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Abstract

Legal scholars have long discussed the gap, or “acoustic separation”, between stringent standards of conduct (“conduct rules”) and more lenient standards of review (“decision rules”) in legal regulation. This gap has been particularly stark in the United States in relation to directors’ duty of care. The goal of this chapter is to explore a range of developments relating to directors’ duties across several common law jurisdictions, including the US, UK Australia and Canada against the backdrop of conduct and decision rules. For example, contemporary Australian case law on the duty of care and diligence, although highlighting the ongoing tension between conduct rules and decision rules, diverges from US law in many key respects. Also, under Australia’s regulatory model, the Australian Securities and Investments Commission (“ASIC”), the primary corporate regulator, operates as the main enforcement mechanism for breach of directors’ duties. Finally, the chapter assesses some recent developments in the common law world on the perennial issue of to whom directors owe their duties, and the extent to which stakeholder interests can, or must, be taken into account in board decision-making.

Keywords: Global Financial Crisis, Corporate Governance, Directors, Boards, Monitoring, Directors’ Duties, Directors’ Liability, Duty of Care, Business Judgment Rule, Duty of Oversight, James Hardie Litigation, Centro Litigation, Financial Disclosure

JEL Classifications: G18, G28, G30, G32, G38, K20, K22, 016

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Evolving Directors’ Duties in the Common Law World

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1. Introduction

Legal scholars have long discussed the gap, or “acoustic separation”, between stringent standards of conduct (“conduct rules”) and more lenient standards of review (“decision rules”) in legal regulation.¹ This gap has been particularly stark in the United States in the area of directors’ duties.² For example, although the duty of care appears on its face to be a relatively strict doctrine, adjudication by the courts has tended to be generous to directors. The gap between conduct and decision rules is also relevant to the question of whose interests directors should take into account in the performance of their duties.

The goal of this chapter is to explore a range of developments relating to directors’ duties across several common law jurisdictions, against the backdrop of conduct and decision rules. The chapter is structured as follows. First, it examines US law relating to directors’ duty of care and the business judgment rule, from the perspective of acoustic separation. As US case law, such as the Disney litigation,³ shows, the liability risk to directors, particularly non-executive directors, for breach of the duty of care is negligible.⁴

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Secondly, the chapter discusses some contemporary Australian case law on directors’ duty of care and diligence, which highlights the ongoing tension between conduct rules and decision rules, yet diverges from US law in many respects. Under Australia’s regulatory model, the corporate regulator, namely the Australian Securities and Investments Commission (“ASIC”), operates as the main enforcement mechanism for breach of directors’ duties. The section of the chapter provides a detailed examination of three important recent cases brought by ASIC in the context of the duty of care and diligence – the James Hardie litigation, ASIC v Rich, and the Centro litigation.8

Finally, the chapter assesses some recent developments in the common law world on the perennial issue of to whom directors owe their duties, and the extent to which stakeholder interests can, or must, be taken into account in board decision-making. This is by no means a new topic in corporate law. It dates back at least to the 1930s, when Professors Berle and Dodd engaged in their seminal debate on the subject. However, corporate scandals at the turn of the last decade, such as Enron, gave this issue new momentum, and this has continued through the global financial crisis. Developments in this regard include the introduction in 2006 of a controversial statutory duty for directors in the United Kingdom, two Australian government reports on corporate responsibility, and some interesting recent case law in Australia and Canada on directors’ duties and stakeholder interests.

2. Conduct Rules and Decision Rules in the United States – Disney, Van Gorkom et alia


8 ASIC v Healey (2011) 196 FCR 291.

Professors Melvin Eisenberg\(^\text{10}\) and Meir Dan-Cohen\(^\text{11}\) have written about the gap between standards of conduct and standards of review in legal regulation. Their analysis assumes a divergence, or “acoustic separation”, between the messages directed to legal actors as conduct rules, and the messages directed to the courts as legal adjudicators via decision rules. Although this paradigm is not without its critics,\(^\text{12}\) it is a helpful way to conceptualise US developments concerning director’s duties where, in many cases, the regulatory bark has been much worse its bite.\(^\text{13}\)

In the United States, nowhere has this regulatory dissonance been more striking than in the area of directors’ duties,\(^\text{14}\) where the law often reveals a divide between legal rules and aspirational standards.\(^\text{15}\) Thus, although conduct rules under US corporate law require directors to act with a reasonable degree of care and diligence,\(^\text{16}\) the business judgment rule provides protection to directors at the time of any adjudication of their actions.\(^\text{17}\) With the

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\(^{12}\) See Singer, “On Classism and Dissonance in the Criminal Law: A Reply to Professor Meir Dan-Cohen” (1986) 77 J Crim L & Criminology 69; and Velasco, “The Role of Aspiration in Corporate Fiduciary Duties” (2012) 54 Wm & Mary L Rev 519, 17-21. Both authors argue that “acoustic separation” between the rules communicated to the public and those communicated to officials cannot, and perhaps more importantly should not, be maintained. Velasco is particularly critical of the application of the concept in the context of director’s duties, because directors can be expected to have obtained legal advice and thus be aware of the decision rules that apply to them: \textit{id.},541.


\(^{16}\) Prior to 1998, the US Model Business Corporation Act (MBCA) § 8.30(a)(2), borrowing from concepts of tort law, required directors to carry out their duties “with the care an ordinarily prudent person in a like position would exercise under similar circumstances”. Amendments were introduced by the ABA Committee on Corporate Laws in 1998, which altered the wording of § 8.30(a)(2) to require directors to “discharge their duties with the care that a person in a like position would reasonably believe appropriate under the circumstances”.

notable exception of the famous Delaware Supreme Court decision in the mid-1980s, *Smith v Van Gorkom*,¹⁸ this protection is capacious. The disciplinary effect of the *Van Gorkom* “bomb”¹⁹ proved to be remarkably short-lived. Delaware responded to the decision, by rapidly enacting § 102(b)(7) of the Delaware General Corporations Law (“DGCL”), which authorised inclusion in the corporate charter of exculpation provisions for this kind of breach.²⁰

Liability for breach of duty of care has always been rare in the United States and tends to be limited to egregious conduct that also implicates the duty of loyalty.²¹ Recent US case law continues this trend.²² The business judgment rule has been a prominent buffer against director liability. Nonetheless, other factors, including delegation, exculpation clauses in corporate charters and insurances, have also effectively insulated US directors, particularly non-executive directors, either from liability or the financial consequences of liability for breach of the duty of care.²³

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The high profile Disney litigation provided a good example of the gap between conduct rules and decision rules in the United States. In 2003, the Delaware Court of Chancery confirmed that a shareholders’ derivative action for breach of duty could proceed against directors and officers at the Walt Disney Company (“Disney”) who approved an executive contract that resulted in payment of a US$140 million severance package to former President, Michael Ovitz, for a mere 15 months of unremarkable work. Some obiter dictum in this case caused consternation in the US business community, by suggesting that directors would lose the protection of the business judgment rule if their conduct could be characterised as reckless and in conscious disregard of known risks. The 2003 Disney decision therefore countenanced a narrowing of the traditional gap between conduct rules and decision rules in these particular circumstances.

Subsequent decisions in the Disney litigation, however, restored both “acoustic separation” to the duty of care, and equanimity to US company directors. In his 2005 decision, which considered whether Disney’s directors had breached their duties in approving Mr Ovitz’s extravagant termination package, Chancellor Chandler condemned the behaviour of the directors and officers of Disney in approving the package, and identified serious procedural flaws in the pay determination process. Accusing the board of “collective kowtowing”, Chancellor Chandler described Disney as a place where CEO, Michael Eisner, had “enthroned himself as the omnipotent and infallible monarch of his personal Magic


25 In re the Walt Disney Company Derivative Litigation, 825 A.2d 275 (Del. Ch., 2003).

26 For a good summary of the background facts relating to the appointment and removal of Michael Ovitz, see “Recent Cases” (2006) 119 Harv L Rev 923, 923-926.

27 According to Chancellor Chandler, this would occur if the “defendant directors consciously and intentionally disregarded their responsibilities, adopting a ‘we don’t care about the risks’ attitude”. In re the Walt Disney Company Derivative Litigation, 825 A.2d 275, 289 (Del. Ch., 2003) (original emphasis). Another matter of great concern to directors arising from this dictum was that such a finding could also deprive them of the protection of exoneration clauses in corporate charters. See, for example, s 102(b)(7) Delaware General Corporation Law.

28 In re The Walt Disney Company Derivative Litigation, 907 A.2d 693 (Del. Ch., 2005).

29 See id, 708, 734, 736-777.

30 Id., 761, n 488 (Del. Ch., 2005).
Kingdom”.  

Although some scholars argue that the days of the “imperial” CEO are now numbered, such imperialism appeared to be alive and well at Disney during this period.

Although Chancellor Chandler considered the actions of Disney’s directors to provide “many lessons of what not to do” as a director, he, nonetheless, drew a sharp distinction between legally enforceable directors’ duties and “aspirational” standards of corporate governance. According to Chancellor Chandler:

> Delaware law does not - indeed, the common law cannot - hold fiduciaries liable for a failure to comply with the aspirational ideal of best practices...

Chancellor Chandler’s 2005 decision, which was approved by the Delaware Supreme Court the following year, reflected a clear gap between conduct rules and decision rules. He considered that, although the defendants’ behaviour fell well short of aspirational standards, it did not constitute a breach of legally enforceable duties. In spite of numerous procedural flaws, he held that, since the directors acted in good faith and “did not intentionally shirk or ignore their duty”, their actions were protected by the business judgment rule. Although some commentators consider that the business judgment rule rests upon a rational policy basis for others, the outcome of the Disney litigation merely perpetuated what has been

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31 Id., 763.


33 In re The Walt Disney Company Derivative Litigation, 907 A.2d 693, 760 (Del. Ch., 2005).

34 A leading proponent of the aspirational theory of fiduciary duties in the United States was Chancellor Allen of the Delaware Court of Chancery, who stated that the US duty of care was “essentially aspirational: informing well-intentioned persons of what they should be doing in a general way…” See generally Velasco, “The Role of Aspiration in Corporate Fiduciary Duties” (2012) 54 Wm & Mary L Rev 519, 537-538.


36 In re the Walt Disney Company Derivative Litigation, Del.Supr., 906 A.2d 27 (2006). In the decision of the Delaware Supreme Court, Jacobs J considered that there were rational commercial justifications for the Disney directors agreeing to the enormous termination payment to Michael Ovitz. See id, 58.

37 Id, 772.

38 See, for example, Winter J’s discussion of some of the policy justifications for the business judgment rule in Joy v North, 692 F.2d 880, 885-86 (1982).
described as Delaware’s “elaborate theology of deference” to decisions of the board of directors.\textsuperscript{39}

The Disney litigation\textsuperscript{40} sits somewhat uncomfortably with Smith v Van Gorkom,\textsuperscript{41} decided more than twenty years earlier, which itself had been described as “a recital of explicit and implicit do’s and don’ts” for directors.\textsuperscript{42} In Van Gorkom’s case, however, the Delaware Supreme Court held the directors liability for breach of the duty of care, noting that mere absence of bad faith or fraud was insufficient to satisfy the duty.\textsuperscript{43}

The 2005 Disney decision accords with the approach taken in other contemporary US cases, such as In re Caremark International Inc. Derivative Litigation (“Caremark decision”),\textsuperscript{44} which also recognise a divide between aspirational and legally enforceable rules.\textsuperscript{45} Although some of Chancellor Allen’s rhetoric in the Caremark decision suggested the espousal of a more stringent duty of oversight,\textsuperscript{46} this was ultimately counteracted in the case by certain

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\textsuperscript{40} In re The Walt Disney Company Derivative Litigation, 907 A.2d 693 (Del. Ch., 2005).

\textsuperscript{41} Del.Supr., 488 A.2d 858 (1985). It has been suggested that Smith v Van Gorkom can be reconciled with the later cases by recognising that Smith v Van Gorkom was essentially a takeover case, rather than a case about business judgment. See Macey and Miller, “Trans Union Reconsidered” (1988) Yale Law Journal 127, 128. Nonetheless, Chancellor Chandler went to some lengths in the 2005 Disney decision to distinguish the case from Smith v Van Gorkom. Some of his points of distinction were transactional, others were not. In re The Walt Disney Company Derivative Litigation, Del.Ch., 907 A.2d 693, 767 (2005). See generally Hill, “Centro and the Monitoring Board – Legal Duties versus Aspirational Ideals in Corporate Governance” (2012) 35 UNSW LJ 341, 350-351.

\textsuperscript{42} See Manning, “Reflections and Practical Tips on Life in the Boardroom After Van Gorkom” (1985) 41 Business Law 1. For a list of the relevant do’s and don’ts for directors in the context of the Smith v Van Gorkom decision, see id, 7, Appendix.

\textsuperscript{43} Smith v Van Gorkom, Del.Supr., 488 A.2d 858, 872 (1985).


\textsuperscript{46} The Caremark decision reassessed directors’ duties of oversight thirty years after the former leading case, Graham v Allis-Chalmers Manufacturing Company, Del., 188 A.2d 125 (1963), which had previously set a relatively undemanding standard for directors in terms of their oversight duty.
procedural limitations and presumptions, including the business judgment rule, which ultimately protected the board of directors from liability.\(^{47}\)

3. Recent Australian Case Law on the Duty of Care – A ‘Wake-Up Call from Down Under’?\(^{48}\)

Recent Australian case law on directors’ duty of care reflects the continuing tension between conduct rules and decision rules. Whereas contemporary US law tends to be relatively static and predictable in this regard, Australian case law exhibits greater fluidity. Some recent Australian decisions strongly suggest a narrowing of the traditional “acoustic separation”.

Australia has a distinctive regulatory model for the enforcement of directors’ duties. In contrast to the United States and the United Kingdom, where the primary means of enforcing breach of directors’ duties is by way of private litigation,\(^{49}\) Australia’s regulatory system\(^{50}\) relies heavily on a public enforcement model.\(^{51}\) Under this paradigm, the Australian Securities and Investments Commission (“ASIC”) operates as the main enforcement

According to the decision in *Graham v Allis-Chalmers Manufacturing Company*, the directors were entitled to rely upon the integrity of their subordinates in the absence of grounds for suspicion, and were not required “to install and operate a corporate system of espionage to ferret out wrongdoing which they have no reason to suspect exists”. *Id*, 130.


mechanism for breach of directors’ duties under Australia’s civil penalty regime. The goal of the civil penalty regime at the time of its introduction in 1993 was to draw a clearer line between civil and criminal liability. However, these boundaries have become increasingly blurred since that time. ASIC has extensive enforcement powers under the civil penalty regime, including power to enforce breaches of the statutory duty of care and diligence under s 180(1) of the Corporations Act. In the light of these broad powers, ASIC has been described as occupying a “special role…as a regulator”.

In recent years, ASIC has brought numerous cases alleging breach of directors’ duty, many of which reflect the shifting balance between standards of conduct and standards of review. A high profile example of this trend relates to Australia’s well-known James Hardie saga.

3.1 The James Hardie Saga

James Hardie Industries Ltd (“JHIL”), a public company with shares listed on the Australian Stock Exchange (“ASX”), was the ultimate holding company of the James Hardie group. Two of its wholly owned subsidiaries were involved in the manufacture and sale of asbestos


53 See, for example, Rich v ASIC (2004) 220 CLR 129, where, in recognition of the blurring of these boundaries, the High Court of Australia rejected an argument that the civil penalty provisions are purely “protective” in nature.

54 As the NSW Court of Appeal noted in Morley v ASIC (2010) 274 ALR 205, para [723], ASIC alone is granted authority under s 1317J(1) of the Corporations Act to apply for a declaration of contravention or for a pecuniary penalty under the civil penalty regime in Part 9.4B of the Corporations Act.

55 For a list of ASIC’s general enforcement powers, see Morley v ASIC (2010) 274 ALR 205, para [725].

56 \textit{Id}, para [724].

57 For a summary of some of the key cases for breach of directors’ duties brought by ASIC in recent years, see Gibson and Brown, “ASIC’s Expectations of Directors” (2012) 35 UNSW LJ 254.


in Australia until 1987. As a result of these operations, the James Hardie group was “haunted by…the spectre of asbestos litigation”.

In 2001, the James Hardie group undertook a complex restructure, which was designed to contain potential asbestos liabilities. The restructure included a “separation proposal”, whereby the two affected subsidiaries would be quarantined from the rest of the group. On 15 February 2001, JHIL held a critical meeting of its board of directors, at which the separation proposal was approved. The proposal included the creation of a Foundation to manage and satisfy asbestos claims, as well as conduct medical research into asbestos-related diseases. Also, a new company, James Hardie Industries NV (“JHINV”) would be incorporated in the Netherlands, replacing JHIL as the group’s ultimate holding company.

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63 ASIC v Hellicar (2012) 286 ALR 501, para [13]. The threat of asbestos litigation was viewed as deleterious to JHIL’s share price, and possibly the James Hardie group’s long-term viability. Id, paras [180] - [181]. This problem was exacerbated by the proposed adoption of a new accounting rule which would have required JHIL to disclose, not only known asbestos claims, but also expected future liability, and there was concern that this would negatively affect the company’s balance sheet. Id, paras [43], [50], [188].

64 The Foundation was a newly formed Australian company called the Medical Research and Compensation Foundation.

65 See James Hardie Industries Limited, James Hardie Resolves its Asbestos Liability Favourably for Claimants and Shareholders, 16 February 2001 (available at http://www.asx.com.au/asx/statistics/displayAnnouncement.do?display=text&issuerId=602&announcementId=645410). Under the corporate restructure, implemented in a Deed of Covenants and Indemnity, JHIL effectively transferred its shares in Coy and Jsekarb to the Foundation, agreeing to pay A$3 million for research and to pay over $100 million over time to the two subsidiaries, which, for their part, agreed to make no claim against JHIL and to indemnify JHIL with respect to any asbestos liabilities. See ASIC v Hellicar (2012) 286 ALR 501, paras [13], [49].

66 The restructuring, under which JHIL became a wholly owned subsidiary of James Hardie Industries NV (“JHINV”), was effected by a scheme of arrangement under s 411 of the Corporations Act 2001 (Cth). See generally Jackson QC, Report of the Special Commission of Inquiry into the Medical Research and Compensation Foundation (2004), 32-35.
The separation proposal, which effectively limited the funding available to satisfy present and future asbestos claims, was potentially controversial as asbestos compensation had become a matter of public interest and concern. On 16 February 2001, JHIL issued a market announcement to the ASX (“ASX announcement”) stating that the Foundation, which had starting assets of A$293 million, was “fully-funded”, with “sufficient funds to meet all future legitimate compensation claims…” The minutes of the board meeting one day earlier recorded that JHIL’s directors had considered and approved a draft of this announcement, although the directors later denied that this had occurred.

It soon became clear that JHIL’s assurance concerning adequacy of funding was false. In October 2003, the Foundation announced a massive funding shortfall and that it would soon exhaust the funds allocated to compensate victims. It was apparent that, far from being “fully-funded”, the Foundation would in fact be unable to satisfy any claims beyond the first half of 2007. The funding shortfall, coupled with estimated future asbestos liabilities assessed at A$1.5 billion, prompted the launch in 2004 of a Special Inquiry and Report (“Jackson Commission Report”). In 2005, following intense political pressure and public backlash, JHINV and the New South Wales state government entered into the largest personal injury settlement in Australian history.

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67 See ASIC v Hellicar (2012) 286 ALR 501, para [186].
69 These minutes were subsequently confirmed as having been “signed as a correct record” of JHIL’s 15 February board meeting by the chairman at JHIL’s next board meeting on 4 April 2001. See ASIC v Hellicar (2012) 286 ALR 501, para [15]; ASIC v Macdonald (No 11) (2009) 256 ALR 199, para [53].
74 The original Heads of Agreement signed in December 2004 provided for an open-ended funding agreement for a minimum term of 40 years, under which JHINV agreed to cover an estimated A$1.5
In spite of this settlement, in 2007 ASIC announced that it had filed civil penalty proceedings against former JHIL officers and directors. According to ASIC’s then-Chairman, the regulator’s objective in bringing the proceedings, which centred around JHIL’s disclosures concerning the Foundation’s adequacy of funding, was “to reinforce the standards of corporate behaviour that are vitally important in ensuring public confidence in Australia's corporate sector and capital markets.”

The *James Hardie* litigation traversed several courts between 2009 and 2012. Key decisions were *ASIC v Macdonald (No 11)* in the Supreme Court of New South Wales, *Morley v ASIC* in the New South Wales Court of Appeal, and finally *ASIC v Hellicar* in the High Court of Australia.

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75 It is interesting to note that JHINV tried, but failed, in its negotiation of the final Heads of Agreement, to obtain immunity for officers and directors from any civil action brought by ASIC. See Higgins, “Hardie board bid to desert victims”, *The Australian*, 13 August 2005, 4; Heywood, “Costello fights Hardie civil immunity claim”, *The Courier-Mail*, 29 November 2005, 7. In announcing the civil penalty proceedings, ASIC’s Chairman stated that, while new compensation arrangements “were very much welcomed, they do not diminish the need for those responsible for the breaches we have identified to be held to account for their actions”. See ASIC, Media Release 07-35, *ASIC commences proceedings relating to James Hardie*, 15 February 2007.


78 (2009) 256 ALR 199.


At first instance in *ASIC v Macdonald (No 11)*, Gzell J held that JHIL’s non-executive directors, together with the chief executive officer (“CEO”), chief financial officer (“CFO”) and the joint company secretary/general counsel, had breached the statutory duty of care and diligence under the *Corporations Act*. The judge subsequently imposed a five year disqualification order and a pecuniary penalty of A$30,000 for each of the non-executive directors.

Gzell J held that JHIL’s issuance of the final ASX announcement to the effect that the Foundation was “fully-funded” was misleading or deceptive, thereby contravening the *Corporations Act*. The non-executive directors were found to have breached the statutory duty of care and diligence under s 180 of the *Corporations Act* on the basis that they knew, or should have known, that unequivocal public statements of this kind could result in legal liability, harm to the company’s reputation, and market backlash. The specification of particulars of harm to the company was important, since it countered a possible argument, arising from the earlier decision of *ASIC v Maxwell*, that directors do not have automatic personal liability for breaches of law by the corporation itself.

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82 See *ASIC v Macdonald (No 12)* (2009) 259 ALR 116, paras [481] - [492].

83 At the time, ss 995 and 999 *Corporations Act 2001* (now replaced by ss 104H and 1308). See also *ASIC v Macdonald (No 11)* (2009) 256 ALR 199, paras [628], [638].

84 Section 180(1) states that:-

A director or other officer of a corporation must exercise their powers and discharge their duties with the degree of care and diligence that a reasonable person would exercise if they:

(a) were a director or officer of a corporation in the corporation’s circumstances; and
(b) occupied the office held by, and had the same responsibilities within the corporation as, the director or officer.

85 *ASIC v Macdonald (No 11)* (2009) 256 ALR 199, paras [259], [343].


87 See *id*, para [104]; Young QC, “Directors’ Duty of Care and Diligence: A Review in Light of the Recent Decision in *ASIC v Macdonald (No 11)*”, in Austin and Bilski (eds), *Directors in Troubled Times* (2009), 60, 91. See also Petrin, “The Curious Case of Directors’ and Officers’ Liability for Supervision and Management: Exploring the Intersection of Corporate and Tort Law” (2010) 59 *Am U L Rev* 1661, arguing that the current US liability regime fails to distinguish properly between corporate duties and duties of directors/officers, resulting in an unwarranted expansion of the latter group’s risk and potential liability.
Gzell J’s finding that JHIL’s board had approved a draft version of the final ASX announcement at its meeting on 15 February 2001, while consistent with the board minutes, directly contradicted the evidence of JHIL’s directors. In what was described as an example of “collective memory loss”, none of the defendant directors who gave evidence in the proceedings recalled the draft ASX announcement being tabled or approved at the meeting. In spite of the lack of “positive evidence” in this regard, Gzell J considered that such board approval could be inferred from other evidence which suggested that the draft ASX announcement had been brought to the board meeting.

The JHIL directors not only denied authorising the draft ASX announcement, but also asserted that they would not have authorised an unqualified announcement, thereby reinforcing ASIC’s claim that the announcement was indeed misleading or deceptive. The judge held that approval of the draft ASX announcement was part of the directors’ monitoring function, rather than a matter of “operational responsibility”.

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88 See ASIC v Macdonald (No 11) (2009) 256 ALR 199, para [53]. ASIC failed in an argument that these minutes should attract a statutory presumption of accuracy under s 251A(6) Corporations Act, because the minutes had not been recorded in a minute book within one month of the meeting as required by s 251A(1). Id, [56]. The minutes were therefore procedurally flawed and deprived of any special evidentiary value. Id, [69], [72].


91 Five of the seven non-executive director defendants entered the witness box. Two of these directors, Koffel and Willcox, who attended the meeting by phone from the US, swore that they had neither been provided with a copy, nor approved, the draft ASX announcement. Three others, Brown, Gillfillan and Hellicar did not agree that the announcement had been approved. The two other non-executive directors, O’Brien and Terry, did not give evidence in the case. ASIC v Macdonald (No 11) (2009) 256 ALR 199, paras [331], [338]; Sexton, “The suits that turned to dust”, Sydney Morning Herald, 25 April 2009, 1; Frith, “Hardie’s adverse finding will be closely analysed by corporate Australia”, The Australian, 24 April 2009, 18.


93 According to Gzell J, “[b]y acknowledging they would have spoken against, or in modification of, the Draft ASX Announcement those directors impliedly conceded that they had a duty to do so”. ASIC v Macdonald (No 11) (2009) 256 ALR 199, para [331].

94 Id, para [262].

95 Id, paras [332] - [333].
Several possible liability safe havens were unavailable to the non-executive directors on the particular facts of the case. Since the directors denied approving the draft ASX announcement, they did not seek to rely on the business judgment rule.\(^96\) Reflecting a trend in contemporary Australian corporate law,\(^97\) Gzell J also held that delegation was unavailable to insulate directors from liability. In his view, “[m]anagement having brought the matter to the board, none of them was entitled to abdicate responsibility by delegating his or her duty to a fellow director”.\(^98\) In this respect, there was less scope for delegation to operate as a safe haven for directors than, for example, was possible in the US Disney litigation.\(^99\)

Several defendants lodged appeals against Gzell J’s decision.\(^100\) In \textit{Morley v ASIC},\(^101\) the New South Wales Court of Appeal reversed Gzell J’s decision in relation to the non-executive directors.\(^102\) The Court of Appeal held that ASIC had failed to establish that the

\(^{96}\) See Blake Dawson (now Ashurst), “Lessons for directors and officers from the James Hardie litigation”, \textit{Company Law & Governance Update}, 8 May 2009 (available at \url{http://www.blakedawson.com/Templates/Publications/x_article_content_page.aspx?id=55219}), 4; Young QC, “Directors’ Duty of Care and Diligence: A Review in Light of the Recent Decision in \textit{ASIC v Macdonald (No 11)}”, in Austin and Bilski (eds), \textit{Directors in Troubled Times} (Ross Parsons Centre of Commercial, Corporate and Taxation Law, 2009), 60, 81. For an overview of some of the ambiguities and weaknesses associated with the Australian statutory business judgment rule, see Young QC, \textit{id}, 79-82.

\(^{97}\) See generally Young QC, \textit{id}, 60, 76-79.

\(^{98}\) \textit{ASIC v Macdonald (No 11)} (2009) 256 ALR 199, para [260].

\(^{99}\) Delegation was an important theme in the decision of Jacobs J in the Delaware Supreme Court decision, \textit{In re the Walt Disney Company Derivative Litigation}, 906 A.2d 27 (Del. Supr., 2006). Jacobs J considered that, since Disney’s charter conferred exclusive responsibility for pay decisions on the compensation committee, the board of directors as a whole was protected from liability as a result of this form of delegation. \textit{Id}, 41-42. Jacobs J noted that nothing in the Delaware General Corporation Law “mandates that the entire board must make those decisions”. \textit{Id}, 54.

\(^{100}\) Appeals were lodged by the non-executive directors, the CFO (Mr Morley), the company secretary/general counsel (Mr Shafron) and JHNV, with ASIC filing a notice of cross-appeal. These appeals resulted in two judgments delivered by the New South Wales Court of Appeal in December 2010 – \textit{Morley v ASIC} (2010) 274 ALR 205 and \textit{James Hardie Industries NV v ASIC} (2010) 274 ALR 85. See Jacobs, “Former Hardie Directors Lodge Appeals,” \textit{Australian Financial Review} (October 17, 2009), 7; Sexton, “Accelerated Appeals for Banned Directors,” \textit{Sydney Morning Herald} (October 2, 2009), 2; Hutton, “James Hardie to Appeal,” \textit{Australian Financial Review} (September 24, 2009), 16.


\(^{102}\) The appeal by Mr. Shafron was partially successful only and the appeal by Mr. Morley failed. See \textit{Morley v ASIC} (2010) 274 ALR 205, paras [871] ff, [1075] ff.
non-executive directors had approved the draft ASX announcement at the relevant board
meeting, thereby rejecting a central finding of fact at first instance.

A controversial aspect of the Court of Appeal’s decision related to ASIC’s duties as corporate
regulator. The court considered that, in bringing civil proceedings of this kind, government
agencies like ASIC owe an “obligation of fairness”, arising from its status as a model
litigant. The Court of Appeal considered that ASIC had breached its obligation of fairness
by failing to call a particular witness, JHIL’s solicitor, to help determine the “true facts” on
which the action was based, and that failure to do this undermined the cogency of ASIC’s
case and its ability to discharge the burden of proof.

Although the Court of Appeal diverged from the first instance decision in terms of its
findings of fact, the appellate decision did not depart substantively from Gzell J’s analysis of
directors’ duties. Indeed, the Court of Appeal agreed that had ASIC proved that the non-
executive directors voted in favour of the draft ASX announcement they would have
breached their statutory duty of care and diligence, and been unable to invoke the
protection of reasonable reliance on management.

A final volte-face in the James Hardie litigation occurred in 2012, when the High Court of

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103 Morley v ASIC (2010) 274 ALR 205, paras [789] - [792], [804]. The Court of Appeal admitted,
however, that there was some basis for a finding that the directors had approved the draft ASX
announcement. Id, para [796].

104 Although acknowledging that the JHIL board minutes bolstered ASIC’s case to some degree,
ultimately the Court of Appeal thought that a range of factors weakened the reliability of the minutes as
a correct record of events. Id, para [791].

105 Id, paras [710] - [713]. According to the Court of Appeal, this is reflected in the special role occupied
by ASIC, and its enhanced powers in relation to corporate law enforcement. Id, paras [723] - [728]. Cf
D’Aloisio, “ASIC played by the rules, but the court rewrote them”, The Australian, 21 December 2010,
22, arguing that ASIC had in fact conducted the James Hardie litigation as a model litigant in
accordance with legal services directions and had complied with the law as it stood prior to the Court
of Appeal decision.


107 Id, paras [777], [796].

108 Id, para [810]. See generally Minter Ellison, Alert – James Hardie in the NSW Court of Appeal,

109 Id, paras [817], [821]. See D’Aloisio, “ASIC played by the rules, but the court rewrote them”, The
Australian, 21 December 2010, 22, describing this as a “significant finding for corporate governance”.

Australia (“High Court”) considered the matter.  In *ASIC v Hellicar*, the High Court unanimously allowed ASIC’s appeal, and restored Gzell J’s first instance decision that the non-executive directors and company secretary/general counsel had breached their statutory duty of care and diligence.

The High Court’s approach differed from the NSW Court of Appeal decision in several critical respects. The High Court held, for example, that the Court of Appeal was wrong in its assessment that ASIC had failed to prove that the JHIL directors authorised the draft ASX announcement at their February 2001 board meeting. According to the High Court, the board minutes, although procedurally flawed, constituted a formal record of the proceedings at the meeting, including the fact that the draft ASX announcement was tabled and approved. The High Court also considered that the Court of Appeal was wrong in holding that ASIC breached its duty of fairness by failing to call a particular witness, and in concluding that this “diminished the cogency” of ASIC’s evidence.


There were also appeals and cross appeals in relation to the Court of Appeal’s decision concerning Mr Shafron. In *Shafron v ASIC* (2012) 286 ALR 612, the High Court dismissed Mr Shafron’s appeal, holding that he had contravened s 180(1) of the *Corporations Act*, by failing to discharge his duties as an officer with the requisite degree of care and diligence. See generally Austin, Standen and Reynolds, *Alert - The High Court Decides the James Hardie Case*, Minter Ellison Lawyers, May 8, 2012 (available at http://www.minterellison.com/Pub/NA/20120504_JamesHardieDecision/).

In *ASIC v Macdonald (No 11)* (2009) 256 ALR 199.

*ASIC v Hellicar* (2012) 286 ALR 501, para [6].

The board minutes had not been recorded in a minute book within one month of the meeting as required by s 251A(1). *Id*, para [56].

*ASIC v Hellicar* (2012) 286 ALR 501, para [7].

*Id*, para [9].
ASIC v Hellicar\textsuperscript{119} represented a major victory for ASIC and other government regulators,\textsuperscript{120} as well as a cautionary tale for directors. The James Hardie litigation as a whole represents a watershed in Australian corporate law. Previously, Australian corporate law, like its US counterpart, tended to maintain a clear divide between conduct and decision rules, particularly in relation to non-executive directors.\textsuperscript{121} Although the leading decision on directors’ duty of care and diligence, the mid-1990s case of Daniels v Anderson,\textsuperscript{122} contained strong dicta about the responsibilities of all directors, ultimately these aspirational statements were not matched by liability for non-executive directors. However, by reinstating Gzell J’s first instance decision in the James Hardie litigation, the High Court in ASIC v Hellicar\textsuperscript{123} signalled support for a narrowing of the traditional “acoustic separation” between conduct rules and decision rules for non-executive directors.

The James Hardie litigation provides an interesting counterpoint to two other recent Australian cases in which ASIC has brought civil penalty proceedings based on directors’ breach of duty. The first of these cases was ASIC v Rich,\textsuperscript{124} delivered in by Austin J of the Supreme Court of New South Wales in 2009. This decision arguably recognises a higher degree of “acoustic separation” between conduct rules and decision rules than is apparent in the findings of liability in the James Hardie litigation.

3.2 The Surprising Case of ASIC v Rich

ASIC v Rich\textsuperscript{125} arose out of the collapse in May 2001 of One.Tel Ltd (“One.Tel”), a relatively

\textsuperscript{119} (2012) 286 ALR 501.
\textsuperscript{120} See Maiden, "Court sends message to boards", The Age, 4 May 2012, 9, stating that the decision “re-arms all government regulators in civil court cases”.
\textsuperscript{121} See generally Cheffins and Black, “Outside Director Liability Across Countries” (2006) 84 Tex L Rev 1385, 1433-1441.
\textsuperscript{122} (1995) 16 ACSR 607.
\textsuperscript{123} (2012) 286 ALR 501.
\textsuperscript{124} (2009) 75 ACSR 1; [2009] NSWSC 1229. A slightly abridged version of the case can also be found at (2009) 136 FLR 1.
\textsuperscript{125} Ibid.
new player at the time in Australia’s telecommunications sector. At the time of the company’s collapse, it had claimed debts totalling A$377 million. News Corporation Ltd and Publishing and Broadcasting Ltd, companies controlled by the Murdoch and Packer families, respectively, held a forty percent stake in One.Tel, and James Packer and Lachlan Murdoch sat as non-executive directors on One.Tel’s board. Following the company’s collapse, Lachlan Murdoch swore in an affidavit that he had been “profoundly misled” about its financial position.

In late 2001, ASIC commenced civil penalty proceedings against four former One.Tel directors. ASIC’s central allegation was that these directors had breached their statutory duty of care and diligence under s 180(1) of the Corporations Act by failing to keep the board of directors adequately informed of the company’s true financial position. The regulator sought disqualification and compensation orders of up to A$93 million. Prior to the commencement of proceedings, two of the defendants entered into settlement agreements with the regulator, under which they accepted disqualification and compensation orders.


130 The defendants to the suit were joint managing directors, John David (“Jodee”) Rich and Bradley Keeling, finance director, Mark Silbermann, and non-executive chairman, John Greaves See ASIC, Media Release 01/441, ASIC commences civil proceedings against former One.Tel officers and Chairman, 12 December 2001.

131 ASIC v Rich (2009) 75 ACSR 1, paras [3], [85] - [123].


133 The two directors who entered into settlements with ASIC were Bradley Keeling and John Greaves.

134 Mr Keeling was banned from managing a corporation for 10 years, and found jointly and severally liable for A$92 million compensation to One.Tel. See ASIC, Media Release 03-099, Brad Keeling settles in ASIC One.Tel proceedings, 21 March 2003. Mr. Greaves was banned from managing a corporation for 4 years and found liable for A$20 million compensation to One.Tel. See ASIC, Media Release 04-283, ASIC reaches agreement with John Greaves in One.Tel proceedings, 6 September 2004.
There are a number of interesting contrasts between the James Hardie and One.Tel litigation in relation to both their proceedings and outcomes. First, ASIC set its sights on different targets in these two cases. In the James Hardie litigation, ASIC brought civil penalty proceedings against not only the executive officers, but also the non-executive directors. In the One.Tel litigation, however, ASIC initially commenced civil proceedings against One.Tel’s former officers and its non-executive chairman, but no proceedings were brought against the company’s other non-executive directors, including James Packer and Lachlan Murdoch. Justice Austin described this fact as “noteworthy”. The judge pointed out that one of the non-executive directors, James Packer, was substantially involved in One.Tel’s day to day business, and that PBL and News executives received frequent briefings on aspects of the One.Tel business.

Secondly, ASIC v Rich is a surprising case since, unlike the James Hardie litigation where ASIC succeeded in its claims against both executive and non-executive directors, Austin J held that ASIC failed to prove its pleaded case against either of One.Tel’s remaining executive defendant directors, and awarded the defendants A$15 million in costs. In sharp contrast with ASIC’s High Court success in ASIC v Hellicar, the decision in ASIC v Rich has been described as “an emphatic victory for the defendant directors and defeat for

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135 ASIC announced, at the time of commencing the civil penalty proceedings, that evidence available to it indicated that the non-executive directors were unaware of One.Tel’s “true financial position” until shortly before the appointment of the administrator on 29 May 2001”. See ASIC, Media Release 01/441, ASIC commences civil proceedings against former One.Tel officers and Chairman, 12 December 2001.


137 ASIC v Rich (2009) 75 ACSR 1, para [2].

138 Id, para [7247].


142 (2009) 75 ACSR 1.
ASIC as corporate regulator”. Austin J was highly critical of the scope and management of the case by ASIC, contrasting it unfavourably with the far narrower evidentiary focus of the James Hardie litigation.

Thirdly, the business judgment rule, which was invisible in the James Hardie litigation due to the unusual facts of the case, played an important role in ASIC v Rich and laid the groundwork for acoustic separation. Australia’s statutory business judgment rule in s 180(2) of the Corporations Act, was first introduced in 2000. Although based on the American Law Institute’s version of the business judgment rule, ASIC v Rich shows that the Australia’s statutory formulation of the rule is no simple Antipodean transplant of US law. In contrast to the operation of the US business judgment rule, for example, Austin J considered that Australia’s statutory business judgment rule imposes the onus of proving that the preconditions to protection have been satisfied on the defendant directors, not the

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144 (2009) 75 ACSR 1, para [65]. Austin J stated that “there is a real question whether ASIC should ever bring civil proceedings seeking to prove so many things over such a period of time as in this case”. This criticism related to the fact that ASIC’s case required it to prove the financial position of the multi-national group of companies comprising the One.Tel group over a period of four months. Id, para [4].

145 For background to Australia’s statutory business judgment rule, see Byrne, “Directors to Hide from a Sea of Liabilities in a New Safe Harbour” (2008) 22 Australian Journal of Corporate Law 255. Under s 180(2) of the Corporations Act, a director is deemed to have complied with the requirements of the duty of care and diligence if the director has made a business judgment in good faith for a proper purpose, does not have a conflicting interest, has adequately informed himself or herself, and rationally believes that the decision is in the best interests of the corporation. See generally, Hill, “Australia: The Architecture of Corporate Governance” in Fleckner and Hopt (eds), Comparative Corporate Governance (forthcoming, 2013, Cambridge University Press), 106, 126-128.


147 For a discussion of some important differences between the US business judgment rule and its Australian statutory counterpart., see generally Redmond, Companies and Securities Law: Commentary and Materials (5th ed, 2009), [7.105].

148 See Bainbridge, “The Business Judgment Rule as Abstention Doctrine” (2004) 57 Vand L Rev 83, arguing that, rather than operating as a standard of liability by which courts review board decisions, the US business judgment rule in fact functions as a doctrine of abstention, precluding judicial review of board decisions unless the plaintiff satisfies certain demanding preconditions.
plaintiff. It seems that ASIC’s “special role” in relation to enforcement of directors’ statutory duties played a role in justifying such an interpretation of the provision.

Following its reception into Australian law, some commentators argued that the statutory business judgment rule was ineffectual and mere “window dressing”. However, in ASIC v Rich, the rule took on a considerably more robust aspect. One of the requirements for the application of the rule is that a director or other officer has made a “business judgment”, which is defined in the Corporations Act as “any decision to take or not take action in respect of a matter relevant to the business operations of the corporation”. In ASIC v Rich Austin J agreed with ASIC’s contention that, according to this definition, the business judgment rule would not protect directors in breach of their oversight duties. The judge accepted, however, that the business judgment rule could protect directors in relation to an array of other managerial conduct, including planning, budgeting and forecasting, and

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149 (2009) 75 ACSR 1, para [7264]. The issue of who bears the onus of proof in relation to the Australian business judgment rule has been a vexed one, which Austin J recognised will ultimately need to be resolved at appellate level. Id, para [7269]. See also Young QC, “Directors’ Duty of Care and Diligence: A Review in Light of the Recent Decision in ASIC v Macdonald (No 11)”, in Austin and Bilski (eds), Directors in Troubled Times (2009), 60, 80-81; Lumsden, “The Business Judgement Defence: Insights from ASIC v Rich” (2010) 28 Comp & Sec LJ 164, 169.

150 For example, Justice Austin stated that “it would be unusual if…ASIC were required to establish…that the defendant’s business judgment was not made in good faith for a proper purpose, since that would amount to proving a more serious contravention of the law, namely a contravention of s 181” (citing Santow J in ASIC v Adler (2002) 41 ACSR 72). Id, para [7269]. See also Lumsden, “The Business Judgement Defence: Insights from ASIC v Rich” (2010) 28 Comp & Sec LJ 164, 169.

151 See, for example, Young QC, “Directors’ Duty of Care and Diligence: A Review in Light of the Recent Decision in ASIC v Macdonald (No 11)”, in Austin and Bilski (eds), Directors in Troubled Times (Ross Parsons Centre of Commercial, Corporate and Taxation Law, 2009), 60, 79-82.


154 The terms “director” and “officer” are defined in s 9 of the Corporations Act.

155 Section 180(3) Corporations Act.

156 (2009) 75 ACSR 1

157 The judge took the view that monitoring the company’s affairs and maintaining familiarity with the company’s financial position are not in themselves matters than involve a “decision to take or not take action”: see ASIC v Rich (2009) 75 ACSR 1, para [7278].

158 Id, paras [125], [7273] - [7276].
applied the rule to provide protection in this regard to the defendant directors’ decision to continue to grow One.Tel’s business despite certain overdue debts.\textsuperscript{159} It seems likely that, following \textit{ASIC v Rich},\textsuperscript{160} the business judgment rule will become an important part of Australian directors’ defensive armoury.\textsuperscript{161}

ASIC, although originally signalling its intention to appeal Austin J’s judgment in \textit{ASIC v Rich},\textsuperscript{162} later reversed its decision, on the basis of "[p]ublic policy considerations, cost and effluxion of time".\textsuperscript{163}

\subsection*{3.3 The \textit{Centro} Litigation - Directors’ Duties and the Global Financial Crisis}

Australian directors, executive and non-executive alike, were, however, back in dangerous territory in \textit{ASIC v Healey}\textsuperscript{164} ("\textit{Centro} decision"). This litigation arose directly out of the global financial crisis, and highlighted potential dangers to boards posed by the crisis.\textsuperscript{165} The Centro Group,\textsuperscript{166} like many other highly leveraged firms at the time, experienced intense liquidity problems when the crisis hit. The Group came close to collapse in December 2007, when an announcement signalled the Group’s difficulty in refinancing A$3.9 billion in short-term debt.\textsuperscript{167}

\begin{footnotesize}
\begin{enumerate}
\item Although the relevant debts owed to certain creditors by One.Tel were overdue according to the terms of the contract, Austin J found that the One.Tel directors reasonably held the belief that the debts were not required to be paid immediately: \textit{Id}, para [3766]. See also Lumsden, “The Business Judgement Defence: Insights from ASIC v Rich” (2010) 28 \textit{Comp & Sec LJ} 164, 169-171.
\item \textit{ASIC v Rich} (2009) 75 ACSR 1.
\item See ASIC, Media Release 09-259AD, \textit{ASIC lodges notice of intention to appeal}, 17 December 2009.
\item ASIC, Media Release 10-34AD, \textit{ASIC not to appeal One.Tel decision}, 26 February 2010.
\item (2011) 196 FCR 291.
\item See generally Hill, “Centro in the Monitoring Board – Legal Duties Versus Aspirational Ideals in Corporate Governance” (2012) 35 \textit{UNSW LJ} 341.
\item The Centro Group comprised Centro Properties Ltd (‘CPL’); Centro Property Trust (‘CPT’); and Centro Retail Trust (‘CRT’): see \textit{ASIC v Healey} (2011) 196 FCR 291, 296, para [2].
\item See Centro Properties Group, “Centro Earnings Revision and Refinancing Update” (ASX Media Release, 17 December 2007). See also Harley and Dunckley, “Credit Crisis Savages Centro”, \textit{Australian Financial Review}, 18 December 2007, 1; “Tread Carefully in Volatile Times”, \textit{Australian...}
\end{enumerate}
\end{footnotesize}
Two years after this corporate funding crisis, ASIC commenced civil penalty proceedings against the Centro Group’s former directors and CFO. The action, which related to the board’s of consolidated financial statements for the Centro Group for the financial year ended June 2007, merged issues relating to financial disclosure with directors’ duties. ASIC claimed that the financial statements failed to comply with relevant accounting standards and regulations and did not give a true and fair view of the group’s financial position. This was because the financial statements had wrongly classified around A$2 billion of debt as non-current liabilities and failed to disclose guarantees of short-term liabilities amounting to approximately US$1.75 billion. ASIC alleged that the defendants had failed to take all reasonable steps to ensure compliance with the Centro Group’s reporting obligations under the Corporations Act and had breached their statutory duty of care and diligence by failing to detect these critical errors in the accounts.

Australia was not alone in confronting issues of defective financial disclosure, and such

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168 The defendants included former Centro CEO and Managing Director, Andrew Thomas; former CFO, Mr Romano Nenna; and former Chairman and non-executive director, Mr Brian Healey: See ASIC Media Release, 09-202AD, “ASIC Commences Proceedings against Current and Former Officers of Centro”, 21 October 2009. See generally Crutchfield and Button, “Men Over Board: The Burden of Directors’ Duties in the Wake of the Centro Case” (2012) 30 Comp & Sec L J 83, 86–9.

169 The board’s approval, which formed the basis that the action, related to financial statements for the Centro Group for the financial year ended 30 June 2007.

170 Section 296(1) of the Corporations Act requires that financial reports must comply with the accounting standards. The relevant accounting standard for the purposes of Centro was Australian Accounting Standards Board (“AASB”) 101, “Presentation of Financial Statements”, which related to the classification of liabilities as current in a corporation’s financial reports: ASIC v Healey (2011) 196 FCR 291, 302, para [40]ff.


172 See ASIC v Healey (2011) 196 FCR 291, 297, para [9].

173 Section 344(1) of the Corporations Act requires a director “to take all reasonable steps to comply with, or to secure compliance with, Part 2M.2 or 2M.3”. Part 2M.2 of the Corporations Act 2001 (Cth) relates to financial records, which the corporation is obliged to keep. Part 2M.3 deals with financial reports, including the annual directors’ report and audit. See generally ASIC v Healey (2011) 196 FCR 291, 321, para [125]ff.

issues are still highly relevant in the Australian corporate governance context. These were also crucial issues in the United States during the global financial crisis, and had been on the radar screen of US corporate legislators since the time of Enron’s collapse in 2001. However, the merging of directors’ duties and financial disclosure issues, such as occurred in the Centro decision, would be precluded under US law, given that the two matters are regulated under state corporations law and federal securities law respectively.

As in the James Hardie litigation, ASIC’s claim in the Centro decision focused on approvals given at a specific board meeting, and included both executive and non-executive directors in its enforcement sights. Justice Middleton agreed with ASIC’s contention that the defendants had “failed to take all reasonable steps required of them”, and had performed their directors duties without the requisite degree of care and diligence. This was in spite of the fact that, according to the judge, the directors were “intelligent, experienced and conscientious people”, against whom no suggestion of dishonesty had been levelled. The judge's finding of breach of duty of care and diligence by the directors was also despite the existence of an audit committee, and audit sign-off by a major accounting firm.

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175 The Hastie Group, for example, was placed into administration in May 2012, following the discovery of a $20 million accounting shortfall. A representative of the group’s administrator, PPB Advisory, recently linked issues of financial disclosure with possible breach of directors’ duties, stating that “[r]eporting from subsidiaries up to head office level was inadequate and open to manipulation. The board did not have an inquiring mind as to the reliability of financial statements and overall reporting”. The representative further stated that these concerns had been reported to ASIC. See LaFrenz, “Call for Hastie Directors Inquiry”, Australian Financial Review, 31 January 2013, 7. See also Boxsell, “Hastie Class Action in Slater Sights”, Australian Financial Review, 22 January 2013, 13.


180 ASIC v Healey (2011) 196 FCR 291, 296, para [8].

As in Gzell J’s first instance decision in the James Hardie litigation, delegation and reliance failed to protect Centro’s directors. Although acknowledging that delegation and reliance are permissible, the Centro decision emphasised that there are limits to legally sanctioned buck-passing, and that directors must critically analyse material presented to them and maintain “an inquiring mind”. According to Middleton J, this had not occurred on the facts of the case. Rather, he considered that the directors had engaged in wholesale reliance on management and external advisors with respect to the financial statements, thereby relinquishing a vital aspect of their duties to the company. Justice Middleton stated that a “core, irreducible requirement of directors [is] to be involved in the management of the company and to take all reasonable steps to be in a position to guide and monitor”. Commentators have suggested that, since Australian directors appear to have a number of "core", non-delegable duties, it would be useful to know the precise contours of those duties.

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183 The Corporations Act gives directors explicit permission to delegate "any of their powers" unless the company's constitution provides otherwise. See s 198D Corporations Act. See also s 190 Corporations Act. In relation to a director’s reliance on information or advice provided by others, see 189 Corporations Act.


185 ASIC v Healey (2011) 196 FCR 291, 298, para [20]. See also Leung and Webster, “Directors’ Duties, Financial Literacy and Financial Reporting After Centro” (2012) 30 Comp & Sec LJ 100, 106–7. This requirement of independent scrutiny is consistent with Corporations Act 2001 (Cth) s 189(b)(ii), which requires that reliance be made ‘after making an independent assessment of the information or advice, having regard to the director’s knowledge of the corporation and the complexity of the structure and operations of the corporation’.

186 ASIC v Healey (2011) 196 FCR 291, 427, para [582].

187 Justice Middleton states that ‘[w]hilst there are many matters a director must focus upon, the financial statements must be regarded as one of the most important’: Id, 426, para [567]. See generally Lowry, ‘The Irreducible Core of the Duty of Care, Skill and Diligence of Company Directors: Australian Securities and Investments Commission v Healey’ (2012) 75 Mod L Rev 249. The judge suggests that if the directors had taken care to read and understand the final accounts, the errors might have come to light earlier. ASIC v Healey (2011) 196 FCR 291, 427, para [582]. Justice Middleton also stated that it was not possible for directors to delegate ultimate responsibility for their declaration regarding the annual financial report under section 295(4) of the Corporations Act. Id, 321, para [125].

188 Id, 298, para [16]. See also Deputy Commissioner of Taxation v Clark (2003) 57 NSWLR 113, para [108].

189 See generally Golding, “Tightening the Screws on Directors: Care, Delegation and Reliance” (2012) 35 UNSW LJ 266, 278.
The *Centro* decision reflects the strengthening of the duty of care and diligence in Australia, a trend which is also apparent in the United Kingdom.\(^{190}\) Since the pivotal mid-1990s decision in *Daniels v Anderson*,\(^{191}\) there has been a significant increase in reported Australian cases in this area, and ASIC has had an "extraordinarily high success rate" in these cases.\(^{192}\) The *James Hardie* and *Centro* litigation exemplifies this trend, while *ASIC v Rich*\(^{193}\) is an outlier in this regard.\(^{194}\)

From a US/Australian comparative law perspective, the *Centro* decision bears a much closer family resemblance to *Smith v Van Gorkom*\(^{195}\) than to the *Disney* litigation. The *Centro* decision has been described as "a wake-up call from down under",\(^{196}\) just as *Smith v Van Gorkom* was once labelled (at least in the pre-§ DGCL 102(b)(7) era) a “wake-up call to passive boards”.\(^{197}\) As in *Smith v Van Gorkom*, “mere absence of bad faith”\(^{198}\) did not save the Centro Group’s directors from breach of duty. Each of these judgments sharply criticised the board for effectively delegating all decision-making to management, when the directors...

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191 (1995) 16 ACSR 607. As noted earlier, however, the heightened standards identified in this case were not matched by liability for the non-executive directors. For general developments in the area of directors’ duty of care and insolvent trading at the time of *Daniels v Anderson*, see Bird and Hill, “Regulatory Rooms in Australian Corporate Law” (1999) 25 Brook J Int’l L 555, 560-572.


194 In spite of the fact that it concerned executive directors, it is one of only two cases, out of twenty reported cases, where the trial judge held that the defendants had not breached their duty. *Id*, 273.

195 488 A 2d 858 (Del, 1985).


198 488 A 2d 858, 872 (Del, 1985).
should themselves have assessed information with “a critical eye”\textsuperscript{199} and “an inquiring mind.”\textsuperscript{200}

On its face, the Centro decision appears to be an example of narrow acoustic separation. It should be noted, however, that the decision did not tell the entire story. Another important part of the narrative is found in a subsequent decision by Middleton J, ASIC v Healey (No 2) (“Centro penalty decision”),\textsuperscript{201} which considered the appropriate penalties to impose for the directors’ breaches of duty. Whereas, in the original Centro decision,\textsuperscript{202} Middleton J held that the executive officers and non-executive directors had all breached their duties of care and diligence, in the later penalty decision\textsuperscript{203} he distinguished between the defendants for the purposes of punishment. In the Centro penalty decision, Middleton J made detailed declarations of contravention against all defendants. He imposed a fine of A$30,000 on Centro’s former CEO, and a two year managerial disqualification order on its former CFO.\textsuperscript{204} However, interestingly, no penalties were imposed on the six non-executive directors. Middleton J considered that declarations of contravention, without disqualification or pecuniary penalty orders, were sufficient “to indicate the Court’s disapproval” of the conduct of the non-executive directors,\textsuperscript{205} and that a range of factors to “militate[d] very strongly against more excessive penalties”.\textsuperscript{206}

Whereas the original Centro decision was criticised for the stringency of Middleton J’s findings, the Centro penalty decision received widespread censure for being too lenient.\textsuperscript{207} In

\textsuperscript{199} Ibid.

\textsuperscript{200} ASIC v Healey (2011) 196 FCR 291, 298, para [20].

\textsuperscript{201} ASIC v Healey (No 2) (2011) 196 FCR 430.

\textsuperscript{202} ASIC v Healey (2011) 196 FCR 291.

\textsuperscript{203} ASIC v Healey (No 2) (2011) 196 FCR 430.

\textsuperscript{204} Id, 433, paras [4] - [5].

\textsuperscript{205} Id, 433, para [6].

\textsuperscript{206} Indeed, Middleton J considered that imposition of more extreme penalties could be contrary to “public interest”: Ibid.

\textsuperscript{207} See, for example, Lenaghan and Durkin, “A Fine, a Ban and Off the Hook”, Australian Financial Review, 1 September 2011, 9; Durkin, “Investors Vent Anger at ‘Injustice’”, Australian Financial Review, 1 September 2011, 9; West, “Off the Hook, With Barely a Slap”, Sydney Morning Herald, 3 September 2011, 2. Leniency of penalties was also an issue in the final phase of the James Hardie
spite of the potential incongruity between the two judgments, they can be viewed as complementary parts of holistic determination of directors’ conduct, where aspirational standards make a late entry, namely at the penalty stage.\textsuperscript{208} Although, when viewed in isolation, the original \textit{Centro} liability decision would suggest that Australia’s law relating to the duty of care and diligence is considerably stricter than comparable US law,\textsuperscript{209} the combined effect of the two \textit{Centro} judgments is that this jurisdictional difference is ultimately less dramatic than at first sight.\textsuperscript{210} However, it is worth noting that there is growing pressure to increase penalties in the Australian corporate law arena, which could itself operate to narrow acoustic separation.\textsuperscript{211}

4. Directors’ Duties, Shareholder versus Stakeholder Interests, and Corporate Social Responsibility

The tension between conduct rules and decision rules can also be discerned in the context of the debate concerning shareholder and stakeholder interests. How do directors decide whose

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\textsuperscript{208} See \textcite{Singer} for a detailed analysis of the interrelation between the \textit{Centro} liability and penalty decisions against the backdrop of US corporate law, see Hill, “Centro and the Monitoring Board – Legal Duties versus Aspirational Ideals in Corporate Governance” (2012) 35 UNSW LJ 341, 353-358.

\textsuperscript{209} See, for example, \textcite{In re The Walt Disney Company Derivative Litigation} arguing that the time is now ripe, following the \textit{Centro} and \textit{James Hardie} litigation to consider, from a policy perspective, allowing courts to grant substantially larger penalties in appropriate cases. See also the comments of Finkelstein J in \textit{ASIC v Vizard} (2005) 54 ACSR 394, paras [39] - [40] on the importance of “formal retribution” as a means of ensuring “proper punishment”.

\textsuperscript{211} See \textcite{Golding}.
interests to promote, and to what extent can their choices result in legal liability for breach of directors’ duties?

In the United States, the traditional message of legal rules directed to corporate managers was one of profit maximisation for shareholders. This is reflected in the classic case of *Dodge v Ford Motor Co* ("*Dodge v Ford*"), where Ostrander CJ famously declared:

“[a] business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end. The discretion of directors is to be exercised in the choice of means to attain that end, and does not extend to a change in the end itself.”

Yet, *Dodge v Ford* was hardly a pin-up decision for a shareholder primacy norm. The case involved a conflict, not between shareholder and other stakeholders, but rather between majority and minority shareholders. According to one commentator, the failure of *Dodge v Ford* to acknowledge other stakeholder interests potentially renders it bad law.

In spite of the lip-service paid to shareholder primacy, the US business judgment rule provides directors with considerable leeway to consider non-shareholder interests,
including in *Dodge v Ford* itself.\textsuperscript{219} Case law permits directors to take into account stakeholder interests in the hostile takeover context,\textsuperscript{220} except where the company is up for sale, when shareholder interests will prevail.\textsuperscript{221} In addition, US constituency statutes explicitly permit, or in some rare instances require,\textsuperscript{222} directors to have regard to a broad range of stakeholder interests.\textsuperscript{223} Although sometimes portrayed as exemplifying principles of corporate social responsibility, US constituency statutes in fact operate as anti-takeover devices, and arguably represent another example of legal deference to the board of directors.\textsuperscript{224}

Corporate scandals at the beginning of the last decade, including the collapse of Enron, focused greater attention on the plight of stakeholders, particularly employees,\textsuperscript{225} and highlighted the underlying tension between shareholder and stakeholder interests in corporate law.\textsuperscript{226} In spite of this, the US regulatory response to Enron was largely focused on protecting shareholder interests.\textsuperscript{227} The express aim of the US *Sarbanes-Oxley Act* of 2002, for example, was “[t]o protect investors by improving the accuracy and reliability of


\textsuperscript{222} Over thirty US states have adopted constituency statutes. Only two constituency statutes are mandatory in nature: Connecticut and Arizona.


corporate disclosures”,228 which some scholars have viewed as reinforcing a shareholder primacy norm.229

The impact of these corporate scandals on debate concerning stakeholders, and corporate social responsibility generally, was arguably much greater in other common law jurisdictions, such as the United Kingdom, Australia and Canada. These countries possess strong historical legal ties, and have been described as “three peas in a pod” in terms of their approach to directors’ duties and corporate social responsibility.230 Although directors’ conduct rules in these jurisdictions have traditionally been shareholder-centred,231 in the post-Enron era, stakeholder interests and corporate social responsibility became major topics of debate. A key issue in this debate, which continued to resonate throughout the global financial crisis, is whether the law should encourage higher levels of “laudable” and “enlightened” board conduct, by reframing directors’ conduct rules to protect stakeholder, as well as shareholder, interests.232

In the United Kingdom, this trend was manifested in reforms introduced in the Companies Act 2006. This Act codified UK directors’ duties into a number of basic duties. One aspect of the UK reforms that provides an interesting contrast with Australian law is the interaction between the statutory duties and the general law. Whereas the Australian Corporations Act, which also codifies directors’ duties, explicitly preserves the operation of general law duties,233 the UK reforms seek to supplant the general law.234

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233 See ss 179(1) and 185 Corporations Act 2001 (Cth).

234 Section 170(3) of the UK Act states that the statutory duties are based on certain common law rules and equitable principles, and operate in place of those rules and principles in relation to directors’ duties. However, the statutory provisions which displace the general law also relate back to the general law, and the body of case law comprising it, since s 170(4) of the UK Act states that the general duties are
The most contentious of the statutory duties enunciated in the UK Companies Act 2006 is s 172, requiring UK directors to “promote the success of the company”. Section 172 states:

(1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to:-(a) the likely consequences of any decision in the long term, (b) the interests of the company’s employees, (c) the need to foster the company’s business relationships with suppliers, customers and others, (d) the impact of the company’s operations on the community and the environment, (e) the desirability of the company maintaining a reputation for high standards of business conduct, and (f) the need to act fairly as between members of the company.

The goal of s 172 was to introduce an “enlightened self-interest” approach to UK corporate law. However, not all stakeholders were necessarily better off under this new provision – employees, for example, arguably went backwards. Earlier, under s 309 of the UK to be interpreted and applied in the same way as common law rules or equitable principles, and regard must be had to the corresponding common law rules and equitable principles in interpreting the general law duties. This turns traditional statutory interpretation on its head, by directing the adjudicator to look outside the legislator’s wording to determine its meaning. For a discussion of the complexity created by this interaction between the UK statutory duties and the general law, see Alcock, “An Accidental Change to Directors' Duties?” (2009) 30 Comp Law 362, 362, 368; Austin, “Australian Company Law Reform and the UK Companies Bill” in Austin (ed), Company Directors and Corporate Social Responsibility: UK and Australian Perspectives (Ross Parsons Centre of Commercial, Corporate and Taxation Law, 2007), 3, 5-6.


Companies Act 1985, directors had been explicitly required to consider the interests of employees, as well as those of members.\textsuperscript{238} Under s 172 of the Companies Act 2006, on the other hand, employee interests are just one of a far more diverse set of interests and factors to which directors must have regard. Section 172 remains “shareholder-centric”, particularly from an enforcement perspective, since the directors’ duty is owed to the company, and can therefore only be enforced by the company or its shareholders in derivative suit, not by stakeholders generally.\textsuperscript{239} The UK Company Law Review regarded s 172 as representing best practice in directors’ duties in a modern context.\textsuperscript{240}

Section 172 of the UK Companies Act 2006 presents aspirational standards in a new manner.\textsuperscript{241} In spite of its worthy goals, scathing criticism of the section’s policy and drafting has been made by some commentators, including one Australian critic who described the provision as “British folly”.\textsuperscript{242} Case law, which to date has been scant,\textsuperscript{243} will be needed to determine what the words, “success of the company”, in s 172 actually mean, and whether their meaning is synonymous with “maximising wealth”.\textsuperscript{244}


\textsuperscript{240} Arden, “Clause 173 (Section 172): The UK’s Proposed Re-formulation of the Directors’ Duty of Good Faith”, in Austin (ed), Company Directors and Corporate Social Responsibility: UK and Australian Perspectives (Ross Parsons Centre of Commercial, Corporate and Taxation Law, 2007), 20, 24. It is worth noting that s 172 applies to non-UK companies that are listed on the UK stock exchange. This means, for example, that the provision is applicable to some major Australian mining companies, such as BHP Billiton and Rio Tinto, which have dual listing on the UK stock exchange: Kerr, Seminar, “Corporate Social Responsibility: International Legal Developments and the Global Recession” (Sydney Law School, 7 September 2009).


\textsuperscript{244} Beerworth, “Should the Corporations Act Require Directors to Consider Non-Shareholder “Stakeholders”? Two Perspectives”, in Austin (ed), Company Directors and Corporate Social Responsibility: UK and Australian Perspectives (Ross Parsons Centre of Commercial, Corporate and
A particular concern relating to s 172 is the potential gap between motivation and ultimate outcome in law reform. In spite of its goal of promoting "enlightened self-interest", there is the danger that s 172 will, by specifying such a broad range of factors for consideration, ultimately dilute director accountability. Paralleling similar problems in the context of US constituency statutes, the risk is that the presence of multiple interests may enable management to justify any decision by reference to the interests of a particular stakeholder. Also, early predictions of a spate legal actions against directors following the introduction of a statutory derivative action in the UK Companies Act 2006, are, as yet, unfulfilled. In the light of these factors, it seems that s 172 reflects an aspirational approach to directors’ duties, comparable to that in US case law, such as the Disney litigation and the Caremark decision.

In Australia, the James Hardie saga focused attention on stakeholders and corporate social responsibility in an acute way, after it was announced in late 2003 that the Foundation,
formed to satisfy the group’s asbestos claims, was dramatically underfunded. JHIL took the view that legally it had no responsibility in relation to the compensation of the tort victims. According to JHIL, such action would be precluded under Australian law. The subtext of this statement was that the JHIL’s directors were prohibited from acting to benefit the company’s affected workers, since this would conflict with their primary duty to maximise profits for their shareholders.

These events prompted a Special Inquiry and Report on the Foundation (“Jackson Commission Report”), and two government reports on the broader issue of corporate responsibility – one by the Parliamentary Joint Committee on Corporations and Financial Services (“PJC Report”), and the other by the Corporations and Markets Advisory Committee (“CAMAC Report”).

The Jackson Commission Report agreed with JHIL’s assessment that under Australian corporate law, there was no legal obligation to contribute to the shortfall in the Foundation’s funding, due to the operation of the principles of separate legal personality and limited

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253 In a media release issued at the time, JHIL stated that there was “no legal or other legitimate basis on which shareholders’ funds could be used to provide additional funds to the Foundation”. See James Hardie, Media Release, Possible Asbestos Funding Shortfall Suggests Significant Change in Claims, 29 October 2003 (available at www.ir.jameshardie.com.au/public/download.jsp?id=1171).

254 Ibid.

255 Ibid. The media release suggested that the “duties of the company’s directors would preclude them” from using shareholders’ funds to provide further funding to the Foundation.


liability. However, the Jackson Commission Report considered this legal outcome less than satisfactory, stating:

… there are significant deficiencies in Australian corporate law … In addition, the circumstances have raised in a pointed way the question whether existing laws concerning the operation of limited liability … within corporate groups adequately reflect contemporary public expectations and standards.

The two Australian government reports, the PJC Report and the CAMAC Report, considered whether Australia should follow the statutory reforms embodied in s 172 of the UK Companies Act 2006. A major focus of these reports was the scope of directors’ duties, and the extent to which the current Australian legal framework permits directors to consider the interests of stakeholders or the broader community. This investigation was a direct response to the argument that existing law required JHIL’s to protect and preserve shareholder interests “at all costs”, and that law reform was therefore needed in Australia to provide directors with a “safe harbour” to consider stakeholder interests without the risk of liability. In relation to James Hardie’s argument that the law required the directors to


261 It has been suggested that Australian and Canadian legislators keep a close eye on the operation of s 172 of the UK Companies Act 2006 to assess whether they too should adopt the provision, and the PJC Report and the CAMAC Report are good examples of this development. See Pitts, “Corporate Social Responsibility: Current Status and Future Evolution” (2009) 6 Rutgers J L & Pub Pol’y 334; cf Green, “Should the Corporations Act Require Directors to Consider Non-Shareholder “Stakeholders”? Two Perspectives”, in Austin (ed), Company Directors and Corporate Social Responsibility: UK and Australian Perspectives (Ross Parsons Centre of Commercial, Corporate and Taxation Law, 2007), 44, 50.


consider only shareholder interests, the PJC Report observed that “rampant corporate irresponsibility certainly decreases shareholder value”.265

Nonetheless, both the PJC Report and the CAMAC Report rejected the desirability or need for legislative reform to directors’ duties in Australia, comparable to s 172 of the Companies Act 2006. The PJC Report was critical of the UK amendment to directors’ duties, on the basis that it was overly prescriptive and would result in confusion.266 The CAMAC Report considered that a comparable statutory amendment in Australia would provide “no worthwhile benefit”.267 Contrary to the arguments of the James Hardie directors that they were strait-jacketed by narrow shareholder-centred legal rules, the two reports found that Australian law already provided directors with considerable discretion to consider a range of interests and factors, such as environmental and social interests, in the exercise of their duties.268

In undertaking their review of corporate social responsibility, both the PJC and CAMAC reports revisited the thorny issue of the meaning of “the company’s interests”, or the “best interests of the corporation”, in the context of directors’ duties.269 Historically, cases such as the Australian High Court decision, Nguiri Ltd v McCann,270 interpreted the concept to mean the shareholders as a general body, in preference to a commercial entity approach.271 The PJC and CAMAC Reports appeared to diverge on this issue. While the CAMAC Report followed the traditional view that the corporation is an aggregation of its shareholders, the PJC Report adopted a holistic approach, treating the corporation as a separate commercial

266 Id, 54-6.
269 See generally Heydon, “Directors’ Duties and the Company’s Interests” in Finn (ed), Equity and Commercial Relationships (The Law Book Company Ltd, 1987), 120.
270 Nguiri Ltd v McCann (1953) 90 CLR 425, 438.
entity to its stakeholders. The PJC Report considered that a “shareholders first” approach to directors’ duties was overly narrow and constrained, and denied that acting in the best interests of the corporation was equivalent to acting in the best interests of the shareholders.

The issue of the meaning of “the company’s interests” for the purposes of directors’ duties has also been recently considered in some important Australian and Canadian case law. The 2008 Australian case, The Bell Group Ltd (in liq) v Westpac Banking Corp (No 9) (“the Bell Group decision”), a legacy of the 1989 financial crash, diverged from the traditional position concerning directors’ duties. In that case, Owen J explicitly accepted an approach in which duties are owed to the company itself as a commercial entity. Adopting a nuanced and highly contextualised approach to directors’ duties, the judge stated:-

This does not mean that the general body of shareholders is always and for all purposes the embodiment of ‘the company as a whole’. It will depend on the context, including the type of company and the nature of the impugned activity or decision. And it may also depend on whether the company is a thriving ongoing entity or whether its continued existence is problematic. In my view the interests of shareholders and the interests of the company may be seen as correlative not because the shareholders are the company but, rather, because the interests of the company and the interests of the shareholders intersect.

In the insolvency context under consideration in the Bell Group decision, Owen J considered that the directors, in fulfilling their duty to the company, had an obligation, not

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275 Id, para [4389].

276 Id, para [4393].

277 Owen J acknowledged, however, that directors might have an obligation to take account of creditor interests in circumstances falling short of actual insolvency. Id, para [4445].
merely a discretion, to consider the interests of creditors.\textsuperscript{278} The judge accepted, however, that this duty was one of “imperfect obligation”, since it did not constitute an independent duty owed to, and enforceable by, the creditors.\textsuperscript{279} The directors were held to have breached the duty by entering into a refinancing transaction and providing securities to a consortium of banks at a time when the directors knew, or should have known, that the company was insolvent. The banks, in turn, were found to have knowledge of the breach of duty and were liable as constructive trustees. On appeal, the Western Australia Court of Appeal upheld, by a majority of two to one, Owen J’s first instance decision.\textsuperscript{280}

The theoretical approach taken by Owen J was not dissimilar to that adopted by Chancellor Allen in the 1991 Delaware Court of Chancery decision in \textit{Credit Lyonnais Bank Nederland NV v Pathe Communications Corp}.\textsuperscript{281} In that case, which reflected the trend of taking into account creditor interests when a company approaches insolvency, Chancellor Allen likened

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\item \textsuperscript{280} \textit{Westpac Bank Banking Corporation v Bell Group Ltd (in liq) (No 3) (2012) 89 ACSR 1; [2012] WASCA 157 per Lee and Drummond AJJA, Carr AJA dissenting. Subtle differences in the conceptualisation of directors’ duties with respect to creditor interests emerged in the appellate decision. Lee AJA adopted an approach similar to that of Owen J in the first instance decision. Carr AJA stated that “[a]lthough it appears that a company is insolvent, creditors of the company are regarded as having a direct interest in the company...in the sense that...an obligation will then be imposed on the company not to prejudice the interests of the creditors”: \textit{id}, para [767]. Drummond AJA, the other member of the majority, considered that the court’s willingness to intervene to protect the interests of creditor was based upon the obligation of directors to exercise their powers for “proper purposes”, rather than simply an aspect of the duty to act in the interest of the company: \textit{id}, paras [2031] - [2032]. This distinction was important, because Drummond AJA interpreted the test for breach of the duty to act bona fide in the interests of the company as a subjective standard only, which was dependent on the beliefs of the directors, whereas the test for breach of the duty to act for proper purposes was objective and therefore subject to more rigorous scrutiny: \textit{id}, paras [2027] - [2028]. On the other hand, Carr AJA, in dissent, appears to have interpreted the duty of directors to act “bona fide in the best interests of the company and for a proper purpose” as a composite duty, which should be assessed by a subjective standard, and which would fully protect the board’s discretion and autonomy, provided the directors “bona fide believe that a transaction is in the best interests of the company”: \textit{id}, para [2819]. Carr AJA believed that where there is no allegation of dishonesty or negligence, directors should be given more latitude to make entrepreneurial decisions in the context of insolvency: \textit{id}, paras [3064] - [3066]. He was consequently critical of what he regarded as Owen J’s conduct in “looking over the directors’ shoulders and applying a business decision” to assess whether the directors had breached their duty to the company. \textit{id}, para [2804].
\item \textsuperscript{281} 1991 Del Ch LEXIS 215, 108-9.
\end{itemize}
the corporation to an autonomous collective entity, representing a “community of interests”. According to the judge, “[a]t least where a corporation is operating in the vicinity of insolvency, a board of directors is not merely the agent of the residue risk bearers, but owes its duty to the corporate enterprise”.282 Like Owen J, Chancellor Allen considered that the interests of the “corporate enterprise” will not necessarily coincide with the interests of any particular group of stakeholders.283

The Bell Group litigation, while addressing some basic theoretical problems of corporate law, also had a profound commercial impact, creating significant risks for directors of distressed corporations engaged in refinancing and other material “work-out” transactions.284 In addition, the litigation highlighted the associated risks for banks, and other entities, engaged in such transactions.285 These risks were exacerbated by the global financial crisis.286

Canada’s courts have also considered the meaning of “the company’s interests” for the purposes of directors’ duties in recent times. Section 122(1) of the Canada Business Corporations Act287 states that “[e]very director and officer of a corporation in exercising their powers and discharging their duties shall … act honestly and in good faith with a view to the best interests of the corporation”. The 2004 Supreme Court of Canada decision, Peoples Department Stores Inc (Trustee of) v Wise (“the Wise decision”)288 deviated from the

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282 Id, 108.


284 Directors are often in a particularly difficult situation in such circumstances, given that they can be personally liable for corporate debts under Australia’s somewhat draconian insolvent trading regime, which has been described by the Chief Justice of the Supreme Court of Western Australia as “arguably the strictest in the world”. See Martin CJ, “Official Opening Address” (Speech delivered at Insolvency Practitioners’ Association of Australia 16th National Conference, Perth, 28 May 2009). See generally, Hill, “Australia: The Architecture of Corporate Governance” in Fleckner and Hopt (eds), Comparative Corporate Governance (forthcoming, Cambridge University Press, 2013), 106, 123-124.


traditional approach of regarding the corporation’s interests as coextensive with the interests of shareholders, echoing the commercial entity approach adopted by Owen J in Australia’s *Bell Group* decision. 289  According to the *Wise* decision, directors at all times “owe their fiduciary obligations to the corporation, and the corporations’ interests are not to be confused with the interests of the creditors or those of any other stakeholder”. 290  The court also accepted that, in determining whether directors have acted in the best interests of the corporation, it may be legitimate, depending upon the circumstances of the case, for the board to consider a broad range of stakeholder interests, including those of shareholders, employees, suppliers, creditors, consumers, governments and the environment. 291  In 2008, the Supreme Court of Canada in *BCE Inc v 1976 Debentureholders*, 292 agreed with the *Wise* decision that the duty of directors is to act in the long term interests of the corporation. 293  This emphasis on the corporation’s long term interests reflects another important theme underlying s 172 of the UK *Companies Act 2006* 294 and a diverse range of regulatory responses to the global financial crisis. 295

5. Conclusion

The goal of this chapter has been to traverse a wide range of recent developments in the area of directors’ duties in the common law world, through the conceptual lens of “acoustic separation”.  The chapter discusses US case law concerning directors’ duty of care and the business judgment rule, where directors, particularly non-executive directors, face little risk


290  *Peoples Department Stores Inc (Trustee of) v Wise* [2004] 3 S.C.R. 461; 2004 SCC 68, para [43].

291  *Id*, para [42].


293  *Id*, paras [37] - [38].

294  See s 172(1)(a) *Companies Act 2006* (UK), which requires a director to have regard to “[t]he likely consequences of any decision in the long term”.  See also See Keay, “The Duty To Promote The Success Of The Company: Is It Fit For Purpose?”, University of Leeds School of Law, Centre for Business Law and Practice Working Paper (2010), 11.

295  Long-termism was, for example, a central regulatory theme arising out of the global financial crisis in connection with executive compensation.  See generally Hill, “Regulating Executive Remuneration After the Global Financial Crisis: Common Law Perspectives” in Thomas and Hill (eds), Research Handbook on Executive Pay (Edward Elgar, 2012), 219, 232-233.
of legal liability. Against this backdrop, the chapter also considers contemporary recent Australian decisions which arguably send conflicting messages in relation to the duty of care and diligence. Although from a liability perspective, some of the Australian decisions are far more stringent than their US counterparts, to some degree it appears that aspirational standards are reintroduced into Australia at the penalty stage.

The chapter also discusses several recent developments across the common law world relating to the issue of to whom directors owe their duties when making decisions. This issue has gained significance since the corporate scandals, such as Enron, and more recently, the global financial crisis. Some of these developments, such as the introduction of s 172(1) of the UK Companies Act 2006, are aimed at promoting long-termism and ensuring that directors consider a range of stakeholder interests. It remains to be seen, however, whether such reforms will achieve their goals, or will, paradoxically, increase “acoustic separation”, thereby reducing board accountability.

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297 I am grateful to Jerome Entwisle for pointing out this potential paradox in relation to some of the reforms discussed.
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