

THE AUSTRALIAN BUSINESS JUDGMENT RULE AFTER *ASIC v RICH*: BALANCING DIRECTOR AUTHORITY AND ACCOUNTABILITY

ABSTRACT

The decision in *Australian Securities and Investments Commission v Rich* (2009) 236 FLR 1 (*ASIC v Rich*) has resurrected the business judgment rule in Australian corporate law, so that the rule is capable of providing a defence in some cases that would otherwise amount to a breach of a director's duty. This article reviews the controversial elements of the business judgment rule that were determined in *ASIC v Rich*, namely: (a) which party should bear the onus of proof in raising the defence; (b) what is required for a director to be informed about the subject matter of the judgment; and (c) is the standard that the director's judgment must meet to be in the best interests of the corporation one of rationality or reasonableness? The article concludes that the balance currently struck between a director's authority and accountability is weighted too heavily towards the former and, as a result, requires further reform.

I INTRODUCTION

The decision by Austin J in *Australian Securities and Investments Commission v Rich* (2009) 236 FLR 1 (*ASIC v Rich*) substantially redrew the contours of the business judgment rule in Australia. This article discusses the business judgment rule — and the decision in *ASIC v Rich* — through a focus on three main issues that are central to ensuring the striking of an effective balance between directors' authority and accountability, namely:

- Which party should bear the onus of proof in raising the defence?
- What is required for a director to be informed about the subject matter of the judgment?
- Is the standard that the director's judgment must meet to be in the best interests of the corporation one of rationality or reasonableness?

This article discusses these issues, and the struggle to strike an appropriate balance between competing policy concerns, with reference to the historical

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development of the business judgment rule in Australia. This is supplemented by a review of the American Law Institute's ('ALI') *Principles of Corporate Governance*,¹ a key source for both the design of the business judgment rule in Australia, and Austin J's decision in *ASIC v Rich*.

II BACKGROUND

To understand the application of the business judgment rule in *ASIC v Rich*, and the current state of Australian law in this area, it is crucial to understand both the origins of the rule, and its application and treatment in the period between its introduction and *ASIC v Rich*.

A The Introduction of the Business Judgment Rule in Australia

Directors today are on the front line. So far as exposure to liability is concerned, the 'exposures' are increasing in both the criminal and the civil areas.²

The above words, quoted by the 1989 Cooney Report,³ clearly indicate the fear⁴ felt by Australian directors in regards to both criminal and civil liability at this time, due to what was perceived to be the subjective interpretation of the obligation on directors to exercise skill and care in the performance of their duties. The Cooney Report thus recommended the establishment of a clear objective duty of care for directors in Australian companies legislation.⁵ An objective standard was defined by the Cooney Report as 'one that all individuals would be expected to meet, regardless of their particular capacities and circumstances'.⁶

¹ ALI, *Principles of Corporate Governance: Analysis and Recommendations* (American Law Institute Publishers, rev ed, 2002).

² Kenneth McPherson, 'Directors' Responsibilities — A Regulator's Perspective' (Address delivered to the Company Directors Seminar, Adelaide, 1 June 1989), quoted in Senate Standing Committee on Legal and Constitutional Affairs, Parliament of Australia, *Company Directors' Duties* (1989) 27 [3.22] ('Cooney Report').

³ Cooney Report, above n 2.

⁴ This fear was compounded by the fact that the only common law protection afforded to directors in regards to their liability for business decisions was judicial reticence regarding the review of business judgments. See, eg, *Harlowe's Nominees Pty Ltd v Woodside (Lakes Entrance) Oil Co NL* (1968) 121 CLR 483, 493:

[d]irectors 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 considerations, and their judgment, if exercised in good faith and not for irrelevant purposes, is not open to review in the courts.

And see: *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821, 832: 'courts of law [will not] assume to act as a kind of supervisory board over decisions within the powers of management honestly arrived at'.

⁵ The Cooney Report found that although s 229 of the *Companies Code* (the then principal statutory provision which governed the duties of company officers) on its face imposed an objective standard, the test being applied by the courts was a subjective one.

⁶ Cooney Report, above n 2, 25 [3.19].

In fleshing out this objective standard, the Cooney Committee considered adopting a business judgment rule similar to that developed by courts in the United States that provided special protection to directors' informed business decisions.⁷ The policy underlying a business judgment rule is said to be to recognise the need for directors to engage in considered risk taking and to protect the directors when those risks are part of an informed business judgment.⁸ The Cooney Committee recommended that a business judgment rule be introduced into Australian company law, that it should oblige directors to inform themselves of matters relevant to the administration of the company, and that directors 'should be required to exercise an active discretion in the relevant matter or, alternatively, to show a reasonable degree of care in the circumstances'.⁹

The federal government responded to the recommendations of the Cooney Committee by amending the Corporations Law¹⁰ to 're-enforce that the duty of care is an objective one, requiring a company officer to exercise the degree of care and diligence that a reasonable person in a like position as the officer of a corporation would exercise in the corporation's circumstances'.¹¹ However, these amendments to the Corporations Law did not include the introduction of a statutory business judgment rule, prompting Senator Hill, then in opposition, at the Second Reading of the Bill to say:

The Coalition would have preferred that the Bill also introduce a statutory business judgment rule. The advantage of such a rule is that it provides certainty for directors. Corporate law should encourage, and afford broad protection to, informed business judgments in order to stimulate risk taking and innovation and to give directors the confidence to make commercial decisions on their true merits.¹²

⁷ Ibid 29–30 [3.30].

⁸ See, eg, *ASIC v Maxwell* (2006) 59 ACSR 373; *ASIC v Macdonald [No 11]* (2009) 256 ALR 199, 245 [236]; *ASIC v Rich* (2009) 236 FLR 1, 128–9.

⁹ Cooney Report, above n 2, 31 [3.35] (emphasis added). The Cooney Report observed: American courts have developed a 'business judgment rule' which provides special protection to directors informed business decisions. The American Law Institute has devised a relatively precise formulation which is consistent with the rule developed by the courts which avoids much of the confusion that has arisen from the various ways in which the courts have started to rule. The main feature of the rule that the American Law Institute proposes is that a 'safe harbour' is created for a director or officer who makes a business judgment in good faith if: (a) he or she has no personal interest in the subject of the business judgment rule; (b) he or she is informed to an appropriate extent about the subject of the business judgment; and (c) he or she rationally believes that the business judgment is in the best interests of the company.

¹⁰ This is a reference to the coordinated legislation of 1990 whereby the Commonwealth and the states sought to produce a national system of regulation by each enacting the same legislation. It continued until 2001 when the states referred their powers to the Commonwealth. The relevant Acts were the *Corporations Act 1989* (Cth), with each state and territory enacting separate legislation: see, eg, *Corporations (Victoria) Act 1990* (Vic).

¹¹ Explanatory Memorandum, Corporate Law Reform Bill 1992 (Cth) 23 [82]. The new s 232(4) became effective on 1 February 1993.

¹² Commonwealth, *Parliamentary Debates*, Senate, 17 December 1992, 5297 (Robert Hill).

In 1997, the new federal government released its Corporate Law Economic Reform Program ('CLERP') policy papers. One of the areas proposed for reform was directors' duties. The then Treasurer, Mr Costello, spoke of the perceived difficulties in finding an appropriate balance between encouraging risk taking and ensuring the protection of investors. Prominent amongst the issues raised in the CLERP policy papers was the appropriateness of a proposal to develop a statutory business judgment rule.

The Explanatory Memorandum to the CLERP Bill 1998 stated that 'the fundamental purpose of the business judgment rule is to protect the authority of directors in the exercise of their duties, not to insulate directors from liability'.¹³ The Explanatory Memorandum also stated that the proposed statutory formulation of the business judgment rule would 'clarify and confirm the common law position that the Courts will rarely review bona fide business decisions'.¹⁴ Furthermore, under the proposed CLERP legislation, provided directors fulfilled their requirements, they would have an explicit safe harbour for any breach of their duty of care and diligence, and the merits of their business judgments would not be the subject of review by the Courts. The business judgment rule would therefore act as a rebuttable presumption in favour of directors which, if rebutted, would still require a plaintiff to establish that the directors breached their duty of care and diligence.¹⁵

The business judgment rule anticipated by the CLERP policy papers was inserted into the Corporations Law¹⁶ in March 2000. It provided:

180(2) — Business Judgment Rule

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

- (a) make the judgment in good faith for a proper purpose; and
- (b) do not have a material personal interest in the subject matter of the judgment; and
- (c) inform themselves about the proper subject matter of the judgment to the extent they reasonably believe to be appropriate; and
- (d) rationally 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.¹⁷

¹³ See Explanatory Memorandum, Corporate Law Economic Reform Program Bill 1998 (Cth) 17 [6.3].

¹⁴ Ibid 17 [6.4].

¹⁵ Ibid 18 [6.9].

¹⁶ See above n 10.

¹⁷ *Corporate Law Economic Reform Program Act 1999* (Cth) sch 1 (13 March 2000), inserting the provision at s 180(2).

Notwithstanding the introduction of a statutory business judgment rule in Australia, it is fair to say that, to date, it has not provided the certainty for directors which Senator Hill spoke of in such an aspiring manner in 1992.

*B From Enactment to ASIC v Rich: The Business Judgment Rule
Between 2000–09*

In the period between the introduction of the business judgment rule in 2000 and the case of *ASIC v Rich* in 2009, the business judgment rule had not been successfully invoked.¹⁸ However, the Australian Securities and Investments Commission's ('ASIC') high profile prosecution of former HIH Insurance Ltd directors Rodney Adler, Raymond Williams and Dominic Fodera saw an unsuccessful attempt to invoke the business judgment defence, as the NSW Supreme Court found that no actual decision had been made that could attract the operation of the rule.¹⁹

This failure to successfully invoke the business judgement rule was accompanied by criticism of the scope of the rule, most notably in the June 2007 submission to Treasury by the Australian Institute of Company Directors ('AICD'). The AICD argued that senior, experienced, and potential directors, particularly recently retired senior executives, were shying away from board positions especially in the listed environment, because of concerns about personal liability risks and damaged reputations arising from claims against them. Further, many directors were thought by the AICD to be forming the view that there was no longer a fair balance between risk and reward, or that the risks were exceeding the rewards of directorships.²⁰

In November 2007 in a speech to AICD members, the then-Chairman of ASIC Mr Tony D'Aloisio appeared to throw his weight behind the AICD view. He stated that 'it may be time ... to assess this balance between ensuring our boards take risks (so that our economy keeps growing) with protection of shareholders and creditors and consumers where individual liability may be appropriate'.²¹

In 2008, Professor Robert Baxt also indicated his support for the AICD position, and joined calls for law reform initiatives to relax director duties and encourage entrepreneurial spirit. Professor Baxt recommended governmental consideration of

¹⁸ H A J Ford, R Austin and I Ramsay, LexisNexis, *Ford's Principles of Corporations Law* (at August 2013) [8.310].

¹⁹ *ASIC v Adler* (2002) 41 ACSR 72, 173, 175–176, 196. See also *Gold Ribbon (Accountants) Pty Ltd (in liq) v Sheers* [2006] QCA 335, [186], [247].

²⁰ AICD, Submission to Corporations and Financial Services Division of The Treasury, *Review of Sanctions for Breaches of Corporate Law* (June 2007) 3. See also Australian Government, *Review of Sanctions in Corporate Law* (March 2007).

²¹ Tony D'Aloisio, 'An Update on ASIC's Priorities for 2007/2008 and How These Relate to AICD Members' (Paper presented at the AICD Luncheon, Sydney, 26 November 2007) <<http://www.asic.gov.au>>.

a new and improved business judgment rule, which would apply not only to s 180 of the *Corporations Act* but also to other provisions such as insolvent trading.²²

However, not all commentators writing in this period believed that a more extensive business judgment rule was necessary. The most prominent criticism was that a revamped business judgment rule would remain under-used as it would continue to require the defence to disprove the elements contained in the directors' duties provisions with the burden of proof shifting to the director.²³ For example, Neil Young QC noted that directors already have recourse to s 1318 of the *Corporations Act*, whereby if a director demonstrates to the Court that he or she has acted honestly, and in the circumstances ought fairly to be excused, the director may be excused by the court from civil liability for negligence, default, breach of trust, or breach of duty. Young cited the decision of Palmer J in *Hall v Poolman*²⁴ as demonstrating the capacity of courts to excuse directors from liability when they make honest mistakes.²⁵

²² Robert Baxt, 'Forgiving Directors for Insolvent Trading — Some Promising Signs' (February 2008) *Company Director Magazine* 48. The Federal Government subsequently issued the discussion paper: Corporations and Financial Services Division, The Treasury, *Insolvent Trading: A Safe Harbour for Reorganisation Attempts Outside of External Administration*, Discussion Paper (2010) which sought comment on a proposal to enact a business judgment rule in respect of the director's duty to avoid insolvent trading.

²³ Neil Young, 'Has Directors' Liability Gone Too Far or Not Far Enough? A Review of the Standard of Conduct Required of Directors Under Sections 180 to 184 of the *Corporations Act*' (2008) 26(4) *Companies and Securities Law Journal* 216, 223.

²⁴ (2007) 215 FLR 243. In *Hall v Poolman*, Palmer J found that a director's contravention of s 588G(2) should be wholly relieved pursuant to ss 1317S and 1318 for a specified period of time. See also *Re McLellan; The Stake Man Pty Ltd v Carroll* (2009) 76 ACSR 67, excusing pursuant to s 1317S(2) a sole director of a company from contravention of the insolvent trading provisions.

²⁵ Young, above n 23, 222–3. However, it is worth noting the disadvantages of seeking relief under s 1318, including the uncertainty of obtaining the desired outcome, given judicial discretion, and the differing consequences for a director's reputation to seeking relief from liability under s 1318 rather than using the business judgment rule defence to prevent a finding of breach of duty. Furthermore, a survey of the use of s 1318 indicates its limited success in Australian law, thus reducing its attractiveness: see Steven Wong, 'Forgiving a Director's Breach of Duty: A Review of Recent Decisions' (Research Report, Centre for Corporate Law and Securities Regulation, 1 December 2008) 6 <http://www.law.unimelb.edu.au/files/dmfile/stevenwong_essay_6_May_20091.pdf>. See also Jason Harris, 'Relief from Liability for Company Directors: Recent Developments and Their Implications' (2008) 12 *University of Western Sydney Law Review* 152. Most recently, the case of *ASIC v Healey [No 2]* [2011] FCA 1003 (31 August 2011) demonstrated judicial reluctance to grant relief under s 1317S or s 1318 once directors have been found to have breached their duty. Justice Middleton held that 'the seriousness of the contraventions preclude[d] [him] from exercising discretion to relieve any of the defendants from liability, having regard to the principles of general deterrence': at [133].

Subsequently, Young expressed the view that directors should be held to ‘a fairly high standard of reasonable care and diligence’ as the company board is the responsible corporate organ for managing the affairs of the company, and the law should aim to set norms of behaviour that will deter unwanted conduct.²⁶ Furthermore, Young has probed the utility of the business judgment rule in s 180(2), questioning whether a director who has made a decision in good faith and for a proper purpose, has properly informed him or herself, and the decision is rational, could nevertheless be in breach of s 180(1).²⁷

It was in this context and against this background of criticism that the decision of Austin J in *ASIC v Rich* was handed down on 18 November 2009. However, before turning to the findings in the judgment, it is important to review the experiences of the United States in applying the business judgment rule, given the statements of many commentators, as well as Austin J himself, that the Australian business judgment rule in s 180(2) was largely drawn from the ALI’s statement of the business judgment rule.²⁸

III THE ALI’S BUSINESS JUDGMENT RULE

The business judgment rule has existed in American corporate law for almost two centuries.²⁹ However, in 1992, the ALI sought to formulate a standard business judgment rule based on that historical development set out in para 4.01(c) of its *Principles of Corporate Governance*.³⁰

The ALI’s business judgment rule is based largely on two rationales. First, it protects directors from shareholders second guessing directors’ decisions with the benefit of hindsight. In line with Australian concerns, American commentators fear that directors might not take calculated risks, or even serve on boards, if they are open to derivative litigation as a result of every failed board decision. Secondly, it has

²⁶ Neil Young, ‘Directors Duty of Care and Diligence: A Review in Light of the Recent Decision in *ASIC v MacDonald (No 11)*’ in R P Austin and A Y Bilski (eds), *Directors in Troubled Times* (Ross Parsons Centre of Commercial, Corporate and Taxation Law, 2009) 94.

²⁷ *Ibid* 81.

²⁸ *ASIC v Rich* (2009) 236 FLR 1, 146 [7256]–[7257]; Ford, Austin and Ramsay, above n 18, [8.310]; Cooney Report, above n 2, 31 [3.35]; Companies and Securities Law Review Committee, *Company Directors and Officers: Indemnification, Relief and Insurance*, Discussion Paper No 9 (1990) 32 [69].

²⁹ S Samuel Arsht, ‘The Business Judgment Rule Revisited’ (1979) 8 *Hofstra Law Review* 93; *Percy v Millaudon*, 8 Mart (ns) 68, 77–78 (La, 1829); *Godbold v Branch Bank at Mobile*, 11 Ala 191, 199 (1847).

³⁰ ALI, above n 1, 166. ‘The formulation of the business judgment rule set forth in paragraph 4.01(c) is believed to be consistent with present law as it would be interpreted in most jurisdictions today, and each of the rule’s basic elements (paragraph 4.01(c)(1)–(3)) is supported by substantial precedential authority’; R P Austin, H A J Ford and I M Ramsay, *Company Directors: Principles of Law and Corporate Governance* (LexisNexis Butterworths, 2005) 242–3 [6.12].

been said that directors are better suited than courts to make business decisions, and thus the rules protect directors from liability for honest mistakes of judgment or unpopular business decisions.³¹

Paragraph 4.01(c) states that:

A director or officer who makes a business judgment in good faith fulfils the duty [of care] ... 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 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.³²

A comparison with s 180(2) demonstrates a close resemblance to the Australian business judgment rule, except that the ALI's version does not have the 'qualification' that follows s 180(2)(d) regarding a view that 'no reasonable person' would possess. Further, para 4.01(d) provides that a person challenging the conduct of a director or officer under this section has the burden of proving a breach of the duty of care, including the inapplicability of the provisions as to the fulfilment of duty under para 4.01(c), and, in a damages action, the burden of proving that the breach was the legal cause of damage suffered by the corporation.³³

A Prerequisite of a Conscious Exercise of Judgment

The ALI states that to be afforded the protection of the business judgment rule, a decision must have been consciously made and judgment must, in fact, have been exercised. The Delaware case of *Aronson v Lewis*,³⁴ consistent with the ALI's formulation, held that

³¹ ALI, above n 1, 130–1; Ann Scarlett, 'Confusion and Unpredictability in Shareholder Derivative Litigation: The Delaware Court's Response to Recent Corporate Scandals' (2008) 60 *Florida Law Review* 589, 600.

³² ALI, above n 1, 134.

³³ *Ibid.* See also Austin, Ford and Ramsay, above n 30, 238–9 [6.7]. The ALI formulation is not the only way in which the business judgment rule is expressed in the US, but it is the formulation that was relied on for the drafting of s 180(2). For another formulation, see, eg, *Robotti & Co LLC v Liddell*, 2010 Del Ch LEXIS 4, 46–7:

The business judgment rule, as a general matter, protects directors from liability for their decisions so long as there exist 'a business decision, disinterestedness and independence, due care, good faith and no abuse of discretion and a challenged decision does not constitute fraud, illegality, ultra vires conduct or waste'. There is a presumption that directors have acted in accordance with each of these elements, and this presumption cannot be overcome unless the complaint pleads specific facts demonstrating otherwise. Put another way, under the business judgment rule, the Court will not invalidate a board's decision or question its reasonableness, so long as its decision can be attributed to a rational business purpose.

³⁴ 473 A 2d 805 (Del, 1984).

‘the business judgment rule operates only in the context of director action ... it has no role where directors either abdicated their functions, or absent a conscious decision, failed to act’.³⁵ Further, *Kaplan v Centex Corp* noted that it must be shown ‘that [the] director[’s] judgment was brought to bear with specificity on the transactions’.³⁶

In other words, the business judgment rule will not protect directors in situations where no business decision-making has occurred, including those situations where directors have failed to contemplate the need for a decision to be made.³⁷

B Prerequisite of Good Faith and No Interest

Good faith and disinterested decision-making are prerequisites for the application of the business judgment rule’s safe harbour.³⁸ Good faith has been interpreted to mean that a decision is motivated by acting in the corporation’s best interest, whilst disinterested decision-making means that the director does not have a conflict of interest.³⁹ To render the business judgment rule inapplicable, the party challenging a decision has the onus of establishing a lack of good faith and disinterested decision-making. If this challenge is successful, then the ‘burden shifts to the director to prove that the transaction was found reasonable to the corporation’.⁴⁰

There have been some suggestions that a good faith standard alone should suffice for a director’s actions to be protected. However, the ALI maintains that courts have articulated that a mere good faith test may, depending on the court’s interpretation of that test, provide too much insulation for directors and officers.⁴¹

C Prerequisite of an Informed Decision

Directors are required to inform themselves prior to making the business decision of all material information reasonably available to them.⁴² This informed decision

³⁵ Ibid 813.

³⁶ *Kaplan v Centex Corp*, 284 A 2d 119, 124 (Del Ch, 1971).

³⁷ ALI, above n 1, 167–8. This includes situations involving omissions. For example, the ALI offers the example of directors failing to even consider the need for an effective audit process to prevent executives from absconding with corporate funds as a scenario where para 4.01(c) will not protect directors — as the directors in question will have failed to make a decision attracting the application of the business judgment rule.

³⁸ Ibid 169.

³⁹ Dennis J Block, Nancy E Barton and Stephen A Radin, *The Business Judgment Rule: Fiduciary Duties of Corporate Directors* (Prentice Hall Law & Business, 3rd ed, 1989) 13–17, 19.

⁴⁰ ALI, above n 1, 169–170, citing *Treadway Companies Inc v Care Corp*, 638 F 2d 357, 382 (2nd Cir, 1980).

⁴¹ Ibid 174.

⁴² Ibid 170. See also *Casey v Woodruff*, 49 NYS 2d 625, 643 (Sup Ct, 1944); *Miller v American Telephone & Telegraph Co*, 507 F 2d 759, 762 (3rd Cir, 1974); *Treadway Companies Inc v Carecorp*, 638 F 2d 357, 384 (2nd Cir, 1980).

prerequisite focuses on the preparedness of a director or officer in making a business decision, as opposed to the quality of the decision itself.⁴³

The ALI lists the following factors that may have to be taken into account in judging a director's reasonable belief about what was 'appropriate under the circumstances':

- (a) the importance of the business judgment to be made;
- (b) the time available for obtaining information and deciding the extent to which he or she should be informed;
- (c) the costs related to obtaining information;
- (d) the director's confidence in those who explored a matter and those making presentations;
- (e) the state of the corporation's business at the time and the nature of competing demands for the board's attention;
- (f) the different backgrounds and experience of individual directors, the distinct role each plays in the corporation, and the general value of maintaining board cohesiveness; and
- (g) the general views or specialised experience of colleagues.⁴⁴

The classic American example of failing to make an informed decision is encapsulated in *Smith v Van Gorkom*,⁴⁵ where the board approved a merger after only two hours of consideration, relying on a 20 minute presentation by the CEO who had arranged the merger, and despite the advice of senior management that the offer was too low.

D The 'Rationally Believes' Requirement

The ALI states that if the requirements of 'good faith' and para 4.01(c)(1)–(2) are met, the business judgment rule will protect a director or officer from liability for a business judgment provided the director or officer actually believes that the business judgment is in the best interests of the corporation, and that belief is rational.⁴⁶ This rational belief test is the ALI's amalgam of various formulations used in various US jurisdictions, such as 'egregious', 'reckless', and 'irrational', to denote a decision which no person of ordinary sound business judgment would make.⁴⁷

In ascertaining the ALI's perspective on how this test should be interpreted, the ALI describes Delaware case law as establishing that 'gross negligence is the standard to

⁴³ ALI, above n 1, 170.

⁴⁴ Ibid 171.

⁴⁵ 488 A 2d 858 (Del, 1985).

⁴⁶ ALI, above n 1, 172.

⁴⁷ Charles Hansen, 'The Duty of Care, The Business Judgment Rule and the American Law Institute Corporate Governance Project' (1993) 48 *Business Lawyer* 1355, 1375.

be applied in deciding ... whether the directors may be held liable for reaching the wrong decision',⁴⁸ and that the rational belief standard may be similar to an absence of gross negligence.⁴⁹ Conversely, Californian case law supports the view that a director or officer's business judgment must be 'reasonable' to be protected.⁵⁰

However, the ALI states that sound public policy dictates that directors and officers should be given greater protection than a 'reasonableness' test would afford.⁵¹ The ALI's policy is not clearly specified, but appears to be that the rational belief test provides a 'significantly wider range of discretion'⁵² than 'reasonable', whilst also accommodating some objective element, as seen in the Delaware 'gross negligence' test.⁵³

E Process v Substance Approach

The ALI draws a distinction between the level of judicial scrutiny of the director's decision itself, and review of the process the directors used to arrive at the decision. The ALI approach limits judicial scrutiny of the substance of the director's decision. However, the ALI formulates a standard of reasonable belief regarding the process the director uses to reach the decision, or, more specifically, whether the director gathered adequate information before acting. When it comes to the substance of the director's decision, however, the ALI's version of the business judgment rule lowers the standard of care to a rational belief.⁵⁴

F Onus of Proof

The ALI formulation places the burden of proving the failure of a director to comply with the duty of care, including the inapplicability of the business judgment rule in para 4.01(c), on the party challenging the director's conduct.⁵⁵

⁴⁸ ALI, above n 1, 173.

⁴⁹ Ibid 172. See also *Rabkin v Philip A Hunt Chemical Corp*, 547 A 2d 963 (Del Ch, 1986): 'In the corporate area, gross negligence would appear to mean "reckless indifference to or a deliberate disregard of the stockholders"' [quoting *Allaun v Consolidated Oil Co*, 147 A 257, 261 (Del Ch, 1929)], or actions which are "without the bounds of reason" [quoting *Gimbel v Signal Companies Inc*, 316 A 2d 599, 615 (Del Ch, 1974)]; *McPadden v Sidhu*, 964 A 2d 1262, 1274 (Del Ch, 2008); Franklin Gervurtz, 'The Business Judgment Rule: Meaningless Verbiage or Misguided Notion' (1994) 67 *Southern California Law Review* 287, 301.

⁵⁰ See, eg, ALI, above n 1, 174. See also *McDonnell v American Leduc Petroleum Ltd*, 491 F 2d 380, 384 (2nd Cir, 1974), in which the Second Circuit Court of Appeals applied Californian precedent and concluded that the 'business judgment rule protects only reasonable acts of a director or officer'.

⁵¹ ALI, above n 1, 173, 178–9.

⁵² Ibid 136.

⁵³ Ibid 173.

⁵⁴ Gervurtz, above n 49, 300–1.

⁵⁵ ALI, above n 1, 179.

Courts within the American jurisdiction of Delaware have described the rule as 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 company.⁵⁶ The ALI declines to use this phraseology, but expects the outcome to be the same.⁵⁷

The party alleging liability may rebut the presumption by showing either:

- that the directors violated any one of their fiduciary duties; or
- that the business judgment rule is inapplicable because the directors committed an act of fraud, illegality or waste.⁵⁸

If the party alleging liability fails to rebut the presumption, then the business judgment rule will protect the directors from liability for their decision.⁵⁹ If the party alleging liability rebuts the presumption, the director must prove that the challenged transaction was ‘entirely fair’ to the corporation and its shareholders.⁶⁰

IV *ASIC v RICH*

Until its collapse in May 2001, OneTel Ltd (‘OneTel’) was a large listed telecommunications company in Australia, which counted Publishing and Broadcasting Limited (‘PBL’) and News Corporation (‘News Corp’) as two of its major shareholders. In April 2001, there were ultimately futile discussions about the possibility of PBL and News Corp injecting cash into OneTel through a rights issue. In May 2001, PBL and News Corp united to remove CEO Jodie Rich and finance director Mark Silbermann from the OneTel board. The board then appointed voluntary administrators to OneTel.⁶¹

Proceedings were commenced by ASIC against four defendants, but orders were made before the hearing in respect of two of those defendants, so that the

⁵⁶ Deborah De Mott, ‘Inside the Corporate Veil: The Character and Consequences of Executive Duties’ (2006) 19 *Australian Journal of Corporate Law* 251, 261; *Aronson v Lewis*, 473 A 2d 805, 812 (Del, 1984); *Carsanaro v Bloodhound Technology Inc*, 65 A 3d 618, 637 (Del Ch, 2013):

[b]ecause the business judgment rule establishes a presumption in favor of the directors, a plaintiff only can proceed by alleging facts sufficient to overcome one of the elements of the rule. Under the business judgment rule, the burden of pleading and proof is on the party challenging the decision.

⁵⁷ ALI, above n 1, 178–80.

⁵⁸ Ann Scarlett, ‘A Better Approach for Balancing Authority and Accountability in Shareholder Derivative Litigation’ (2008–09) 57 *Kansas Law Review* 39, 59–60.

⁵⁹ *Ibid.*

⁶⁰ Scarlett, above n 31, 600.

⁶¹ *ASIC v Rich* (2009) 236 FLR 1, 16 [8], 206 [7515].

case proceeded against only Rich and Silbermann. In this case ASIC sought civil penalties for alleged breaches of the statutory duty of care and diligence arising out of the collapse of OneTel in May 2001.

Justice Austin's introduction to the judgment⁶² shows that ASIC sought to establish, as the central component of its case, that the financial position of the OneTel Group was much worse over the relevant period than the information provided to the board revealed, and that the forecast that had been provided to the board had no proper basis. ASIC also contended, amongst other things, that the defendants were aware of OneTel's poor financial position, or ought to have been aware, and failed to make proper disclosure to the board. The hearing lasted 232 days.

Ultimately, Austin J held that ASIC had failed to prove its case that Mr Rich and Mr Silbermann had contravened s 180.⁶³ At the heart of this decision was his Honour's conclusion that the rational belief required as an element of the business judgment rule in s 180(2) does not have to be reasonable. In other words, a director can invoke the business judgment rule if he shows that he arrived at the business judgment after a reasoning process 'whether or not the reasoning process was convincing to the judge and therefore reasonable in an objective sense'.⁶⁴

A Who Bears the Onus of Proof?

The starting point for the application of the business judgment rule must be identifying the party bearing the onus of proving its elements. This is particularly true given the 'substantial findings of fact' often required in cases involving the business judgment rule, which Austin J described as ensuring that the issue of onus of proof was 'critically important'.⁶⁵

In construing the provision, Austin J noted that the statutory provision itself does not expressly indicate which party carries the onus of proving the application of the business judgment rule, and that he could not 'extract any reliable indication either way from simply reading the text'.⁶⁶ Nor did his Honour find any significant assistance from the statement of legislative policy considerations in the Explanatory Memorandum or Second Reading Speech.⁶⁷ His Honour then moved to consider the formulation of the United States business judgment rule upon which, to a large degree, s 180(2) was modelled. Whilst the ALI's business judgment rule appears

⁶² Ibid 184–5 [7391].

⁶³ Ibid.

⁶⁴ Ibid 154 [7289].

⁶⁵ Ibid 146 [7259].

⁶⁶ Ibid 147–8 [7264].

⁶⁷ Ibid 148–9 [7265]–[7268].

to place the onus upon the plaintiff,⁶⁸ his Honour considered that if Parliament had intended to replicate that position, it might have more clearly done so.

In ascertaining where the onus of proof should lie, Austin J discussed the conflicting practical consequences emerging from placing the onus of proof on the directors and officers or on the party asserting liability — in this case, ASIC. In particular, his Honour focused on the trade off between legislative attempts to encourage responsible risk taking, which he believed would be hampered by placing the onus of proof on directors, against placing a higher burden on those seeking to hold directors against a higher level of accountability. In particular, he believed that the latter would ‘add substantial elements to the burden of proof of contravention that were not present in previous statutory formulations of the duty of care and diligence’.⁶⁹

Justice Austin ultimately took the stance that the question of whether the plaintiff or defendant bore the onus of proof was ‘an important one that will eventually need to be resolved at an appellate level’, but that, although bearing in mind the US approach, s 180(2) casts the onus on the defendants.⁷⁰

His Honour based this conclusion on two reasons. First, he concluded that placing the onus on the plaintiffs would have been inconsistent with the clear intention expressed in the Explanatory Memorandum and the Second Reading Speech that there was to be no reduction in the statutory requirement. Secondly, he found that if the plaintiff was required to establish that the four criteria had not been met, then as part of that obligation the plaintiff would be required to show that the defendant’s business judgment was not made in good faith for a proper purpose. Proving this would amount to a requirement to prove a more serious contravention of the law — a contravention of s 181. His Honour also noted that the four elements, required to

⁶⁸ See *ibid* 147 [7261], citing Deborah De Mott, ‘Legislating Business Judgment — A Comment from the United States’ (1998) 16 *Company and Securities Law Journal* 575, 576:

As defined by cases in Delaware (by far the United States jurisdiction with the most fully developed body of corporate law doctrine), the business judgment rule clearly creates a presumption on behalf of directors that the prerequisites to the rule’s applicability have been satisfied [citing, for example, *Aronson v Lewis*, 473 A 2d 805 (Del, 1984)]. As a consequence, the plaintiff bears the onus as to whether the director’s decision was disinterested, made in good faith with adequate information, and made with a rational belief that the decision served the corporation’s best interests.

⁶⁹ *ASIC v Rich* (2009) 236 FLR 1, 148 [7266].

⁷⁰ *Ibid* 149 [7269]. See also Young, above n 26, 80, who states that the business judgment rule:

does not attempt to define the standard of care required of directors making business judgment nor is it formulated as a preliminary presumption that explicitly puts the burden of rebuttal on the party alleging a breach of section 180(1). Rather it is framed as a deemed provision that will operate only if the four conditions in sub-section (2) are proved. It is hard to see how a director can avail himself or herself of the business judgment rule without adducing evidence satisfying these conditions.

be proven to make good the business judgment defence, were matters principally within the knowledge of the director or officer.⁷¹

Nevertheless, Austin J appears to have been troubled that the view that he ultimately came to was inconsistent with the objectives of the Explanatory Memorandum to the CLERP Bill of 1998. This Explanatory Memorandum stated that the purpose of the CLERP legislation was to protect directors exercising their duties from review by the courts, and not to discourage them from taking advantage of opportunities involving responsible risk taking. His Honour reconciled his position on the onus issue through a conclusion that placing the onus of proof on directors was not necessarily incompatible with the Explanatory Memorandum's purpose, as

[i]t may happen in practice that the evidential burden can be shifted to the plaintiff relatively easily, if the defendant addresses the statutory elements in his or her affidavit, though the price to be paid is that the defendant is exposed to cross-examination on those matters.⁷²

Justice Austin's concerns were well-founded. The placement of the onus of proof on the director ensures that the elements of the director's decision — contrary to the very purpose of a business judgment rule — are subject to judicial scrutiny. A business judgment rule is believed desirable because judges lack the information and skill necessary to evaluate business judgments, business is inherently risky, and the quality of a business decision cannot always be judged by the immediate results. Therefore, liability for a decision that produces bad results would discourage a board from entrepreneurial risk taking and make it difficult to secure the services of able and experienced corporate directors.⁷³

Equally, the business judgment rule is not meant to insulate directors from liability. Put another way, as argued by Stephen Bainbridge, the business judgment rule reflects the need to reach a compromise between recognising the director's authority and discretion to decide, and the need for those directors to be accountable.⁷⁴ Although in the interpretation of a provision of an Act, a construction that would promote the purpose or object underlying the Act is to be preferred to a construction that would not promote that purpose or object, this may be of little assistance where a statutory provision strikes a balance between competing policy concerns, as is the case here. Consequently, it is the text — construed according to such principles of

⁷¹ *ASIC v Rich* (2009) 236 FLR 1, 149 [7269].

⁷² *Ibid* 149–50 [7270].

⁷³ Randy Holland, 'Delaware Director's Fiduciary Duties: the Focus on Loyalty' (2009) 11 *University of Pennsylvania Journal of Business Law* 675, 679; William Meade Fletcher et al, *Fletcher Cyclopedia of the Law of Corporations* (Thomson/West, 1931) 1037.

⁷⁴ Stephen Bainbridge, 'The Business Judgment Rule as Abstention Doctrine' (2004) 57 *Vanderbilt Law Review* 83, 84.

interpretation as provide rational assistance in the circumstances of the particular case — that must control the court’s interpretation of the provision.⁷⁵

That is not to say that Austin J’s construction of the legislation is inconsistent with the text of the provision. Conversely, it is for Parliament to revisit the business judgment rule and clarify the question of onus. It should be noted that a change in onus would not require the plaintiff to establish that all four criteria have not been met, but rather, that where one of the criteria has not been established, the safe harbour is not available. If one of the criteria is not met, then the Court will examine whether s 180(1) has been complied with. It is to be expected that in most cases alleging negligence the focus would be on s 180(2)(c)–(d), as was the case in *ASIC v Rich*.

B *What is a Business Judgment?*

Section 180(3) of the *Corporations Act* provides that for the purposes of s 180:

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

Justice Austin, drawing on the experiences of the United States, suggests that, in general, decisions to enter into transactions for financial purposes are business judgments. The question for his Honour in the proceedings was thus ‘how much further the concept of business judgment is extended into the realm of management, organisation and planning’.⁷⁶

His Honour found that to be a business judgment for the purposes of the Australian definition, there had to be a decision to take or not take action in respect of matters relevant to the business operations of the corporation. The important element, according to his Honour, is the need for a conscious decision — that is to say, whether or not the directors or officers in fact turned their minds to the matter.⁷⁷

Justice Austin also noted that in using the language ‘in respect of a matter relevant’, s 180(3) utilises an expression well recognised as being of great breadth. Accordingly, he thought it inevitable that the Courts would give the definition of ‘business judgment’ a wide interpretation.⁷⁸ He concluded that the following decisions would be covered by the business judgment rule:

- decisions that are preparatory to the making of a business decision;
- decisions relating to corporate personnel;

⁷⁵ *Carr v Western Australia* (2007) 232 CLR 138, 143; *Alcan (NT) Alumina Pty Ltd v Commissioner of Territory Revenue* (2009) 239 CLR 27. See also Murray Gleeson, ‘The Meaning of Legislation: Context, Purpose and Respect for Fundamental Rights’ (2009) 20 *Public Law Review* 26, 32–3.

⁷⁶ *ASIC v Rich* (2009) 236 FLR 1, 150 [7272].

⁷⁷ *Ibid* 151 [7277].

⁷⁸ *Ibid* 151 [7276].

- decisions relating to the termination of litigation;
- the setting of policy goals;
- the apportionment of responsibilities between the Board and senior management; and
- decisions about planning, budgeting and forecasting.⁷⁹

Notwithstanding the breadth of the statutory language, not all action taken by directors and officers will fall within the definition of a business judgment. Because of the need for directors or officers to make a conscious decision (that is to actively turn their minds to the matter), the discharge by them of their ‘oversight’ responsibilities (that is monitoring the company’s affairs and policies and maintaining familiarity with its financial position) is not covered. On his Honour’s interpretation, this does not involve any business judgment as defined.⁸⁰ More recently, the Full Federal Court in *Fortescue Metals*⁸¹ adopted a similar approach in relation to compliance with the continuous disclosure obligations under the *Corporations Act*, stating that

the decision not to disclose the true effect of the agreements cannot be described as ‘business judgment’ at all. A decision not to make accurate disclosure of the terms of a major contract is not a decision related to the ‘business operations’ of the corporation. Rather it is a decision related to compliance with the requirements of the Act.⁸²

Justice Austin thus found, generally speaking, that the case before him was not one where the defendant directors had failed to turn their minds to decisions that ASIC alleged they should have taken. Rather, to a substantial degree, it was a case where the defendants considered the matters of which ASIC complained and made decisions with which ASIC disagreed. In those circumstances, the decisions by the defendant directors taken in planning, budgeting and forecasting were capable of receiving the protection of the Australian statutory business judgment rule.⁸³

⁷⁹ Ibid 150 [7273]–[7274]; Paul Redmond, ‘Safe Harbours or Sleepy Hollows: Does Australia need a Statutory Business Judgment Rule?’ in Ian Ramsay (ed), *Corporate Governance and the Duties of Company Directors* (University of Melbourne, 1997) 195.

⁸⁰ *ASIC v Rich* (2009) 236 FLR 1, 151 [7278].

⁸¹ *ASIC v Fortescue Metals Group Ltd* (2011) 190 FCR 364.

⁸² Ibid 427 [197] (Keane CJ). The High Court of Australia overturned the Full Court’s judgment in *Forrest v ASIC* (2012) 291 ALR 399, but did not need to address the business judgment rule so that Keane CJ’s observations remain good law.

⁸³ *ASIC v Rich* (2009) 236 FLR 1, 150 [7274].

C Good Faith for a Proper Purpose and No Material Personal Interest

The requirement in s 180(2)(a)–(b) of making the judgment ‘in good faith for a proper purpose’ and not having a ‘material personal interest’ in the subject matter of the business judgment did not require detailed examination in *ASIC v Rich*.⁸⁴

ASIC submitted to his Honour in relation to the former that it was doubtful whether the element of good faith could be established if the directors or officers had failed to take action, in discharge of their responsibility to supervise, and the inaction has resulted in a failure to discover substantial corporate losses. His Honour said in response to this submission:

It seems to me that as far as the Australian law is concerned, the problem in such a case is that the officer who has failed to take action has probably not made any decision not to take action, and therefore there is no business judgment to be protected. If an officer decides not to do something, and that decision results in a failure to discover substantial corporate losses, there may well be a question of good faith on the facts, but there is no reason in principle why good faith cannot be established by evidence.⁸⁵

It was accepted by ASIC that the latter issue of material personal interest did not arise.⁸⁶

D Informing Oneself about the Subject Matter

Section 180(2)(c) requires that directors ‘inform themselves about the subject matter of the judgment to the extent they reasonably believe to be appropriate’.⁸⁷

Justice Austin endorsed ASIC’s list of factors said to be relevant to determining the reasonableness of the purported discharge of this element.⁸⁸ However, he rejected ASIC’s submission that regard should be had not only to what the director knew, but also what he should have known.⁸⁹

⁸⁴ For a discussion of these requirements, see Andrew Lumsden, ‘The Business Judgment Defence: Insights from *ASIC v Rich*’ (2010) 28 *Company and Securities Law Journal* 164, 171–4.

⁸⁵ *ASIC v Rich* (2009) 236 FLR 1, 152 [7281].

⁸⁶ *Ibid* 152 [7282].

⁸⁷ *Corporations Act 2001* (Cth) s 180(2)(c).

⁸⁸ *ASIC v Rich* (2009) 236 FLR 1, 152 [7283], listing the relevant factors as: (1) the importance of the business judgments to be made; (2) the time available for obtaining information; (3) the costs related to obtaining information; (4) the director or officer’s confidence in those exploring the matter; (5) the state of the company’s business at that time and the nature of competing demands on the board’s attention; (6) whether or not material information is reasonably available to the director.

⁸⁹ *Ibid* 152–3 [7284].

In his Honour's view, the statutory language related to the decision-making occasion rather than to the general state of knowledge of the director. It requires the director to become informed about the subject matter of the decision prior to making it. His Honour held that:

The qualifying words, 'to the extent they reasonably believe to be appropriate', convey the idea that protection may be available even if the director was not aware of the available information material to the decision, if he reasonably believed he had taken appropriate steps on the decision-making occasion to inform himself about the subject matter.⁹⁰

So much may be accepted. But what work does the word 'reasonably' perform if it is not an objective reality check for the belief held by the director or officer? Would the protection of which his Honour speaks be available if the directors' enquiries, although sufficient in their minds, were objectively inadequate?

In summarising the operation of the business judgment rule Austin J observed that the rule will operate only where:

- [the directors] make their decision after informing themselves about the subject matter to the extent they believe to be appropriate having regard to the practicalities listed at 23.9.5.4; [and]
- their belief about the appropriate extent of information gathering is reasonable in terms of the practicalities of the information gathering exercise (including such matters as the accessibility of information and the time available to collect it).⁹¹

The latter point suggests that there is some objective requirement about the information gathering process. However, this sits uncomfortably with his Honour's earlier analysis.

The ALI explained that US courts will not interfere in matters of business judgment if reasonable diligence and care have been exercised.⁹² The requirement in para 4.01(c)(2) of reasonable belief has both subjective and objective content; a reasonable belief will not exist if the director does not believe the inquiry made is adequate, or if the director is unreasonable in believing that the inquiry made is adequate.⁹³ While Austin J's reasoning seems to be weighted too heavily towards the subjective belief of the director and with insufficient regard for what is objectively adequate, the later summary seems to be consistent with the ALI position.

While the text of s 180(2)(c) refers to the director's belief, suggesting a subjective element, the requirement of reasonableness in Australia also suggests that there is

⁹⁰ Ibid.

⁹¹ Ibid 155 [7294].

⁹² ALI, above n 1, 170.

⁹³ Ibid 157, 171.

an objective test.⁹⁴ An objective element is warranted because it better balances the competing demands of recognising a director's need to make business decisions while also being accountable.

E Rational Belief

The fourth element of the business judgment rule in s 180(2) is that the director must 'rationally believe that the judgment is in the best interests of the corporation'.⁹⁵ This requirement is qualified by the statement that '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'.

ASIC submitted that the rationality of a director's belief is determined by whether it is reasonable. In that sense, the Australian provision differs from the rule that applies under the American principles. The Australian defence, if ASIC's submissions were supported, would not be available if the director's decision was based on an unreasonable belief.⁹⁶

His Honour noted that some 'unfortunate consequences' would flow from accepting ASIC's submission, including that:

- since the s 180(1) duty of care is based on reasonableness, the business judgment rule would have no work to do if it only applied to decisions that were reasonable; and
- ASIC's interpretation of the business judgment rule would differentiate our business judgment rule from that of the United States, which was not the intention of the drafters of the Australian legislation.⁹⁷

⁹⁴ See *Shafron v ASIC* (2012) 286 ALR 612, 617–618 [18]. See also *WA Pines Pty Ltd v Bannerman* (1980) 30 ALR 559, 572 (Lockhart J):

In my opinion the words in s 155 'has reason to believe ...' mean that the Commission must believe that a person is capable of furnishing information, producing documents or giving evidence; and there must be reasonable grounds or cause for that belief, before the powers conferred by s 155(1) may be exercised.

And see *Zecevic v DPP (Vic)* (1987) 162 CLR 645, 673 (Deane J) (finding the test for self defence that required reasonable belief was a mixture of the objective and subjective); *Lemoto v Able Technical Pty Ltd* (2005) 63 NSWLR 300, 332 [137] (finding that the solicitors state of mind of a reasonable belief under the *Legal Profession Act 1987* (NSW) had to be objective); *Healy v Commissioner for Consumer Protection* [2010] WASC 177 (22 July 2010) [35] (Heenan J) (holding that the reasonableness of the appellant's belief that they could supply a heating system was not dependent on the appellant's actual state of knowledge, but on what a reasonable belief in the circumstances would have been).

⁹⁵ *Corporations Act 2001* (Cth) s 180(2)(d).

⁹⁶ *ASIC v Rich* (2009) 236 FLR 1, 153 [7287].

⁹⁷ *Ibid* 153–4 [7288].

Justice Austin referred to the ALI's formulation of the business judgment rule and the Shorter Oxford English Dictionary to determine that the standard of the word 'rational' is less than that of 'reasonable'.⁹⁸ His Honour acknowledged that one meaning of the word 'rational' in the Shorter Oxford English Dictionary is 'agreeable to reason' or 'reasonable', but preferred another meaning: 'based on, derived from, reason or reasoning'.⁹⁹ His Honour thought it plausible to say that the drafters of the sub-section intended to capture the latter meaning so that:

the director's or officer's belief would be a rational one if it was based on reason or reasoning (whether or not the reasoning was convincing to the judge and therefore 'reasonable' in an objective sense), but it would not be a rational belief if there was no arguable reasoning process to support it. The drafters articulated the latter idea by using the words 'no reasonable person in their position would hold'.¹⁰⁰

Therefore, a director's belief that a certain decision is in the best interests of the corporation will be rational, on his Honour's view, if there is some arguable reasoning process to support it. This is so whether or not no reasonable person in the director's position would share that opinion. His Honour's preferred construction of sub-s (d) interprets the Australian business judgment rule in a way that is similar to, but more forgiving than, the ALI's interpretation. This construction also allows his Honour to reach the position, upon which doubt was cast by Young,¹⁰¹ that s 180(2) has some protective work to do in cases where in its absence there would arguably be a contravention of s 180(1). It will be recalled that Young had questioned whether the business judgment rule was really just a form of 'window dressing'.

His Honour then tied together the third and fourth elements of the statutory business judgment rule. He stated:

The director or officer's belief about the best interests of a corporation is to be formed, and its rationality assessed, on the basis of the information obtained through compliance with sub-[s] (c). It is not to be assumed, for the purposes of applying sub-[s] (d), that the director or officer knew everything that he or she ought to have known, but only the things that he or she reasonably had believed to be appropriate to find out.¹⁰²

The above reasoning raises two issues for consideration: the standard applicable to the director's or officer's belief that the judgment is in the best interests of the corporation, and the interaction between ss 180(2)(c) and 180(2)(d).

⁹⁸ Ibid 153–4 [7288]–[7289].

⁹⁹ Ibid 154 [7289].

¹⁰⁰ Ibid.

¹⁰¹ Young, above n 26, 94.

¹⁰² *ASIC v Rich* (2009) 236 FLR 1, 154 [7291].

1 *Rational, Reasonable, or Something In-Between*

The interpretation placed on s 180(2)(d) is not free from doubt, as pointed out by *Ford's Principles of Corporations Law*. This text asks the question of whether, because s 180(2) provides that a director's belief will be a rational one unless the belief is one that no reasonable person in their position would hold, the rationality of the belief 'is to be assessed according to whether it is reasonable'.¹⁰³ The consequence of such a view, the text argues, is that the rule in s 180(2) will have a narrower application than the ALI's business judgment rule.¹⁰⁴ However, the decision in *ASIC v Rich* is quite the opposite.

Consequently, it is necessary to revisit the ALI's position on the rational belief requirement. The ALI was clearly cognisant of the distinction between 'rational' and 'reasonable', recognising that although the words have sometimes been used interchangeably, there is an important distinction to be drawn in their use here:

The phrase 'rationally believes' is intended to permit a significantly wider range of discretion than the term 'reasonable', and to give a director or officer a safe harbour from liability for business judgments that might arguably fall outside the term 'reasonable' but are not so removed from the realm of reason when made that liability should be incurred.¹⁰⁵

However, as explained earlier, the ALI states that the term 'rationally believes' has both an objective and a subjective content. In order to obtain the protection of the business judgment rule, a director or officer must actually believe that the business judgment is in the best interests of the corporation, and that belief must be rational.¹⁰⁶ Further, the ALI's equation of 'rationally believes' with the Delaware 'gross negligence' standard also suggests an objective element, as the negligence test is objective. This rationality standard is much less stringent than a reasonability standard, but nevertheless does involve some, although limited, objective review of the quality of the decision.

The interpretation that *ASIC v Rich* gives to the qualification 'that no reasonable person in their position would hold' at the end of s 180(2) is strained. Essentially, his Honour is saying that where the drafters of the legislation deliberately used the word 'reasonable', they in fact had in mind something quite different to the objective test usually signified by that word.¹⁰⁷ The lack of an objective element may be contrary to the balance between director authority and accountability that the legislature sought, and may even set the bar below that required by the ALI. If 'rational' and 'reasonable' are points on a spectrum, then the last sentence in s 180(2) can be read

¹⁰³ Ford, Austin and Ramsay, above n 18, [8.310].

¹⁰⁴ *Ibid.*

¹⁰⁵ ALI, above n 1, 136. See also *ASIC v Rich* (2009) 236 FLR 1, 153 [7286].

¹⁰⁶ ALI, above n 1, 172.

¹⁰⁷ See, eg, *Corporations Act 2001* (Cth) ss 674(2B), 731.

such that whilst ‘rational’ does not have to mean ‘reasonable’, there is a floor below which directors will lose their entitlement to the benefit of the business judgment rule.

If however, what is required from directors is that they have a rational belief, this might arguably give rise to too low a standard for directors.¹⁰⁸ The United States Third Circuit Court of Appeals has commented that ‘[o]vercoming the presumptions of the business judgment rule on the merits is a near-Herculean task’.¹⁰⁹ If lack of rational belief is akin to gross negligence, then some have asked why the law gives much greater protection to directors, given that ‘ordinary’ negligence is sufficient to create liability for just about anyone else.¹¹⁰ A construction of s 180(2) that arguably sets the bar even lower in Australia, arguably defeats the legislature’s objective of balancing the protection of the authority of directors in the exercise of bona fide business decisions and ensuring they remain accountable to shareholders.

2 *The Interaction Between ss 180(2)(c) and 180(2)(d)*

This article has argued that there should be an objective element to both ss 180(2)(c) and 180(2)(d) in order to strike an appropriate balance between competing policy concerns.

Simply put, a distinction may be drawn between the *process* of arriving at the decision and the *substance* of the decision. If the process by which a decision was made satisfies a reasonability standard — including matters such as the preparations to make a decision, general monitoring, and following up in suspicious circumstances — then the substantive decision itself can be reviewed only under the much looser standard of rationality.¹¹¹ If the director’s enquiry of the subject matter of the decision is reasonable, the court will not interfere. To have both ss 180(2)(c) and 180(2)(d) tested on a subjective standard risks insulating directors from due oversight.

V CONCLUSION

The decision in *ASIC v Rich* should be viewed as resurrecting the business judgment rule as it exists in Australian corporate law, so that the rule is capable of providing a defence in some cases that would otherwise amount to a breach of duty. This

¹⁰⁸ William Lucius Cary and Melvin Aron Eisenberg, *Cases and Materials on Corporations* (Federation Press, 7th ed, 1995) 411:

The rationality standard of review is much easier for a defendant to satisfy than a prudence or reasonability standard. To see how exceptional a rationality standard is, one need only think about the judgments we make in everyday life. It is common to characterise a persons conduct as imprudent or unreasonable, but it is very uncommon to characterise a person’s conduct as irrational.

¹⁰⁹ *In re Tower Air, Inc*, 416 F 3d 229, 238 (3rd Cir, 2005).

¹¹⁰ Gervurtz, above n 49.

¹¹¹ *Ibid* 300–1; Cary and Eisenberg, above n 108, 435.

development is to be applauded. However, the controversy that has long surrounded the implementation of a business judgment rule in Australia is likely to continue through the close and critical consideration of the correctness of the reasoning in *ASIC v Rich*.

This controversy may well be the inevitable result of any judgment applying this rule, given that s 180(2) is a statutory compromise between two competing policy objectives: recognising the director's authority to make decisions without being second-guessed, and ensuring that the director remains accountable. Further, the statutory language is elusive in how it seeks to resolve the competition.

However, although there are inherent difficulties in applying s 180(2), the balance currently struck between a director's authority and accountability is weighted towards the former. This is the result of over-reliance on a subjective state of mind of directors in relation to both the process adopted to inform themselves, and to whether a business judgment is in the best interests of the corporation. Without an objective element in the business judgment rule, the standard of care required of directors may become overly protected and, as a consequence, the objective of accountability is compromised. As a result, Australian policy-makers must revisit the wording of s 180(2) in an attempt to strike an appropriate balance between a director's authority and accountability.