[17] CLERP Paper No 3 agreed, highlighting a number of decisions as having led to "... a climate of uncertainty thereby potentially affecting, whether directly or indirectly, directors' behaviour."[18]

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13 *Harlowe's Nominees Pty Ltd v Woodside (Lakes Entrance) Oil Co NL* (1968) 121 CLR 483 at 493, as cited by D Tan: op cit n 2 at p 445.

14 Op cit n 10.

15 Redmond: op cit n 2 at p 198.

16 Op cit n 4 at p 41.

17 See for example *Vrisakis v Australian Securities Commission* (1993) 9 WAR 395; 11 ACSR 162; *Dempster v Mallina Holdings Ltd* (1994) 15 ACSR 1; *Permanent Building Society (in liq) v Wheeler* (1994) 14 ACSR 109; 12 ACLC 674; and *Daniels (formerly practising as Deloitte Haskins & Sells) v Anderson* (1995) 13 ACLC 614.

18 Op cit n 1 at pp 21-22, including cases where the courts have refused to exercise their discretion to excuse directors from liability where they acted fairly and honestly (*Standard Chartered Bank of Australia v Antico & Ors* (1995) 38 NSWLR 290; *Commonwealth Bank of Australia v Friedrich* (1991) 9 ACLC 946; *Knightswood Nominees Pty Ltd v Sherwin Pastoral Co Ltd* (1989) 7 ACLC 536; *Chew v R* (1991) 4 WAR 21); and decisions allegedly inconsistent with the Court of Appeal decision in the *AWA* case and with each other (*Re Property Force Consultant Pty Ltd* (1995) 13 ACLC 1051; *Dempster v Mallina Holdings Ltd* (1994) 13 WAR 12; *Permanent Building Society (In liq) v Wheeler* (1994) 11 WAR 187; *Vrisakis v Australian Securities Commission* (1993) 9 WAR 395; 11 ACSR 162).

It is not within the scope of this paper to assess the legitimacy of those concerns or to review the case law in the area of directors' duties and the standard of care in depth,[19] although it is noted that criticisms of apparent inconsistencies in the relevant caselaw are not uniformly accepted:

> "Although there have been only a few decisions (on the issue of directors' duty of care) ... since *Daniels v Anderson* (the *AWA* case), the majority decision in that case does not appear to have greatly affected the way in which Australian judges have approached the issue of directors' duty of care. If one looks at all these cases as a group the general picture becomes reasonably clear. Australian courts are developing a practical and realistic approach to this issue ...."[20]

Certainly, however, there are many who believe clarification is required of the standard of care and the steps directors need to take in order to have some certainty that, at the time they make a business decision, they will be protected against claims they have breached their duty of care. What may seem a reasoned decision at the time the decision is made may appear a wild hunch viewed after the event, against a background of perfect knowledge. If directors and other officers are to have confidence in being able to make business decisions in the knowledge that they will not be exposed to unreasonable legal challenge with the benefit of hindsight, they require clear guidance as to their duties and liabilities. In that regard the stated purpose of the proposed statutory business judgment rule is to remove the lack of certainty regarding the limits of directors' duties and thus improve the performance of directors by encouraging responsible risk-taking. In other words, if one accepts there are concerns amongst directors and other officers, and their advisers, that the courts have failed to adopt clear and consistent approaches to the duties of care and the liabilities of such officers, and that such concerns may discourage responsible risk-taking, it is reasonable to argue that the introduction of a statutory business judgment rule is in the interests of companies, their officers, and shareholders alike.

OVERSEAS EXPERIENCE

Although this paper does not purport to shed any new light on comparable rules in other jurisdictions, the business judgment rule in the United States and its equivalent in Canada are briefly examined for the purposes of comparison with the Australian formulation. There are, however, dangers in attempting to draw direct parallels and the likely operation of the rule in Australia, particularly in relation to the US experience. As noted by Law, there are many distinguishing features between Australian and US corporate law, for example, "US principles on corporate governance do not seem to maintain the strict doctrinal distinction between duty of care and diligence (that is, negligence) and duties of good faith (that is, fiduciary duties) as has existed more recently in Australia. There appears to be much more 'overlap' in that directors' duties are all regarded as fiduciary."[21]

US Formulation of the Business Judgment Rule

The US business judgment rule can be traced back as far as 1829 to a case (*Percy v Millaudon* 8 Mart (ns) 68 (La 1829)), in which the directors were being sued because of the behaviour of certain staff of the bank, but were found to have no particular duty to try and find out if the company was being managed honourably. The court held that "(i)f nothing has come to their

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19 For excellent discussions on the major decisions in the area of directors' duties following the *AWA* case, refer to R Baxt: "The Duty of Care of Directors – Does it Depend on the Swing of the Pendulum?" in *Corporate Governance and Directors Duties*: op cit n 2 at p 92; L Law: "The Business Judgment Rule in Australia: A Reappraisal Since the *AWA* Case": op cit n 2; A Comerford and L Law: "Directors' Duty of Care and the Extent of 'Reasonable' Reliance and Delegation" (1998) 16 *CSLJ* at 103; and A S Sievers: "Directors Duty of Care: What is the New Standard?" (1997) 15 *CSLJ* 392.

20 A S Sievers: Ibid at pp 408-409.

21 L Law: op cit n 2 at p 178. Refer to pages 176-178 for a discussion of other areas of divergence between Australian and US corporate law relevant to an analysis of the business judgment rule.

knowledge to awaken the suspicion of the fidelity of the president and cashier, ordinary attention to the affairs of the institution is sufficient." Whereas, had the directors become aware of any fact that would have put prudent men on their guard, a commensurate degree of care would have been required. The rule grew from concern that suitable persons (of reason, intellect and integrity) would not serve as directors if they were required to exercise a degree of skill and care and precision above that possessed by people of ordinary intellect.[22]

Although most jurisdictions in the US apply the business judgment rule, there is no uniform material expression of the rule. However, in the area of modern US corporate law and corporate governance Delaware is viewed as the most progressive and sophisticated State, and most other State courts rely upon (or at least consult) Delaware law when addressing issues of corporate law.[23] It is hardly surprising then that the first real formulation of the rule was provided by the Delaware Supreme Court in *Aronson v Lewis*, in which the court concluded there was:

> "... 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 was taken in the best interests of the corporation. Absent an abuse of discretion, that judgment will be respected by the courts."[24]

E Norman Veasey,[25] Chief Justice of the Supreme Court of the State of Delaware, has described the current formulation of the US business judgment rule as follows:

> "In making a business decision, the directors are presumed to have acted independently, on an informed basis, in good faith, and in the honest belief that the decision is in the best interests of the corporation. A business decision will normally be sustained unless the presumption is rebutted in either of two ways: (a) the process, independence or good faith of the directors is compromised; or (b) the decision cannot be attributed to a rational business purpose."

In this view, there are two essential pre-conditions to protection – namely, the decision-maker must have exercised good faith, and the decision must be for a rational business purpose.

One of the most frequently quoted formulations of the business judgment rule is the model rule approved by the American Law Institute (ALI) (in its Principles of Corporate Governance),[26] which operates consistently with the common law of Delaware and most US jurisdictions and places the US business judgment rule in the context of the duty of care imposed on directors and officers.

The persuasive authority of the ALI Principles and its formulation of the business judgment rule is illustrated by a recent Pennsylvania decision,[27] in which the court held that a board of directors has the right to terminate derivative litigation under the US business judgment rule *where a*

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22 D Tan: op cit n 2 at p 443.

23 Redmond: op cit n 2 at p 191, quotes US legal commentary to the effect that the Delaware Court system is often viewed as "the Mother Court of corporate law" in the US due to the large numbers of major companies incorporated in that state.

24 473 A 2d 805, 812 (Del 1984).

25 E Norman Veasey CJ: "The Defining Tension in Corporate Governance in America", Ch 2, *Corporate Governance and the Duties of Company Directors* (Ian Ramsay ed), Centre for Corporate Law and Securities Regulation, University of Melbourne (1997) at p 17.

26 American Law Institute: *Principles of Corporate Governance: Analysis and Recommendations* (1994) (Paragraph 4.01(c)) (copy attached at Annexure "A"). The ALI's approval of that model rule in 1994 appears to have lent support to renewed calls for the introduction of a statutory business judgment rule in Australia, and a number of key features of that model have been adapted to the proposed Australian formulation.

27 *Cuker v Mikalauskas* 692 A 2d 1042 (Pa 1997). Prior to this decision the Pennsylvania Supreme Court had never expressly used or adopted the term "business judgment rule" in a corporate context.

decision was made in the ordinary course of business under proper circumstances. The court was prevented from examining the merits of that decision unless shareholders could establish improper conduct by the board (eg fraud, self-dealing, violation of statutory duties).[28]

Although there may appear to be considerable overlap between the business judgment rule and directors' ordinary duty of care and diligence, "(t)he business judgment rule does not replace the duty of ordinary care and its simple negligence standard of culpability, but requires that reasonable diligence be exercised in the decision-making process."[29] To illustrate the relationship between the duty of care and the US business judgment rule, it is necessary to consider the duty of care in closer detail.

The Model Business Corporation Act (1991) provides a model for codification of the duty of care standard that has been followed in many states.[30] Under that formulation a director or officer is required to discharge their duties in good faith, with the care an ordinary person in a like position would exercise under similar circumstances[31] and in a manner they "reasonably" believe to be in the best interests of the corporation. In discharging their duty of care, directors are permitted to rely on information and opinions from management and professionals if they "reasonably" believe them to be competent and reliable, but only so long as the directors do not have knowledge regarding the matter in question which makes reliance unwarranted.[32] The statute provides a shield from liability for any action taken as a director where he performed the duties of his office in compliance with these requirements.

The duty of care owed by directors has two aspects, one where decisions are involved; and a second, where the *quality* of the director's supervisory, oversight or monitoring performance will be in question when determining whether a director or officer has discharged their duty of care.[33] The business judgment rule applies only to the first aspect, essentially narrowing the duty to the process by which the decision is made, that is, whether the director made their decision in good faith, on a properly informed basis etc.

Veasey makes a similar distinction as to the kinds of issues that directors face in fulfilling their duties, although he raises a further question when he characterises the types of issues directors deal with:

- First, *enterprise issues* (operational decisions, the responsibilities of executives and directors);

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28 This is contrasted with the proposed statutory derivative action under Part 2F.1A of the Bill, discussed later in this paper. In effect, under the Bill, satisfaction of the rule will only create a rebuttable presumption that granting leave to bring, or intervene in, proceedings between the company and a third party is in the "best interests of the company". The applicant can still tender evidence to rebut that presumption and, if the court is satisfied that granting leave is in the "best interests of the company" (and the applicant also satisfies the other criteria in subclause 111(2) of the Bill), the court must grant the application.

29 *FDIC v Stahl* F 3d 1510, 1517-1518 (11th Cir 1996).

30 Section 8.30 of the Model Business Corporation Act (1991), General Standards for Directors has, for example, been incorporated in section 4-27-830 of the Arkansas Business Corporation Act of 1987. Paragraph 4.01(a) of the ALI's Principles of Corporate Governance sets out a similar model for the duty of care (copy attached at Annexure "A").

31 Compare the proposed formulation of the Australian statutory duty of care in subclause 2(1), discussed earlier in this paper, which reinforces the principle that a director is only required to act with the care that could reasonably be expected from a person in that director's position, with that director's responsibilities and experience.

32 Compare clause 10 of the Bill, discussed later in this paper, which describes the types of information or advice upon which directors may reasonably rely (unless the contrary is proved).

33 Charles Hansen: "The Supreme Court of the United States – The Continuing Importance of the American Law Institute Corporate Governance Project: Of *Cuker v Mikalauskas*", NCLPI Publications (Dec 1997) at p 6.

- Second, *ownership issues* (such as stockholder rights and whether a company should merge with another company); and
- Third, *oversight issues* (the board's non-decision-making oversight role, or responsibility to monitor management to make sure it is doing what it should do).[34]

Veasey notes the business judgment rule protects directors in regard to decisions they take in the enterprise area, but not in the other two areas, particularly in the area of oversight, which does not involve decision-making.

Compare the apparently similar outcome under subclause 2(3) of the proposed Australian rule, which limits the operation of the rule to any decision to take or not take action in respect of a matter relevant to the business operations of the corporation. Also note clause 11 of Part 2D.1 of the Bill, which deals with the circumstances in which directors will be responsible for the actions of a delegate, confirming directors will be held responsible for the actions of any person to whom power has been delegated (even if that person acts fraudulently or outside the scope of their power) unless the directors reasonably believed the delegate would exercise the power properly and the directors have "monitored, by means of reasonable methods properly used" the delegate's exercise of power.

Where the duty of care standard is defined in terms of simple negligence, an objective evaluation of the director's decision has no role to play in the court's determination as to whether the director exercised a good faith effort to be informed and to exercise appropriate judgment, and thus complied with their duty of care:

> "(c)ompliance with a directors' duty of care can never appropriately be judicially determined by reference to the content of the board decision that leads to a corporate loss, apart from consideration of the good faith or rationality of the process employed. That is, whether a judge or jury considering the matter after the fact, believes a decision substantively wrong, or degrees of wrong (sic) extending through 'stupid' to 'egregious' or 'irrational', provides no ground for director liability."[35]

Accordingly, US courts have been reluctant to find directors liable for negligent business decisions, citing the business judgment rule.[36] This is confirmed by Professor Eisenberg, who argues the business judgment rule is an "easy standard for directors to satisfy ... (a) director will not be found negligent unless he has made an extremely bad decision."[37]

It is, however, generally recognised that if the decision was one which *no reasonable person of sound, ordinary business judgment* would have made, the protection of the business judgment

34 Op cit n 25 at p 17.

35 C Hansen: op cit n 33 at p 8, citing the decision of Chancellor Allen in *In re Caremark International Inc Derivative Litigation* 1996 Del Ch LEXIS 125 (Del Ch 1996).

36 C A Schipani: "Defining the Corporate Director's Duty of Care Standard in the United States and Australia" (1994) 4 *AJCL* 152 at p 155 citing, among others, *Aronson:* op cit n 24 at 812; *Auerbach v Bennett* (NY 1979) 393 NE 2d 994, 1000; and *Miller v AT&T* (3d Cir 1974) 507 F 2d 759, 762. There have, however, been inconsistent results in US court decisions which apply the business judgment rule in the context of the statutory duty of care. See, for example, *Theriot v Bourg* 1997 La App LEXIS 414 (La App 1997), as cited by Hansen (op cit n 33 at p 9), where the Louisiana Supreme Court found the directors liable for damages due to mismanagement, for having made bad business decisions, under a statute based on the "ordinary prudent person" standard.

37 Koret Professor of Law, University of California and Chief Reporter of the ALI's Principles of Corporate Governance; as quoted by L Law: op cit n 2 at p 176, paraphrasing an interview by R Baxt in (1992) 8 *Company Director* 22-25.

rule does not apply, as the decision would be treated as having been made in constructive bad faith.[38]

Comparison with the Position in Canada

Although they have not specifically adopted the US business judgment rule, Canadian courts have reached much the same result. Essentially directors must exercise the care, diligence and skill of a reasonably prudent person in comparable circumstances, giving full credit to the skills that the director possesses (similar to the Australian standard). Where the director makes an informed business decision in keeping with these standards, Canadian courts will generally be reluctant to second-guess decisions of a board of directors.

However, it is thought that the Canadian business judgment rule does not offer quite the same protection as its American counterpart, largely because of the availability in Canada of the oppression remedy which is available regardless of whether a board follows the proper process in making a decision,[39] and derivative actions (where an interested party applies to court for the right to institute an action in the name of the corporation seeking redress from the conduct of the director in question).[40]

The Canadian case of *Keeprite* is a good example of how Canadian courts may review a business decision by a board of directors, but will not interfere with the decision if it was properly made and was not oppressive.[41] The facts involved a challenge by minority shareholders of a corporation's decision to purchase the assets of a subsidiary. An independent committee of the board (whose members were not officers or directors of the subsidiary) had concluded that the decision was fair to the corporation as a whole, including the minority shareholders. Dissenting shareholders attacked the proceedings under the Canada Business Corporations Act as being oppressive or unfairly prejudicial to their interests. The court placed a good deal of emphasis on the process by which the board came to its decision and in particular took into account the fact that the matter had been considered by an independent board committee. On this basis the court found no reason to question the business judgment of the directors. The trial judge, supported by the Court of Appeal, stated:

> "Business decisions, honestly made, should not be subjected to microscopic examination. There should be no interference simply because a decision is unpopular with the minority."

HOW WILL THE RULE APPLY IN AUSTRALIA?

Elements of the Business Judgment Rule

As indicated above, the proposed Australian business judgment rule begins with an assumption that directors should not be judged in hindsight, as we cannot expect all of the decisions of directors will be the right ones, and directors should be encouraged to engage in responsible risk-taking and other entrepreneurial activities with the certainty that, if they have met the specific preconditions to the rule's operation, their decisions will be beyond challenge. Accordingly, if a court makes a preliminary determination that a business decision was properly made it will not

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38 C Hansen: op cit n 33 at p 15, citing as an example *Citron v Fairchild Camera and Instrument Corporation*, 1988 Del Ch LEXIS 67 (Del Ch 1988).

39 Shelley Obal (ed): *Directors Duties – A Guide to the Responsibilities of Corporate Directors in Canada* (2nd ed), published by the firm Osler Hoskin & Harcourt.

40 Compare section 260 of the Corporations Law (pursuant to which directors' business decisions are potentially subject to review if an action is brought for minority oppression) and the proposed statutory derivative action in Part 2F.1A of the Bill.

41 *Brant Industries v Keeprite* (1991) 3 OR (3d) 289.

review the merits of that decision. In that regard the focus of the rule is on the process of decision-making, not on its results.

To satisfy the elements of the rule:

1. *A business decision must be made*

As indicated by subclause 2(3) of the proposed provision, "business decision" means any decision to take or not take action in respect of a matter relevant to the business operations of the corporation. In other words, the business decision must involve a conscious exercise of judgment. Failure to act will be protected only if it is taken in the context of an exercise of judgment. The rule will not protect omissions such as failure in oversight or monitoring of management.

2. *In good faith and for a proper purpose*

If a plaintiff establishes that a decision was made in circumstances of bad faith or undertaken for an improper motive, the decision-maker will be denied the protection of the rule.

That directors must act honestly and in good faith have long been recognised common law duties. The latter element, "proper purpose", may be a little more difficult to reconcile. For example, directors may believe they are acting in the best interests of the corporation, yet they may be using their powers for purposes other than for which they were conferred. In that regard Tan[42] believes the test in Australia for good faith is not a difficult one to fulfil, citing a number of High Court cases to suggest the test for good faith is arguably a subjective one, whereas the test for exercise for a proper purposes is an objective one (where the impermissible purposes would have to have been "causative").

3. *Without material personal interest in the subject matter*

This element of the business judgment rule encompasses a traditional formulation of the law governing the conduct of fiduciaries, where a fiduciary may not place themself in a position where their duty and interest conflict. Where the decision-maker is in a position through which they would gain some form of material personal benefit from the transaction, they will be obliged to refrain from participating in the decision, and to disclose their personal interest in the subject matter of that decision.[43] It should be noted that the courts have historically taken a firm stand on the application of the rule against self-interest,[44] although it has been suggested the courts "appear to be less inflexible in their application of this rule" as commercial situations become more complex.[45]

Under the proposed rule, if a director participates in a decision where they have a "material personal interest" in the subject matter, that is, if they stand to benefit personally from a decision in which they participate (which would be determined according to the particular circumstances of the decision-maker), they will be denied the protection of the business judgment rule.

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42 D Tan: op cit n 2 at pp 448-449, who cites a number of cases including *Harlowe's Nominees* (op cit n 13); *Mills v Mills* (1938) 60 CLR 150, 163, 169; and *Whitehouse v Carlton Hotel Pty Ltd* (1986-7) 162 CLR 285, 294. Tan also suggests the most prevalent forms of bad faith or improper purpose include improper attempts by directors to retain office; a lack of independence on the part of the decision-maker necessary to make a good faith business judgment; or a knowing violation of the law, even where the decision was taken in the best interests of the corporation.

43 Compare the decision in *State of South Australia v Marcus Clark* (1996) 19 ACSR 606, as discussed in R Baxt: "The Duty of Directors – Does it Depend on the Swing of the Pendulum?": op cit n 2 at pp 116-117.

44 Ibid at p 116.

45 D Tan: op cit n 2 at p 450, citing *Chan v Zacharia* (1984) 154 CLR 178, 201.

Regard should also be had to Clause 13 of the Bill, which deals with "Duties on conflicts of interest" and sets out the director's duty to disclose a "material personal interest" when a conflict arises.

4. Having informed themselves about the subject matter to the extent they reasonably believe appropriate

The proposed rule imposes an obligation for directors and other officers to "inform themselves about the subject matter of the decision to the extent that they reasonably believe to be appropriate." Accordingly, although the rule may protect a mistaken judgment, it will not shield directors or other officers where they have failed to exercise informed judgment. As a general rule, in order for directors or other officers to obtain protection under the business judgment rule, their decision must be the result of a decision-making process which takes advantage of all the information available to them and, where there is a deficiency in the available information, on further due enquiry by them.

The requirement to be properly informed restates the position which appears to have developed under Australian law, as evidenced by the appeal court's decision in the *AWA* case. The facts of the case are well known, and the decision has been reviewed in detail by many commentators.[46] The following comments provide only a brief outline for the purpose of this discussion.

The breach of the duty of care by the directors in the *AWA* case arose out of an action in which the company sued its auditors for damages for breach of contract, alleging that the failure of the auditors to report and follow up foreign exchange losses was deliberate or negligent. The auditors counter-claimed against AWA, the CEO, the non-executive directors and the banks. Rogers CJ held that the auditors were in breach of their duties of care; that the CEO was in breach of his duties and had to contribute to the damages; that AWA should bear 20% of the liability; but that the non-executive directors were not liable. On appeal the contribution was altered by apportioning damages one third to AWA and two thirds to the auditors.

The Court in the *AWA* appeal was unanimous in confirming the view that the non-executive directors were not in breach of their duty (affirming the decision of Rogers CJ), but it rejected Rogers CJ's formulation of the duty of enquiry concerning the extent to which non-executive directors could rely on management and officers to carry out board policy, by implication, on the basis that it set too low a standard.[47] Similar obligations appear to have been recognised under New Zealand case law, as evidenced by comments by Thorp J in *Jagwar Holdings Ltd v Julian* that "while directors ... have always been required to pay attention and give appropriate consideration to material placed before them ... (there may also be) special matters which should have alerted the directors to ... the need for some special enquiry on their part."[48]

Clause 10 of the Bill deals with reliance on information or advice provided by others, and establishes a rebuttable presumption that the director's reliance on information or advice in the

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46 See for example the discussion in R Baxt: "The Duty of Care of Directors – Does it Depend on the Swing of the Pendulum?": op cit n 2 at pp 95 et ff.

47 Rogers CJ had noted the right to rely on management supervision would have been displaced only where an individual director was aware of circumstances "of such a character, so plain, so manifest and so simple of appreciation that no person, with any degree of prudence acting on his behalf, would have relied on the particular judgment, information and advice of the officers"). The standard of care referred to in the *AWA* appeal (op cit n 10), was not "merely subjective, limited by the director's knowledge and experience or ignorance or inaction". The court quoted extensively from the leading US case of *Francis v United Jersey Bank* 432 A 2d 814 (1981) on the minimum standards expected of directors, who are required to maintain a minimum objective skill standard, and who have a continuing obligation to keep informed about corporate activities and a duty of enquiry arising in particular circumstances.

48 (1992) 6 NZCLC 68,040, 68,075; as cited by D Tan: op cit n 2 at p 450.

circumstances prescribed is reasonable. Essentially a director may rely upon information, or professional or expert advice given by:

(i) employees the director reasonably believes to be reliable or competent in the matters concerned, or

(ii) professional advisers or experts in relation to matters the director reasonably believes to be within that person's professional or expert competence, or

(iii) another director or officer in relation to matters within that person's authority, or

(iv) a committee of directors on which the director did not serve in relation to matters within the committee's authority,

provided the reliance was made in good faith and provided the director made proper inquiry if the circumstances indicated further inquiry was necessary.

The standard adopted under the proposed rule (that directors inform themselves "to the extent they reasonably believe to be appropriate") is similar to the ALI formulation of the rule. In this regard, Redmond provides a useful summary of the ALI's guidelines as to matters that may be relevant to assessing whether further inquiry by the board may be "appropriate", including:

i) the importance of the business judgment to be made;

ii) the time available for obtaining information;

iii) the costs related to obtaining information;

iv) the directors' confidence in those who explored a matter and those making presentations; and

v) the state of the corporation's business at the time and the nature of competing demands for the board's attention.[49]

Accordingly, circumstances in which a director or other officer may reasonably be considered to have informed themselves as to a particular business decision will depend on the relevant subject matter of that decision and whether they have received information which may reasonably be considered to "excite suspicion" such that additional enquiry is warranted.[50] From a practical

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49 Redmond: op cit n 2 at p 195, where he cites the American Law Institute's *Principles of Corporate Governance: Analysis and Recommendations* (1994) at p 177.

50 Redmond: Ibid at p 196, notes the ALI's guidelines indicate "different backgrounds of individual directors, the distinct role each plays in the corporation, and the general value of maintaining board cohesiveness may all be relevant when determining whether a director acted 'reasonably' in believing that the information before him or her was appropriate under the circumstances." Additional guidance from the US perspective is provided by Thomas S Richey: *Director and Officer Liability: Red Flags, Business Judgment and the Standard of Care*, memorandum published by the firm of Powell, Goldstein, Frazer & Murphy LLP, where the author suggests the following examples of sources or forms of information should "excite suspicion" under the US business judgment rule and require enquiry, and potentially action, by the board: i) reports from internal or independent auditors, or unexplained or unreasonable delays in receiving reports; ii) adverse trends which show up in management reports on production, sales, revenues or expenses; iii) anomalies appearing in regularly distributed financial information (such as interim financial statements which suggest adverse business developments, unauthorised expenditures or inadequate controls); iv) observations or reports regarding the conduct of officers in either their business or personal lives which call into question their competence, judgment or integrity; v) inconsistencies in statements made or positions taken by officers which raise questions regarding their veracity; vi) press reports or inquiries, inquiries by shareholders or analysts which suggest breaches of confidentiality; vii) actions by management without necessary board approval or exceeding authority set out in board policies or resolutions;

perspective, it may also be prudent to document any action taken to verify that information, as this will help to establish that the decision qualifies for protection under the rule.

5. *In a rational belief that the action was in the best interests of the corporation*

In order to obtain the protection of the statutory business judgment rule the decision-maker must act in a manner that they honestly believe to be in the best interests of the corporation.

First, subclause 2(2) provides that a belief that the decision is in the best interests of the corporation will be a reasonable one "unless ... (it is) one that no reasonable person in their position would hold". Secondly, subclause 2(2) refers only to the "best interests of the corporation" and not to the shareholders or creditors. The Commentary on the New Provisions indicates that it will be assumed that the decision-maker's belief that a business decision is in the best interests of the corporation is a rational belief unless no reasonable person in the position of the decision-maker could hold that belief.[51]

Effect of the Business Judgment Rule

To re-iterate, the rule will act as a presumption in favour of directors and other officers where they have made, in short, bona fide business decisions. The onus is on the plaintiff who is challenging a decision to rebut the presumption that a decision was not in good faith. Where the presumption of good faith business judgment is not rebutted, the substantive effect of the rule is to validate the corporate decision.

Is the proposed rule really a "safe harbour" and if it is, does it provide any greater defence than the common law position?

The statutory business judgment rule begins with an assumption that in making business decisions directors and other officers have acted in good faith for a proper purpose, without a material personal interest, on an informed basis, and in a rational belief that the decision is in the best interests of the corporation. If the criteria for the rule are satisfied the decision-maker will be taken to have satisfied their statutory and general law duty of care and diligence, thus avoiding a review of the reasonableness of the decision.

On one view this creates more certainty for directors than the position under the common law insofar as, absent either fraud or, in short, bad faith, they will not be challenged regarding the fulfilment of their duty of care and diligence. For example, Tan argues "(t)he legislative implementation of the business judgment rule will clarify the steps that a corporate officer ought to take in making a business judgment in order to be protected against claims that they have breached their duty of care if their decisions do not turn out well (and) at the same time it provides the courts with some guidance as to when the business judgment rule ought to be applied."[52]

If, however, a plaintiff can establish that the relevant decision-maker has failed to meet any one of the elements of the rule due to, for example, lack of good faith, failure to adequately inform themself, or fraud, the decision-maker will be denied the protection of the business judgment rule and the court will consider the decision.

There is a "safe harbour" from liability for decision-makers, but only to the extent that the decision-maker has met the preconditions to the operation of the rule. It does not provide blanket protection to directors and other officers from the possibility of legal challenge to decisions

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viii) management requests for board or committee decisions without providing sufficient time or information.

51 Op cit n 4 at p 42. The presumption is enshrined in the provisions dealing with derivative actions (see clause 111).

52 Tan: op cit n 2 at p 452.

involving business judgment. As noted by Redmond the requirement that the decision-makers inform themselves to the extent they "reasonably believe" to be appropriate in the circumstances (contained in subclause 2(2)(c) of the Bill) "... is susceptible to easier challenge (and) the terms of this prerequisite offer a safe, but by no means, assured harbour."[53]

Is the proposed rule likely to reduce the number of cases before the courts?

Certainly if a court makes a preliminary determination that in making a decision in the ordinary course of business, the decision-maker has acted in good faith and for a proper purpose, without material personal interest, on an informed basis and in the honest belief that the decision was in the best interests of the corporation, the decision-maker will be taken to have met the requirements of the statutory and general law duty of care and diligence. And, thus the matter will proceed no further.

It is arguable whether the rule will allow decision-makers any more comfort, at the point of decision-making, that they will be protected from hindsight review of the merits of their decision.[54]

If one accepts that the rule provides greater certainty as to the circumstances in which a director may avoid a breach of their statutory and general law duty of care and diligence then there may well be a benefit for directors and management, which will encourage responsible entrepreneurial decision-making and risk-taking. Similarly the rule may act as a deterrent to actions based on a breach of the duty of care and diligence, at least where it is prima facie evident that the decision-maker has complied with the rule's criteria.

It should also provide clearer guidance to the courts, when called upon to consider whether there is a cause of action for an alleged breach of the duty of care and diligence, as to the circumstances where it may make a preliminary determination that the criteria under the rule were met by the decision-maker (and thus look no further into the merits of the relevant business decision). Of course there is always a concern that the courts may interpret the criteria in that rule in ways which are not anticipated.

Finally, there is also the positive prospect that statutory confirmation of a "safe harbour" for directors who have complied with the criteria of the business judgment rule may encourage boards to be more open with shareholders as to their decision-making processes.

SCOPE OF THE RULE

As indicated earlier in this paper, the operation of the Australian statutory business judgment rule is confined to the duties of care and diligence under the replacement provisions for subsection 232(4) of the existing Corporations Law, and the equivalent common law duty, in relation to instances involving business decisions made about the *ordinary business operations of the company.*

Directors' decisions remain subject to review in a number of areas of the Corporations Law. The accompanying Commentary on the New Provisions notes that the rule "will not apply, for example, to business decisions made by directors in the context of insolvent trading [see section 588G of the Corporations Law] or in relation to misstatements in a prospectus or takeover document."[55] Consider also the potential scope for review of directors' decisions in relation to actions brought for minority oppression under section 260 of the Corporations Law (which is being renumbered, although it remains substantively the same).

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53 Redmond: op cit n 2 at p 203.

54 An argument put forward by Redmond: op cit n 2 at p 204.

55 Op cit n 4 at p 42.

Statutory Derivative Action

Satisfaction of the requirements of the business judgment rule in the context of the proposed statutory derivative action provisions under Part 2F.1A of the Bill will merely establish a rebuttable presumption that granting leave to an applicant to bring, or intervene in, proceedings between the company and a third party is not in the "best interests of the company".

An applicant may still tender evidence to rebut that presumption and if the Court is satisfied overall that:

- the company will not itself bring an action,
- the applicant is acting in good faith,
- granting leave is in the "best interests of the company",
- and there is a serious question to be tried, (see subclause 111(2) of Part 2F.1A of the Bill),

the court must grant the application.[56] This allows the court to consider a board's decision not to bring, not to defend or to settle proceedings on behalf of the company and, even though the board may have satisfied the business judgment criteria in reaching its decision, the court has an overriding discretion to determine that it is in the "best interests of the company" to grant the application.[57]

EARLY REACTIONS TO THE DRAFT FORMULATION

Initial responses as to the likely effect of the proposed statutory business judgment rule vary greatly, although the general consensus in the business sector is that the proposed reform is to be welcomed.

Detractors seem to believe that the reform is an unwarranted increase in the defences available to directors and corporate officers which is unlikely to improve the performance of Australian boards. In response to such arguments, it has been suggested that:

> "(t)he idea that the proposals offer additional protection to directors is ... misconceived. It is true that the Australian Institute of Company Directors has lobbied for the introduction of a statutory business judgment rule and that the government's decision to introduce one will

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56 Clauses 110 to 116 of the Bill deal with derivative actions. A person wishing to bring an action on behalf of a company (where the company is unwilling or unable to do so) may apply for leave from the court to do so (subclause 111(1)). The court must grant the application if it is satisfied as to certain criteria (subclause 111(2)) which, according to the Commentary on the New Provisions, are intended to prevent actions which lack merit. Under the second and third criteria the court may refuse to grant leave in circumstances where the applicant is unable to show that it is in the best interests of the company. Subclause 111(3) establishes a rebuttable presumption that granting the application is not in the best interests of the company if all the directors who participated in the decision (not to bring, not to defend or to settle proceedings involving a third party) satisfy criteria identical to those in the statutory business judgment rule.

57 According to CLERP Paper No 3 (op cit n 4 at p 67), the "best interests of the company" criterion is intended to "... allow the court to focus on the true nature and purpose of the proceedings (and) would recognise that a company might have sound business reasons for not pursuing the cause of action open to it and that its management might legitimately have decided that the best interests of the company would be served by not taking action." On that basis it is difficult to imagine circumstances in which the board has met the criteria of the business judgment rule, that is, the business decision was made in good faith, for a proper purpose etc, yet the court finds the subsequent presumption (that granting leave to bring, or intervene in, proceedings is not in the best interests of the company) rebutted.

> be welcomed by many directors. But Australian court judgments have always been consistent with the proposed rule, and putting it into legislation will not offer directors any actual increase in protection."[58]

Supporters argue that the reform is a critical step in removing the uncertainties surrounding the limits of directors' duties, and will ensure directors and other officers are able to exercise their responsibilities and undertake sensible, legitimate risk-taking. They support the stated rationale for the rule that excessive liabilities can have a negative impact on the competitiveness of corporations, for example if they serve to discourage innovative or entrepreneurial decision-making, or limit the number of qualified people who are willing to serve on corporate boards.

Further, supporters say that under the proposed formulation of the rule directors and other officers will have confidence that if they have exercised their decision-making powers according to the requisite criteria, that is, in good faith for a proper purpose, without a material personal interest in the subject matter of the decision, on a properly informed basis, and in what they rationally believe to be in the best interests of the corporation, they will not be exposed to unreasonable legal challenge with the benefit of hindsight. For example, Ian T Dunlop, the Chief Executive Officer of the Australian Institute of Company Directors has commented that:

> "... as a result of a series of inconsistent and unhelpful court decisions in recent times, businesses have incurred extraordinary expense and directors have been placed in a position of great uncertainty in regard to their obligations and responsibilities .... The business judgement rule will not insulate directors from the compliance aspects of liability for negligent, ill-informed or fraudulent decisions. The introduction of legislation of this kind is in the interests of companies and shareholders alike. At a time when risk-taking must be encouraged, current uncertainty is leading to a risk-averse attitude which corporate Australia can ill-afford."[59]

Similarly, Gilbert & Tobin partner John Williamson-Noble has suggested that, while the proposed statutory derivative action is likely to result in more actions being brought against directors, the business judgment rule offers a level of comfort to directors in that it "will provide them with greater confidence they will have a defence."[60] On this view the proposed rule strikes a balance between the competing values of risk encouragement and accountability without weakening the standard of care and thereby eroding shareholders' rights.

CONCLUSION

Prima facie the business judgment rule will bring clarity to the standard required of directors and other company officers in the exercise of their powers and the discharge of their duty of care and diligence. It will focus the attention of directors and management on the process of decision-making and will increase the level of responsibility and accountability on the part of management, on whom directors will be relying to discharge their duty of being properly informed. It may be anticipated that more questions and enquiries will be directed to management.

However, the rule will be yet another piece of regulation governing an already heavily regulated field of commercial enterprise.

The law in relation to directors' (and other officers') liabilities is particularly complex. For example, directors have numerous other obligations under the Corporations Law, including obligations relating to dealings with financial benefits to related parties of public companies; the duty to ensure proper accounts are maintained by the company; duties relating to financial statements and directors' reports; the duty to prevent insolvent trading by a company; duties in relation to

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58 H Bosch: op cit n 3 at p 58.

59 Ian T Dunlop: Letter to the *Australian Financial Review* dated March 1998.

60 From commentary published on Gilbert & Tobin's web site.

general meetings and directors' meetings; duties in relation to disclosure of information in prospectuses; duties in relation insider trading; disclosure requirements in relation to takeovers etc. Consider also the potential impact on directors' duties under proposed changes under the Managed Investments Bill 1997, which will dispense with the use of a separate trustee and manager for public unit trust schemes, replacing them with a single "responsible entity."[61] In addition, directors' liabilities under the Superannuation Industry (Supervision) Act 1993 (for directors of a trustee company or investment manager); the Life Insurance Act 1995 (for directors of a life company); the Insurance (Agents and Brokers) Act; the Insurance Contracts Act 1984; as well as other miscellaneous statutes, for example, the Trade Practices Act (eg for misleading and deceptive conduct).

There is the real risk that the laws governing directors are becoming so prescriptive that they could stifle the competitive and entrepreneurial spirit which has seen the growth of many successful enterprises in Australia. In that regard the business judgment rule may act as a restraint upon entrepreneurial decision-making (the very justification for enactment of the business judgment rule), at least initially, until its boundaries are clearly settled.

61 The "responsible entity" will have legal status as a trustee, with full control and responsibility for management of the trust, and will be subject to fiduciary obligations under the general law of trusts, as well as statutory performance obligations to act honestly, in the best interests of members, exercising the care and diligence a reasonable person would exercise if they were in the responsible entity's position, etc. Officers and employees of the responsible entity, and compliance committee members, will be subject to performance obligations mirroring those of the responsible entity (with civil sanctions applying). For a detailed discussion of the key features of the Managed Investments Bill 1997, see P Hanrahan: "(Ir)responsible Entities: Reforming Manager Accountability in Public Unit Trusts" 16 *CSLJ* 76.

ANNEXURE "A" – TO THE PAPER PRESENTED BY BETTIE McNEE

AMERICAN LAW INSTITUTE PRINCIPLES OF CORPORATE GOVERNANCE

Section 4.01 of the American Law Institute Principles of Corporate Governance provides, among other things, that:

(a) A director or officer has a duty to the corporation to perform the director's or officer's functions in good faith, in a manner that he or she reasonably believes to be in the best interests of the corporation, and with the care that an ordinarily prudent person would reasonably be expected to exercise in a like position and under similar circumstances. This Subsection (a) is subject to the provisions of Subsection (c) (the business judgment rule) where applicable.

(1) The duty in Subsection (a) includes the obligations to make, or cause to be made, an enquiry when, but only when, the circumstances would alert a reasonable director or officer to the need therefor. The extent of such enquiry shall be such as the director or officer reasonably believes to be necessary.

...

(c) A director or officer who makes a business judgment in good faith fulfils his duty under this Section if the director or officer:

(1) is not interested in the subject of the business judgment;

(2) is informed with respect to the subject of the business judgment to the extent the director or other officer reasonably believes to be appropriate under the circumstances; and

(3) rationally believes that the business judgment is in the best interests of the corporation.