STRIKING A BALANCE

Jenifer Varzaly asks, do directors' duties provide adequate scope for risk taking while also protecting the company and shareholders?

The most recent debate surrounding directors' legal responsibility in Australia concerns the available defences which can be argued by directors whose conduct is impugned and whether these should be reformed, extended, or remain the same. This article deals with this question, particularly as it relates to the business judgment rule (BJR).

Directors must be able to make decisions which inevitably involve some degree of commercial risk if the economy is to be advantaged. Likewise, careless and dishonest director behaviour must be discouraged if shareholder interests are to be adequately protected.

Legal rules have played an important role in the corporate governance framework in Australia by ensuring that relevant information is provided to shareholders and that directors meet certain standards of conduct in carrying out their management function. However, the question of whether the content of these rules is helping to achieve that adequate balance between entrepreneurialism and the deterrence of questionable conduct remains contentious.

Debate continues as to what the optimal content of Australian law should be, in order that a proper balance is struck between the ability of directors to take reasonable risks in exercising their management function, while ensuring that such actions benefit the company and its associated stakeholders.

Australian corporate law has attempted to strike this balance through the enactment of provisions such as the BJR contained in s180(2) of the Federal *Corporations Act 2001*. This rule was introduced for the purpose of protecting and providing defence to directors in making management decisions. Yet, since its enactment, the rule has seldom been argued and has never been successfully applied in a major case. The narrow scope and application of the Australian BJR leads to the conclusion that a general defence should be preferred to an extension of the current BJR. It would appear that extending the existing BJR to apply as a defence to other directors' duties would have little practical effect.

A general defence should be drafted to specifically remedy the outlined difficulties when relying not only on the BJR, but on other defences in the Corporations Act such as those contained in s588H.

This paper begins with a focus on the existing legal framework of directors' duties and the corresponding defences which are currently available. It then outlines the key aspects of the Australian BJR, followed by the US BJR which is presented as a comparative example of a successful director defence.

Lastly the article examines current law reform proposals to broaden the protection available to directors in order to address the issue of balance between active management on one hand and deterrence of undesirable commercial conduct on the other.

The article concludes that a general defence should be enacted to provide better protection for directors and prevent the undue restriction of their entrepreneurial activities.

While upright conduct is certainly desired, the growth of the Australian economy requires directors to be both encouraged in their entrepreneurialism and motivated to accept director positions without undue hesitation due to the extensive legal regulation of management activity.

Further empirical research in this area is undoubtedly needed; however there is no doubt that the Australian courts would be better equipped to deal with directors' duty situations if a broader and more wide-ranging defence was available.

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