

Directors' Duties and Legal Safe Harbours: A Comparative Analysis

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Jennifer G. Hill
University of Sydney and ECGI

Matthew Conaglen
The University of Sydney

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Abstract

Directors' duties are a core element of corporate governance, yet a range of legal safe harbours ultimately shape the contours and stringency of these duties in practice. Although the standards of conduct that constitute directors' duties (so-called 'conduct rules') are often relatively strict, legal safe harbours can dilute those rules, resulting in the application of more lenient standards of judicial review ('decision rules'). The potential gap between conduct rules and decision rules, which has been labelled 'acoustic separation', is particularly striking in the context of the duty of care and diligence ('duty of care'). Directors' duties and legal safe harbours can also involve complex interaction between equitable and common law ('general law') principles on the one hand, and statutory regimes on the other. This paper explores, from a comparative law perspective, differences in the shape of directors' duties and the legal safe harbours that accompany those duties. The paper examines directors' duties in the United States (focusing on Delaware law), the United Kingdom and Australia. It considers the nature, operation and enforcement of directors' duties in these three jurisdictions, with particular attention to the duty of care and two related legal safe harbours - the business judgment rule and exculpatory clauses. The chapter explores how differences in relation to these various aspects of directors' duties can alter 'acoustic separation', by expanding or reducing the gap between conduct rules and decision rules concerning directors' duties. This issue has a direct bearing on the effectiveness of directors' duties as a regulatory technique in the United States, the United Kingdom and Australia.

Keywords: directors' duties, comparative law, decision rules, conduct rules, Delaware corporate law, UK company law, Australian company law, duty of care, codification of directors' duties, enforcement, business judgment rule, exculpation and exoneration clauses, organizational origins, legal history

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Jennifer G. Hill*
Professor of Corporate Law
The University of Sydney, Sydney Law School
Eastern Avenue, Camperdown
Sydney, NSW 2006, Australia
phone: +61 2 9351 0280
e-mail: jennifer.hill@sydney.edu.au

Matthew Conaglen
Professor of Equity and Trusts
The University of Sydney, Sydney Law School
Eastern Avenue, Camperdown
Sydney NSW 2006, Australia
phone: +61 2 9114 0962
e-mail: matthew.conaglen@sydney.edu.au

*Corresponding Author

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Jennifer G. Hill and Matthew Conaglen

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Fiduciary Law (Edward Elgar, 2018)*

1. Introduction

Directors' duties are a core element of corporate governance, yet a range of legal safe harbours ultimately shape the contours and stringency of these duties in practice.¹ Although the standards of conduct that constitute directors' duties (so-called 'conduct rules') are often relatively strict, legal safe harbours can dilute those rules, resulting in the application of more lenient standards of judicial review ('decision rules'). The potential gap between conduct rules and decision rules, which has been labelled 'acoustic separation',² is particularly striking in the context of the duty of care and diligence ('duty of care').³

Directors' duties and legal safe harbours can also involve complex interaction between equitable and common law ('general law') principles on the one hand, and statutory regimes on the other.⁴

* We would like to thank Ron Barusch and Randall Thomas for helpful comments and suggestions for this chapter and Alan Ngo for excellent research assistance.

¹ These safe harbours include, for example, the business judgment rule; exculpatory clauses in corporate constitutions; delegation and reliance; approval of directors' conduct by shareholders or independent directors; judicial discretion concerning breach and penalties; indemnification by the corporation for damages; and D&O insurance.

² See Dan-Cohen, 'Decision Rules and Conduct Rules: On Acoustic Separation in Criminal Law' (1984) 97 *Harv L Rev* 625; Eisenberg, 'The Divergence of Standards of Conduct and Standards of Review in Corporate Law' (1993) 62 *Fordham L Rev* 437; Smith, 'A Proposal to Eliminate Director Standards from the Model Business Corporation Act' (1999) 67 *U Cin L Rev* 1201.

³ Velasco, 'The Role of Aspiration in Corporate Fiduciary Duties' (2012) 54 *Wm & Mary L Rev* 519.

⁴ See generally Conaglen, 'Interaction Between Statutory and General Law Duties Concerning Company Director Conflicts' (2013) 31 *Comp & Sec LJ* 403.

This chapter examines directors' duties in the United States (focusing on Delaware law),⁵ the United Kingdom and Australia. It considers the nature, operation and enforcement of directors' duties, with specific attention to the duty of care and two related legal safe harbours - the business judgment rule and exculpatory clauses.

The chapter explores how differences in relation to these various aspects of directors' duties can alter 'acoustic separation', by expanding or reducing the gap between conduct rules and decision rules concerning directors' duties. This issue has a direct bearing on the effectiveness of directors' duties as a regulatory technique in the United States, the United Kingdom and Australia.

2. A Comparative Overview of Directors' Duties

The general law regarding directors' duties exhibits strong similarities in Delaware, the United Kingdom and Australia - each jurisdiction has duties designed to address the dual problems of 'shirking' and 'sharking' by directors.⁶

The characterization of directors as 'fiduciaries' developed under early UK law by analogy to agents and trustees,⁷ with the latter regarded as the '[t]he archetype of a fiduciary'.⁸ According to Lord Hardwicke LC in the watershed 1742 UK decision, *Charitable Corp v Sutton* ('Sutton's case'), 'by accepting a trust of this sort, a person is obliged to execute it with fidelity and reasonable diligence'.⁹ *Sutton's case*

⁵ Delaware is the dominant state for incorporation of public companies, and the Delaware courts and corporations code occupy a special position within US corporate law. Although commentators may differ on whether the US state-based system of corporate law generates a race to the top or to the bottom, few doubt that 'Delaware has won'. Barzuza, 'Market Segmentation: The Rise of Nevada as a Liability-Free Jurisdiction' (2012) 98 *Virginia L Rev* 935, 939.

⁶ See Orts, 'Shirking and Sharking: A Legal Theory of the Firm' (1997) 16 *Yale Law & Policy Review* 265.

⁷ See Conaglen, 'Interaction Between Statutory and General Law Duties Concerning Company Director Conflicts' (2013) 31 *Comp & Sec LJ* 403, 404-405.

⁸ *Hospital Products Ltd v United States Surgical Corp* (1984) 156 CLR 41, 68.

⁹ *Charitable Corporation v Sutton* (1742) 2 Atk 400, 406; 26 ER 642. See also Bishop, 'Sitting Ducks and Decoy Ducks: New Trends in the Indemnification of Corporate Directors and Officers' (1968) 77 *Yale LJ* 1078, 1096-7; *ASIC v Cassimatis (No 8)* [2016] FCA 1023, [417]ff.

measured the standard of care and diligence required by directors against the lowest standard available at that time, one of ‘gross neglect’ or ‘*crassa negligentia*’.¹⁰

The Delaware Court of Chancery acknowledged directors as fiduciaries in the 1926 decision, *Bodell v General Gas and Electric Corp.*¹¹ Directors’ fiduciary duties constitute the flipside of Delaware statutory corporate law’s ‘cardinal precept’ of centralized board power under §141(a) of the Delaware General Corporation Law (‘Del GCL’).¹² Yet, the duties owed by directors under Delaware law, although a response to this specific statutory provision, are themselves equitable¹³ - the central duties of loyalty and care are modern versions of the 18th century duties of ‘fidelity’ and ‘reasonable diligence’ in *Sutton*’s case.¹⁴ Although under modern Delaware law, there was some uncertainty as to where another duty, the duty of good faith, sat within this rubric, it is now accepted as a component of the broader duty of loyalty.¹⁵

Historically, conflict of interest transactions, which transgressed a director’s duty of ‘undivided and unselfish loyalty to the corporation’,¹⁶ were either void or voidable in the United States.¹⁷ This standard was relaxed over time, and Delaware, along with most other US states, now permits conflict of interest transactions if they satisfy the

¹⁰ See *ASIC v Cassimatis*, *id*, [417]ff; Getzler, ‘Duty of Care’ in Birks and Pretto (eds), *Breach of Trust* (Hart Publishing, 2002), 45, 47.

¹¹ 132 A. 442 (Del. Ch. 1926) (affirmed, 140 A.2d. 264 (Del. 1927)). See generally, Holland, ‘Delaware Directors’ Fiduciary Duties: The Focus on Loyalty’ (2009) 11 *U. Penn J Bus L* 675, 680-1.

¹² See, for example, *Aronson v. Lewis*, 473 A.2d 805, 811 (Del. 1984); *Malone v. Brincat*, 722 A.2d 5, 9 (Del. 1998).

¹³ Holland, ‘Delaware Directors’ Fiduciary Duties: The Focus on Loyalty’ (2009) 11 *U. Penn. J. Bus. L.* 675, 678-9.

¹⁴ *Id*, 679. For a detailed analysis of the historical development of directors’ fiduciary duties in the United States, see McMurray, ‘An Historical Perspective on the Duty of Care, the Duty of Loyalty and the Business Judgment Rule’ (1987) 40 *Vand L Rev* 605.

¹⁵ *Stone v Ritter*, 911 A.2d 362 (2006). See generally Arlen, ‘The Story of Allis-Chalmers, Caremark, and Stone: Directors’ Evolving Duty to Monitor’, in Ramseyer (ed), *Corporate Law Stories* (Foundation Press, 2009), 323.

¹⁶ *Weinberger v UOP, Inc.*, 457 A.2d 701, at 710 (Del. 1983) (quoting *Guth v. Loft, Inc.*, 5 A.2d 503, 510 (Del. 1939)). See generally Holland, ‘Delaware Directors’ Fiduciary Duties: The Focus on Loyalty’ (2009) 11 *U. Penn. J. Penn. Bus. L.* 675, 684-685.

¹⁷ O’Kelley and Thompson, *Corporations and Other Business Associations: Cases and Materials* (7th ed, Wolters Kluwer, 2014), 304.

‘intrinsic fairness’ test¹⁸ and the director adequately discloses the conflict.¹⁹ The modern judicial standard for breach of the duty of care, as shaped by the business judgment rule,²⁰ is the same as that adopted in *Sutton’s* case - one of ‘gross negligence’.²¹ Yet, the Delaware standard is actually far lower in practice, due to the operation of exculpatory charter clauses.²²

In the United Kingdom and Australia, directors and officers are subject to a variety of duties, which are also a concomitant of centralised managerial power.²³ These duties derive from two general law sources – equity and common law. However, directors’ duties in these two jurisdictions differ from Delaware law (and indeed from each other) in a number of fundamental and intriguing ways.

First, in contrast to Delaware, where all duties owed by directors tend to be classified as ‘fiduciary’ in nature,²⁴ modern UK and Australian courts have adopted a more nuanced interpretation. Since the 1990s, the courts have limited the term ‘fiduciary’ to duties that are peculiar to fiduciaries and are not owed by any other actors.²⁵ Thus, according to Ipp J in the influential Australian decision, *Permanent Building Society (in liq) v Wheeler*:²⁶

¹⁸ The intrinsic fairness test requires both fair dealing and fair price. See *Weinberger v UOP, Inc.*, 457 A.2d 701, at 710-711 (Del. 1983).

¹⁹ See Del GCL s 144; DeMott, ‘The Figure in the Landscape: A Comparative Sketch of Directors’ Self-Interested Transactions’ (1999) 62 *Law & Contemp Probs* 243, 251; McMurray, ‘An Historical Perspective on the Duty of Care, the Duty of Loyalty and the Business Judgment Rule’ (1987) 40 *Vand L Rev* 605, 624-6.

²⁰ Note that there is some academic debate in the United States as to whether the duty of care is shaped by the business judgment rule, or whether it is doctrinally separate from the business judgment rule and merely protected by it. For the latter approach, see Johnson, ‘The Modest Business Judgment Rule’ (2000) 55 *Bus Law* 625; Smith, ‘The Modern Business Judgment Rule’ in Hill and Davidoff Solomon (eds), *Research Handbook on Mergers and Acquisitions* (Edward Elgar, 2016), 83.

²¹ See, for example, *Smith v Van Gorkom*, 488 A. 2d 858, 873 (Del. 1985); *Aronson v. Lewis*, 473 A.2d 805 (Del. 1984).

²² See further below, 5.1.3 ‘US Exculpatory Clauses’.

²³ See, for example, comments of Weinberg J in *Downey v Crawford* (2004) 51 ACSR 182, [172].

²⁴ See Conaglen, *Fiduciary Loyalty: Protecting the Due Performance of Non-Fiduciary Duties* (Hart Publishing, 2010), 13.

²⁵ See generally Conaglen, ‘Interaction Between Statutory and General Law Duties Concerning Company Director Conflicts’ (2013) 31 *Comp & Sec LJ* 403, 405ff.

²⁶ (1994) 11 WAR 187.

'It is essential to bear in mind that the existence of a fiduciary relationship does not mean that every duty owed by a fiduciary to the beneficiary is a fiduciary duty. In particular, a trustee's duty to exercise reasonable care, though equitable, is not specifically a fiduciary duty'.²⁷

Under this analysis, the term 'fiduciary duty' only encompasses the duty of loyalty, with its dual prohibitions on (i) acting with a conflict between duty and interest (or between duties); and (ii) making unauthorised profits from the fiduciary position.

Fiduciary duties under Anglo-Australian corporate law are therefore prescriptive only, and do not impose any positive behavioural obligations on directors.²⁸ On this reasoning, two other general law duties owed by company directors – the duty of care,²⁹ and the duty to act in good faith in the best interests of the company – do not qualify as 'fiduciary'.³⁰ Although fiduciary and non-fiduciary duties are distinct under Anglo-Australian case law, they are nonetheless interrelated. The former bolster the latter, by increasing the likelihood that, if the core fiduciary duties are fulfilled, non-fiduciary duties will also be properly performed.³¹

Secondly, there are fundamental differences in the contours of directors' duties and the methods of avoiding breach. In contrast to Delaware, the standard for breach of the duty of care under modern UK and Australian courts has risen considerably and is no longer one of 'gross negligence'. In relation to the duty of loyalty, Anglo-Australian corporate law has no sanitizing mechanism that parallels the US concept of 'entire fairness'.³² It is simply not open to UK and Australian courts to review the

²⁷ *Id*, 237. See also *Breen v Williams* (1996) 186 CLR 71, 93, 137.

²⁸ *Attorney-General v Blake* [1998] Ch 439, 455 (CA). In the Australian context, see *P & V Industries Pty Ltd v Porto* [2006] VSC 131 at [23], (2006) 14 VR 1 (per Hollingworth J).

²⁹ Cf, however, Heath, 'The Director's "Fiduciary" Duty of Care and Skill: A Misnomer' (2007) 25 *Comp & Sec LJ* 370 and Heydon, 'Are the Duties of Company Directors to Exercise Care and Skill Fiduciary?', in Degeling and Edelman (eds), *Equity in Commercial Law* (Lawbook Co, 2005), 185.

³⁰ As Austin J stated in *Aequitas Ltd v AEFC Leasing Pty Ltd*, 'obligations to act in the interests of another, or to act prudently, are not fiduciary obligations': *Aequitas Ltd v AEFC Leasing Pty Ltd* [2001] NSWSC 14 at [284], (2001) 19 ACLC 1006.

³¹ *Harris v Digital Pulse Pty Ltd* [2003] NSWCA 10 at [406], (2003) 56 NSWLR 298. See generally Conaglen, 'Interaction Between Statutory and General Law Duties Concerning Company Director Conflicts' (2013) 31 *Comp & Sec LJ* 403, 407-408; Conaglen, *Fiduciary Loyalty: Protecting the Due Performance of Non-Fiduciary Duties* (Hart Publishing, 2010).

³² See generally DeMott, 'The Figure in the Landscape: A Comparative Sketch of Directors' Self-Interested Transactions' (1999) 62 *Law & Contemp Probs* 243.

merits of a board decision from a fairness standpoint.³³ Also, independent directors have tended to play a far less significant role in approving conflicts than in the United States.³⁴ Under Anglo-Australian company law, this role is predominantly reserved for shareholders,³⁵ including under statute, in areas such as related party transactions.³⁶

Thirdly, unlike Delaware corporate law, which relies on equitable directors' duties, modern Anglo-Australian company law involves complex interaction between general law and statutory directors' duties. Although the general law duties are very similar in the United Kingdom and Australia, the introduction of statutory directors' duties has created divergence between these previously similar corporate law regimes.³⁷

3. Codification of Directors' Duties in the United Kingdom and Australia

Directors' duties were codified for the first time in the United Kingdom under the *Companies Act 2006*. This Act introduced a range of statutory directors' duties, paralleling, though not coextensive with, pre-existing general law rules.³⁸ The statutory directors' duties contained in the 2006 Act are exclusive, supplanting the general law principles on which they are based.³⁹ However, the Act also creates an intricate relational looping between the general law and statutory duties because s

³³ See *Aberdeen Railway Co v Blaikie Bros* (1854) 1 Macq 461.

³⁴ See Cox, 'Corporate Governance in the United States: The Evolving Role of the Independent Board', in Low (ed), *Corporate Governance: An Asia-Pacific Critique* (Sweet & Maxwell Asia, 2002), 379, 388, stating that '[t]he most noticeable aspect of American corporate governance is the law's repeated resort to the independent director as a cleansing agent'.

³⁵ See *Regal (Hastings) Ltd v Gulliver* [1967] 2 AC 134; *Furs Ltd v Tomkies* (1936) 54 CLR 583; *Winthrop Investments Ltd v Winns Ltd* [1975] 2 NSWLR 666.

³⁶ See generally Hill, 'Visions and Revisions of the Shareholder' (2000) 48 *Am J Comp L* 39, 67-72.

³⁷ See Conaglen, 'Interaction Between Statutory and General Law Duties Concerning Company Director Conflicts' (2013) 31 *Comp & Sec LJ* 403, 409-412.

³⁸ The statutory duties under Part 10, Chapter 2 of the *Companies Act 2006*, c. 46 (UK) include the duty to:- act in accordance with the constitution, and exercise powers for proper purposes (s 171); exercise independent judgment (s 173 (1)) and reasonable care, skill and diligence (s 174 (1)); avoid situations in which they have a conflict, or possible conflict, between their own interests and those of the company (s 175(1)); not accept from any third party a benefit, which is conferred by reason of their position as director (s 176(1)).

³⁹ See *Companies Act 2006* c. 46, s 170(3) (UK).

170(4) stipulates that the statutory duties are to be ‘interpreted and applied in the same way as common law rules or equitable principles’.

This drafting turns traditional statutory interpretation on its head. By directing the adjudicator to look outside the legislator’s wording to determine its meaning, s 170(4) creates a new layer of complexity between UK statutory duties and the general law.⁴⁰ It is also puzzling how statutory duties that are not identical with fiduciary doctrine’s general principles can be applied ‘in the same way’. The interpretation provision of s 170(4) is akin to a *mutatis mutandis* proviso, which is hardly the most precise and effective approach to statutory drafting.⁴¹

Section 172(1) of the UK *Companies Act* 2006 included a controversial new duty⁴² that lacked any direct predecessor at general law. This duty requires directors to act in the way they consider ‘in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole’.⁴³ In fulfilling the duty, directors must have regard to a non-exhaustive list of factors, many of which relate to stakeholder interests.⁴⁴

The accepted goal of s 172(1) was to introduce an ‘enlightened shareholder value’ approach to UK company law.⁴⁵ Commentators are, however, divided on whether the

⁴⁰ See generally 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.

⁴¹ See Conaglen, ‘Interaction Between Statutory and General Law Duties Concerning Company Director Conflicts’ (2013) 31 *Comp & Sec LJ* 403, 412.

⁴² See, for example, Adams and Eaglesham, ‘Fears weight of law will fall on directors – Reform of Company legislation’, *Financial Times*, 3 February 2006, 3.

⁴³ *Companies Act* 2006, c. 46, s 172(1) (UK). See generally Davies and Worthington, *Gower & Davies Principles of Modern Company Law* (10th ed., Sweet & Maxwell, 2016), [16-37]ff.

⁴⁴ Under s 172(1) of the *Companies Act* 2006, c. 46 (UK), directors must 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.’

⁴⁵ See Keay, ‘The Duty to Promote the Success of the Company: Is it Fit for Purpose in a Post-Financial Crisis World?’ in Loughrey (ed), *Directors’ Duties and Shareholder Litigation in the Wake of the Financial Crisis* (Edward Elgar, 2013), 50, 60; Keay, ‘Tackling the Issue of the Corporate Objective:

section will change the prior law of directors' duties in any meaningful way.⁴⁶ It seems, for example, that it is the directors themselves who are responsible for determining what constitutes 'the success of the company',⁴⁷ and that some stakeholders, such as employees, may actually be worse off as a result of the provision.⁴⁸ Also, in spite of its apparently stakeholder-friendly form and aspirational goal of providing 'mutually reinforcing benefits for all',⁴⁹ in practice, the duty remains firmly shareholder-oriented. This is because it is owed to the company,⁵⁰ and is therefore only enforceable by the company or its shareholders in a derivative suit.⁵¹ There are relatively few cases on s 172(1) to date, and those that exist do not suggest any major departure from the prior general law.⁵² It has been argued, however, that the real significance of s 172(1) may be revealed, not in the courts, but rather in UK boardrooms.⁵³

Australia's statutory directors' duties regime differs from the UK reforms in two fundamental ways.⁵⁴ The first relates to the interaction between the general law and the statutory provisions. The second involves enforcement and remedies for breach of

An Analysis of the United Kingdom's 'Enlightened Shareholder Value Approach' (2007) 29 *Sydney L Rev* 577; Wen and Zhou, 'Exploring the Rationale of Enlightened Shareholder Value in the Realm of UK Company Law – The Path Dependence Perspective' (2011) 14 *Int'l Trade & Bus L Rev* 153.

⁴⁶ Cf Williams and Conley, 'An Emerging Third Way? The Erosion of the Anglo-American Shareholder Value Construct' (2005) 38 *Cornell Int'l LJ* 493, 499 and Keay, 'Moving Towards Stakeholderism? Constituency Statutes, Enlightened Shareholder Value, and More: Much Ado About Little?' [2011] *EJBLR* 1, 40.

⁴⁷ See, for example, *Re Smith and Fawcett* [1942] Ch 304.

⁴⁸ See, for example, Wynn-Evans, 'The Companies Act 2006 and the Interests of Employees' (2007) 36 *Industrial LJ* 188, 190; Worthington, 'Reforming Directors' Duties' (2001) 64 *Mod L Rev* 439, 446.

⁴⁹ See Financial Reporting Council, *Corporate Culture and the Role of Boards: Report of Observations*, July 2016, 8.

⁵⁰ See *Companies Act 2006*, c. 46, s 170(1) (UK); *Arbuthnott v Bonnyman aka Re Charterhouse Capital Limited* [2015] EWCA (Civ) 536; [2015] 2 BCLC 627, [50].

⁵¹ See Harper Ho, 'Enlightened Shareholder Value: Corporate Governance Beyond the Shareholder-Stakeholder Divide' (2010) 36 *J. Corp. L.* 59, 79.

⁵² See, for example, *Re Southern Counties Fresh Foods Ltd* [2008] EWHC 2810 (Ch); *Re West Coast Capital (LIOS) Ltd* [2008] CSOH 72.

⁵³ See Keay, 'Moving Towards Stakeholderism? Constituency Statutes, Enlightened Shareholder Value, and More: Much Ado About Little?' (2011) 22 *EJBLR* 1, 39-40.

⁵⁴ It is worth noting that, historically, Australia has placed more emphasis on corporate legislation than the United Kingdom. See Santow, 'Codification of Directors' Duties' (1999) 73 *Aust LJ* 336.

directors' duties.

As previously noted, the UK statutory directors' duties now comprise an exclusive code,⁵⁵ although they depend upon the prior general law for their interpretation. The Australian *Corporations Act 2001* ('*Corporations Act*'), on the other hand, explicitly preserves the operation of directors' duties at general law,⁵⁶ and the contours of the general law and statutory duties are not necessarily the same.⁵⁷ In contrast to the unconventional model of statutory interpretation in s 170(4) of the UK Companies Act 2006, the Australian regime adopts a more familiar approach. In *Vines v ASIC*,⁵⁸ Spigelman CJ stated:

'[W]hen a common law formulation is incorporated as a provision in a statute, its legal nature is altered. The words must now be interpreted as statutory language, albeit having regard, in an appropriate way, to the origins of the statutory formulation'.⁵⁹

Australia's statutory directors' duties do not include any equivalent of s 172(1) of the UK *Companies Act 2006*, which requires directors to consider stakeholder interests. Although Australia considered replicating this provision, two government reports in 2006⁶⁰ rejected the desirability of such reform in Australia, on the basis that the UK provision was overly prescriptive and would result in confusion.⁶¹ One Australian commentator was even more direct in his criticism of s 172(1), describing it as

⁵⁵ *Companies Act 2006*, c. 46, s 170(3) (UK). See also Santow, 'Codification of Directors' Duties' (1999) 73 *Aust LJ* 336, noting that Australia's statutory regime was 'always additive to the general law rather than substitutionary'; Harris, Hargovan and Austin, 'Shareholder Primacy Revisited: Does the Public Interest Have Any Role in Statutory Duties?' (2008) 26 *Comp & Sec LJ* 355, 359-362.

⁵⁶ *Corporations Act 2001* (Aust), s 185.

⁵⁷ The duties at general law under Australian corporate law include the duty of care and diligence; the duty to act in good faith, in the best interests of the company and for proper purposes; and the duty to avoid conflicts of interest. These duties are replicated to some degree and extended in the statutory duties regime under *Corporations Act 2001* (Aust), ss 180–184. See generally Harris, Hargovan and Austin, 'Shareholder Primacy Revisited: Does the Public Interest Have Any Role in Statutory Duties?' (2008) 26 *Comp & Sec LJ* 355, 361ff.

⁵⁸ (2007) 62 *ACSR* 1.

⁵⁹ *Id*, [136].

⁶⁰ See Parliament of Australia, Parliamentary Joint Committee on Corporations and Financial Services ('PJC'), *Corporate Responsibility: Managing Risk and Creating Value* (2006); Corporations and Markets Advisory Committee, *The Social Responsibility of Corporations: Report* (2006).

⁶¹ PJC, *Corporate Responsibility: Managing Risk and Creating Value* (2006), 54-56. See generally Hill, 'Evolving Directors' Duties in the Common Law World', in Paolini (ed), *Research Handbook on Directors' Duties* (Edward Elgar, 2014), 3, 36-38.

‘British folly’.⁶²

Whereas the key UK statutory duties are restricted to ‘directors’,⁶³ Australian statutory duties target a range of corporate participants. Some, such as the duty of care in s 180(1),⁶⁴ apply only to company directors and officers.⁶⁵ Others, such as the prohibitions on improper use of position⁶⁶ and information,⁶⁷ are broader in their reach, applying, not only to directors and officers, but also to employees. In addition, directors, but not officers, have a duty to prevent insolvent trading by their company.⁶⁸ These statutory duties form part of a broader civil penalty regime,⁶⁹ which governs the enforcement of certain contraventions of the Australian *Corporations Act*.

The second way in which statutory directors’ duties in Australia differ from those in the United Kingdom relates to enforcement and remedies. The civil penalty regime plays an integral role in this regard, differentiating enforcement of directors’ duties in Australia from the position under both UK and Delaware corporate law.

4. Enforcement of Directors’ Duties

The codification of directors’ duties in Australia, combined with the civil penalty regime, has significant implications for the enforcement of directors’ duties, making Australia an outlier vis-à-vis the other common law jurisdictions. Whereas Delaware and the United Kingdom rely mainly on private enforcement for breach of directors’

⁶² Comments by John M. Green in Austin (ed), *Company Directors and Corporate Social Responsibility: UK and Australian Perspectives* (Ross Parsons Centre of Commercial, Corporate and Taxation Law, 2007), 44, 49.

⁶³ The UK statutory directors’ duties may also extend to shadow directors. See *Companies Act* 2006, c. 46 (UK), ss 170(5) and 251.

⁶⁴ See also *Corporations Act* 2001 (Aust), s 181, which encompasses the duty to act in good faith in the best interests of the company and for proper purposes.

⁶⁵ For the definitions of ‘director’ (which includes ‘shadow director’) and ‘officer’, see *Corporations Act* 2001 (Aust), ss 9 and 179.

⁶⁶ *Corporations Act* 2001 (Aust), s 182.

⁶⁷ *Corporations Act* 2001 (Aust), s 183.

⁶⁸ *Corporations Act* 2001 (Aust), s 588G.

⁶⁹ See *Corporations Act* 2001 (Aust), Part 9.4B; s 1317E(1). See generally Austin and Ramsay, *Principles of Corporations Law* (16th ed, LexisNexis Butterworths, 2015), [3.400] – [3.410].

duties,⁷⁰ Australia has adopted a primarily public enforcement regime.⁷¹

Although Delaware and the United Kingdom both rely on private enforcement of directors' duties, in practice, the private litigation model operates differently in each jurisdiction. It has been said that the legal environment in the United States is 'uniquely hospitable'⁷² to litigation against directors. In Delaware, actions for breach of fiduciary duty can be pursued in a number of ways. They may be brought by the company, or by shareholders in direct suits, derivative litigation or, most commonly, by means of class actions.⁷³ A high percentage of civil actions filed in the Delaware Court of Chancery involve questions of fiduciary duty.⁷⁴

In contrast, the amount of private litigation commenced against company directors in the United Kingdom is negligible.⁷⁵ The reality is that directors of UK public companies run virtually no risk of being sued for damages for breach of directors' duties.⁷⁶

Variations in US and UK civil litigation procedures help explain this disparity in the volume of legal actions involving breach of directors' duties. These include the availability of class actions and contingency fees in Delaware (but not the United Kingdom) and the 'loser pays' system that operates in the United Kingdom (but not

⁷⁰ See Armour, Black, Cheffins and Nolan, 'Private Enforcement of Corporate Law: An Empirical Comparison of the United Kingdom and the United States' (2009) 6 *J Empirical Legal Studies* 687. There are, however, some aspects of public enforcement in United Kingdom. See generally *id.* 716-717.

⁷¹ See generally Kraakman et al, *The Anatomy of Corporate Law: A Comparative and Functional Approach* (3rd ed, Oxford University Press, 2017), 40-42. For a comparative analysis of the US and Australian enforcement models, see Jones and Welsh, 'Toward a Public Enforcement Model for Directors' Duty of Oversight' (2012) 45 *Vand J Transnat'l L* 343.

⁷² Cheffins and Black, 'Outside Director Liability Across Countries' (2006) 84 *Tex L Rev* 1385, 1393.

⁷³ Thompson and Thomas, 'The New Look of Shareholder Litigation: Acquisition-Oriented Class Actions' (2004) 57 *Vand L Rev* 133, 167-169.

⁷⁴ *Id.* 165ff.

⁷⁵ Armour, Black, Cheffins and Nolan, 'Private Enforcement of Corporate Law: An Empirical Comparison of the United Kingdom and the United States' (2009) 6 *J Empirical Legal Studies* 687; Moore, 'Redressing Risk Oversight Failure in UK and US Listed Companies: Lessons from the RBS and Citigroup Litigation' (2017) 18 *Eur Bus Org L Rev* 733.

⁷⁶ Armour, Black, Cheffins and Nolan, 'Private Enforcement of Corporate Law: An Empirical Comparison of the United Kingdom and the United States' (2009) 6 *J Empirical Legal Studies* 687, 687, 690, 699-700, 710.

Delaware).⁷⁷ The legendary rule in *Foss v Harbottle*⁷⁸ severely inhibited shareholder litigation for breach of directors' duties in the United Kingdom, and the UK version of the derivative suit differed in substance from, and was far less generous to plaintiff shareholders than, its US counterpart.⁷⁹ Finally, a significant amount of litigation involving directors' duties in Delaware occurs in the context of takeovers,⁸⁰ whereas in the United Kingdom (and also Australia), takeover disputes are determined, not by the courts, but rather by a specialized takeover panel.⁸¹

Historically, Australian corporate law adopted a UK-style private enforcement model, which resulted in minimal litigation against public company directors for breach of directors' duties.⁸² However, this picture changed in 1993, when Australia introduced the statutory civil penalty regime to extend and complement its private enforcement model.⁸³ A key goal of this statutory enforcement regime was to draw a clearer line between civil and criminal corporate law breaches.⁸⁴

⁷⁷ See *id.* 692-693. Although the 2014 decision, *ATP Tour, Inc v Tennis Bund*, 91 A. 3d. 554 (Del 2014), *prima facie* upheld the validity of litigation fee shifting by-laws under Delaware law, subsequent reforms to the Del GCL prohibited this. See Richman and Noreuil, 'Del GCL Amendments Authorize Exclusive Forum Provisions and Prohibit Fee-Shifting Provisions', *Harvard Law School Forum on Corporate Governance and Financial Regulation*, 6 July 2015.

⁷⁸ (1843) 2 Hare 461; 67 ER 189. See generally Rider, 'Amiable Lunatics and the Rule in *Foss v Harbottle*' (1978) 37 *Cambridge LJ* 270.

⁷⁹ Armour, Black, Cheffins and Nolan, 'Private Enforcement of Corporate Law: An Empirical Comparison of the United Kingdom and the United States' (2009) 6 *J Empir Legal Stud* 687, 694; DeMott, 'Shareholder Litigation in Australia and the United States: Common Problems, Uncommon Solutions' (1987) 11 *Syd L Rev* 259. Derivative claims in the United Kingdom are now governed by the *Companies Act 2006*, c. 46, ss 260-263 (UK).

⁸⁰ See Thompson and Thomas, 'The New Look of Shareholder Litigation: Acquisition-Oriented Class Actions' (2004) 57 *Vand L Rev* 133.

⁸¹ The Panel on Takeovers and Mergers. See Armour, Black, Cheffins and Nolan, 'Private Enforcement of Corporate Law: An Empirical Comparison of the United Kingdom and the United States' (2009) 6 *J Empir Legal Stud* 687, 692, 717-718; Armour and Skeel, 'Who Writes the Rules for Hostile Takeovers and Why? The Peculiar Divergence of US and UK Takeover Regulation' (2007) 95 *Geo LJ* 1727; Hill, 'Takeovers, Poison Pills and Protectionism in Comparative Corporate Governance' in Grundmann et al (eds), *Festschrift für Klaus J. Hopt* (de Gruyter, 2010), 795, 802-805.

⁸² See Cheffins and Black, 'Outside Director Liability Across Countries' (2006) 84 *Texas L Rev* 1385, 1433-1437.

⁸³ See generally Varzaly, 'The Enforcement of Directors' Duties in Australia: An Empirical Analysis' (2015) 16 *Eur Bus Org L Rev* 281.

⁸⁴ See Welsh, 'The Regulatory Dilemma: The Choice Between Overlapping Criminal Sanctions and Civil Penalties for Contraventions of the Directors' Duty Provisions' (2009) 27 *Company and Securities LJ* 370; Golding, 'Tightening the Screws on Directors: Care, Delegation and Reliance' (2012) 35 *UNSW LJ* 266, 272-273.

Australia's civil penalty regime provides a distinctive public enforcement regime for certain contraventions of the *Corporations Act*, including statutory directors' duties.⁸⁵ The main enforcement mechanism is the corporate regulator, the Australian Securities and Investments Commission ('ASIC'). Unlike the civil consequences for breach of statutory directors' duties under the UK *Companies Act* 2006, which are identical to those at general law,⁸⁶ remedies under Australia's civil penalty regime are quite different. Enforcement tools and remedies available to ASIC under the regime⁸⁷ include:- (i) pecuniary penalties (of up to A\$200,000 for an individual and A\$1 million for corporations);⁸⁸ (ii) compensation orders;⁸⁹ and (iii) disqualification orders.⁹⁰

It has been argued that the civil penalty enforcement regime has fundamentally altered the nature of directors' duties in Australia, by weakening their historic private law roots and enhancing their 'public' nature.⁹¹ This hypothesis is supported by ASIC's enforcement role and self-image, as well as by case law.⁹² For example, ASIC

⁸⁵ See Austin and Ramsay, *Principles of Corporations Law* (16th ed, LexisNexis Butterworths, 2015), [3.400].

⁸⁶ See *Companies Act* 2006, c. 46 (UK), s 178(1).

⁸⁷ For a discussion of ASIC's regulatory powers, tools and enforcement strategies, see Australian Securities and Investments Commission, *ASIC's Approach to Enforcement*, Information Sheet 151 (September 2013), 4-7; Redmond, *Corporations and Financial Markets Law* (7th ed., Lawbook Co, 2017), [11.110]-[11.120]; Austin and Ramsay, *Principles of Corporations Law* (16th ed., LexisNexis Butterworths, 2015), [8.355]ff.

⁸⁸ *Corporations Act* 2001 (Aust), s 1317G. Note, however, that recent reform proposals have recommended a significant increase in the maximum penalties under the civil penalty regime for both corporations and individuals. See generally Australian Government, *ASIC Enforcement Review: Positions Paper 7, Strengthening Penalties for Corporate and Financial Sector Misconduct* (Commonwealth of Australia, 2017).

⁸⁹ *Corporations Act* 2001 (Aust), ss 1317H and 1317HA.

⁹⁰ *Corporations Act* 2001 (Aust), s 206C. Disqualification of 'unfit' directors is also possible in the United Kingdom under the *Company Directors Disqualification Act* 1986, c. 46 (UK). For discussion of perceived limitations of the disqualification regime under this Act, see Lowry and Edmunds, 'Directors' Duties and Liabilities: Disqualifying "Unfit" Directors at Banks? Political Rhetoric and the Directors' Disqualification Regime' in Chiu and McKee (eds), *The Law on Corporate Governance in Banks* (Edward Elgar, 2015), 75.

⁹¹ See Welsh, 'Realising the Public Potential of Corporate Law: Twenty Years of Civil Penalty Enforcement in Australia' (2014) 42 *Federal Law Review* 217, 223-228; Harris, Hargovan and Austin, 'Shareholder Primacy Revisited: Does the Public Interest Have Any Role in Statutory Duties?' (2008) 26 *Comp & Sec LJ* 355.

⁹² See, for example, *ASIC v Adler* (2002) 168 FLR 253, [56]; *Forge v ASIC* (2004) 213 ALR 574, 654, [381]; *International Swimwear Logistics Ltd v Australian Swimwear Co Pty Ltd* [2011] NSWSC 488, [106].

has stressed its role in protecting the ‘public interest’.⁹³ Also, in the recent Federal Court of Australia decision, *ASIC v Cassimatis (No 8)*,⁹⁴ Edelman J accepted that breach of the statutory duty of care is not only a private, but also a public, wrong, and that there is a public interest in the enforcement of directors’ duties in Australia.⁹⁵

The distinctive nature of Australia’s statutory directors’ duties has important regulatory consequences, which reinforce Australia’s outlier status in this area. For example, ASIC’s ‘public interest’ role has implications for its choice of remedy.⁹⁶ It has been argued that the regulator’s obligation is not to obtain compensation for individual shareholder losses, but rather to protect the public interest at large by securing ‘maximum voluntary compliance’.⁹⁷ Data on ASIC’s remedy choice in civil penalty proceedings supports this view – applications in which ASIC has sought pecuniary penalty and disqualification orders far outnumber those seeking compensation orders.⁹⁸

Another issue raised by the public nature of Australia’s statutory directors’ duties is relief from breach of duty.⁹⁹ In contrast to the Anglo-Australian position at general law,¹⁰⁰ where fully informed shareholder consent is *prima facie* effective to waive breach of directors’ duties,¹⁰¹ it has now been judicially accepted in Australia that

⁹³ See Australian Securities and Investments Commission, *ASIC’s Approach to Enforcement*, Information Sheet 151 (September 2013), 6. See also Harris, Hargovan and Austin, ‘Shareholder Primacy Revisited: Does the Public Interest Have Any Role in Statutory Duties?’ (2008) 26 *Comp & Sec LJ* 355, 372-373.

⁹⁴ [2016] FCA 1023. See *id*, [461], [496]*ff*, [503].

⁹⁵ *Id*, [455].

⁹⁶ See Welsh, ‘Realising the Public Potential of Corporate Law: Twenty Years of Civil Penalty Enforcement in Australia’ (2014) 42 *Federal Law Review* 217, 220.

⁹⁷ *Id*, 230-1, 233, 239. ASIC has itself stressed the importance of ‘effective deterrence’ in its approach to civil penalty enforcement. See Australian Securities and Investments Commission, *ASIC’s Approach to Enforcement*, Information Sheet 151 (September 2013), 4.

⁹⁸ Welsh, ‘Realising the Public Potential of Corporate Law: Twenty Years of Civil Penalty Enforcement in Australia’ (2014) 42 *Federal Law Review* 217, 237-9.

⁹⁹ See generally Harris, Hargovan and Austin, ‘Shareholder Primacy Revisited: Does the Public Interest Have Any Role in Statutory Duties?’ (2008) 26 *Comp & Sec LJ* 355, 363-365.

¹⁰⁰ *Regal (Hastings) Ltd v Gulliver* [1967] 2 AC 134; *Furs Ltd v Tomkies* (1936) 54 CLR 583; *Winthrop Investments Ltd v Winns Ltd* [1975] 2 NSWLR 666.

¹⁰¹ See generally Austin and Ramsay, *Principles of Corporations Law* (16th ed, LexisNexis Butterworths, 2015), [9.330].

shareholders cannot waive or ratify breach of the statutory directors' duties.¹⁰² This can be compared with the recent Delaware Supreme Court decision in *Singh v Attenborough*,¹⁰³ which held that a fully informed, uncoerced vote of disinterested shareholders is effective to waive, not only breach of the duty of care by a company's directors, but also by the board's financial advisor. The Australian courts' emphasis on the public nature of statutory directors' duties provides a sharp contrast with the strong private/contractual interpretation of shareholder rights under *Singh v Attenborough*¹⁰⁴ and other contemporary Delaware cases.¹⁰⁵

5. Acoustic Separation in Action - The Duty of Care (and Associated Safe Harbours)

The interaction of general law principles and statutory provisions affects the complexity of directors' duty liability regimes. Australia's statutory directors' duties, for example, form part of a more complicated legal ecosystem than that which applies under either Delaware or UK law. Directors of Australian public companies face overlapping, but separate, liability regimes under both general fiduciary doctrine and statute, which potentially increases the doctrinal differences between Australian and Anglo-American law.

Legal safe harbours create another level of complexity that may affect acoustic separation in relation to directors' duties. Legal safe harbours can alter the shape, scope and enforceability of duties and create a disjunction between law on the books and law in practice.¹⁰⁶ The interface between directors' duties and legal safe harbours

¹⁰² See *ASIC v Cassimatis (No 8)* [2016] FCA 1023, [457], [459], [508]; *Forge v ASIC* (2004) 213 ALR 574.

¹⁰³ No. 645 (Del. Sup. Ct. May 6, 2016).

¹⁰⁴ No. 645 (Del. Sup. Ct. May 6, 2016).

¹⁰⁵ See, for example, *Boilermakers Local 154 Retirement Fund v Chevron*, 73 A. 3d 934 (Del Ch 2013) and *ATP Tour, Inc v Deutscher Tennis Bund*, 91 A. 3d 554 (Del 2014). See also Cox, 'Whose Law Is It? Battling Over Turf in Shareholder Litigation' in Hill and Thomas, (eds), *Research Handbook on Shareholder Power* (Edward Elgar, 2015), 333.

¹⁰⁶ See, for example, Skeel Jr, 'Book Review: Corporate Anatomy Lessons' (2004) 113 *Yale LJ* 1519, 1543; Coffee Jr, 'Law and the Market: The Impact of Enforcement' (2007) 156 *U Penn L Rev* 229, 243–5; Jackson, 'Variation in the Intensity of Financial Regulation: Preliminary Evidence and Potential Implications' (2007) 24 *Yale J Reg* 253.

may itself involve interactions between general law principles and statutory regimes.¹⁰⁷

The duty of care is emblematic of this complexity and divergence.¹⁰⁸ It also provides a good example of the impact of legal safe harbours and their ability to affect acoustic separation. Two legal safe harbours are particularly influential in defining the ultimate scope and enforceability of the duty – namely, the business judgment rule and exculpatory clauses.

5.1 The Duty of Care in Action Under Delaware Law

5.1.1 The Duty of Care in Delaware

It is routinely stated that, under US corporations law, directors and officers owe a duty to exercise reasonable care and diligence.¹⁰⁹ In spite of the hospitable US environment for litigation against directors, successful derivative suits for breach of the duty of care were historically so rare as to constitute ‘an endangered species’.¹¹⁰ Successful actions tended to be limited to egregious conduct that also implicated the duty of loyalty.¹¹¹

¹⁰⁷ See generally Conaglen, ‘Interaction Between Statutory and General Law Duties Concerning Company Director Conflicts’ (2013) 31 *Comp & Sec LJ* 403.

¹⁰⁸ It has been said, for example, that Australia’s duty of care alone is perhaps the most complex in the world, with the ‘absurd luxury’ of three separate regimes – under common law, equity, and statute – each with distinct remedial consequences. See Farrar, ‘Towards a Statutory Business Judgment Rule in Australia’ (1998) 8 *Aust J Corp L* 237, 239.

¹⁰⁹ Although this duty is equitable under Delaware law, most US states have codified the duty by adopting a variant of the duty in § 8.30(b) of the Model Business Corporation Act (MBCA). See generally McMurray, ‘An Historical Perspective on the Duty of Care, the Duty of Loyalty and the Business Judgment Rule’ (1987) 40 *Vand L Rev* 605, 607-609; O’Kelley and Thompson, *Corporations and Other Business Associations: Cases and Materials* (7th ed, Wolters Kluwer, 2014), 326-327.

¹¹⁰ See Cohn, ‘Demise of the Director’s Duty of Care: Judicial Avoidance of Standards and Sanctions Through the Business Judgment Rule’ (1983) 62 *Texas L Rev* 591, 591, 592-3; Bishop, ‘Sitting Ducks and Decoy Ducks: New Trends in the Indemnification of Corporate Directors and Officers’ (1968) 77 *Yale LJ* 1078, 1095.

¹¹¹ See Johnson, ‘Rethinking Judicial Review of Director Care’ (1999) 24 *Del J Corp L* 787, 801; Armour, Black, Cheffins and Nolan, ‘Private Enforcement of Corporate Law: An Empirical Comparison of the United Kingdom and the United States’ (2009) 6 *J Empirical Legal Stud* 687; Furlow, ‘Good Faith, Fiduciary Duties, and the Business Judgment Rule in Delaware’ (2009) 3 *Utah L Rev* 1061.

Modern Delaware case law continues this trend,¹¹² with the high profile *Disney* litigation illustrating the wide acoustic separation between conduct rules and decision rules in relation to the duty of care.¹¹³ The 2005 *Disney* case¹¹⁴ drew a sharp distinction between legally enforceable directors' duties and corporate governance standards that are merely 'aspirational'.¹¹⁵ In that decision, Chancellor Chandler stated that 'Delaware law does not - indeed, the common law cannot - hold fiduciaries liable for a failure to comply with the aspirational ideal of best practices'.¹¹⁶

5.1.2 The US Business Judgment Rule

Part of the reason for the duty of care's transformation from law to mere aspiration is the business judgment rule. The US business judgment rule has a long pedigree, having been developed by the courts over the last 150 years.¹¹⁷ According to Professor Robert Clark, in contrast to the 'worrisome' duty of care, the very mention of the business judgment rule 'brings smiles of relief to corporate directors'.¹¹⁸

The business judgment rule represents an acknowledgement that certain matters should be off-limits to judicial scrutiny or review.¹¹⁹ This legal no-fly zone is created through a rebuttable presumption, which the plaintiff bears the onus of displacing, that the directors' conduct is proper.¹²⁰ The rule assumes that the directors, in making

¹¹² In relation to derivative litigation pleadings, see, for example, *In re Citigroup Inc. Shareholder Derivative Litigation*, 964 A.2d 106 (Del. Ch. 2009).

¹¹³ See generally Hill, 'Evolving Directors' Duties in the Common Law World', in Paolini (ed), *Research Handbook on Directors' Duties* (Edward Elgar, 2014), 3, 5-10.

¹¹⁴ *In re The Walt Disney Company Derivative Litigation*, 907 A.2d 693 (Del. Ch. 2005).

¹¹⁵ See Velasco, 'The Role of Aspiration in Corporate Fiduciary Duties' (2012) 54 *Wm & Mary L Rev* 519, 537-538.

¹¹⁶ *In re The Walt Disney Company Derivative Litigation*, 907 A.2d 693, 697 (Del. Ch. 2005) (approved *In re the Walt Disney Company Derivative Litigation*, Del. Supr., 906 A.2d 27 (Del. 2006)).

¹¹⁷ Smith, 'The Modern Business Judgment Rule' in Hill and Davidoff Solomon (eds), *Research Handbook on Mergers and Acquisitions* (Edward Elgar, 2016), 83.

¹¹⁸ Clark, *Corporate Law* (Little, Brown & Co, 1986), 123.

¹¹⁹ See, for example, Bainbridge, 'The Business Judgment Rule as Abstention Doctrine' (2004) 57 *Vand L Rev* 83; Johnson, 'The Modest Business Judgment Rule' (2000) 55 *Bus Law* 625, 631. For a broad discussion of the policy arguments against, and in favour of, judicial intervention in decision-making processes of organizations, see Chafee, 'The Internal Affairs of Associations Not For Profit' (1930) 43 *Harv L Rev* 993.

¹²⁰ See Arsh, 'The Business Judgment Rule Revisited' (1980) 8 *Hofstra L Rev* 93, 133-134.

a business decision, have acted ‘on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company’.¹²¹

Key goals of the business judgment rule are to encourage managerial risk-taking, guard against the danger of hindsight bias, and, in particular, to protect directors from liability for ‘good bets gone bad’.¹²² In *Joy v North*,¹²³ Winter J. stressed that the rule extends only as far as its policy justifications.¹²⁴ It does not, therefore, apply where there is evidence of fraud, conflict of interest or illegality,¹²⁵ or, according to *Smith v Van Gorkom*,¹²⁶ gross negligence.

Yet, even with these limits, the business judgment rule is an extremely broad doctrine, and its protection extends well beyond shielding US directors from liability for ‘good bets gone bad’.¹²⁷ The rule’s remit is also expanding in Delaware. The 2014 Delaware Supreme Court decision, *Kahn v M & F Worldwide Corp*,¹²⁸ showed that the business judgment rule has now colonized some transactional areas, such as mergers with a controlling stockholder, that were previously assessed under the more stringent ‘entire fairness’ standard.¹²⁹

5.1.3 US Exculpatory Clauses

¹²¹ *Aronson v Lewis*, 473 A. 2d 805, 812 (Del. 1984). See also *Gagliardi v Trifoods International, Inc*, 683 A. 2d 1049, 1052-3 (Del. Ch. 1996), which states that the business judgment rule will protect directors, provided they ‘act in good faith and meet minimal proceduralist standards of attention’.

¹²² Armour and Gordon, ‘Systemic Harms and Shareholder Value’ (2014) 6 *Journal of Legal Analysis* 35, 51. See *id*, 51-53.

¹²³ 692 F.2d 880 (2d Cir. 1982), cert den. 460 U.S. 1051 (1983).

¹²⁴ These policy justifications include voluntary assumption of risk by shareholders; freedom of choice regarding investment options; the limitations of after-the-fact litigation; the fact that directors are not trustees and have a risk-taking role; and the ability of shareholders to diversify their investments. *Id*, 885-886.

¹²⁵ *Shlensky v Wrigley*, 237 N. E. 2d, 776, 780 (Ill. App. 1968).

¹²⁶ 488 A. 2d 858, 873 (Del. 1985).

¹²⁷ Armour and Gordon, ‘Systemic Harms and Shareholder Value’ (2014) 6 *Journal of Legal Analysis* 35, 51.

¹²⁸ 88 A.3d 635 (Del. 2014).

¹²⁹ See generally, Hill, ‘Images of the Shareholder - Shareholder Power and Shareholder Powerlessness’, in Hill and Thomas (eds), *Research Handbook on Shareholder Power* (Edward Elgar, 2015), 53, 64-65.

The ‘on the books’ duty of care standard in Delaware is, when combined with the business judgment rule, one of gross negligence. Yet, as noted previously, the scope of the duty has been further reduced in practice through use of exculpatory clauses in corporate charters.

Delaware became the first US state to provide authorization for inclusion of exculpatory clauses in corporate charters, when it enacted Del GCL § 102(b)(7) in 1986. This reform was a rapid regulatory response to *Smith v Van Gorkom*,¹³⁰ where the defendant directors were held to have been grossly negligent for making an uninformed business judgment. This determination by the Delaware Supreme Court upended the ‘almost reflexive deference’ that the judiciary had previously accorded to board decisions.¹³¹ Del GCL § 102(b)(7) plugged this *Smith v Van Gorkom* liability gap.¹³² It effectively overruled the case through statute, by permitting companies to exclude director liability for good faith breaches of the duty of care, even where that breach involved gross negligence.¹³³

Exculpatory clauses are now a familiar part of the US corporate law landscape. The majority of states provide statutory authorization for exculpatory clauses,¹³⁴ and the charter of almost every Delaware incorporated company includes such a provision.¹³⁵ Most states base their enabling legislation on either Del GCL § 102(b)(7), or its Model Business Corporations Act counterpart, MBCA § 2.02(b)(4).¹³⁶

¹³⁰ See generally Hanks, ‘Evaluating Recent State Legislation on Director and Officer Liability Limitation and Indemnification’ (1988) 43 *Bus Law* 1207, 1208-1209. The enactment of Del GCL § 102(b)(7) was also in response to a directors’ liability insurance crisis. See *id.*, 1209; Holland, ‘Delaware Directors’ Fiduciary Duties: The Focus on Loyalty’ (2009) 11 *U Penn J Bus L* 675, 691.

¹³¹ Hanks, ‘Evaluating Recent State Legislation on Director and Officer Liability Limitation and Indemnification’ (1988) 43 *Bus Law* 1207, 1209.

¹³² Kahan and Rock, ‘Symbiotic Federalism and the Structure of Corporate Law’ (2005) 58 *Vand L Rev* 1573, 1596.

¹³³ *Ibid.*; Elson and Thompson, ‘Van Gorkom’s Legacy: The Limits of Judicially Enforced Constraints and the Promise of Proprietary Incentives’ (2002) 96 *Nw U L Rev* 579, 583. For a good example of the operation of such exculpatory provisions, see *Malpiede v Townson*, 780 A.2d 1075 (Del. 2001).

¹³⁴ According to O’Kelley and Thompson, *Corporations and Other Business Associations: Cases and Materials* (7th ed, Wolters Kluwer, 2014), 353, approximately 40 states have now enacted legislation permitting corporations to adopt exculpatory clauses.

¹³⁵ See Black, Cheffins and Klausner, ‘Outside Director Liability’ (2006) 58 *Stan L Rev* 1055, 1090.

¹³⁶ *Ibid.*

The safe harbour offered by Del GCL § 102(b)(7) is not unlimited. Under the section, an exculpatory charter clause can protect a director from monetary damages for breach of the duty of care, unless the plaintiff alleges facts showing that the director breached the ‘duty of loyalty’; engaged in conduct that was not in ‘good faith’ or involved intentional misconduct or breach of law; or afforded the director an ‘improper personal benefit’.¹³⁷

Exculpatory clauses are a powerful form of defence because they can provide the basis for early dismissal of any complaint brought by shareholders against directors for breach of directors’ duty.¹³⁸ By providing authorization for inclusion of such clauses in the corporate charter, Del GCL § 102(b)(7), therefore, enables a Delaware court to dismiss a claim for breach of the duty of care, even when it involves *Smith v Van Gorkom*-style gross negligence.¹³⁹ Attempts by plaintiffs to repackage gross negligence claims as breach of the duty of loyalty, in order to avoid Del GCL § 102(b)(7)’s protective shield, have met with strong judicial resistance.¹⁴⁰

The safety zone for directors created by exculpatory clauses has expanded in several ways in the United States. The first relates to who is entitled to this safe harbour. Del GCL § 102(b)(7) only authorizes exoneration of directors,¹⁴¹ however, some US states, such as Nevada, Louisiana and New Jersey, also authorize protection of company officers.¹⁴²

There has also been an expansion of the kind of fiduciary duty breaches that are capable of exoneration. In Delaware, the duty of loyalty has consistently been treated, both under Del GCL § 102(b)(7) and by the courts, as the immutable core of fiduciary

¹³⁷ See Del GCL § 102(b)(7)(i)-(iv).

¹³⁸ Kapnick and Rosen, ‘The Exculpatory Clause Defense to Shareholder Derivative Claims’ (2010) 17 *Bus Torts J* 1.

¹³⁹ See, for example, *Malpiede v Townson*, 780 A.2d 1075 (Del. 2001).

¹⁴⁰ See, for example, *Lyondell Chemical Co v Ryan*, 970 A.2d 235, 242-244 (Del. 2009).

¹⁴¹ This is in spite of the fact that corporate officers owe the same fiduciary duties as directors. See *Gantler v Stephens*, 965 A. 2d 695 (Del. 2009).

¹⁴² See, for example, Nev Rev Stat § 78.037(2) (2013); LA Rev Stat § 12:24(C)(4) (2011); NJ Rev Stat § 14A:2-7(3) (2013).

obligation, which cannot be subverted by contract.¹⁴³ In fact, however, Del GCL § 122(17)¹⁴⁴ was amended in 2000 to allow for precisely this circumstance, by permitting waiver of the corporate opportunity doctrine.¹⁴⁵

Perhaps no state has pushed the exoneration envelope quite so far as Nevada.¹⁴⁶ It has been suggested that, as a result of reforms from 2001 onwards, Nevada company directors are now potentially shielded from core fiduciary duties, such as the duty of loyalty, the duty to act in good faith, and the no profit principle.¹⁴⁷ The authorization of such broad exculpatory clauses has cemented Nevada's reputation as a 'no-liability corporate safe haven'¹⁴⁸ and bolstered its position vis-à-vis Delaware in the competition for out-of-state incorporations.¹⁴⁹

5.1.4 The Duty of Care in Action in Delaware - Concluding Remarks

It is important to recognize that the business judgment rule and Del GCL § 102(b)(7) operate against a highly litigious backdrop. There has been an explosion of mega-deal litigation in Delaware in recent years,¹⁵⁰ and the consequences of successful breach of

¹⁴³ Holland, 'Delaware Directors' Fiduciary Duties: The Focus on Loyalty' (2009) 11 *U Penn J Bus L* 675, 676.

¹⁴⁴ See Welch and Saunders, 'Freedom and Its Limits in the Delaware General Corporation Law' (2008) 33 *Del J Corp L* 845, 855, 859-860; Steele, 'Judicial Scrutiny of Fiduciary Duties in Delaware Limited Partnerships and Limited Liability Companies' (2007) 32 *Del J Corp L* 1, 10.

¹⁴⁵ See Rauterberg and Talley, 'Contracting Out of the Fiduciary Duty of Loyalty: An Empirical Analysis of Corporate Opportunity Waivers' (2017) 117 *Colum L Rev* 1075. The trend toward waiver of the corporate opportunity doctrine is even more pronounced in the context of limited liability companies (LLCs) and limited partnerships (LPs). See Strine and Laster, 'The Siren Song of Unlimited Contractual Freedom' in Hillman and Loewenstein (eds), *Research Handbook on Partnerships, LCs and Alternative Forms of Business Organizations* (Edward Elgar, 2015), 11, 12.

¹⁴⁶ See generally Barzuza, 'Market Segmentation: The Rise of Nevada as a Liability-Free Jurisdiction' (2012) 98 *Virginia L Rev* 935.

¹⁴⁷ *Id*, 940-941, 948. See Nev Rev Stat § 78.037(2).

¹⁴⁸ Barzuza, 'Market Segmentation: The Rise of Nevada as a Liability-Free Jurisdiction' (2012) 98 *Virginia L Rev* 935, 938.

¹⁴⁹ *Id*, 953-955.

¹⁵⁰ The percentage of transactions of \$100 million dollars or more resulting in litigation rose from 39.3% to 94.9% between 2005 and 2014. See *In re Truglia Inc., Stockholder Litigation*, 129 A. 3d 884, 894 (Del. Ch. 2016). See also *In re Walgreen Co Stockholder Litigation* (*Hays, et al v Walgreen Co., et al.*), No 15-3799, 8 (US Court of Appeals for the Seventh Circuit, 2016); 'Posner versus the Plaintiffs Bar', *The Wall Street Journal*, 12 August 2016; Hoffman, 'The Judge Who Shoots Down Merger Lawsuits', *The Wall Street Journal*, 10 January 2016.

duty litigation can be ruinous for directors.¹⁵¹ Chancellor Allen has highlighted the ‘stupefying disjunction between risk and reward’¹⁵² that US company directors face. In *Smith v Van Gorkom*,¹⁵³ for example, the settlement figure was US\$23.5 million,¹⁵⁴ but could have been far higher if damages had been judicially assessed.¹⁵⁵

The business judgment rule and exculpatory clauses provide an antidote to Delaware’s hyper-litigious environment. Given, the expansive protection offered by these safe havens, the duty of care in Delaware today is not so much an endangered species of liability,¹⁵⁶ as an extinct one. Its only substantive effect appears to be derivative, where, for example, third parties, such as M&A advisors, may be liable for aiding and abetting a breach of fiduciary duty by directors.¹⁵⁷

The evisceration of the duty of care in the United States has long been rationalized on policy grounds. There is a widely held view that the operation of legal safe harbours as virtually impenetrable liability shields is justified on the basis that otherwise directors might make risk-averse decisions, contrary to the interests of diversified shareholders.¹⁵⁸ In recent times, however, this conventional wisdom has been questioned. For example, Professors Armour and Gordon have claimed that where systemic risk exists the business judgment rule can lead to excessive risk-taking by

¹⁵¹ See Spemann, ‘Monetary Liability for Breach of the Duty of Care?’ (2016) 8 *J Legal Analysis* 337, 339; Cohn, ‘Demise of the Director’s Duty of Care: Judicial Avoidance of Standards and Sanctions Through the Business Judgment Rule’ (1983) 62 *Tex L Rev* 591, 595; Trebilcock, ‘The Liability of Company Directors for Negligence’ (1969) 32 *Mod L Rev* 499, 517-518.

¹⁵² *Gagliardi v Trifoods International, Inc*, 683 A. 2d 1049, 1052-1053 (Del. Ch. 1996).

¹⁵³ 488 A. 2d 858 (Del. 1985).

¹⁵⁴ See Manning, ‘Reflections and Practical Tips on Life in the Boardroom After Van Gorkom’ (1985) 41 *Bus Law* 1, ‘Editor’s Note’. In fact, the acquirer in *Smith v Van Gorkom* picked up the tab for the directors in relation to the amount of the settlement not covered by D&O insurance. See ‘Roundtable Discussion: Corporate Governance’ (2001) 77 *Chicago-Kent L Rev* 235, 237-8.

¹⁵⁵ O’Kelley and Thompson, *Corporations and Other Business Associations: Cases and Materials* (7th ed, Wolters Kluwer, 2014), 349, n 1.

¹⁵⁶ Cohn, ‘Demise of the Director’s Duty of Care: Judicial Avoidance of Standards and Sanctions Through the Business Judgment Rule’ (1983) 62 *Tex L Rev* 591, 591.

¹⁵⁷ See, for example, *In re Del Monte Food Co Shareholders Litigation* 25 A.3d 813 (Del. Ch. 2011).

¹⁵⁸ See, for example, *Gagliardi v Trifoods International, Inc*, 683 A. 2d 1049, 1052-3 (Del. Ch. 1996); *Joy v North*, 692 F.2d 880, 886 (2d Cir. 1982), cert den. 460 U.S. 1051 (1983). See generally Armour and Gordon, ‘Systemic Harms and Shareholder Value’ (2014) 6 *Journal of Legal Analysis* 35, 51-53; Kraakman et al, *The Anatomy of Corporate Law: A Comparative and Functional Approach* (3rd ed., Oxford University Press, 2017), 70.

directors and officers of some financial institutions, which is contrary to the preferences of diversified shareholders and justifies the imposition of liability rules.¹⁵⁹ Professor Spamann has gone further, arguing that, even in the general corporate law realm, the current US regime of complete exclusion of liability for breach of the duty of care is not necessarily justified by standard policy rationales and should be reassessed.¹⁶⁰ The more nuanced liability approach to enforcement of the duty of care adopted in other common law jurisdictions, particularly Australia, is directly relevant to this emerging US debate.

5.2 The Duty of Care in Practice Under Anglo-Australian Corporate Law

5.2.1 The Duty of Care in the United Kingdom and Australia

The economic justifications for limiting the duty of care have been less influential in the United Kingdom and Australia, where there has been far more attention paid to the issue of accountability. Although the original legal standard for directors' duty of care in both jurisdictions was one of gross negligence,¹⁶¹ this standard was widely regarded as unsatisfactory and as giving directors 'remarkable freedom to run companies incompetently'.¹⁶² In contrast to Delaware, where, due to exculpatory clauses, the modern 'law in action' standard is lower than gross negligence, the relevant standard for directors' conduct has risen significantly under Anglo-Australian law. This coincided with increased recognition that managerial incompetence can cause massive corporate losses, and may constitute a greater threat to society than classic loyalty-based fiduciary breaches.¹⁶³ Events in the United Kingdom, such as the

¹⁵⁹ Armour and Gordon, 'Systemic Harms and Shareholder Value' (2014) 6 *Journal of Legal Analysis* 35, 61ff.

¹⁶⁰ See Spamann, 'Monetary Liability for Breach of the Duty of Care?' (2016) 8 *J Legal Analysis* 337.

¹⁶¹ See generally Trebilcock, 'The Liability of Company Directors for Negligence' (1969) 32 *Mod L Rev* 499.

¹⁶² Finch, 'Company Directors: Who Cares About Skill and Care?' (1992) 55 *Mod L Rev* 179, 179.

¹⁶³ See Worthington, 'The Duty to Monitor: A Modern View of the Director's Duty of Care' in Macmillan (ed), *Perspectives in Company Law: 2* (Kluwer Law International, 1997), 181, 194; Loughrey, 'The Director's Duty of Care and Skill and the Financial Crisis' in Loughrey (ed), *Directors' Duties and Shareholder Litigation in the Wake of the Financial Crisis* (Edward Elgar, 2013), 12. See also Armour and Gordon, 'Systemic Harms and Shareholder Value' (2014) 6 *J Legal Analysis* 35, 40ff and

1995 collapse of Barings Bank and the global financial crisis, reinforced this perception.

The leading case on the duty of care under both UK and Australian corporate law was the 1925 decision, *In re City Equitable Fire Insurance Co* ('*City Equitable*').¹⁶⁴ In this decision, Romer J. applied a subjectively formulated 19th century standard of negligence, under which a director 'need not exhibit a greater degree of skill than may reasonably be expected from a person of his knowledge and experience'.¹⁶⁵ This formulation of the duty insulated ignorant and inexperienced directors from the financial consequences of their mistakes.¹⁶⁶

The *City Equitable* standard attracted widespread criticism over the years. It was described as 'remarkably low',¹⁶⁷ 'wholly inadequate',¹⁶⁸ and based on 'legacies of outmoded economic and social philosophies from another age'.¹⁶⁹ It was also often referred to as 'the amiable lunatic' standard.¹⁷⁰ Nonetheless, the decision held sway for almost 70 years as the benchmark for the duty of care in the United Kingdom and Australia. A series of cases from the 1990s onwards finally changed this, however, making it clear that *City Equitable* no longer represented good law in either jurisdiction.

In the United Kingdom, decisions in the early 1990s, such as *Re D'Jan of London Ltd*¹⁷¹ and *Norman v Theodore Goddard*,¹⁷² strengthened the law relating to the duty

Trebilcock, 'The Liability of Company Directors for Negligence' (1969) 32 *Mod L Rev* 499, making the point several decades earlier.

¹⁶⁴ [1925] Ch 407; See generally Teele-Langford, Ramsay and Welsh, 'The Origins of Company Directors' Statutory Duty of Care' (2015) 37 *Syd L Rev* 489, 507-508.

¹⁶⁵ *In re City Equitable Fire Insurance Co* [1925] Ch 407, 428.

¹⁶⁶ See, for example, comments of Neville J. in *Re Brazilian Rubber Plantations & Estates Ltd* [1911] 1 Ch. 425, 437. See also *Re Denham & Co* (1883) 25 Ch.D. 752.

¹⁶⁷ *Daniels v Anderson* (1995) 37 NSWLR 438, 494G.

¹⁶⁸ See Trebilcock, 'The Liability of Company Directors for Negligence' (1969) 32 *Mod L Rev* 499, 509.

¹⁶⁹ *Ibid.*

¹⁷⁰ See Kershaw, *Company Law in Context: Text and Materials* (Oxford University Press, 2009), 390. See also Rider, 'Amiable Lunatics and the Rule in *Foss v Harbottle*' (1978) 37 *Camb LJ* 270, 285ff.

¹⁷¹ [1993] BCC 646.

¹⁷² [1992] BCC 14.

of care.¹⁷³ These cases adopted a more demanding objective test for directors' conduct,¹⁷⁴ which is now reflected in s 174 of the UK *Companies Act* 2006.¹⁷⁵

A similar trend occurred in a series of Australian cases involving insolvent trading¹⁷⁶ and directors' duties during the 1990s.¹⁷⁷ This trend from aspiration to law had been predicted several decades earlier by a former judge of the High Court of Australia, Sir Douglas Menzies, who stated that 'what is in general expected of directors will tend to become the measure of what is required of them'.¹⁷⁸

The prominent 1995 *AWA Appeal* decision¹⁷⁹ led the way in this regard. The facts were analogous to those of the contemporaneous UK Barings Bank collapse.¹⁸⁰ AWA Ltd sued its auditors, for massive corporate losses attributable to foreign exchange trading by one of its employees.¹⁸¹ The auditors responded by claiming contributory negligence by the company, its managing director and non-executive directors.

¹⁷³ See generally Davies and Worthington, *Gower & Davies Principles of Modern Company Law* (10th ed., Sweet & Maxwell, 2016), [16-16]ff.

¹⁷⁴ These decisions were influenced by higher statutory standards in the insolvency context - they suggested that the director's duty of care was now comparable to the more exacting statutory duty under the *Insolvency Act* 1986. See *Insolvency Act* 1986, c. 45, s 214(4) (UK).

¹⁷⁵ Directors of UK financial institutions are also required to exercise 'due skill, care and diligence' in managing their firm's business, and this duty is subject to public enforcement. See generally Loughrey, 'Breaching the Accountability Firewall: Market Norms and the Reasonable Director' (2014) 37 *Seattle U L Rev* 989, 990.

¹⁷⁶ See *Statewide Tobacco Services Ltd v Morley* (1990) 2 ACSR 405 (aff'd *Morley v Statewide Tobacco Services Ltd* [1993] 1 VR 423); *Commonwealth Bank of Australia v Friedrich* (1991) 5 ACSR 115.

¹⁷⁷ See generally Bird and Hill, 'Regulatory Rooms in Australian Corporate Law' (1999) 25 *Brook J Int L* 555, 561ff.

¹⁷⁸ Menzies, 'Company Directors' (1959) 33 *Aust LJ* 156, 164.

¹⁷⁹ *Daniels v Anderson* (1995) 37 NSWLR 438.

¹⁸⁰ Indeed, the AWA Appeal decision was cited with approval in the UK decision, *Re Barings plc (No 5)*, *Secretary of State for Trade and Industry v Baker Re Barings plc and others (No 5)*, *Secretary of State for Trade and Industry v Baker* [1999] 1 BCLC 433, one of the cases arising from the fraudulent activities of Nick Leeson, a Barings Bank trader.

¹⁸¹ See generally, Redmond, *Corporations and Financial Markets Law* (7th ed., Lawbook Co, 2017), [7.80].

It has been said that the *AWA Appeal* decision represented ‘a quantum shift’¹⁸² in the legal expectations regarding the duty of care for directors and officers in Australia.¹⁸³ This upward trajectory has continued in recent cases, such as *ASIC v Healey*,¹⁸⁴ where it was held that the directors and officers of a major public listed company breached their statutory duty of care by failing to detect critical errors in the company’s financial statements.¹⁸⁵ This was in spite of the non-executive directors having relied on the company’s senior management and auditors, who themselves had reviewed, but failed to identify, the errors.¹⁸⁶

These developments might suggest convergence between UK and Australian law in the area of the duty of care. However, that would not be an accurate assessment, given the differences in their enforcement regimes. As noted previously, the directors’ duty of care is a ‘practically insignificant’¹⁸⁷ accountability mechanism in the United Kingdom. This is because, although there is strong substantive law, there has been remarkably little private enforcement against public company directors¹⁸⁸ even in the aftermath of the global financial crisis.¹⁸⁹

¹⁸² Golding, ‘Tightening the Screws on Directors: Care, Delegation and Reliance’ (2012) 35 *UNSW LJ* 266, 268. It should be noted, however, that the New South Wales Court of Appeal ultimately held that the non-executive directors of AWA Ltd did not breach their duty of care.

¹⁸³ For concise summaries of the legal content of the duty of care under modern Australian law, see Golding, ‘Tightening the Screws on Directors: Care, Delegation and Reliance’ (2012) 35 *UNSW LJ* 266, 270-271; *ASIC v Adler* (2002) 168 FLR 253, [372].

¹⁸⁴ See *ASIC v Healey* (2011) 196 FCR 291. See generally, Hill, ‘Centro and the Monitoring Board – Legal Duties Versus Aspirational Ideals in Corporate Governance’ (2012) 35 *UNSW LJ* 341; Hill, ‘Evolving Directors’ Duties in the Common Law World’, in Paolini (ed), *Research Handbook on Directors’ Duties* (Edward Elgar, 2014), 3, 24-30.

¹⁸⁵ See 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, 250.

¹⁸⁶ According to Middleton J, there is ‘a core, irreducible requirement’ of the directors themselves ‘to be involved in the management of the company and to be in a position to guide and monitor’. *ASIC v Healey* (2011) 196 FCR 291, [16]. Cf Trebilcock, ‘The Liability of Company Directors for Negligence’ (1969) 32 *Mod L Rev* 499, 506-508 discussing the historically generous approach under UK company law to reliance by directors on others.

¹⁸⁷ Moore, ‘Redressing Risk Oversight Failure in UK and US Listed Companies: Lessons from the *RBS* and *Citigroup* Litigation’ (2017) 18 *Eur Bus Org L Rev* 733.

¹⁸⁸ See Armour, Black, Cheffins and Nolan, ‘Private Enforcement of Corporate Law: An Empirical Comparison of the United Kingdom and the United States’ (2009) 6 *J Empirical Legal Studies* 687, 721-722.

¹⁸⁹ See Loughrey, ‘Breaching the Accountability Firewall: Market Norms and the Reasonable Director’ (2014) 37 *Seattle U L Rev* 989, referring to a statement by the UK Parliamentary Commission on

In Australia, on the other hand, the majority of civil penalty applications brought by ASIC for breach of statutory directors' duties relate to the statutory duty of care under s 180(1) of the *Corporations Act*. These applications increasingly target executive and non-executive directors of high profile public corporations. ASIC has a very high success rate - there have been findings of liability in the vast majority of its civil penalty applications.¹⁹⁰ Also, an increasing number of these applications involve so-called 'stepping stone' liability,¹⁹¹ where ASIC has argued that the directors have breached their statutory duty of care by allowing the corporation to contravene another provision of the *Corporations Act*, thereby jeopardizing the corporation's interests in exposing it to a penalty.¹⁹²

How do legal safe harbours, such as the business judgment rule and exculpatory clauses interact with the duty of care in the United Kingdom and Australia compared to Delaware? There are a number of striking contrasts in the scope and operation of these safe harbours across the three jurisdictions.

5.2.2 Judicial Abstention Under Anglo-Australian Law

Whereas the business judgment rule is a core feature of Delaware law, it is an alien concept in the United Kingdom. However, even without a formal rule of judicial

Banking Standards, which described the dearth of public or private enforcement against UK bank directors in relation to the global financial crisis as 'an accountability firewall'. See also Loughrey, 'The Director's Duty of Care and Skill and the Financial Crisis' in Loughrey (ed), *Directors' Duties and Shareholder Litigation in the Wake of the Financial Crisis* (Edward Elgar, 2013), 12; Moore, 'Redressing Risk Oversight Failure in UK and US Listed Companies: Lessons from the *RBS* and *Citigroup* Litigation' (2017) 18 *Eur Bus Org L Rev* 733.

¹⁹⁰ See generally Welsh, 'Realising the Public Potential of Corporate Law: Twenty Years of Civil Penalty Enforcement in Australia' (2014) 42 *Federal Law Review* 217, 233ff; Hedges and Ramsay, 'Has the Introduction of Civil Penalties Increased the Speed and Success Rate of Directors' Duties Cases?' (2016) 34 *Comp and Sec LJ* 549, 552-553; Golding, 'Tightening the Screws on Directors: Care, Delegation and Reliance' (2012) 35 *UNSW LJ* 266, 273-274, 287-289; Gibson and Brown, 'ASIC's Expectations of Directors' (2012) 35 *UNSW LJ* 254.

¹⁹¹ On the evolution of 'stepping stone' liability, see Herzberg and Anderson, 'Stepping Stones - From Corporate Fault to Directors' Personal Civil Liability' (2012) 40 *Fed L Rev* 181; Bednall and Hanrahan, 'Officers' Liability for Mandatory Disclosure: Two Paths, Two Destinations?' (2013) 31 *Comp & Sec LJ* 474.

¹⁹² See, for example, *ASIC v Maxwell* (2006) 59 ACSR 373; [2006] NSWSC 1052, [104]-[106]. See generally Harris, Hargovan and Austin, 'Shareholder Primacy Revisited: Does the Public Interest Have Any Role in Statutory Duties?' (2008) 26 *Comp & Sec LJ* 355. Although some judges have expressed concern about stepping stone liability being used as a back-door means of imposing accessorial liability on directors, this type of liability has been successful in a number of recent Australian cases. See, for example, *ASIC, in re Sino Australia Oil and Gas Ltd (in liq) v Sino Australia Oil and Gas Ltd (in liq)* [2016] FCA 934, [85]-[86]; *ASIC v Cassimatis (No 8)* [2016] FCA 1023.

abstinance,¹⁹³ UK courts were traditionally reluctant to hold directors liable for honest mistakes of judgment,¹⁹⁴ and recent UK cases have continued this ‘soft’¹⁹⁵ non-interventionist approach,¹⁹⁶ which arguably operates as a functional equivalent of Delaware’s business judgment rule.

Contemporary Australian law provides an interesting contrast with both UK and US law. The Australian courts, like their UK counterparts, were traditionally reluctant to second-guess the merits of directors’ decisions.¹⁹⁷ However, in 2000, Australia moved away from its UK origins, by adopting a legislative rule of judicial abstention, which introduced a stronger US-style statutory business judgment rule.¹⁹⁸ This reform was a partial response to business community concern that the *AWA Appeal* decision¹⁹⁹ had raised directors’ duty of care to an unreasonably high level.

Australia’s statutory business judgment rule is found in s 180(2) of the *Corporations Act*,²⁰⁰ which was modelled on the American Law Institute’s business judgment rule.²⁰¹ Under s 180(2), directors and officers, who make a ‘business judgment’,²⁰² are

¹⁹³ See Cheffins and Black, ‘Outside Director Liability Across Countries’ (2006) 84 *Tex L Rev* 1385, 1401.

¹⁹⁴ See, for example, *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821, at 835; *Turquand v Marshall* (1869) LR 4 Ch App 376, 386; *Lagunas Nitrate Co v. Lagunas Syndicate* [1899] 2 Ch. 392. See also Trebilcock, ‘The Liability of Company Directors for Negligence’ (1969) 32 *Mod L Rev* 499, 500; Tunc, ‘The Judge and the Businessman’ (1986) 102 *LQR* 549.

¹⁹⁵ For an interesting analysis of the various ‘soft’ and ‘strong’ versions of the business judgment rule in a wide range of countries, see Gurrea-Martinez, ‘Re-examining the Law and Economics of the Business Judgment Rule: Notes for its implementation in Non-US Jurisdictions’ (forthcoming, 2018, *Journal of Corp Law Studies*).

¹⁹⁶ The UK courts have justified this non-interventionist approach as guarding against hindsight bias. See, for example, *Regentcrest plc (in liq) v Cohen* [2001] BCC 494, [127]; *Re Sherborne Associates Ltd* [1995] BCC 40, 50; *Re Brian D. Pierson (Contractors) Ltd* [1999] BCC 26, 50. See also *Re Continental Assurance Company of London plc* [2007] 2 BCLC 287, [399], expressing the view that the role of the duty of care is ‘not to ensure that the company gets everything right’.

¹⁹⁷ See, for example, the High Court of Australia decision in *Harlowe’s Nominees Pty Ltd v Woodside (Lakes Entrance) Oil Co* (1968) 121 CLR 483, 493.

¹⁹⁸ For background to the introduction of the business judgment rule in Australia, see Byrne, ‘Directors to Hide from a Sea of Liabilities in a New Safe Harbour’ (2008) 22 *Aust J Corp L* 255, [1.2].

¹⁹⁹ *Daniels v Anderson* (1995) 37 NSWLR 438.

²⁰⁰ See generally Redmond, *Corporations and Financial Markets Law* (6th ed, Lawbook Co, 2013), [7.105]-[7.125]; Boros and Duns, *Corporate Law* (3rd ed., Oxford University Press, 2013), [10.7.2].

²⁰¹ American Law Institute, *Principles of Corporate Governance* (1994), s 4.01.

²⁰² *Corporations Act 2001* (Aust), s 180(3).

taken to have complied with the duty of care if four conditions are satisfied. These conditions are that the directors/officers:- act in good faith for a proper purpose; have no material personal interest in the subject matter of the judgment; adequately inform themselves; and rationally believe that the decision is in the best interests of the corporation.²⁰³

Section 180(2) is intriguing from a legal transplant perspective. In spite of the powerful protection offered by its Delaware counterpart, Australia's statutory business judgment rule has been variously described as 'an alien graft on Anglo-Australian corporate jurisprudence of no real assistance to directors',²⁰⁴ 'largely symbolic',²⁰⁵ and mere 'window dressing'.²⁰⁶ In the sixteen years since it was introduced in Australia, the rule has been considered in only a handful of cases.²⁰⁷

In spite of its US origins, the business judgment rule operates quite differently in Australia to Delaware. First, the scope of the protection offered by the Australian business judgment rule is narrower than under US law. Section 180(2) only operates in relation to the duty of care (either at general law or under statute).²⁰⁸ Furthermore, it does not protect all actions and decisions of directors and officers, only those falling within the statutory definition of a 'business judgment' - namely, 'any decision to take or not take action in respect of a matter relevant to the business operations of the corporation'.²⁰⁹ It is been suggested that many types of managerial conduct fall outside the scope of this definition, including, for example, failure:- to respond to a business crisis; to monitor the business or supervise delegates; to prevent the

²⁰³ *Corporations Act 2001 (Aust)*, 180(2)(a)-(d).

²⁰⁴ Santow, 'Codification of Directors' Duties' (1999) 73 *Aust LJ* 336, 337.

²⁰⁵ Bird, 'The Duty of Care and the CLERP Reforms' (1999) 17 *Company and Securities LJ* 141, 151.

²⁰⁶ Young, 'Has Directors' Liability Gone Too Far or Not Far Enough? A Review of the Standard of Conduct Required for Directors under Sections 180–184 of the Corporations Act' (2008) 26 *Company and Securities LJ* 216, 222.

²⁰⁷ Most notably, *ASIC v Rich* [2009] NSWSC 1229; (2009) 75 ACSR 1, [7248]-[7295] and *ASIC v Mariner Corp Ltd* (ACN 002 989 782) (2015) 327 ALR 95, [483]*ff*.

²⁰⁸ See note to *Corporations Act 2001 (Aust)*, s 180(2).

²⁰⁹ *Corporations Act 2001 (Aust)*, s 180(3).

company engaging in insolvent trading; and to redress misstatements in a prospectus or takeover document.²¹⁰

The second difference relates to the onus of proof under the Australian business judgment rule. It seems that s 180(2) was originally intended, as in the United States, to operate as a rebuttable presumption in favour of a defendant director. However, at the time of its enactment, one US scholar suggested the drafting of the provision was ‘more apt to place the onus on the director’.²¹¹

The issue of whether Australian law follows, or diverges from, US law in terms of the onus of proof was considered in the 2009 decision, *ASIC v Rich*.²¹² ASIC alleged that the defendants, who were directors of the collapsed telecommunications company One.Tel, had committed numerous breaches of the duty of care. Each side argued that the other bore the onus of proof in relation to the four conditions under s 180(2). Although Austin J. described s 180(2) as ‘opaque’²¹³ and ‘profoundly ambiguous’ on this point,²¹⁴ he concluded in *obiter dicta* that Australia’s statutory business judgment rule places the onus of proof, not on the plaintiff, but rather on the defendant directors.²¹⁵ Interestingly, one of the justifications of this conclusion was Australia’s public enforcement regime. According to Austin J., it would be unusual if ASIC, as part of its evidentiary burden, were obliged, not only to prove breach of the statutory duty of care, but also to rebut the four conditions in s 180(2).²¹⁶ Subsequent cases have confirmed this statutory interpretation of Australia’s statutory business judgment rule with regard to the onus of proof.²¹⁷

²¹⁰ See *Corporate Law Economic Reform Program Bill*, Explanatory Memorandum, [6.8]. In *ASIC v Rich*, however, Austin J envisaged a relatively broad interpretation of the rule as extending to board decisions involving planning, budgeting and forecasting. *ASIC v Rich* [2009] NSWSC 1229; (2009) 75 ACSR 1, [7274].

²¹¹ DeMott, ‘Legislating Business Judgment – A Comment from the United States’ (1998) 16 *Company and Securities LJ* 575, 576.

²¹² [2009] NSWSC 1229; (2009) 75 ACSR 1, [7248] – [7295].

²¹³ *Id*, [7263].

²¹⁴ *Id*, [7264].

²¹⁵ *Id*, [7269].

²¹⁶ *Id*, [7269].

²¹⁷ See *ASIC v Fortescue Metals Group Ltd* (2011) 190 FCR 364; 274 ALR 731; [2011] FCAFC 19, [197]; *ASIC v Mariner Corp Ltd* (ACN 002 989 782) (2015) 327 ALR 95, [485].

5.2.3 Exculpatory Clauses Under Anglo-Australian Law

Exculpatory clauses, or exemption clauses, constitute another context involving interaction between the general principles of fiduciary doctrine and statutory corporations law. Both Delaware law and Anglo-Australian law deal with exculpatory clauses via statute. However, the relevant statutory provisions operate in diametrically opposite ways. Whereas in the United States, statutory provisions, such as Del GCL § 102(b)(7), were passed to authorize exculpatory clauses, in the United Kingdom and Australia, statutory reforms were introduced to prohibit them.

The reason for this sharp divergence is historical. US corporations and Anglo-Australian companies have different organizational origins.²¹⁸ US corporate law derived from early UK royal chartered corporations²¹⁹ and were therefore originally quasi-public entities, subject to state control.²²⁰ UK and Australian companies, on the other hand, developed from unincorporated joint stock companies, which had strong contractual elements.²²¹ As a result of these different starting points, US corporations required explicit statutory authorization to enable them to include exculpatory clauses in the charter, whereas shareholders in UK and Australian companies could freely amend the corporate constitution ('articles of association' or 'articles') to include such a provision, without any specific statutory authorization.²²²

It is for this reason that provisions exempting directors from liability for breach of fiduciary duty emerged in the United Kingdom much earlier than their appearance in

²¹⁸ See generally Gower, 'Some Contrasts Between British and American Corporate Law', (1956) 69 *Harv L Rev* 1369; Hill, 'The Trajectory of American Corporate Governance: Shareholder Power and Private Ordering Combat' (forthcoming, March 2019, *University of Illinois Law Review*, available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2921692).

²¹⁹ See Gower, 'Some Contrasts Between British and American Corporate Law', (1956) 69 *Harv L Rev* 1369, 1370; Wells, 'Shareholder Power in America 1800-2000: A Short History' in Hill and Thomas (eds), *Research Handbook on Shareholder Power* (Edward Elgar, 2015), 13.

²²⁰ See Maier, 'The Revolutionary Origins of the American Corporation' (1993) 50 *William & Mary Quarterly* 51, 55-57; Millon, 'Theories of the Corporation' [1990] *Duke LJ* 201, 206-207; Williston, 'History of the Law of Business Corporations Before 1800', 2 *Harv L Rev* 105, 110-111, 113-114.

²²¹ See Gower, 'Some Contrasts Between British and American Corporation Law' (1956) 69 *Harvard Law Review* 1369, 1371-72, 1376; Hill, 'The Trajectory of American Corporate Governance: Shareholder Power and Private Ordering Combat' (forthcoming, March 2019, *University of Illinois Law Review*, available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2921692).

²²² It has been argued that this 'free contracting' aspect of the articles is the cornerstone of shareholder rights in the United Kingdom. See Nolan, 'Shareholder Rights in Britain' (2006) 7 *Eur Bus Org L Rev* 549, 554-556.

Delaware in 1986.²²³ There is evidence that such provisions were common in the articles of UK companies in the early 20th century.²²⁴ Their inclusion was justified in the United Kingdom under both contractual²²⁵ and general fiduciary principles.²²⁶

One case in particular highlighted this emerging UK phenomenon in the early 20th century – the 1925 *City Equitable* decision.²²⁷ In spite of the low standard adopted in that case, Romer J. found that the defendant directors of a reinsurance company had, in fact, breached their duty of care. They were, however, relieved of liability for the breach because the company's constitution contained a provision exempting the directors from liability for all conduct except 'wilful neglect or default'.²²⁸ The articles of some contemporaneous companies went even further, providing blanket protection to directors except for actual dishonesty.²²⁹

One year after the *City Equitable* decision, a prominent UK company law reform committee, the Greene Committee, turned its attention to the increasing use of exculpatory clauses.²³⁰ This Committee, was scathing in its assessment of these clauses, stating:

'We consider that this type of article gives a quite unjustifiable protection to directors. Under it a director may with impunity be guilty of the grossest negligence provided that he does not consciously do anything which he recognises to be improper'.²³¹

²²³ I.e. in response to *Smith v Van Gorkom* 488 A. 2d 858, 873 (Del. 1985).

²²⁴ The Greene Committee, for example, stated that exculpatory clauses had become 'common' during this period. Board of Trade, United Kingdom, *Report of the Company Law Amendment Committee 1925-1926* (Greene Committee) (Command Paper 2657, 1926), [46].

²²⁵ See *Hickman v Kent or Romney Marsh Sheep-Breeders' Association* [1915] 1 Ch 881.

²²⁶ See generally Conaglen, 'Interaction Between Statutory and General Law Duties Concerning Company Director Conflicts' (2013) 31 *Comp & Sec LJ* 403, 412-413. The only restriction at common law was that directors could not be indemnified against liability for fraud. Austin and Ramsay, *Principles of Corporations Law* (16th ed, LexisNexis Butterworths, 2015), [8.400].

²²⁷ [1925] Ch 407.

²²⁸ *Id*, 468-9, 474.

²²⁹ See, for example, *Re Brazilian Rubber Plantation and Estates Ltd* [1911] 1 Ch 425; Board of Trade, United Kingdom, *Report of the Company Law Amendment Committee 1925-1926* (Greene Committee) (Command Paper 2657, 1926), [46].

²³⁰ See Board of Trade, United Kingdom, *Report of the Company Law Amendment Committee 1925-1926* (Greene Committee) (Command Paper 2657, 1926), [46]-[47].

²³¹ *Id*, [46].

The Greene Committee recommended statutory reform to prohibit and invalidate any provision exempting directors from liability for breach of duty, including negligence.²³² The recommended reform was passed in the United Kingdom in 1928.²³³ Its adoption reflected increased reliance during this period on mandatory statutory provisions to protect shareholder interests.²³⁴ Analogous statutory prohibitions still operate in both the United Kingdom and Australia,²³⁵ and specifically prevent exemption of directors from liability for breach of the duty of care. The modern UK provision is found in s 232(1) of the *Companies Act* 2006, which states that:-

‘any provision that purports to exempt a director of a company (to any extent) from any liability that would otherwise attach to him in connection with any negligence, default, breach of duty or breach of trust in relation to the company is void’.²³⁶

Admittedly, there are some exceptions to, and ways around, the broad UK and Australian statutory prohibitions on exemption or indemnification of directors for liability.²³⁷ However, these tend to be considerably narrower than the authorized US safe harbours under, for example, contemporary Delaware and Nevada statutory law.

6. Concluding Remarks

It is often assumed that directors’ duties in common law jurisdictions are relatively homogeneous. However, this chapter shows that, although the laws of Delaware, the

²³² *Id.* [47].

²³³ *Companies Act* 1928, 18 & 19 Geo 5, c. 45 (UK), s 78(1).

²³⁴ Nolan, ‘The Continuing Evolution of Shareholder Governance’ (2006) 65 *Cambridge LJ* 92, 103-105.

²³⁵ The current iterations of the prohibition are found in *Companies Act* 2006, c. 46 (UK), 232(1) and *Corporations Act* 2001 (Aust), ss 199A-199C. See generally Conaglen, ‘Interaction Between Statutory and General Law Duties Concerning Company Director Conflicts’ (2013) 31 *Comp & Sec LJ* 403, 413-414, 418.

²³⁶ The Australian version of the prohibition, which is found in *Corporations Act* 2001 (Aust), s 199A(1), provides that ‘a company...must not exempt a person...from a liability to the company incurred as an officer or auditor of the company’. This is bolstered by s 199C(2), which states that ‘anything that purports to indemnify or insure a person against a liability, or exempt them from a liability, is void to the extent that it contravenes section 199A’. See generally Austin and Ramsay, *Principles of Corporations Law* (16th ed, LexisNexis Butterworths, 2015), [8.400].

²³⁷ See *id.* [8.410]; Conaglen, ‘Interaction Between Statutory and General Law Duties Concerning Company Director Conflicts’ (2013) 31 *Comp & Sec LJ* 403, 421.

United Kingdom and Australia share many common features in this regard, there are also significant differences. These differences are at times surprising, although in a number of respects they track back to the different historical paths by which Delaware, UK and Australian corporate law have developed. The differences manifest themselves in the scope of legal standards and safe harbours; the complex interaction between the general law and statute; and enforcement mechanisms, which ultimately shape directors' duties in action. Also, as the discussion of the duty of care in this chapter shows, the interaction between fiduciary doctrine and legal safe harbours can significantly expand, or contract, the gap between conduct rules and decision rules.

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