Division 1 — General duties [ss 180–190B]

[2D.180] Care and diligence — civil obligation only — Annotations to section 180

Key principles underlying section 180(1)

This is one of the cardinal duties of company directors and officers. It is a corollary of more specific statutory duties and constitutional provisions, in the sense that where the statute or the corporate constitution requires directors or officers to do or refrain from doing something, s 180 adds the proposition that the statutory or constitutional duty must be performed with reasonable care and diligence. Thus in *Re HIH Insurance Ltd (in prov liq); Australian Securities and Investments Commission v Adler* (2002) 41 ACSR 72; 20 ACLC 576; [2002] NSWSC 171; BC200200827 (appeal largely dismissed: *Adler v ASIC* (2003) 46 ACSR 504; 21 ACLC 1810; [2003] NSWCA 131; BC200303670) it was found that the company's chief executive had contravened s 180(1)by failing to put in place proper safeguards to ensure that an investment proposed by another director, which was indirectly an investment in the company's own shares, was properly appraised in accordance with the company's procedures and approved by the company's board (or at least its investment committee).

The test is an objective test, because the standard is set by reference to the degree of care and diligence that a reasonable person would exercise, though it has regard to the circumstances of the particular case by bringing into account the corporation's circumstances, the nature of the defendant's office and the responsibilities attached to that office (*Australian Securities and Investments Commission v Rich* (2009) 75 ACSR 1; [2009] NSWSC 1229; BC200910410, at [7201]–[7202] per Austin J). It appears that, to the extent explained below, s 180 imposes on company directors an objective standard of skill and competence, notwithstanding the omission of the word "skill" from the statutory formula.

As to s 180(1)(a), the significance of the reference to "a corporation in the corporation's circumstances" was explained in the EM to the CLR Bill 1992, set out below (under the heading "History and explanatory materials for s 180"). The corporation's circumstances include the type of company, the provisions of its constitution, the size and nature of the company's business, the composition of the board, the director's position and responsibilities within the company, the particular function the director is performing, the experience or skills of the particular director, the terms on which he or she has undertaken to act as a director, the manner in which responsibility for the business of the company is distributed between its directors and employees, and the circumstances of the specific case: *Australian Securities and Investments Commission v Maxwell* (2006) 59 ACSR 373; 24 ACLC 1308; [2006] NSWSC 1052; BC200608176 at [99]–[102] per Brereton J; *Australian Securities and Investments Commission v Macdonald (No 11)* (2009) 256 ALR 199; 71 ACSR 368; [2009] NSWSC 287; BC200903649 at [236], [240] per Gzell J.

As to s 180(1)(b), the wording of s 180(1) does not set the statutory standard of care and diligence by reference to a reasonable person occupying an office that is merely of the same kind as was occupied by the defendant (for example, a person occupying the position of chief financial officer if the defendant was the company's chief financial officer). Instead, the section refers to a reasonable person occupying the very office held by the defendant. The responsibilities of the defendant's office therefore include any particular arrangements that might alter the usual responsibilities attaching to an office of

The highlighted text was quoted by the NSW Court of Appeal in its decision in the appeal by former James Hardie directors and officers: Morley & Ors v Australian Securities and Investments Commission [2010] NSWCA 331 at [903]. To view, click the red square.

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that kind: *Australian Securities and Investments Commission v Vines* (2003) 48 ACSR 322; 22 ACLC 37; [2003] NSWSC 1116; BC200308116; *Australian Securities and Investments Commission v Rich* (2009) 75 ACSR 1; [2009] NSWSC 1229; BC200910410, at [7202]. For example, the evidence might show that the defendant, though appointed chief financial officer, did not have some of the usual responsibilities of a CFO and had some additional responsibilities not usually possessed by the holder of that office — say, full responsibility for corporate tax planning, but no responsibility for the company's treasury operations because of the appointment of a corporate treasurer accountable to the CEO.

The personal, subjective characteristics of the defendant, relating to such things as qualifications, expertise and experience, are not relevant, per se, to the statutory standard of care and diligence. But it appears, from the language and history of the provision, that those personal characteristics may come to be relevant to the determination of the defendant's responsibilities, and hence the statutory standard, if the evidence shows that they have been taken into account by the company in allocating responsibilities to the defendant. For example, a person appointed to an expert position as a non-director executive officer (say, an actuary or mining engineer appointed to an executive position) may, pursuant to his or her contract of service, have special responsibilities related to the professional expertise that led to the appointment: *Australian Securities and Investments Commission v Vines* (2005) 55 ACSR 617; 23 ACLC 1387; [2005] NSWSC 738; BC200507884; *Australian Securities and Investments Commission v Macdonald (No 11)* (2009) 256 ALR 199; 71 ACSR 368; [2009] NSWSC 287; BC200903649.

It is less likely that the responsibilities of a non-executive director of a listed public company would be augmented by virtue of the director possessing special expertise, even if the expertise relates to the business activities of the company and was the occasion for appointment to the board. This is because, in normal circumstances, non-executive directors are not called upon to accept responsibilities additional to those of their board colleagues, except through relatively formal processes such as appointment to board sub-committees. On the other hand, the responsibilities of a non-executive director of a listed public company are not reduced because the appointee has little or no knowledge of the company's business and financial affairs, even if the evidence shows that the director was appointed because of, say, celebrity status or business and government contacts. As noted below, this is because there is now an irreducible minimum standard of competence for company directors.

The development of the statutory standard through legislative amendments over the last 50 years, and the interpretation of the statutory language, have been influenced by the case law concerning the standard of care of company directors at general law. Modern authorities indicate that the general law and statutory standards of care are generally the same, notwithstanding the availability of a civil penalty for contravention of the statutory standard (*Vines v ASIC* (2007) 73 NSWLR 451; 62 ACSR 1; [2007] NSWCA 75; BC200702341, at [63], [142]–[152] per Spigelman CJ, with whom Santow JA (at [587], [779]) and Ipp JA (at [875]) agreed; see also *Australian Securities and Investments Commission v Rich* (2009) 75 ACSR 1; [2009] NSWSC 1229; BC200910410, at [7198]–[7200]). But the issue is not straightforward, and requires analysis both of the meaning of the present statutory language, which was adopted in 1999, and the question whether the current general law standard is purely equitable or is an application of the modern tort of negligence (an issue discussed below).

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As to the meaning of the statutory language, s 180 does not make reference to damage suffered by the company, in contrast with the common law of negligence, where damages are the gist of the action. Nevertheless it appears that there can be no breach of the statutory standard unless at the relevant time it was reasonably foreseeable that harm to the interests of the company might be caused by the director's conduct, the court's task being to balance a foreseeable risk of harm against the potential benefits that could reasonably be expected to accrue to the company from the conduct in question: (see *Vrisakis v Australian Securities Commission* (1993) 11 ACSR 162 at 212; 11 ACLC 763, Ipp J (with whom Malcolm CJ agreed); *Vines v ASIC* (2007) 73 NSWLR 451; 62 ACSR 1; [2007] NSWCA 75; BC200702341 at [595]–[600]) per Santow JA (dissenting as to the application of the law to the facts, but not on questions of law); see also *Australian Securities and Investments Commission v Doyle* (2001) 38 ACSR 606; [2001] WASC 187; BC200104106 at [222]; *Australian Securities and Investments Commission v Maxwell* (2006) 59 ACSR 373; 24 ACLC 1308; [2006] NSWSC 1052; BC200608176 at [102]; *Australian Securities and Investments Commission v Rich* (2009) 75 ACSR 1; [2009] NSWSC 1229; BC200910410, at [7193]–[7197]). Further, it seems that the general law of torts can be called in aid as a source of guiding principles for determining whether a breach of duty has occurred. Thus in both *Australian Securities and Investments Commission v Vines* (2005) 55 ACSR 617; 23 ACLC 1387; [2005] NSWSC 738; BC200507884 at [1070], and *Australian Securities and Investments Commission v Rich* (2009) 75 ACSR 1; [2009] NSWSC 1229; BC200910410 at [7231]–[7236] the court applied the "*Shirt* calculus" (*Wyong Shire Council v Shirt* (1980) 146 CLR 40 at 47; 29 ALR 217; BC8000072 per Mason J) according to which, for the purpose of determining whether a breach of duty has occurred, the court should consider the magnitude of the risk and the degree of probability of its occurrence, along with the expense, difficulty and inconvenience of taking alleviating action and any other conflicting responsibilities the defendant may have had. That general approach was supported on appeal in the *Vines* case (*Vines v ASIC* (2007) 73 NSWLR 451; 62 ACSR 1; [2007] NSWCA 75; BC200702341, at [63] per Spigelman CJ; at [814]–[823] per Ipp JA). Likewise, the distinction drawn in common law cases between negligence and mere mistakes has been applied to s 180 (*Australian Securities and Investments Commission v Vines* (2005) 55 ACSR 617; 23 ACLC 1387; [2005] NSWSC 738; BC200507884 at [1075], and *Australian Securities and Investments Commission v Rich* (2009) 75 ACSR 1; [2009] NSWSC 1229; BC200910410 at [7239]–[7241]). There is an unresolved issue whether, having regard to the fact that contravention of s 180 exposes the defendant to civil penalty orders, the *res ipsa loquitur* doctrine of the general law of torts can have any application to the statutory liability (*Australian Securities and Investments Commission v Rich* (2009) 75 ACSR 1; [2009] NSWSC 1229; BC200910410, at [7243]–[7245]).

Nineteenth and early twentieth century cases fixed the general law duty of care, skill and diligence for non-executive directors at a "remarkably low" level, requiring negligent conduct which was, in a business sense, culpable or gross (*Daniels (formerly practising as Deloitte Haskins & Sells) v Anderson* (1995) 37 NSWLR 438 at 494; 16 ACSR 607; BC9504558). In *Re City Equitable Fire Insurance Company Ltd* [1925] Ch 407 at 426 Romer J emphasised the difficulty of describing the duty of directors in general terms, given the wide variety of activities pursued by companies and vast differences in the sizes of enterprises. However, the following propositions were derived from his Lordship's reasoning (see *Daniels* at 495–6):

1. The performance of a director's duties does not require a greater degree of skill the might reasonably be expected from a person of the director's own knowledge and experience (thus, the director of a rubber company is not bound to bring any special qualifications to the office, and may undertake the management of the

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company in complete ignorance of everything connected with rubber, without incurring responsibility for mistakes, but if he is acquainted with the rubber business he must give the company the advantage of his knowledge: *Re Brazilian Rubber Plantations and Estates Ltd* [1911] 1 Ch 425 at 437);

2. A director is not bound to give continuous attention to the affairs of the company, the duties of a director being of an intermittent nature to be performed at board and board committee meetings; a director is not bound to attend all such meetings although the director should do so when reasonably able;
3. In respect of all duties that, having regard to the contingencies of business and the company's constitution, might properly be left to some other official, a director is, in the absence of grounds for suspicion, justified in trusting that official to perform such duties honestly, and is entitled to rely upon the judgment, information and advice of the chairman and general manager unless there is some reason to suspect the integrity, skill and competence of that person (citing *Dovey & Metropolitan Bank (of England & Wales) Ltd v Cory* [1901] AC 477; see also *Overend & Gurney Co v Gibb & Darby* (1872) LR5HL 480).

None of these three propositions is an accurate statement of the modern general law standard, for "neither the law about the duty of directors nor the law of negligence has stood still in the [over 80] years since the decision in *Re City Equitable*" (*Daniels* at 497; see also *Vrisakis v Australian Securities Commission* 11 ACSR 162; 11 ACLC 763; *Permanent Building Society (in liq) v Wheeler* (1994) 11 WAR 187; 14 ACSR 109; 12 ACLC 674; BC9406797; and note Sir Douglas Menzies "Company Directors" (1959) 33 *ALJ* 156). Thus:

1. Directors are now obliged to become familiar with the business of the company and how the company is run, to understand the company's financial affairs and financial records to the extent necessary to form each year an opinion as to the company's solvency and to be reasonably informed at all times of its financial capacity, to bring an informed and independent judgment to bear on the matters that come to the board for decision, to ensure that the board has available to it the means to audit the management of the company, and generally to take reasonable steps to place themselves in a position to guide and monitor management. To that extent there is an objective standard of skill or competence for company directors, separate from any contractual duty that may be undertaken by directors who accept executive responsibilities. They can no longer necessarily rely on ignorance as a defence. See *Statewide Tobacco Services Ltd v Morley* (1990) 2 ACSR 405; 8 ACLC 827, at 412–13; aff'd [1993] 1 VR 423, esp at 465; *Commonwealth Bank of Australia v Friedrich* (1991) 5 ACSR 115 at 117; 9 ACLC 946; BC9100656; *Daniels* at 500; *Australian Securities and Investments Commission v Vines* (2003) 48 ACSR 322; 22 ACLC 37; [2003] NSWSC 1116; BC200308116 at 331–2). In *Deputy Commissioner of Taxation v Clark* (2003) 45 ACSR 332 at 355, Spigelman CJ found in the cases a "core, irreducible requirement of skill", involving an objective test of "ordinary competence" or "reasonable ability". See also *Vines v ASIC* (2007) 73 NSWLR 451; 62 ACSR 1; [2007] NSWCA 75; BC200702341, esp at [67] per Spigelman CJ, [593] per Santow JA; *Australian Securities and Investments Commission v Rich* (2009) 75 ACSR 1; [2009] NSWSC 1229; BC200910410, at [7205]–[7208]; cf *Australian Securities and Investments Commission v Maxwell* (2006) 59 ACSR 373; 24 ACLC 1308; [2006] NSWSC 1052; BC200608176, at [101] per Brereton J; *Australian Securities and Investments Commission v Macdonald (No 11)* (2009) 256 ALR 199; 71 ACSR 368; [2009] NSWSC 287; BC200903649 at [236] per Gzell J.

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2. The duty of directors is now not limited to giving attention to the affairs of the company at periodical board and board committee meetings; the board should meet as often as it deems necessary to carry out properly the functions identified in para 1 (*Daniels*, at 501). A director is expected to attend all such meetings unless exceptional circumstances, such as illness or absence, prevent the director from doing so (*Commonwealth Bank of Australia v Friedrich*, at 117; *Vrisakis v Australian Securities Commission* 11 ACSR 162 at 170; 11 ACLC 763; note also s 300(10)).
3. According to *Daniels* (at 502 per Clarke and Sheller JJA, citing *Federal Deposit Insurance Corporation v Bierman* 2 F 3d 1424 (7th Cir 1993), directors must exercise a reasonable degree of supervision and control over the activities of the company's executive officers, and may not rely on the judgment of others where there is notice of mismanagement or where a matter for decision by the board poses an obvious risk (see also *Final Report of the Royal Commission into the Tricontinental Group of Companies*, 31 August 1992, Vol 2, [19.58]–[19.68], referring to "the need for directors to be of an inquiring mind"; but the questions of reliance on others and responsibility for the actions of delegates are now addressed by ss 189 and 190, see [2D.189] and [2D.190]).

In *AWA Ltd v Daniels* (1992) 7 ACSR 759, Rogers CJ Comm Div drew a distinction between the position and duties of an executive and a non-executive director. He observed that "many companies today are too big to be supervised and administered by a board of directors except in relation to matters of high policy", so that "the true oversight of the activities of such companies resides with the corporate bureaucracy" and consequently "it is something of an anachronism to expect non-executive directors, meeting once a month, to contribute anything much more than decisions on questions of policy and, in the case of really large corporations, only major policy" (at 832–3). An executive director, who is engaged full-time in the management of the company under a contract of service, is required by an express or implied term of the contract to exercise the care and skill to be expected of a person occupying that position. In his Honour's view (at 867), the standard of care for non-executive directors is a lower standard.

These views were strongly criticised by the Royal Commission into the Tricontinental Group of Companies (Final Report, 31 August 1992, Vol 2, Ch 19). The Commissioners rejected the proposition that a board of directors of a large company is only able to supervise executive management in matters of high policy. That would relegate the boards of the largest corporations to a peripheral role ([19.55]). The Commissioners continued ([19.56]):

> The evidence in this inquiry has brought home to the Commission how vital it is, as a matter of legal responsibility and as a matter of sound commercial practice, that a board should ensure that it retains effective control over management, whatever the size of the corporation. To do that, there must be workable systems which result in the board monitoring accurately the operations of the corporation. It is not enough merely to pronounce upon policy. There is a need to be satisfied properly that policy is being implemented fully and efficiently.

On appeal from the judgment of Rogers CJ Comm Div, Clarke and Sheller JJA rejected the idea that there are different duties of care for executive and non-executive directors (37 NSWLR at 501, citing *Deloitte Haskins and Sells v National Mutual Life Nominees* (1991) 5 NZCLC 67,418 at 67,442–3), though they recognised that that it would be unreasonable to expect every director to have equal knowledge and experience of every aspect of the company's activities.

The present statutory standard in s 180(1) restores Rogers CJ Comm Div's view that there is a difference in the standard of care for executive and non-executive directors

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(although in light of the Court of Appeal's judgment in *Daniels* at 501–5, the standard for non-executive directors is now higher than the standard described by Rogers J at 7 ACSR 866–8, in terms of monitoring management, delegation and reliance on others). This is because the statutory wording requires the court to consider the degree of care and diligence that a reasonable person would exercise when occupying the office held by the defendant, while having the same responsibilities within the corporation as the defendant. An executive office has greater responsibilities attached to it than a non-executive office (*Australian Securities and Investments Commission v Rich* (2009) 75 ACSR 1; [2009] NSWSC 1229; BC200910410, at [7201]–[7208]).

Issues have arisen as to whether the non-statutory duty of care of company directors is now a common law duty, part of the modern tort of negligence, or a special equitable duty, and if the latter, part of the directors' fiduciary responsibilities. These matters are separately addressed below. The issue is not merely historical and theoretical, as the outcome may affect the content of the duty and the remedies available for breach.

It seems that in determining whether an officer has contravened the statutory duty of care, the court will have regard to a number of factors:

(a) what information the officer acquired, and what inquiries the officer made, about the corporation's affairs;
(b) what meetings the officer attended;
(c) how far the officer exercised an active discretion in the matters concerned;
(d) what the officer did to ensure that the corporation had made adequate arrangements:
  (i) to ensure that people who prepared reports, or gave advice or opinions, on which officers and employees of the corporation relied were honest, competent and reliable, and were in other respects such as to inspire confidence in the reports, advice and opinions; and
  (ii) to monitor to ensure compliance with the law, and with the corporation's constitution, by the corporation and its officers and employees; and
  (iii) to ensure that persons who took part in the corporation's management did whatever was necessary to avoid a conflict of their pecuniary or other interests with the proper performance and exercise of their functions and powers; and
  (iv) to ensure that decisions made by persons on the corporation's behalf were adequately monitored; and
  (v) to ensure that persons who made decisions on the corporation's behalf had adequate information about the subject matter of the decisions;
(e) what the officer did to ensure that arrangements of the kind referred to in para (d) were given effect to.

The drafters of the Public Exposure Draft of the CLR Bill 1992 intended that these matters be enacted (in proposed s 232(4AA)) as factors relevant to the discharge of the standard of care and diligence established by s 232(4). But when the Bill was introduced into Parliament, cl 232(4AA) had been abandoned in response to submissions, on the ground that the guidance intended to be provided was not necessary and could be counter-productive. The list is nevertheless useful as an indication of the sorts of matters that are likely to be relevant to a determination of contravention of the present s 180(1).

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Standing to sue for breach of the statutory duty and the general law duty of care

The general law is expressly preserved by s 185, and therefore it continues to exist and be available concurrently with the statute. A breach of the general law duty of care may be asserted by the company, to whom the duty is owed, against directors or officers who are alleged to be negligent, in an action for damages. This may be unlikely to occur if the company is under the control of the directors and officers who are alleged to be negligent, but the possibility of legal proceedings may become real if there is a change of control of the company or the company goes into liquidation, or ASIC takes proceedings in the company's name under s 50 of the ASIC Act. Additionally, a present or former member or officer may, with leave, assert the company's right of recovery in a statutory derivative action under Pt 2F.1A.

The statutory duty in s 180(1) is a civil penalty provision (s 1317E(1)(a)). The civil consequences of contravention are laid out in Pt 9.4B. The contravention may lead to a declaration of contravention under s 1317E, a pecuniary penalty order under s 1317G, a disqualification order under s 206C and a compensation order under s 1317H. Only ASIC may apply for a declaration of contravention, a pecuniary penalty order or a disqualification order with respect to contravention of s 180(1) (ss 1317J(1), (4) and 206C(1)), but both ASIC and the corporation have the statutory standing to apply for a compensation order (ss 1317J(1) and (2)). As with the general law, the corporation's statutory right to seek a compensation order may be asserted derivatively (where the corporation is a company), by ASIC under s 50 of the ASIC Act or by a present or former member or officer, with leave, under Pt 2F.1A.

A note on the sources of the directors' duty of care in equity and at law

It is important to understand the sources of the duty of care of company directors in the general law, for at least three reasons. First, cases on the standard of care in the general law are used in the construction of the statutory provision, subject of course to the statutory wording. The general law cases can be easily misinterpreted if the source of the legal principles that they articulate is misunderstood. Second, the general law is preserved by s 185 and is available to be invoked either in addition to or instead of the statutory duty. Third, both the content of the duty and the principles governing the availability of remedies (including compensation) may be affected by whether the source of the duty is equitable or legal.

Origin of the general law duty

The duty of care of company directors was developed in the exclusive jurisdiction of equity, originally in proceedings by bill in Chancery, resting on an analogy with the duty of care of trustees (eg, *Re Newcastle-upon-Tyne Marine Insurance Co; Ex parte Brown* (1854) 19 Beav 97 at 104; 52 ER 285 at 288; *Overend & Guerney Co v Gibb* (1872) LR5HL 480) and under the influence of the partnership theory of the unincorporated joint stock company (*Daniels (formerly practising as Deloitte Haskins & Sells) v Anderson* (1995) 37 NSWLR 438 at 493; 16 ACSR 607; BC9504558; *Turquand v Marshall* (1869) LR 4 Ch App 376; as to the duty of care of trustees, see esp *Caffrey v Darby* (1801) 6 Ves Jun 488 at 496–7; 31 ER 1159 at 1162–3). In *Bell Group Ltd (in liq) v Westpac Banking Corp (No 9)* (2008) 70 ACSR 1; [2008] WASC 239, at [4375], Owen J asserted that the directors' duty to exercise care, skill and diligence arose primarily from the common law of contract (an express or implied term of the contract of service) or tort (applying conventional principles of law of negligence). However, the cases just cited indicate that the duty was developed, in equity, before the modern law of contract and negligence emerged (see also *Australian Securities and Investments Commission v Rich* (2009) 75 ACSR 1; [2009] NSWSC 1229; BC200910410 at [7188]).

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Is the directors' duty of care a fiduciary duty?

During the nineteenth century the English Court of Chancery also developed the fiduciary duties of loyalty for agents other than trustees, including directors of joint stock companies and corporations. Frequently the duties of loyalty and care were spoken of together (eg, *Lagunas Nitrate Co v Lagunas Syndicate* [1899] 2 Ch 392 at 435). In *Permanent Building Society (in liq) v Wheeler* (1994) 11 WAR 187 at 237; 14 ACSR 109; 12 ACLC 674; BC9406797, the Full Court of the Supreme Court of Western Australia took the view that company directors have an equitable duty to exercise care and skill, but it is not one of the directors' fiduciary duties.

The proposition that the directors' duty of care is not fiduciary has been challenged (JD Heydon, "Are the Duties of Company Directors to Exercise Care and Skill Fiduciary?", in S Degeling and J Edelman (eds), *Equity in Commercial Law* (Lawbook Co, 2005); see also J Getzler, "Equitable Compensation and the Regulation of Fiduciary Relationships" in P Birks and F Rose (eds), *Restitution and Equity: Vol 1, Resulting Trusts and Equitable Compensation* (Mansfield Press, London, 2000); J Getzler, "Duty of Care" in P Birks and A Pretto (eds), *Breach of Trust* (Hart Publishing, Oxford, 2002)). The broader proposition that the duty of care of a fiduciary is not a fiduciary duty is well supported in case law and commentaries: see esp *Giradet v Crease & Co* (1987) 11 BCLR (2d) 361 at 362 (Southin J); *Lac Minerals Ltd v International Corona Resources Ltd* [1989] 2 SCR 574 at 597–8 (Sopinka J) and 647 (La Forest J); *Henderson v Merrett Syndicates Ltd* [1995] 2 AC 145 at 205 (Lord Browne-Wilkinson); *Bristol and West Building Society v Mothew* [1998] Ch 1 at 17 (Millett LJ); *Bank of New Zealand v New Zealand Guardian Trust Co Ltd* [1999] 1 NZLR 664 at 680 (New Zealand Court of Appeal); as to commentaries, see PD Finn, "The Fiduciary Principle", in TG Youdan (ed), *Equity, Fiduciaries and Trusts* (Carswell, Canada, 1989); RP Austin, "Moulding the Content of Fiduciary Duties" in AJ Oakley (ed), *Trends in Contemporary Trust Law* (OUP, Oxford, 1997); other academic literature is cited by Heydon, op cit, fn 79.

None of these cases (other than *Wheeler*) concerned the duty of a company director. Some of them related to the position of a solicitor. A solicitor's duty of care and skill is the common law duty, in tort and contract, of a professional person to his or her client, and "equity has long refused relief" (Heydon, op cit, fn 82). It has been plausibly argued that the statements in these cases, including the statements in Wheeler, are obiter dicta, and attention has been drawn to other dicta in which courts have referred to "fiduciary duties of care", such as *Henderson's* case (at 206) and *White v Jones* [1995] 2 AC 207 at 271, per Lord Browne-Wilkinson and *Cowan v Scargill* [1985] Ch 270 at 276 and 289 per Sir Robert Megarry V-C (Heydon, op cit, at 189; 200–212). The question whether the duty of care of directors is part of their fiduciary duties probably remains an open one in Australia.

There are several reasons for contending that the duty of care of a fiduciary should not be regarded as a fiduciary duty. One is that a distinction should be drawn in equity between wrongdoing that involves a breach of trust or disloyalty, or taking advantage of the principal's vulnerable position (such as misappropriation of the principal's property or profit-making opportunity, or personal dealing with the principal without full disclosure) — where the full panoply of equitable presumptions and remedies should apply; and simple carelessness in giving advice to the principal or handling the principal's property, where the onerous results of applying the equitable approach are less appropriate. It is thought that the duty to avoid careless behaviour is no different for a fiduciary (such as a solicitor), an engineer or a physician (*Giradet's* case at 362; *Wheeler's* case at 237–9; *Guardian Trust* case at 681). A second reason is that equity's technique is to oversee a fiduciary's behaviour by insisting upon loyalty, but not by prescribing the content of the

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fiduciary's conduct towards the principal. Thus, equity demands that fiduciaries act in what they reasonably regard as the interests of their principal, but it does not purport to review their conduct to ascertain whether or not the principal's interests have in fact been served. To establish a special fiduciary duty of care would, it is thought, be inconsistent with equity's approach (Finn, op cit, p 28, cited in *Wheeler's* case at 237). A third reason is that, if equity recognised a special fiduciary standard of care, much of the law of trusts, agency and company law would be rendered superfluous and the law of torts and contract would be displaced from their accepted roles in many relationships (Finn, op cit, p 28).

These reasons have been criticised, and other reasons have been advanced for the view that it is not desirable or practicable to treat a fiduciary's duty of care as a non-fiduciary duty (Heydon, op cit, pp 213–35). Arguably, however, the three justifications for the *Wheeler's* approach have survived this attack, and it seems likely that Australian courts below the High Court will follow the *Wheeler* view on the grounds that is supported by principle and by the weight of judicial observations, even if only in dicta (in *Australian Securities and Investments Commission v Rich* (2009) 75 ACSR 1; [2009] NSWSC 1229; BC200910410 at [7190] the matter was treated as an important issue for determination at the appellate level).

The significance of the question whether the duty of care is a fiduciary duty is intertwined with the question whether there are concurrent duties of care for company directors in equity and at law. The main issues, considered below, relate to remedies (measure of compensation, causation and remoteness) and the content of the duty. It appears, however, that certain aspects of the law of torts have been imported into the statutory analysis under s 180, regardless of whether the origin of the statutory duty was in equity or common law (see the analysis above).

Are there concurrent common law and equitable duties, and if so, why does it matter?

In the decades after the Judicature Acts of 1873–1875 in England, pre-judicature Chancery cases were taken up and applied in important cases such as *Re Railway and General Light Improvement Co; Marzetti's Case* (1880) 28 WR 542, *Re Denham & Co* (1884) 25 Ch D 752, *Masonic and General Life Assurance Co v Sharpe* [1892] 1 Ch 154, *Re Cardiff Savings Bank (Marquis of Bute's Case)* [1892] 2 Ch 100, *Lagunas Nitrate Co v Lagunas Syndicate* [1899] 2 Ch 392, *Dovey & Metropolitan Bank (of England & Wales) Ltd v Cory* [1901] AC 477, *Re Brazilian Rubber Plantations and Estates Ltd* [1911] 1 Ch 425 and *Re City Equitable Fire Insurance Company Ltd* [1925] Ch 407, without any suggestion that the equitable duty had been superseded or supplemented by the common law. It has been said that those cases set a standard of care, skill and diligence for directors which was remarkably low (*Daniels* at 494).

There are some indications in the cases of that era that common law damages might have been available against a careless company director, at least where there was no provision of the corporate constitution exempting them from liability for loss arising from negligence (eg, *Lagunas Nitrate*, at 435), but it has been said that such cases do not refer to the action for negligence in the modern sense (*Daniels (formerly practising as Deloitte Haskins & Sells) v Anderson* (1995) 37 NSWLR 438 at 493; 16 ACSR 607; BC9504558 per Clarke and Sheller JJA). It was only when the common law tort of negligence had been launched on its expansionary path, after *Donoghue v Stevenson* [1932] AC 562, and especially with the later development of the common law of negligent misstatement and actions for recovery of pure economic loss, that it became sensible to consider whether the tort of negligence is available to a company against careless directors and if so, whether the common law duty of care co-exists with the older equitable duty or has superseded and enveloped it. In Australia, those issues were complicated by the fact that a statutory

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duty of care was adopted nationally in 1961 (see *Australian Securities and Investments Commission v Rich* (2009) 75 ACSR 1; [2009] NSWSC 1229; BC200910410, at [7189]).

In *Castlereagh Motels Ltd v Davies-Roe* [1966] 2 NSWR 79; (1966) 67 SR (NSW) 279, it was held that there is no cause of action known at common law for breach by a company director of any of his duties, including the duty of care. But that view was rejected in Australia in the *Wheeler* case and in *Daniels*, and overseas in the *Bristol and West Building Society v Mothew* [1998] Ch 1; [1996] 4 All ER 698; [1997] 2 WLR 436 and *Bank of New Zealand v New Zealand Guardian Trust Co Ltd* [1999] 1 NZLR 664 cases. In the *Wheeler* case the Full Court of Western Australia concluded that the directors' duty of care is owed both in equity and at law, and that an equitable duty of care may arise from the same facts as those giving rise to a tortious duty of care (at 235–7). In *Daniels*, the majority (Clarke and Sheller JJA, Powell JA dissenting) reviewed earlier case law extensively and concluded that directors owe their company a duty of care and skill in tort (at 501–5). The majority held that the relationship between company director and company satisfies the test of proximity imposed by the modern law of negligence, and there is no policy consideration which disqualifies the relationship from giving rise to a duty of care, notwithstanding that the Parliament has declined to impose a statutory duty to exercise reasonable skill (at 490, 492, 505). The courts in the *Mothew* and *Guardian Trust* cases took the view that there is a single duty of care for directors, governed by the principles of the tort of negligence.

The issue arose in *Daniels* because the court was asked to determine whether the directors and auditors were tortfeasors for the purposes of contribution legislation, s 5(1)(c) of the Law Reform (Miscellaneous Provisions) Act 1946 (NSW). In the *Wheeler* case, the proposition that the directors owed their company an equitable duty of care led to the conclusion that equitable compensation was available to the company, assessed and measured in accordance with the principles stated in *Re Dawson; Union Fidelity Co Ltd v Perpetual Trustee Co Ltd* [1966] 2 NSWR 211 at 215. According to those principles, equitable compensation is assessed on a restitutionary basis, which will frequently produce a better result for the plaintiff than common law damages. There are less demanding rules of causation and remoteness than in an action for damages at common law. On the other hand, in both the *Mothew* and *Guardian Trust* cases the courts asserted that the common law rules as to causation, remoteness of damage and measure of damages are to be applied, by analogy, where the suit is for equitable compensation for breach of the duty of care, on the ground that the claims in those cases were not for a breach of a fiduciary duty and were therefore not restitutionary in character (*Mothew* at 17; *Guardian Trust* at 681).

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According to the Full Court in the *Wheeler* case, the contents of the equitable and tortious duties of care of fiduciaries are the same (at 238, 247–8). But in *Mothew's* case, Millett LJ said that the common law and equity developed their duties of care independently of each other and that the standard of care required is not always the same (at 16–17), though he did not identify any particular differences. In *Daniels* Clarke and Sheller JJA took the view that the equitable and common law duties are different, not only historically but also conceptually, because the more recently developed common law duty is based on the principles expounded in *Donoghue v Stevenson* while the equitable duty is not (see Heydon, op cit, p 219). That consideration suggests that the common law standard is higher (more demanding) than the standard recognised in equity. On the other hand, it has been suggested that a higher level of compensation is available in equity because a company director, being a fiduciary, must avoid self-interest, and therefore some of the criteria used by the tribunal of fact for assessing common law damages must be suppressed. Whereas, in other cases, it is relevant for the court, in assessing what a reasonable man would do in response to a risk of injury to the plaintiff, to consider the expense, difficulty and inconvenience of taking alleviating action (see *Wyong Shire Council v Shirt* (1980) 146 CLR 40 at 47–8; 29 ALR 217; BC8000072), it cannot be permissible for a fiduciary to seek to reduce his or her liability by referring to such self-interested matters (Heydon, op cit, pp 225–6).

Though the matter is unresolved in Australia, it seems probable that compensation for breach of equitable duty, measured by the approach in *Re Dawson*, remains available to a company against negligent directors, as an alternative to common law damages for negligence; but less likely, in view of the flexibility of both, that the courts will allow the content of the standard of care in equity to vary from the common law standard of care. The remedies under the statutory provision, are, of course, governed by Pt 9.4B.

In CLERP Paper No 3, *Directors' Duties and Corporate Governance* (p 47), it was noted that concern had been expressed after *Daniels* that the tortious duty of care might be owed by directors and officers to other persons in addition to their company, "as the tortious duty does not have its foundation in the fiduciary relationship between the director and the company, but rather relies on the proximity of the relationship". The authors of the Paper concluded that any such development is a matter of speculation.

Key principles underlying section 180(2) and (3)

Section 180(2) and (3) provide a statutory formulation of the business judgment rule that has emerged from the case law of the United States, especially in the Court of Chancery of Delaware. The version of the "business judgment rule" appearing in s 180 (2) is generally based on the American model, or at least the formulation of the rule in the American Law Institute's *Principles of Corporate Governance: Analysis and Recommendations* (1992). The comparison is developed in *Austin, Ford and Ramsay*, [6.6]. It is also useful to compare the rule as enacted with a draft prepared by the Companies and Securities Law Review Committee, which recommended a statutory business judgment rule in its Report No 10 (May 1990), *Company Directors and Officers: Indemnification, Relief and Insurance* (the CSLRC's draft is set out in *Austin, Ford and Ramsay*, [6.11]).

The introduction of a statutory business judgment rule was intended to offer directors and other officers of a corporation a "safe harbour" from personal liability in relation to honest, informed and rational business judgments (EM to CLERP 1999, [6.1]), and to clarify and confirm the common law position that the courts will rarely review bona fide business decisions (EM, [6.4]).

The "safe harbour" provided by the application of s 180 (2) is a rule that the defendant has met the requirements of the statutory duty of care in s 180(1), and his or her

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"equivalent duties at common law and in equity" in respect of a business judgment. The intention, confirmed by the EM [6.7], is to give protection in respect of the common law and/or equitable duties of care of the director or officer concerned, as well as the statutory duty of care. A problem of interpretation will arise if, in future, the courts allow the common law or equitable standard of care to diverge from the statutory standard to a sufficient degree that they are no longer "equivalent".

As the EM emphasises ([6.7]), s 180(2) does not operate in relation to any other provision of the CA or any other Act or Regulation, or any other general law principle. For example (EM [6.8]), s 180(2) does not apply to business judgments made by directors in the context of statutory liability for insolvent trading or for misstatements in a prospectus or takeover document. Nor does the subsection apply:

- in deciding whether a decision of the directors is for an improper purpose under s 181;
- in deciding whether the directors have acted contrary to the interests of the members as a whole, or in a manner that is oppressive, unfairly prejudicial or unfairly discriminatory, for the purposes of Pt 2F.1;
- in reviewing the directors' decision not to bring proceedings in the company's name, after they have received notice of an intended derivative action, for the purposes of Pt 2F.1A (see esp s 237(2) and (3)) — a surprising omission in view of the wealth of US case law concerning the application of business judgment considerations to a board decision not to sue: see D DeMott "Legislating business judgment — a comment from the United States" (1998) 16 *Co & Sec LJ* 575).

There are some indications in case law that there is a wider general law principle concerning business judgments, available to protect directors from liability not only for breach of their duty of care, but also in other circumstances, such as where it is alleged that the director has failed to act in good faith in the interests of the company or for proper purposes (see, for example, *Harlowe's Nominees Pty Ltd v Woodside (Lakes Entrance) Oil Co NL* (1968) 121 CLR 483 at 493; 42 ALJR 123; BC6800800 per Barwick CJ, McTiernan and Kitto JJ; *Howard Smith Ltd v Ampol Petroleum Ltd* (1974) 3 ALR 448; [1974] 1 NSWLR 68; [1974] AC 821; [1974] 1 All ER 1126 at 832 (Privy Council)). It appears from such cases that the "business judgment principle" in general law forms part of the assessment of whether there is a breach of the relevant general law duty, and probably also the statutory counterpart (including the general law and statutory duties of care), and should not be seen as a separate defence (*Australian Securities and Investments Commission v Rich* (2009) 75 ACSR 1; [2009] NSWSC 1229; BC200910410 at [7253]–[724]).

The protection is available only in respect of a "business judgment", as defined in s 180(3). There is no "business judgment" unless there is a "decision to take or not to take action". There must be a decision involving the exercise of judgment, and therefore evidence is needed to show that the director turned his or her mind to making the decision that is said to be a business judgment (*Re HIH Insurance Ltd (in prov liq); Australian Securities and Investments Commission v Adler* (2002) 41 ACSR 72 at 175; 20 ACLC 576; [2002] NSWSC 171; BC200200827 (appeal largely dismissed: *Adler v ASIC* (2003) 46 ACSR 504; 21 ACLC 1810; [2003] NSWCA 131; BC200303670); *Australian Securities and Investments Commission v Rich* (2009) 75 ACSR 1; [2009] NSWSC 1229; BC200910410 at [7271]–[7277]. The directors' negligent omission to act, or failure to consider a matter, is not protected by s 180(2) (*Re HIH Insurance Ltd (in prov liq); ASIC v Adler* at 175, 196). It seems there is no "decision" where the allegation is that the

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directors have not adequately monitored the executive management of the company's business and affairs or the efficacy of the company's audit system (see *Austin, Ford and Ramsay*, [6.8]).

The directors' decision must be to take or not to take action "in relation to the business operations of the corporation", and therefore it seems that a decision in relation to a matter of compliance with the law, or with a precept of corporate governance or stock exchange disclosure, does not fall within the rule. In this respect s 180(2) appears to be significantly narrower in scope than the US model (see DeMott, op cit at 577). The narrow interpretation appears to be confirmed by the EM [6.8], which says that in light of s 180(3), "compliance (or otherwise) with the prospectus requirements imposed by the Law would not be a decision to which the proposed rule could apply" (and see *Australian Securities and Investments Commission v Rich* (2009) 75 ACSR 1; [2009] NSWSC 1229; BC200910410 at [7278]).

Confusingly, the EM to CLERP 1999 says that s 180(2) creates a "presumption" ([6.4]) and even a "rebuttable presumption in favour of directors" ([6.10]). But the plain effect of s 180(2), in its terms, is that:

- if the conditions for its application are satisfied, then the director or officer who has made the business judgment is taken to have met the requirements of the statutory and general law standards of care and diligence in respect of that judgment (that is the "irrebuttable" effect of the application of the provision); but
- if one or more of the conditions stipulated in the section is not satisfied, s 180(2) has no application.

The drafters' confusion may have arisen because s 180(2) and (3) were modelled on the business judgment rule operative in Delaware, which clearly does give rise to a presumption in favour of the director. The presumption is "that the prerequisites of the rule's applicability have been satisfied" (DeMott, op cit p 576, citing *Aronson v Lewis*, 473 A 2d 805 (Del 1984)), and consequently the plaintiff bears the onus of establishing that the decision was not disinterested, or not made in good faith with adequate information, or not made with a rational belief that the decision would serve the corporation's best interests. As Professor DeMott pointed out, an equivalent result could have been achieved in Australia if s 180(2) had said that the director or officer is taken to meet the requirements of s 180(1) *unless* the party asserting liability establishes that the director or officer does not meet one or more of the four statutory criteria. As it is, s 180(2) does not operate unless all four criteria are present, and the drafting suggests (notwithstanding some statements in the EM, especially at [6.10]) that the onus of establishing the presence of those criteria is borne by the party who contends that s 180(2) applies (that is, the director or officer). In *Re HIH Insurance Ltd (in prov liq); Australian Securities and Investments Commission v Adler* (2002) 41 ACSR 72; 20 ACLC 576; [2002] NSWSC 171; BC200200827 (appeal largely dismissed: *Adler v ASIC* (2003) 46 ACSR 504; 21 ACLC 1810; [2003] NSWCA 131; BC200303670), Santow J (at 175–6) found it unnecessary to decide who bore the onus of proof, because the plaintiff's presentation of its case satisfied any evidentiary onus that it might have borne. He observed, however, that it would be an odd position if, as part of establishing a contravention of s 180, the plaintiff bore the burden of establishing another and more serious contravention, namely of s 181, when it came to whether the judgment was made "in good faith for a proper purpose" for the purposes of s 180(2)(a). Professor DeMott's analysis, and the observations of Santow J, were taken up in *Australian Securities and Investments Commission v Rich* (2009) 75 ACSR 1; [2009] NSWSC 1229; BC200910410 at [7258]–[7270], where the conclusion was reached that s 180(2) casts the onus of proving the four ingredients of the subsection on the defendant who seeks to rely on it.

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As to s 180(2)(a), the meaning of the words "good faith for a proper purpose" is explored in [2D.181] (and see *Australian Securities and Investments Commission v Rich* (2009) 75 ACSR 1; [2009] NSWSC 1229; BC200910410 at [7281]). As to s 180(2)(b) the meaning of "material personal interest" is explored in [2D.191].

Section 180(2)(c) is taken directly from the US law, fully discussed by the ALI (see *Austin, Ford and Ramsay*, 2005, [6.9]). The reasonableness of the belief is to be assessed by reference to factors such as the importance of the business judgment to be made, the time available for obtaining information, the costs relating to obtaining information, the director's confidence in exploring the matter, the state of the company's business at the time, the nature of the competing demands on the board's attention, and whether or not material information is reasonably available to the director (*Australian Securities and Investments Commission v Rich* (2009) 75 ACSR 1; [2009] NSWSC 1229; BC200910410 at [7283]). Where the issue for decision raises an uncertain question of law, compliance with s 180(2)(c) will involve obtaining proper independent legal advice (*Re HIH Insurance Ltd (in prov liq); Australian Securities and Investments Commission v Adler* at 176).

Section 180(2)(d) follows the wording of the ALI formulation. For s 180(2)(d) to be satisfied, the director or officer must in fact hold the belief that it describes. The ALI gives an explanation of the phrase "rationally believes" (see *Austin, Ford and Ramsay*, [6.10]), but in the Australian context there is an express statutory explanation, namely that the director or officer's belief is taken to be a rational belief unless no reasonable person in his or her position could have held it. If that statutory language were read as converting the "rational belief" criterion into a "reasonable person" criterion, the statutory business judgment rule would be rendered useless, because s 180(2)(d) would only be satisfied in circumstances where there would be no breach of the reasonable person standard of care and diligence. For that reason, in *Australian Securities and Investments Commission v Rich* (2009) 75 ACSR 1; [2009] NSWSC 1229; BC200910410 at [7285]–[7294], it was held that s 180(2)(d) is satisfied if the evidence shows that the defendant believed that his or her judgment was in the best interests of the corporation, and that belief was supported by a reasoning process sufficient to warrant describing it as a rational belief, as defined, whether or not the reasoning process was objectively a convincing one. In an earlier case (*Re HIH Insurance Ltd (in prov liq); Australian Securities and Investments Commission v Adler* at 176), s 180(2)(d) was held not to have been satisfied when a director approved a transaction in reliance on the investment ability of another director, without ensuring that adequate documentation was in place and legal advice to protect the company's position was obtained.

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Definitions and cross-references for s 180

"Director" and "officer" are defined in s 9. There is no reason to contend that any part of the definition of "director" is inapplicable to s 180(1), and therefore the statutory duty of care and diligence applies both to de facto and shadow directors. Note that "officer" includes the company secretary, and that by virtue of the definition of "officer", a receiver, administrator or liquidator of a corporation is subject to the statutory duty of care and diligence.

"Corporation" is defined in s 9 and s 57A. As to the extraterritorial application of s 181, see [2D.181].

As to s 180(2)(a), see [2D.181], and as to s 180(2)(b), see [2D.191].

The significance of s 180(1) being a civil penalty provision is explained in Pt 9.4B. Section 1317E(1) provides that if the court is satisfied that the person has contravened s 180(1), it must make a declaration of contravention, and may make a pecuniary penalty order or a disqualification order or compensation order.

Section 180 does not, in terms, say whether contravention of s 180(1) is a criminal offence. The heading of the section says "civil obligation only", but the heading of a section of an Act is not part of the Act (Acts Interpretation Act 1901, s 13(3); made applicable by CA, s 5C). However, there is no provision rendering contravention of s 180(1) a criminal offence. No penalty for contravention of s 180(1) is set out in Sch 3. Section 180(1) does not forbid a person from doing an act or thing or require or direct a person to do an act or thing, for it is addressed to how certain acts or things (namely, the exercise of powers and the discharge of duties) are done rather than whether acts or things are or are not done. Therefore the general penalty provision, s 1311(1) does not apply. Thus, contravention has merely civil consequences, under Pt 9.4B.

History and explanatory materials for section 180(1)

The evolution of the present statutory wording in s 180(1) was traced in *Re HIH Insurance Ltd (in prov liq); Australian Securities and Investments Commission v Adler* (2002) 41 ACSR 72; 20 ACLC 576; [2002] NSWSC 171; BC200200827; *Australian Securities and Investments Commission v Rich* (2003) 44 ACSR 341; 21 ACLC 450; [2003] NSWSC 85; BC200300433 at [31]–[50] and *Australian Securities and Investments Commission v Vines* (2003) 48 ACSR 322; 22 ACLC 37; [2003] NSWSC 1116; BC200308116 at [8]–[24] and [41]–[46].

The drafting history of s 180(1) is, very largely, the history of attempts by the legislature to balance, on the one hand, demands for an objective standard of care that would move away from the laxity of the nineteenth century, and on the other hand, repeated submissions which advocated a "subjective" test that would take into account the specific background and circumstances of the defendant. An ancillary theme related to whether criminal sanctions should be attached to contravention of the statutory standard of care for company directors and officers, when mere negligence is not a criminal offence for anyone else.

UCA s 124(1) said a director shall at all times use reasonable diligence in the discharge of the duties of his office (following s 107 of the Companies Act 1958 (Vic)). The statutory duty was confined to directors, not other officers. Contravention was a criminal offence: s 124(3)(b).

The section did not refer to "care" or "skill". The omission of the word "skill" was thought to be significant, and it was said that the section had adopted only one aspect of the concept of negligence, as developed in the general law cases including *City Equitable* and as acted upon by the courts on misfeasance summonses against directors (*Byrne v Baker* [1964] VR 443 at 450 and 452–3). This reasoning implied that the statutory duty

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of diligence was subjective, in the sense that it was limited to what might reasonably be required of the particular defendant director under the circumstances (*Byrne v Baker* [1964] VR 443 at 450).

The first draft of the CC, proposed in 1980, adopted a proposal in the National Companies Bill 1975 to enact a "more objective test of diligence", based on Canadian legislation (EM to the National Companies Bill 1975, [90]; *Explanatory Paper on Proposed New Australian Companies Code*, 28 March 1980, p 129). The draft would have required an officer of a corporation (including a director) to exercise, in relation to the business or affairs of the corporation, a degree of care, diligence and skill not less than the degree of care, diligence and skill that a reasonably prudent person would exercise in relation to his own business or affairs in comparable circumstances. The "reasonably prudent person" test would have been an objective test not unlike the standard of care of a trustee. It would have been difficult to apply, in the case of a large corporation, because a large corporation's complex and extensive business and financial affairs would have no parallel in personal business affairs. There was concern that imposing the trustee's duty of care on directors would dampen their entrepreneurial endeavours.

Later drafts, and s 229(2) of the CC as enacted in 1981, abandoned this proposal, without any explanation in the explanatory materials. Section 229(2) reverted to the wording of UCA s 124, except that it extended to executive officers as well as directors, spoke of the exercise of powers as well as the discharge of duties, and was a duty to "exercise a reasonable degree of care and diligence" (although the word "skill" was still not employed). A specific pecuniary penalty was prescribed for contravention.

Section 229(2) was thought to be ambiguous on the question whether the "reasonable degree of care and diligence" required of an officer was to be measured by an objective standard that would not take into account the defendant's state of knowledge, experience and personal circumstances (see EM to the CLR Bill 1992 [94]). In 1989 the Senate Standing Committee on Legal and Constitutional Affairs, under the chairmanship of Senator Cooney, published a report entitled *Company Directors' Duties: Report on the Social and Fiduciary Duties & Obligations of Company Directors*, which said that the standard of care for directors was still subjective ([3.19]) and recommended the enactment of an objective standard ([3.28]). However, s 232(2) of the CL, which commenced in January 1991, preserved the substance of the wording of s 229(2) the CC, except that the specific money penalty was removed and the provision was therefore subject to the general penalty provision.

The CLRA 1992 replaced s 232(2) with a new provision, s 232(4). Before the new provision was enacted, the Government released a public exposure draft under which directors and officers would be required, in the exercise of their powers and the discharge of their duties, to exercise the degree of care and diligence "that a reasonable person would exercise in exercising those powers, and discharging those duties, as an officer of a corporation in the corporation's circumstances". According to the explanatory paper for the public exposure draft ([94] and [98]), the introduction of the concept of "an officer of a corporation in the corporation's circumstances" was intended to "reinforce" the view that the duty of care was an objective one, thus overcoming a concern that the duty of care under the old provision may have been measured by reference to the particular officer's knowledge and experience, a subjective standard that was too low.

The explanatory paper ([101]) drew a distinction between the director's circumstances (raising matters such as whether the director was an executive or non-executive director, or are paid or honorary director), and the company's circumstances, and said that the court would not be required to consider matters relevant to the director's circumstances unless they were also relevant to the company's circumstances.

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According to the exposure draft formulation, the standard of care was to be the standard of a reasonable person acting as "an officer" in the corporation's circumstances. But it was unclear whether the reasonable person should be assumed to be:

(i) an officer of some kind, but no particular kind (an interpretation implied by [101] of the explanatory paper); or
(ii) an officer occupying the same kind of position as was occupied by the defendant (eg, chief executive officer if the defendant was the CEO, or chief financial officer if the defendant was the CFO); or
(iii) an officer occupying the same kind of position as was occupied by the defendant, together with all of the factual arrangements and circumstances affecting the content of the responsibilities attached to that office, but excluding personal characteristics of the defendant including the defendant's state of knowledge, expertise and experience; or
(iv) an officer holding the very position in fact occupied by the defendant, with the personal characteristics of the defendant as to knowledge, expertise and experience.

Note, in passing, that the public exposure draft also proposed to set out a list of factors to be considered by the court in determining whether the duty had been breached (cl 232(4AA)). That provision was abandoned when the Bill was introduced into Parliament. According to the EM for the Bill, a number of submissions had been received, which suggested that the guidance intended to be provided was not necessary and could be counter-productive ([39]). But, as mentioned earlier, the list continues to be useful to indicate the kinds of things relevant to the court's determination.

In the form in which it was introduced into Parliament, and enacted, s 232(4) stated:

> In the exercise of his or her powers and the discharge of his or her duties, an officer of a corporation must exercise the degree of care and diligence that a reasonable person in a like position in a corporation would exercise in the corporation's circumstances.

Thus, the reference in the public exposure draft to the degree of care and diligence that a reasonable person would exercise "as an officer of a corporation in the corporation's circumstances" became a reference to "a reasonable person in a like position in a corporation . . . in the corporation's circumstances". The words "in a like position in a corporation" appear to have been intended to overcome the ambiguity, noted above, as to what office the reasonable person was to be assumed to hold. The introduction of those words was inconsistent with para 101 of the explanatory paper for the public exposure draft, and with the first alternative interpretation of the exposure draft (see (i) above). But the language remained ambiguous as to the other three possible interpretations ((ii), (iii) and (iv) above). The EM accompanying the Bill did not overcome the uncertainty. It said that the new wording would maintain "the endorsement of a more objective test . . . while at the same time ensuring that our courts have complete freedom to take into account all relevant considerations in applying the test". It was said that the phrase "in a like position" would enable the court to look both at any special expertise held by individual directors and the distribution of functions within the corporation ([39]). The EM also said ([85]):

> Australian law recognises that the special background, qualifications and management responsibilities of the particular officer may be relevant in evaluating his or her compliance with standard of care. At the same time, Australian or also recognises that decisions must be made on the basis of the circumstances at the time and without the benefit of hindsight.

These statements in the EM suggest that in s 232(4), the words "in a like position" were intended to encompass the subjective characteristics of the defendant, as regards

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background (including, presumably, experience), qualifications and expertise, as well as the particular factual responsibilities assigned to the defendant within the corporation — in other words, that the reasonable person to which the section referred was to be a reasonable person in the exact position of the defendant in terms of background, qualifications, expertise and experience (alternative (iv) above). On this view, any special expertise or experience of the defendant was to be taken into account to raise the standard of care in the particular case (see *Australian Securities and Investments Commission v Rich* (2003) 44 ACSR 341 at 350–1; 21 ACLC 450; [2003] NSWSC 85; BC200300433). This construction would also imply, though the EM did not expressly say so, that a lack of experience or expertise would be relevant to set the standard in the particular case at a lower level, on the ground that the "like position" to be considered was the position of a person with that limited level of experience and expertise.

But the wording of s 232(4) is surely inconsistent with the construction favoured by the EM, for there is a distinction between a person's background, expertise, qualifications and experience, on the one hand, and the *position* occupied by that person, on the other hand. It seems that the drafters' expressed intention was not achieved in the enacted provision.

The EM to the 1992 Bill ([86]) gave a useful explanation of the words "in the corporation's circumstances", saying that the proposed wording: "will recognise that what constitutes the proper performance of the duties of a director of a particular corporation will be influenced by matters such as the state of the corporation's financial affairs, the size and nature of the corporation, the urgency and magnitude of any problem, the provisions of the corporation's constitution, and the composition of its board."

The CLRA 1992 also removed the criminal consequences of a contravention of the statutory duty of care and diligence, introducing a civil penalties regime and rendering s 232(4) a civil penalty provision. Consequently a contravention of s 232(4) exposed the defendant to a declaration of contravention, a pecuniary penalty order, a disqualification order or a compensation order, but not criminal prosecution. Special statutory civil liability provisions in s 232(7) and (8) were removed. However, a contravention of the statutory duty of care and diligence could give rise to a criminal penalty where the contravention occurred knowingly, intentionally or recklessly, and either dishonestly with intention to gain an advantage or with intention to deceive or defraud (s 1317FA(1)).

The statutory duty took its current form in CLERP Act 1999, which took effect on 13 March 2000. The criminal offence in s 1317FA(1) was removed, on the ground that the concept of negligence is inconsistent with dishonesty, the latter suggesting an active awareness of wrongdoing rather than a failure to exercise due care and diligence (EM to the Corporate Law Economic Reform Program Bill, [6.76]).

The reference to "the corporation's circumstances" was retained and seems intended to have the meaning identified in the EM to the 1992 Bill (set out above). But s 180(1) removed the unsatisfactory reference to "a like position in a corporation", and inserted a reference to "the office held by" the defendant and a reference to having "the same responsibilities within the corporation" as the defendant. It has been suggested that the change of wording was partly intended to make clear, after *Daniels*, that non-executive directors are not subject to the same (higher) standard as executive directors are, and partly to affirm that the statutory standard, while related to the office held in the responsibilities of that office, was intended to be an objective standard (*Australian Securities and Investments Commission v Rich* (2009) 75 ACSR 1; [2009] NSWSC 1229; BC200910410 at [7196]).

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Before the Bill was introduced into Parliament, the Government released a proposal paper, *Directors' Duties and Corporate Governance* (Corporate Law Economic Reform Program, Paper No 3). According to the proposal paper ([6.2]), the statutory duty of care was to be re-worded in response to concerns in the business community about the implications of the Court of Appeal's decision in *Daniels*:

> While the majority in that case recognised that not every director can be expected to have equal knowledge and experience of every aspect of the company's activities, they took the view that non-executive directors were subject to the same standard of care and diligence as executive directors and that the standard was an objective one.

This, according to the paper, had raised concern (well founded, it seems) that the statutory formulation of the standard of care and diligence did not sufficiently allow differences in the qualifications and experience of individual directors to be taken into account; that is, the word "position" might have connoted the particular circumstances of the director's office rather than the director's personal qualities. The paper accordingly proposed an amendment along the lines of s 180(1) as enacted, except that instead of referring to a reasonable person having the "same responsibilities" as the director or officer, the proposed wording would refer to a reasonable person having the director or officer's "experience, powers and duties".

The fact that those words were abandoned in the Bill as introduced into Parliament suggests that there was a decision that the standard of care was to be objective. But the significance of the change of wording was obscured by the EM to the Bill, [6.74]–[6.75]:

> The explanatory memorandum [to the Corporate Law Reform Bill 1992] indicated that the words 'in a like position' were intended to allow consideration of the special background, qualifications and management responsibilities of a particular officer in evaluating their compliance with the standard of care. However, doubt has been expressed about whether current s 232(4) enables the Courts to have regard to the circumstances of the particular officer as well as their position in the corporation. The draft provisions have been rewritten to clarify that whether the officer has reached the standard of care and diligence is determined both by regard to the corporation's circumstances and the officer's position and responsibilities within the corporation.

The first sentence is true but, as explained, the language used in s 232(4) failed to convey the idea that the special background and qualifications of the officer were to be taken into account. The second sentence is correct and the doubt so expressed was well founded. The third sentence is a reasonably accurate summary of what s 180(1) says, but it does not make clear whether the drafters intended that the new formulation would bring into account the subjective background, qualifications experience and expertise of the officer. If that was their intention, then (once again) the drafting failed to achieve it (see *Australian Securities and Investments Commission v Rich* (2003) 44 ACSR 341 at 351; 21 ACLC 450; [2003] NSWSC 85; BC200300433).

There is, on the face of it, an important distinction between the words of the section, "the same responsibilities within the corporation", and the words earlier proposed, namely "experience, powers and duties". An officer's responsibilities within the corporation are objective, bilateral arrangements between the officer and the corporation, while the officer's experience is a subjective attribute of that person. By abandoning the proposal to refer to "experience", the drafters made it clear that the standard of care and diligence is an objective one, not directly dependent upon the individual officer's background, expertise or experience. As explained above, these subjective matters are relevant only if, on the evidence, they have been taken into account in the allocation of responsibilities to the officer.

Finally, note that in contrast with ss 181–183, there is no civil penalty provision in s 180 for involvement in a contravention of the statutory duty of care and diligence. Prior

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to CLERP Act 1999, s 1317DB provided that, for the purposes of Pt 9.4B, a person involved in a contravention of a particular provision of the CL was taken to have contravened that provision. Although there is no explanation in the explanatory materials, it was evidently thought inappropriate to continue with civil penalty liability for involvement in a breach of the duty of care and diligence.

History and explanatory materials for ss 180(2) and (3)

The statutory "business judgment rule" in s 180(2) and (3) was introduced into the corporations legislation by CLERP Act 1999. The history of the development of these provisions is fully set out in *Austin, Ford and Ramsay*, [6.11]. In summary:

- the Cooney Committee (Senate Standing Committee on Legal and Constitutional Affairs) recommended in its report on *Company Directors' Duties* (November 1989) that a statutory business judgment rule be introduced into Australian law, effectively as a quid pro quo for making it clear that the duty of care was to be an objective one;
- the Companies and Securities Law Review Committee (CSLRC) also recommended the enactment of a business judgment rule (*Indemnification, Relief and Insurance*, Report No 10 (May 1990), [68]–[92]), to provide legislative recognition of the commercial reality that a limited liability company is a vehicle taking commercial risks;
- the CSLRC Report contained an elaborate draft rule;
- the House of Representatives Standing Committee on Legal and Constitutional Affairs (*Corporate Practices and the Rights of Shareholders* (November 1991), [5.4.22]–[5.4.30]) recommended the enactment of a business judgment rule essentially in the form proposed by the CSLRC;
- but these recommendations were not adopted by the Government in the CLR Act 1992, on the grounds that an honest director could be excused under s 1318 and the question of development of a business judgment rule should be left to the courts, as had occurred in the US, in view of some Australian case law (such as *Harlowe's Nominees Pty Ltd v Woodside (Lakes Entrance) Oil Co NL* (1968) 121 CLR 483 at 493; 42 ALJR 123; BC6800800) that appeared to provide scope for that to occur (see EM to the 1992 Bill [87]–[89]).

The purpose of the reforms to the law of directors' duties introduced by CLERP Act 1999 was said to be to improve the efficiency of corporate regulation and reduce regulatory burdens on business, so as to facilitate a more efficient and competitive business environment (EM [2.1]). A statutory business judgment rule was thought to promote those objectives.

The proposal for a business judgment rule was introduced in Paper No 3 of the Corporate Law Economic Reform Program Proposals for reform, *Directors' Duties and Corporate Governance: Facilitating Innovation and Protecting Investors* (1997). The business judgment rule was seen as part of the strategy for balancing calls by shareholder groups for greater accountability of directors against demands by director groups for greater certainty in respect of their potential liabilities (Paper No 3 [5.1]). It was presented as a quid pro quo for the introduction of a statutory derivative action.

It is plain from the discussion in CLERP Paper No 3 that the government's proposal was for the introduction of a rule operating along the same lines as the US rule, which creates a safe harbour for directors from liability for business judgments on certain conditions, and also makes a presumption in favour of the directors that those conditions are satisfied, so that it is up to the person challenging the directors' conduct to prove that one or more of those ingredients is not present. The Paper specifically advocates the establishment of a statutory presumption (see CLERP Paper No 3, pp 25, 28). However,

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when the authors of the Paper sought out a US formulation of the rule (CLERP Paper No 3, at [5.2.3]), and turned to the formulation contained in the American Law Institute's *Principles of Corporate Governance: Analysis and Recommendations* (1992), they were selective, seizing upon the statement of the ingredients of the business judgment rule found in para 4.01(c) while disregarding the ALR's statement about the onus of proof in para 4.01(d). Paragraph 4.01(d) made it clear that it was up to the person challenging the conduct of a director or officer to prove the inapplicability of the ingredients of subs (c), which consequently would be presumed to be satisfied unless the onus was discharged. CLERP Paper No 3 was internally inconsistent in advocating that the rule operate as a presumption in favour of the directors, while at the same time proposing a rule that, in its terms, would only apply if the conditions for its application were satisfied. That inconsistency was carried over into the drafting of s 180(2) and the explanatory memorandum for CLERP 1999.

According to the EM for the 1999 Bill, the business judgment rule offers directors a safe harbour from personal liability in relation to honest, informed and rational business judgment ([6.1]). Concern was expressed in the EM ([6.3]) that "a failure to expressly acknowledge that directors should not be liable for decisions made in good faith and with due care, may lead to failure by the company and its directors to take advantage of opportunities that involve responsible risk-taking". This statement is misleading, because if the decision is taken with due care, there is no occasion for the application of s 180(2). The effect of s 180(2) is that the officer is taken to have met the requirements of the statutory duty of care and diligence if a number of factors, not including "due care", are present.

Texts and literature

Ford [8.305]–[8.350]; *ACLPP* [3.2.0375]–[3.2.0370]; and esp *Austin, Ford and Ramsay*, Ch 6 (and note the pervasive significance that the duty of care has in other areas analysed by the authors, including the duty to act lawfully and within authority (Ch 11), duties with respect to meetings (Ch 12) and duties with respect to capitalraising (Ch 13), to which one might add duties with respect to the takeover process). For a thorough and useful summary of the general law and the position under the UCA, see *Wallace and Young* pp 393 ff. There is a good discussion of the English position prior to the Companies Act 2006 in *Pennington* pp 731 ff.

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