

IS THE BUSINESS JUDGMENT RULE BEING WHITTLED AWAY?

By Ali Cromie*

The celebrated “safe harbour” for diligent directors appears dead in the water, according to legal experts and company directors.

Lawyer Sibylle Krieger says, given the fanfare which greeted introduction of the Business Judgment Rule in to the Corporations Act in 2000, “you may be surprised to hear that it has very rarely come up in cases before the courts.” Krieger is a partner at Clayton Utz and a director at Sydney Ports Corporation.

Krieger says she has an uneasy feeling that the rule is being “whittled down” to what the Australian Securities and Investments Commission finds “acceptable” in negotiated settlements with errant company directors.

She cites the out of court agreements between ASIC and directors and officers of One-Tel, the failed telecommunications upstart. The agreement ended expectations that the One-Tel case would provide a rigorous test case of the Business Judgment Rule.

Instead Krieger says several “fairly hopeless [legal] examples” went before the courts. HIH trio – Ray Williams, Rodney Adler and finance director Dominic Fodera – endeavoured to reach a safe harbour via the Business Judgment Rule notwithstanding their circumstances afforded “very limited” prospects of success, she says.

Krieger was a keynote speakers at the AICD Directors’ Briefing held in Sydney in April – “Where has the Business Judgment Rule Gone? Is Risk Aversion Best Practice?” She was joined on the rostrum by renowned investment banker Jim Dominguez who founded the forerunner of UBS Australia and by independent director Ian Hutchinson.

Dominguez says the Business Judgment Rule was enacted, “not as a stick or rod” but to prevent judicial adventurism and provide a legislative safe haven for directors and managers against “excessive zealotry”. It was among the CLERP reforms incorporated in the Corporations Act in 2000.

Pressure for a statutory business judgement rule followed the **AWA Ltd v Daniels** litigation which left

directors scratching their head asking, “what are we really expected to do” to meet the appropriate standard of care and diligence as a director?

Dominguez noted the absence of the Business Judgment Rule in landmark corporate cases such as the Greaves case (**ASIC v Rich** [2003] NSWSC 85) which was determined by “the most astute minds” on the bench.

In the Greaves case Justice Austin supported ASIC’s contention that John Greaves, when chairman of listed company One-Tel, had responsibilities beyond those of his fellow non-executive directors. In determining the liability of Greaves for his conduct as company chairman, Justice Austin said it was the Court’s role “to articulate and apply a standard of care that reflects contemporary community expectations.”

Ian Hutchinson says community and government expectations for proper, competent and honest management are “higher than ever” and that the more governments legislate the harder it becomes for directors to remain well informed and function in the increasingly complex business environment.

He says an important question for directors is whether expectations are realistic and represent a standard that directors, particularly the chairman, can reasonably achieve? He believes expectations are “unrealistic” but he is not optimistic that “things are really going to improve that much.” That the standards applying to directors under the Business Judgement Rule have been left to the courts is “a very fundamental matter”.

Hutchinson, a former senior partner and chairman at solicitors, Freehills, believes the courts “shifting the goalposts” and the “increasing web of regulation” have contributed to a corporate environment where directors have numerous incentives to quit their role to reduce risk to their good reputation and to civil and criminal liability.

Hutchinson’s directorships include property group, Australand Holdings, financial services business, Zurich Australian Superannuation and optical supplier, Hoya Lens Australia.

Dominguez says an increasing predilection of

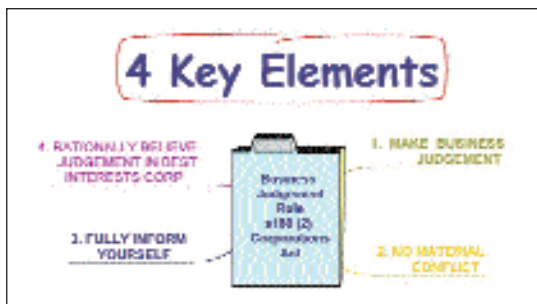
Insolvent trading tops

Hutchinson’s list of

Corporations Act hotspots:

‘There is no safe harbour
for insolvent trading’

Business Judgment Rule



regulators, particularly at state government level, to make directors personally liable is a trend that warrants “sleepless nights”. Tossing and turning is exacerbated for directors who worry about their personal liability should the directors’ and officers’ insurance policy “you thought you had” to support the costs of defending the criminal proceedings prove “null and void”. (**Silbermann, Greaves, Rich v CGU Insurance Limited** [2002] NSWSC 1195)

With the director landscape inhospitable, is risk aversion best practice for directors?

“I think the answer is pretty much yes,” says Hutchinson, highlighting 10 liability “hotspots” in the Corporations Act and further liability triggers affecting directors in other legislation.

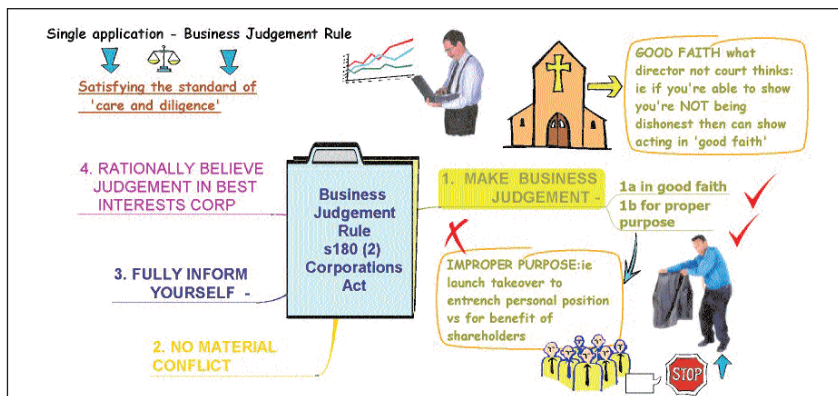
Insolvent trading tops Hutchinson’s list of Corporations Act hotspots. “There is no safe harbour for insolvent trading” and legislation drafted to focus directors’ attention on the welfare of shareholders may, ironically, cause directors to be self-interested, he says.

Oh for that magic bullet for honest directors now the high hopes invested in the Business Judgment Rule have gone by the board. Next?

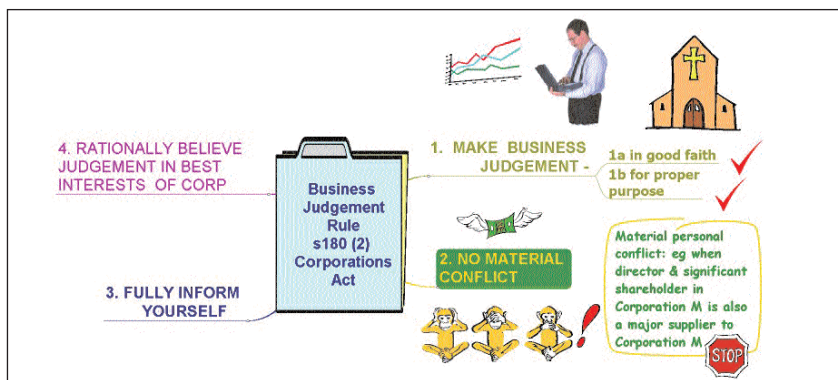
“Quite properly high standards of care and diligence are required,” says Hutchinson. “What we have to do is try and make sure the pendulum is in the right position. We must avoid the danger that good people avoid becoming directors and that good directors become risk adverse.”

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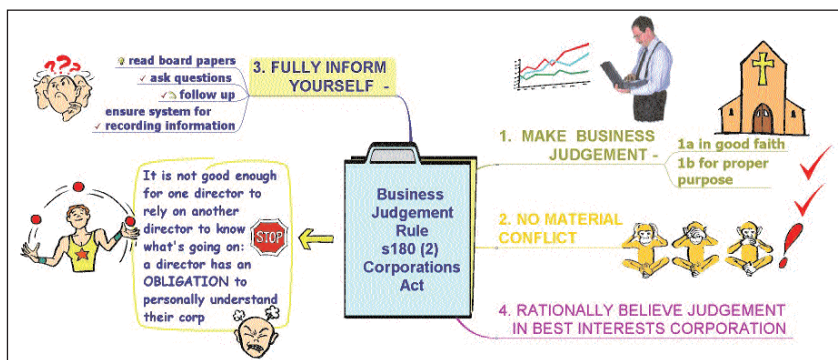
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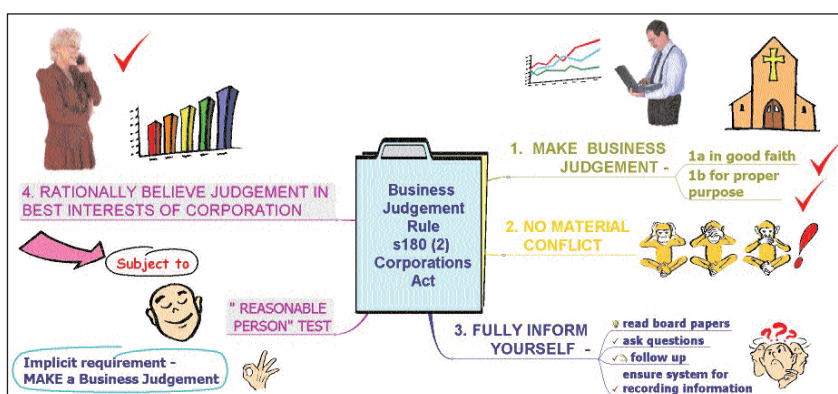
1. Focus on the business judgment element



2. No material conflict



3. Fully inform yourself



4. Rationally believe your judgment is in the best interests of your organisation