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Abstract

This paper analyses the issue of whether directors may use reliance on professional advice as a defence to a claim for breach of duty to exercise care, skill and diligence under common law or companies legislation in England and Australia. While England and Australia share the same common law tradition and have similar statutory provisions on the standard of care of directors, an English court generally regards a director as acting reasonably when he seeks advice from a qualified and independent professional adviser in a specialist matter within his expertise. In the absence of any conflict of interest, reliance is only unreasonable if the circumstances are so plain and obvious that no prudent person will rely on the advice. In contrast, recent Australian cases, particularly *ASIC v Healey*, *ASIC v MacDonald* and *ASIC v Fortescue*, restrict the circumstances in which directors can rely on professional advisers, even in specialist matters. This paper argues that the difference in approach between the two jurisdictions can be explained on two grounds. First, the Australian cases can be distinguished from the English cases because the former are special situations dealing with matters involving non-delegable duties of care imposed by legislation. Second, the potential outcomes of the breach of the duty of care differ in England and Australia, and this difference has a much deeper, substantive influence on the content of the standard of care. Contrary to academic suggestion, it is suggested that the Australian developments may not always be appropriate in determining the scope of the defence of reliance on professional advice in England.

Keywords

Directors' duties, reliance on advice

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Introduction

A consequence of the complexity of modern regulation and higher expectations on directors of large or listed companies to monitor their companies' affairs is an increasing reliance by directors on professional advisers. Directors often assume that they have discharged their duty of care to the company if they rely on the advisers in good faith, notwithstanding that their advice may have turned out to be misguided or wrong. However, recent decisions in England and Australia show a divergence in the approach towards the application of reliance on professional advice to a breach of duty of care claim.

The English cases, including *Re Continental Assurance Co of London (No. 4)*[1] and *Iesini v Westrip Holdings Ltd*,[2] have allowed directors to use the defence of reliance on professional advice in claims involving breach of duty of care under common law or companies legislation[3] as long as the professional adviser is appropriately qualified, independent and his advice is rendered within his qualification. However, notwithstanding the similarities in legal origins and the formulation of the statutory duty of care, the Australian cases, in particular *ASIC v Healey (Healey)*,[4] appear to take a more stringent approach than the English cases towards the invocation of the defence of reliance on professional advice for breach of duty of care claims. In order for the directors to successfully invoke the defence, the court in *Healey* held that the directors must not only assess the competence of the professional advisers, but also possess the skills to assess, and in fact independently assess, the advice that is given.[5] Commentators have described *Healey* as providing a 'wake-up' call for directors of companies,[6] and corporate law scholars have argued that English courts are likely to apply the same approach as *Healey*.[7]

The objectives of this paper are threefold. First, this paper compares and contrasts the application of the defence of reliance on professional advice to breach of duty of care under common law or companies legislation in England and Australia. Second, this paper explains the theoretical and doctrinal reasons for the apparent divergence in the English and Australian case law. Third, this paper offers normative conclusions as to how an English court may apply the defence of reliance on professional advice in breach of duty of care claims arising from materially inaccurate financial statements or public disclosure documents and the general management of the company. For convenience, I characterise the directors' reliance on the professional advisers as the defence of reliance on professional advice, though strictly speaking it is not an independent stand-alone defence to liability to duty of care but one which shows the director as having exercised due care.

'Background to the development of the law on standard of care of directors' sets out the background to the development of law on directors' standard of care under common law or companies legislation in England and Australia. Under 'Criteria for the defence of reliance on professional advice' I compare the application of the defence of reliance on professional advice to breach of duty of care claims in the two jurisdictions. The following Australian cases will be highlighted: *Healey*, *ASIC v MacDonald (No 11) (MacDonald)*[8] and *ASIC v Fortescue Metals Group (Fortescue)*,[9] both of which involve enforcement actions being brought against directors of Australian-listed companies for the contravention of the statutory duty of care.[10] I also argue that the effect of these decisions is to impose more rigorous standards on directors because the directors must not only assess the qualifications and competence of the professional advisers, but also possess sufficient competent skills to assess, and in fact assess, the results of the professional advice.

Under 'Theoretical underpinnings for the reliance defence and reasons for the differences' I examine the theoretical framework and provide two reasons for the differences in the approaches between the two jurisdictions. First, the Australian cases can be distinguished from the English cases because the former relate to breaches of non-delegable duties of care imposed by legislation in special situations. Second, the outcomes of the breach of statutory duty of care are different and it is argued that the different outcomes have deeper, substantive consequences on the content of the standard of care.

Finally, under 'Normative conclusions' I address the normative issue as to whether the English courts should follow the Australian developments. Contrary to academic suggestion,[11] it is suggested that the Australian development may not always be appropriate in determining the scope of the defence of reliance on professional advice in England.

Background to the development of the law on standard of care of directors

England

Historically, at common law, there was considerable deference to the company's prerogative to set its own process for information flow and delegation of authority, in the absence of grounds of actual suspicion.[12] The standard of care imposed on directors, encapsulated by *Re City Equitable Fire Insurance Co Ltd*,[13] was very low and undemanding, and directors were seldom held liable for negligence.[14]

In 1986, two important pieces of legislation were enacted which impose a more demanding standard on directors. First, the Company Directors Disqualification Act 1986 provides that the courts may disqualify a director if, among other things, the court is satisfied that his conduct in relation to the company makes him unfit to be involved in the management of the company, thus raising the possibility that a director may be disqualified on the ground of incompetence.[15] Second, section 214 of the Insolvency Act 1986 provides for the court to make an order for the director to contribute to the assets of the company on an insolvent liquidation if, prior to the commencement of the winding up, the director 'knew or ought to have concluded' that the company would go into insolvent liquidation. The knowledge and conclusions are those which would be known by a reasonably diligent person having both: (a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the same functions as are carried out by that director in relation to the company, and (b) the general knowledge, skill and experience that that director has.[16] In other words, section 214 imposes both an objective element which all directors must meet and a subjective element which raises the standard of the relevant director who possesses the relevant skill.

In the 1990s, influenced by the statutory formulation of the standard of care set out in the Insolvency Act 1986, the English courts began to take a more objective approach to setting the duty of care. Beginning with *Norman v Theodore Goddard*[17] and subsequently *D'Jan of London Ltd*,[18] Hoffmann J held that the directors' duty of care at common law was consistent with the tortious duty of care at common law which was accurately encapsulated in section 214 of the Insolvency Act 1986. Thus the objective and subjective elements of the standard of care became part of English law.

The dual tests of standard of care were eventually codified via the enactment of the UK Companies Act 2006 (UK Companies Act) after extensive consultation.[19] Section 174 of the UK Companies Act makes it clear that there is an objective minimum standard of conduct and that the standard may be raised if the director has any special knowledge, skill and experience.[20]

It is difficult to pinpoint the origins of the modern judicial approach.[21] However, the outcome of *Norman v Theodore Goddard* is consistent with the increasing emphasis that corporate governance committees have placed on the monitoring role played by the boards of large listed companies in the 1990s. In particular, the Cadbury Report,[22] which was published shortly after *Norman v Theodore Goddard*, emphasised the importance that non-executive directors play in performing the monitoring role of large listed companies.[23]

With the marked increase in standards imposed on directors since the historical position taken in *Re City Equitable Fire Insurance*, the question as to whether the defence of reliance on professional advice will protect the directors from a claim based on breach of duty of care becomes important. The UK Companies Act does not contain a statement to the effect that directors may rely on professional advisers. The Company Law Steering Group took the view that there was no need to make any express provision allowing for such reliance, so long as advisers are carefully selected and conclusions carefully scrutinised in accordance with the standard applicable to the director.[24] Thus the position as to the scope of the defence of reliance on professional advice is to be determined by common law. The section on 'Criteria for the defence of reliance on professional advice' discusses of how the defence has been applied in English case law.

Finally, section 1157 of the UK Companies Act grants power to the court to grant relief in respect of a director's negligence, default or breach of duty if, having regard to all the circumstances of the case, he ought fairly to be excused.[25] This provision is relevant as a director who has been found to be in breach of duty of care may use section 1157 to establish that he ought fairly to be excused because he has relied on professional advice.

Australia

In Australia, the statutory duty of care of directors is found in section 180 of the Corporations Act 2001 (Cth)[26] (Corporations Act). Section 180 provides that the director must exercise due care and diligence that a reasonable person would exercise if he were a director of the corporation in the corporation's circumstances and, among other things, had the same responsibilities within the corporation as the director. The reference to the corporation's circumstances requires consideration of the corporation-specific information, such as its size, business, listing status, board composition and the distribution of work between the board and management.[27] Case law has held that section 180 is equivalent to the common law duty of the tort of negligence,[28] and that it requires directors to take reasonable steps to monitor and be reasonably informed on the company's financial position.[29] More pertinently, as is the case in England, Australian case law has held that section 180 encapsulates both objective and subjective tests; the director will be assessed by what a reasonable and prudent person would do and the duty is enhanced if the director is appointed on the basis of a special skill.[30]

Section 189 of the Corporations Act, which does not have an equivalent in the UK Companies Act, provides that directors can rely on information or advice from professional advisers on matters within the professional's expertise in certain circumstances.[31] The Corporations Act also has provisions on insolvent trading, though the regime is stricter than the UK Insolvency Act 1986, in that the provisions impose liability on directors where there is reasonable suspicion of insolvency,[32] with certain defences.[33] However, unlike the UK,[34] a director can claim the statutory discretionary relief from liability under the Corporations Act for insolvent trading. It is beyond the scope of this paper to discuss the differences in the approaches to insolvent or wrongful trading,[35] and this paper will focus only on those situations where discretionary relief is granted on the ground of the reliance on professional advice defence.

Criteria for the defence of reliance on professional advice

The position in England

In claims involving breach of duty of care under common law or companies legislation, the extent to which directors may be able to rely on other directors and professionals to perform their duties is said to be in a state of development and is 'fact sensitive'.[36] This section discusses the application of the defence in breach of duty cases by the English courts.

No requirement of independent assessment. Under English law, in duty of care claims, a director is normally regarded as having discharged his duty of care if he has acted on the advice provided by the appointed professional adviser having the appropriate qualification in specialist areas. The director is not normally expected to have the skills to assess the advice that is rendered in specialist areas. In *Re Continental Assurance Co of London plc (No 4)*,[37] a wrongful trading case under section 214 of the Insolvency Act 1986, the board of an insurance company was held to have acted reasonably in taking advice from its auditors that the company was not insolvent at the relevant time and should continue to trade. The court held that the non-executive directors and the managing director (with the exception of the finance director) were expected to be intelligent laymen who had basic accounting principles for an insurance company but not a high level of accounting expertise such as might be possessed by a specialist in the field.[38] It is important to note that at that time the board comprised two executive and six non-executive directors, all of the eight directors had considerable commercial experience and three of the six non-executive directors had worked in the insurance industry. Nevertheless, the court emphasised that all of the directors, except for the finance director, were regarded as laymen with respect to accounting issues.

Likewise, in *Iesini v Westrip Holdings Ltd*,[39] Westrip entered into an agreement with Rimbal (owned by B and W, who were also directors of Westrip) pursuant to which Westrip acquired Rimbal shares in consideration for the allotment of redeemable shares to B and W. Rimbal had the mineral exploration licence and the intention was for Westrip to exploit the licence. The licence was expressed to be held on trust for Westrip. Westrip entered into a joint venture agreement with another company to exploit the licence. Subsequently, Westrip failed to issue those redeemable shares and B and W proceeded to rescind the agreement and have the Rimbal shares retransferred to them. The board of Westrip obtained legal advice to the effect that B and W had the right to rescind. Westrip accepted the rescission and entered into the settlement agreement pursuant to which Rimbal would be substituted into the joint venture agreement.

Certain shareholders of Westrip brought a shareholders' derivative action against the board of Westrip, arguing that the directors had breached their fiduciary duties by failing to consider the defences to the rescission. The court held that the board of Westrip had acted reasonably in following counsel's advice in respect of its contractual rights under the agreement by accepting the rescission.

It is not relevant that other professional advisers would have given different or better advice. In *Green v Walkling*,[40] in a specialist area involving money laundering, the court held that if the director seeks appropriate advice from solicitors and acts upon such advice, believing it to be correct, he will have *prima facie* fulfilled his duty.[41] It was held that it did not matter that the advice was wrong or that a different solicitor would have given different (and better) advice. Similarly, in *Re Stephenson Cobbold Ltd*,[42] a disqualification case, the non-executive director was entitled to rely on assurances by the company's auditors that certain payments to the managing director were proper, when he co-signed certain cheques, even if other auditors would not have given such assurances.

Adviser must be independent. *Iesini v Westrip Holdings Ltd* established an additional caveat that the professional adviser should not only be qualified but also be independent. In that case, as for the alternative trust claim by the company brought by the shareholders in derivative action, the court noted that the board allowed B and W, the directors with a conflict of interest, to instruct counsel, and this undermined the weight of such reliance. The court directed the board to reconsider Westrip's defence to Rimbal's claim for substitution, on the basis that there might be a strong claim that Westrip held the licence on trust.

Reliance must not be unreasonable. Where the cases have denied the defence of reliance on professional advice, they either involve plainly unreasonable reliance, that is, no prudent person would have relied on such advice or there was no reliance on the adviser's expertise at all.[43]

Re Bradcrown[44] and *Re Loquitur*[45] are illustrative examples of the situations where the circumstances are so obvious that no reasonable person will rely on them. In *Re Bradcrown*, the finance director was found to be unfit for office and disqualified, on the ground of acting in breach of his duty to the company in respect of a demerger of its businesses, notwithstanding the fact that he relied on the solicitors to the transaction. In that case, the reliance was unquestioning and plainly unreasonable as the demerger involved a transfer of assets of the company for no consideration.

In *Re Loquitur*, the directors of a company authorised the payment of certain dividends but failed to provide for tax on the sale of its business, with the consequence that the company did not actually have the profits to make such payment. In the defence to a claim brought by the company for unlawful payment of dividend, the directors argued that they had sought the advice of the company's tax counsel, solicitors and accountants, and reasonably formed the view that tax was not required to be provided for since the company could claim for rollover relief. The application for the discretionary relief failed because the actual advice contemplated certain assumptions relating to the transaction which the directors knew were not met and they should, but did not, refer the transaction back to the relevant advisers for confirmatory advice.[46]

Where the directors have professional skills, despite the fact that section 174 provides that the skills of the director will be taken into account and that similar *dicta* exist in the case law,[47] the English courts have not imposed a higher duty on the director *qua* director. (This is to be distinguished from the situation where higher standards will be expected of executive directors appointed to the company under the employment contracts for their special skills.[48]) For example, in *Re Continental Assurance (No. 4)*, discussed above, the managing director and two non-executive directors with chartered accountancy qualifications were not regarded as having more specialist accounting knowledge than the non-executive directors in respect of an insurance company with specialised accounting rules.[49]

The position in Australia—similarities and divergence with the English approach

Reliance must not be unreasonable. As is the case in England, the courts have denied the defence of reliance on professional advice in cases where there is plainly unreasonable reliance or there was no reliance on the adviser's expertise at all. An example[50] of unreasonable reliance was *ASIC v Australian Property Custodian Holdings Limited*,[51] where the directors of a company, which is a responsible entity of a managed investment scheme (trust), obtained solicitors' advice as to whether they could properly approve a resolution to amend the constitution for new fees to be payable out of the trust property to the company, thereby benefiting the company.[52] The advice was equivocal in that it provided two possible competing interpretations of the relevant provisions of the Corporations Act as to whether such amendment is legal, without stating which the preferred interpretation was.[53] It was held that the directors acted unreasonably in relying on the advice that they could pass such a resolution, particularly in circumstances where the directors were required under the Corporations Act to give priority to the trust members' interests.[54]

Failure to disclose the facts fully to the professional adviser may demonstrate that there is a lack of good faith on the part of the director. *ASIC v Adler*[55] and *ASIC v Hobb*[56] are two Australian examples of less than candid disclosure by the directors. In *ASIC v Adler*, three directors of HIH (including A) caused a subsidiary of HIH to pay A$10 million to PEE (a trust company that was controlled by A), to, among other things, subscribe for shares in HIH, in breach of various legislative provisions relating to unlawful financial assistance for acquiring shares of a subsidiary and to the giving of benefits to related parties without shareholder approval. In proceedings brought against the two directors (other than A) for breach of care and diligence under section 180, they argued unsuccessfully that they relied on the solicitors' advice that the scheme (where the purported purchase of shares was made via a protective trust structure) was lawful; the two directors failed to disclose a number of important facts to the solicitors, including the fact that the purchases were made prior to any trust structure being set up.[57]

In *ASIC v Hobbs*, the individual defendants were directors of various companies which were involved in the operation of unregistered offshore managed investment funds in Australia targeting Australian investors and self-managed superannuation funds, in contravention of the Corporations Act and Australian Securities and Investments Act 2001 (Cth). In enforcement proceedings brought under section 180 of the Corporations Act, the directors argued unsuccessfully that they relied on solicitors' advice that registration was not required for wholly off-shore investment schemes. The directors failed to give the actual scope of activities to the solicitors, suggesting that they lacked good faith.[58]

Independent assessment of professional advice. A detailed comparison between the English and Australian cases shows some divergence on the use of reliance on professional advice as a defence to a breach of duty claim. Recent cases including *Healey*, *MacDonald* and *Fortescue* show a marked increase in standards expected of directors. In particular, the Australian courts have imposed on directors strict monitoring and oversight duties and have required some assessment on the advice obtained. Thus, merely appointing (and relying on) appropriately qualified advisers to advise on specialist matters will not generally exonerate the directors, even in the absence of circumstances suggesting that such reliance is not prudent. The increase in the standards can be seen first in contrasting *ASIC v Maxwell*[59] with *ASIC v Rich*[60] and second in contrasting *Daniels v Anderson*[61] with *ASIC v Healey* and *MacDonald*.

First, in *ASIC v Maxwell*, one of the directors was appointed for his building skills in a real estate company, which promoted schemes for purchase and development of real estate without the appropriate disclosure documents, thereby contravening the Corporations Act. It was held that he was not in breach of section 180 because he could rely on the fact that lawyers and accountants were appointed and who would be expected to ensure that the schemes were lawful. However, that aspect of the decision was doubted in the subsequent case of *ASIC v Rich*. *ASIC v Rich* involved the alleged failure of two executive directors to monitor the deteriorating financial position of One.Tel, which eventually collapsed under the weight of its debts and other financial problems. Austin J held that:

> It seems to me that, in light of [*Vines v ASIC* (2007) 62 ACSR 1], the earlier view that 'directors are not required to exhibit a greater degree of skill in the performance of their duties than may reasonably be

> expected for persons of commensurate knowledge and experience, in the relevant circumstances' (*Maxwell* at [101]) is no longer correct.

Second, in *Healey*, it was held that there was a strict obligation on *all* directors (executive and non-executive) to ensure that the provisions in the Corporations Act dealing with corporate accounts were considered and applied in the proper manner.[62] In that case, there were material errors found in the accounts: the 2007 annual reports of Centro Properties Group (CNP) and Centro Retail Group (CER) failed to disclose significant matters. In the case of CNP, the report failed to disclose some A$1.5 billion of short-term liabilities as they were wrongly classified as non-current liabilities, and failed to disclose guarantees of short-term liabilities of an associated company of approximately US$1.75 billion that had been given after the balance sheet date. In the case of CER, the 2007 annual reports failed to disclose some A$500 million of short-term liabilities that had been classified as non-current. The audit committee and a major auditing firm had signed off on the accounts. The Australian Securities and Investment Commission (ASIC) brought enforcement proceedings against the chief executive officer (CEO), the chief financial officer (CFO) and the six non-executive directors. All of the directors were held to have contravened section 180.[63]

Middleton J noted that the directors had not acted dishonestly but held that:

> The case law indicates that there is a core, irreducible requirement of directors to be involved in the management of the company and to take all reasonable steps to be in a position to guide and monitor. There is a responsibility to read, understand and focus upon the contents of those reports which the law imposes a responsibility upon each director to approve or adopt.
>
> All directors must carefully read and understand financial statements before they form the opinions which are to be expressed in the declaration required by s 295(4) [of the Corporations Act]. Such a reading and understanding would require the director to consider whether the financial statements were consistent with his or her own knowledge of the company's financial position. This accumulated knowledge arises from a number of responsibilities a director has in carrying out the role and function of a director. These include the following: a director should acquire at least a rudimentary understanding of the business of the corporation and become familiar with the fundamentals of the business in which the corporation is engaged; a director should keep informed about the activities of the corporation; while not required to have a detailed awareness of day-to-day activities, a director should monitor the corporate affairs and policies; a director should maintain familiarity with the financial status of the corporation by a regular review and understanding of financial statements; a director, while not an auditor, should still have a questioning mind.[64]

In *Healey*, while directors are entitled to rely on, among others, the auditor, the board audit and risk management committees and senior management, reliance ceases to be reasonable when a director is or should be aware of circumstances which would cause a reasonable person to question what he was being told.[65] On the facts, the errors as to classification of the debt were 'obvious' since the directors were, or should be, aware of accounting standards.[66] A key point to note is that Middleton J did not limit the requirement of understanding basic accounting conventions to the particular board of Centro, which comprises very competent directors (including a chartered accountant and chief executives of other companies).[67] Instead, it was held that all directors must have the requisite grasp of basic accounting conventions; while what is regarded as a 'basic' level of depth is not defined,[68] 'basic' knowledge would include knowledge of a change in the classification of the liabilities in question as a result of the transition to the new Australian International

Financial Reporting standards, which was overlooked by the board committees and the auditors, as well as the disclosure of post-balance sheet events. At a practical level, however, it is difficult to see how a non-executive director with limited accounting knowledge would be able to discharge his duties unless he had a working knowledge of the relevant accounting standards.

In *MacDonald*, ASIC brought enforcement proceedings against the directors of a company formerly known as James Hardie Industries Ltd (JHIL), a publicly listed company which was historically a manufacturer of asbestos products. ASIC alleged that the board of directors (including the CEO and the seven non-executive directors) breached their duty of care under section 180 when they approved JHIL's issuance of an announcement regarding a proposed restructure of the company. This proposed restructure involved the transfer of the asbestos liabilities of two of its subsidiaries to a foundation and the two subsidiaries entered into a deed of covenant and indemnity (DOCI) which provided, among other things, that in return for JHIL making annual payments to the two companies (which were effectively payments to the foundation), the subsidiaries would not make any claim against JHIL relating to asbestos operations and would indemnify JHIL against any claims which might be made against it in relation to asbestos operations. There were two difficulties with the announcement on the proposed restructure; first, the announcement stated that the foundation would be fully funded to meet the expected liabilities, which turned out to be wholly inaccurate. The funding of the foundation was determined using inadequate actuarial reports and the foundation was in fact massively underfunded, leaving victims of asbestos liabilities potentially without any remedy. Second, the announcement did not disclose the DOCI information, and the DOCI information was only published in the annual report in June 2001. The covenants entered into pursuant to the DOCI were valuable because they protected JHIL from co-extensive liabilities as a joint tortfeasor with the two subsidiaries.

The case against the directors of JHIL was that they each breached section 180 by approving the false and misleading announcement, and in the case of the CEO, by failing to advise the board to disclose material information relating to the DOCI.[69] Before Gzell J, JHIL was found to have contravened the Corporations Act relating to false and misleading disclosures and non-disclosure of material information.[70] The CEO and the non-executive directors breached their duties under section 180 in respect of approval of the false or misleading announcement. While there is no specific reference in the Corporations Act (or the Corporations Law) that imposes a duty on each director to assume responsibility for the disclosure announcement, Gzell J found that such a non-delegable duty exists. Further, the CEO breached section 180 by failing to advise the board that it was necessary to disclose the DOCI information. On appeal, the decision was reversed on technical grounds but on further appeal to the High Court the decision of Gzell J was upheld.

In respect of the false and misleading announcement, the directors argued that they had relied on information and advice provided by the actuarial experts and solicitors, pursuant to section 189 of the Corporations Act. The argument based on reliance on the actuarial experts failed before the trial judge and the High Court, on the ground that the directors should have known the misleading nature of the announcement, in light of their knowledge as to the limitations of the actuarial reports.

The directors also failed in their argument that they had relied on the solicitors, who were present in the boardroom when they approved the misleading announcement, to raise their doubts as to the adequacy of funding. The directors could not prove that it was within the mandate of the solicitors to raise these objections at the board meeting. This may come as a surprise since the solicitors were retained to draft the announcement, and were present at the board meeting, and it would be expected that they would raise the requisite queries if the announcement had material inaccuracies. However, in defence of the solicitors' actions, on the facts, they had raised the concerns about the reliability of the actuarial reports to the CEO and general counsel just prior to the board meeting,[71] and the CEO had assured the solicitors that the foundation was fully funded. The CEO's reliance on section 189 failed because there was no reliance nor was there an independent assessment carried out, required under the provision.

In *Fortescue*, Fortescue, a publicly-listed Australian company, was alleged to have issued misleading or deceptive statements to the market that it had entered into binding contracts with Chinese state-owned enterprises for certain projects. Its CEO, F, was alleged to have breached section 180 by procuring Fortescue to issue misleading or deceptive statements. In the first instance,[72] it was found that the statements were not misleading,[73] and F was not in breach of section 180 as he had acted reasonably by relying on Fortescue's in-house counsel, who had reviewed the framework agreements and would have advised F if the agreements were not binding.

On appeal to the Full Federal Court, the decision was overturned on the ground that the statement was misleading or deceptive.[74] F was in breach of section 180 for causing the company to issue such misleading announcement and the defence of reliance on the solicitors failed because there was no evidence that he sought or obtained the in-house legal advice until after the announcement was issued. On appeal to the High Court, it was found that the statement was not misleading or deceptive, with the consequence that there was no breach by F.[75] However, the Full Federal Court's decision as to F's liability is still good law (had the statement been misleading or deceptive) and it is clear that the Australian appellate court expects that specific legal advice must be sought as to the legal enforceability of framework agreements before reliance can be placed. Thus, had Fortescue's statement been misleading, F's outcome would be likely to have been similar to *MacDonald*, where the directors could not rely on the defence of reliance on the solicitors who drafted the disclosure announcement and were present in the boardroom at the time of approval, because the directors could not show that it was within the mandate of the solicitors to raise objections at the board meeting.

Notwithstanding the fact that *Healey* and *MacDonald* emphasise the monitoring role of the board, and academic commentators have argued that they did not establish new principles,[76] the judgments show that the Australian courts expect that the board will be the final check in respect of the financial statements and disclosure documents. Even if the directors are entitled to delegate the tasks to senior officers and professional advisers, they will continue to retain responsibility (and liability) for monitoring those tasks performed by their delegates or advisers. Monitoring in this context requires not only that the directors assess the qualifications and competence of the advisers in appointing them, but also that they possess sufficient competent skills to assess, and carry out the assessment of, the results of the work of the advisers assigned to them. The assessment must also take place in the context of what the directors know and ought to know about the company.

The raising of standards in *Healey* and *MacDonald* can be seen when the cases are contrasted with the earlier decision of *Daniels v Anderson*. While the courts in *Healey* and *MacDonald* paid lip service to following *Daniels v Anderson*, in reality they applied a more rigorous standard, particularly to the non-executive directors. In *Daniels v Anderson*, the CEO, but not the non-executive directors, was found to have been in breach of section 180. AWA, a company in the import business, appointed K as its manager for foreign exchange (forex) trading. The objective of the forex trading was to protect AWA from unfavourable currency swings and not for speculative purposes. K, in breach of the foreign exchange trading guidelines adopted by the board, engaged in unauthorised and speculative trading without any adequate supervision by senior management. The financial statements showed a very large profit arising from the forex trading for 1986 but an

A$49 million loss for 1987. AWA's auditors were found to be negligent because they failed, among other things, to alert the board to the serious lapse in internal controls, particularly when the senior management was not acting upon their advice. The auditors brought a cross-claim against the directors for an indemnity or contribution, arguing that the directors were negligent in the discharge of their duties; it was argued that they were aware of the large (and fluctuating) profit shown by the financial statements for 1986 but failed to make inquiries.

The majority of the Court of Appeal agreed with the trial judge and held that the non-executive directors were not negligent.[77] In the early months of 1987, the non-executive directors had raised the questions at the board meetings with the senior management and auditors regarding the fluctuating profits and had received a confirmation from the auditors that the profits were genuine and the information given was complete. They had relied on the auditors to inform the board about the inadequacies of the internal controls and the auditors had suggested to those directors that everything was above board.[78] Given that the auditors were specifically requested to attend the board meetings relating to the fluctuating profits, the non-executive directors would have justifiably expected that the auditors would inform the board of their earlier concerns relating to the inadequacies of internal controls, which was previously raised with the CEO but not with the board.

In *Healey*, Middleton J emphasised that in relation to approving financial statements, the directors must probe and seek clarifications from the auditors and management if there are issues that arise based not only on the statements and accompanying papers, but also in light of their background knowledge of the affairs of the company. Likewise, in *MacDonald* it was emphasised that the directors should have probed into the adequacy of the funding in light of what they knew before approving the draft announcement, even though the professional advisers were present in the board room.

In contrast, in *Daniels v Anderson*, the non-executive directors were found to have discharged their duty of care because they raised questions and received confirmations from the managing director and the auditors. However, the question still remains as to whether, by today's standards, the non-executive directors would be expected to take the relevant line of inquiry further or press for confirmations, as opposed to taking the assurances of the auditors or senior management at face value.

Theoretical underpinnings for the reliance defence and reasons for the differences

Theoretical underpinnings

It is clear that enabling directors to rely on professional advisers and others will somewhat lessen the standard of care imposed on directors. Are there good reasons to protect, or insulate from liability, directors who have relied on the appropriate advisers within their expertise, in the absence of circumstances or red flags which make such reliance unreasonable? Should directors be compelled to take a more active role in independently assessing the advice obtained?

While there is a general policy that the directors should not have to suffer for the incompetence or negligence of the professional adviser, there is a concern that directors will absolve themselves of responsibility by appointing advisers and shifting all risk of liability to them. This section argues that there are two possible explanations for the difference in the approaches. First, albeit a partial explanation, *Healey*, *MacDonald* and *Fortescue* are cases involving breaches of duty of care involving non-delegable duties, which are treated more rigorously. Second, the outcome of a breach of the statutory duty of care in these three cases is a civil penalty and the court has the power to signal what it regards as aspirational standards without subjecting the defendant director to a serious threat of directorial civil liability. This difference in outcome has deeper and substantive consequences.

Reasons for the differences

Breaches of non-delegable duties of care. *Healey* and *MacDonald* are cases involving the preparation of financial statements and public disclosure documents respectively. The Corporations Act imposes the duty on directors to be responsible for the financial statements.[79] While the Corporations Act does not specifically provide that directors are responsible for public disclosure documents, the court in *MacDonald* held that the legislation imposes a non-delegable duty on the directors of JHIL to assume responsibility for the particular announcement,[80] which is a very significant announcement concerning the future strategic direction of JHIL in respect of its asbestos liabilities.

It could be argued that the more stringent approach in Australia found in *Healey* and *MacDonald* should be confined to breach of duty of care in respect of the production of financial statements and significant public disclosure documents. They are regarded as non-delegable duties under the Corporations Act; in other words, these are duties that the directors are specifically responsible for and which they cannot delegate or shift the responsibility for, even in specialist areas. They are not duties incurred in respect of general management of the company.

By contrast, in England, *Re Continental Assurance Co of London (No. 4)*, *Iesini v Westrip Holdings Ltd* and *Green v Walking* pertain to obtaining professional advice in the course of the management of the company and do not involve matters that directors are specifically made responsible for by legislation. Thus they are analogous to commercial decisions that directors make in the course of management of the company. Courts do not second-guess commercial decisions made by directors[81] and mere errors of judgement by directors are not regarded as negligence.[82] Where the directors appoint the appropriate professional advisers in the course of management and rely on advice which they reasonably believe is purportedly within the advisers' expertise, there is no reason to second-guess the decision relying on such advice in the absence of any red flags or indication that the advice is patently incorrect. Directors have to make decisions, usually under time constraints, and the articulation of the fact that the courts do not second-guess directorial decisions manifests recognition of these realities.

However, distinguishing *Healey* and *MacDonald* from the English cases on the ground that they involve non-delegable duties imposed under legislation is unlikely to be a complete explanation. In other situations involving breaches of what are strict and thus arguably non-delegable duties on the part of directors imposed under the companies legislation, such as the capital maintenance rules,[83] the English courts have been willing to exonerate a director who has relied on professional advice under section 1157 of the UK Companies Act, if there was no dishonesty or self-dealing.[84] It is not a bar to relief under the provision even if the directors have been negligent.[85] For example, in *Re Paycheck Services*,[86] at first instance, the director was held to have acted reasonably in following the advice of counsel and accountants on tax planning, pursuant to which the company had distributed dividends in excess of distributable profits, in contravention of the UK Companies Act. The reliance only became unreasonable subsequently when the director received different (and unequivocal) advice from a Queen's Counsel that the tax structure was unworkable. Given that liability for the unlawful payment of dividends is strict, reliance on counsel is arguably not relevant. However, the English court would have been willing to apply section 727 of the UK Companies Act 1985 (now section 1157 of the UK Companies Act) to excuse the director on such reliance. In contrast, in *Healey (No. 2)*, discussed below, Middleton J refused to exercise the discretion to excuse the directors under the Australian equivalent of section 1157 of the UK Companies Act.

Difference in substantive outcome of breach of duty of care. A more persuasive reason for the difference between the Australian and English approaches lies in the difference in the outcome of breach of the duty of care. *Healey*, *MacDonald* and *Fortescue* are enforcement actions brought by ASIC where a breach of section 180 may lead to an order of financial penalties or disqualification.[87] In England, the statutory duty of care in section 174 is intended as a restatement of the case law in statutory form and the consequences of the breach remain civil. This section of this article argues that the difference in the outcome would lead to deeper and substantive implications on the content of the duties under section 180 in Australia and section 174 in England.

Healey is a civil penalty case and the consequences must be viewed from the perspective not only of liability but also of the sanctions imposed. In *Healey (No. 2)*, while Middleton J refused to exercise his discretion to exonerate the directors under section 1317S or 1318 of the Corporations Act (equivalent to section 1157 of the UK Companies Act), a relatively lenient sentence was imposed on the directors; a fine of A$30,000 was imposed on the former CEO (with no disqualification order) and a two-year disqualification on the former CFO. No penalties were imposed on the six non-executive directors, though declarations of contravention were imposed. This is the regulatory technique in Australia, where civil penalties may be imposed on directors for breach of the statutory duty of care, and both the liability and sentencing judgments in *Healey* reflect the balance reached as regards the tension between legal rules and the aspirational standards that are set for directors.[88] The use of the civil penalty allows the court to achieve the twin goals of expanding the director's monitoring role and, at the same time, not exposing the directors to severe liabilities if they fail to live up to the aspirational role. In contrast, civil penalties are not available for breach of section 174 of the Companies Act 2006 and such a breach leads to personal civil liabilities on the part of the director to the company (subject to causation and loss). Thus caution is required in adopting the apparently rigorous standard of care found in *Healey*, which is only aspirational given the lax sentencing.

The above argument is further buttressed by comparing the cases in both Australia and England on statutory relief from civil *liability* (as opposed to civil *penalty*), which show that the courts are willing to provide relief from civil liability where the director acts reasonably in relying on professional advice within his expertise (without demanding further independent assessment). In England, as outlined above, in *Re Paycheck Services*, the court was willing to exonerate the director as regards his reliance on professional tax advisers, but only until he received unequivocal Queen's Counsel's advice.

In Australia, two recent cases demonstrate that a director has greater success in respect of obtaining the discretionary relief from civil *liability* from insolvent trading based on the reliance defence, as compared to *civil penalty proceedings*. The first case is *Hall v Poolman*,[89] where the tax office issued a notice of assessment which was disputed by the company. The directors engaged restructuring professionals to act on their behalf. It was found that the company was insolvent after the issuance of the notice of assessment, but the court regarded that the directors acted reasonably in not ceasing to trade immediately. The chairman of the board was excused from liability from the insolvent trading until it became clear that the negotiations could not be resolved quickly.

The second case is *McLellan v Carroll*,[90] where the defendant was a director of a company that conducted a business processing and wholesaling raw timber. The company appointed a new accountant who knew the timber mill industry well and told the director on a number of occasions that he did not believe the company was insolvent. In proceedings brought against the director for insolvent trading, he was granted discretionary relief from liability because it was reasonable for the defendant to rely on what the accountant told him, in view of the new accountant's qualifications and experience.

Normative conclusions

This paper demonstrates that despite apparent similarities in the statutory framework on directors' standard of care in England and Australia, there are significant differences in the development in the case law on the use of professional advice as a defence to a breach of duty of care claim.

The recent Australian cases have signalled the importance of certain duties to directors by designating such duties as non-delegable and restricting the ability of directors to rely on professional advisers, even in specialist areas. The question is whether this approach on the defence of reliance on professional advice should be applied in the same manner in England. I will consider the following three situations where the defence of reliance on professional advice to a breach of duty of care claim may arise:

- where the directors rely on professional advice in the general course of management of the company;
- where the directors rely on professional advice in the preparation of financial statements; and
- where the directors rely on professional advice in the preparation of public disclosures to the securities markets.

First, I consider the situation where directors are acting on professional advice in discharging their general duty of management of the company (as opposed to satisfying specific legislative requirements). This situation can be distinguished from the recent Australian cases (*Healey*, *MacDonald* and *Fortescue*) which involve specific duties imposed expressly or impliedly on the directors under the companies legislation. Under existing English law,[91] if directors have sought and relied on the advice of independent professional advisers within their expertise, they should be allowed to avail themselves of the reliance defence unless there are red flags that exist which demonstrate that reliance is plainly unreasonable. If the directors are non-executive directors, they would not ordinarily be held to higher standards in their capacity *qua* directors even if they possess special skills. To require that the directors, particularly non-executive directors, independently assess the advice that is given will be too onerous an obligation, and one which the English courts have rightly not imposed. That is not to say that directors will be let off lightly once they have instructed professional advisers. If the directors in *Continental Assurance Co Ltd* had asked no questions at all at the board meeting that was held to discuss the solvency of the insurance company and blindly accepted the advice of the auditors, the outcome is likely to have been different.

The second situation concerns financial statements that are materially misleading or otherwise fail to conform to the Financial Reporting Standards, and which are not within the safe harbour in respect of directors' reports within section 463 of the UK Companies Act.[92] Similar to Australia, directors of UK companies are under a specific responsibility to ensure that the financial statements give a 'true and fair view' of the state of affairs of the company under section 393 of the UK Companies Act. Would an English court take a similar approach to that in *Healey*, as argued by an academic commentator in respect of an action founded on breach of duty of care owed to the company?[93]

It is submitted that the Australian approach towards the use of professional advice as a defence to liability in the context of financial statements is not appropriate for England. As argued under 'Theoretical underpinnings for the reliance defence and reasons for the differences' above, even if accepting that the preparation of financial statements is a non-delegable duty, *Healey* concerns enforcement action by the securities regulator and the consequence of a breach of the statutory duty of care under section 180 is one of civil penalty or disqualification. Through the use of civil penalties, the court is able to induce directors to play a more active role in the oversight of the preparation of financial statements, and yet not subject the directors to potential severe liabilities if such aspirational conduct is not fulfilled. In England, a finding of breach of duty of care under section 174 of the UK Companies Act will result in the director being liable to potentially significant damages to the company, subject only to causation and remoteness.

The court may exercise its discretion to grant relief under section 1157 of the UK Companies Act, which may mitigate some of the difficulties. *Re Paycheck* has shown that the English courts are ready to regard a director as acting reasonably under section 1157 if he has relied on professional advice (without independent assessment) and the circumstances do not raise any red flag which would render such reliance imprudent. However, it should be noted that the exercise of judicial discretion under section 1157 could lead to great uncertainty to directors.

Could it be argued that reliance on professional advice is a process in which the board reaches its decision and thus should more readily be the subject of judicial review? This argument derives from the corporate scholars' claim that there is a distinction between the substance of the decision of the board and its process in reaching the decision; the process should be more readily subject to judicial review. While the court should not determine whether the decision that is entered into was a sound one based on the information then available, the court is in a position to review the decision-making process in determining whether the directors have taken sufficient steps to independently assess the advice provided so as to meet their duty of care.[94]

Against this view, however, the fact that courts may undertake an analysis as to the process of decision-making itself, including determining whether the reliance on the particular professional advice by the director is appropriate, does not necessarily indicate that the court should substitute its views on what the directors should have done beyond selection of the appropriate advisers, believing that advice is within the advisers' expertise and understanding the basis upon which the advice is given.[95]

The third situation concerns situations where listed issuers are liable to third parties for making false or misleading disclosures or omissions to the securities markets. If an issuer is liable to third parties for damages in respect of such disclosures or omissions and brings an action against the director to recover these damages, could the director use the defence of reliance on professional advice to avoid liability to the company for breach of his duty of care?[96] While this situation is not likely to be common in the UK as UK securities legislation has restricted claims that may be brought by third parties against the issuers,[97] the question remains as to whether non-executive directors are able to use reliance on professional advice as a defence in a claim for breach of duty of care to the company.[98] The approach in *MacDonald* is to determine whether the release of material corporate disclosures is regarded as a non-delegable duty imposed on the directors to satisfy the legislative requirement.[99] If it is characterised as a non-delegable duty, the courts would be slow in allowing the defence of reliance on counsel to succeed unless the director has also independently assessed the advice that is given. In *MacDonald*, Gzell J held that the board was under a non-delegable duty because the particular announcement was very material to the company as it deals with the strategic direction of the company. In other less material and routine announcements, the board will not be expected to scrutinise the announcement as closely.

The line between delegable and non-delegable duties imposed to satisfy the legislative requirement is difficult to draw. However, it is submitted that an English court should take a cautious approach in allowing the directors to rely on professional advice, particularly legal advice, in breach of duty involving disclosure matters. In this respect, there are good reasons why public disclosures should be treated differently from financial statements.

Unlike *Healey*, which raises questions on the application of the relevant accounting standards and should fall squarely within the purview of the auditors as specialist matters, disclosure issues do not usually present themselves as solely questions of law. *Fortescue* is an exception since it raises the issue of whether the framework agreements are legally enforceable. Instead, disclosure issues often present as issues of fact or issues of mixed fact and law. For example, in *MacDonald*, both issues of fact and mixed fact and law were present. Whether the announcement on the restructuring was materially accurate in describing the foundation as fully funded is a question of fact. Whether the DOCI information should be disclosed in the announcement as being material to the restructuring of JHIL is a question of mixed fact and law. Both issues will require judgment on the materiality of the information at hand and how the information is to be presented. The directors will have to form a judgement on both matters and it is within their competence to do so. If reliance on professional advice can easily be raised as a defence to the directors for a claim based on breach of duty, it may perversely encourage the directors to take a passive role and shift the responsibility to conduct an investigation of the accuracy of the statements to the professional advisers, particularly the legal advisers.

In addition, in breach of duty of care involving disclosure issues, the scope and ambit of the advice given is very important. An English court is likely to require a director raising the defence of reliance on professional advice to prove that it was within the scope of the mandate of the adviser to advise on the matters under contention. As an illustrative example, it is not likely to be sufficient for the director to rely on the fact that the legal adviser was appointed by the issuer to draft or advise on the announcement, a point which was raised (and rejected) by the courts in *MacDonald* and *Fortescue*. It must be shown that it is within the scope of work for the legal adviser to advise specifically on the issues (whether they are issues of law, fact or mixed fact and law) which the directors have relied on.

In conclusion, the issue of reliance on professional advice is of great concern to directors since the complexity of modern regulation requires boards to consult professional advisers and they often assume that they have discharged their duty of care if they rely on advisers in good faith. Non-executive directors are particularly concerned because they tend to rely on management and external professional advisers and they are not completely insulated from negligence liability, even with director and officer (D&O) insurance.[100] There is no question that the trend in the UK and Australia, as well as globally, has seen an increase in the expectations placed on the directors to take their monitoring roles seriously. The recent Australian cases represent an important contribution to the jurisprudence on the expectations placed on directors, particularly those of publicly listed companies, and this paper argues that care must be taken in determining whether a more rigorous approach towards directors' liabilities is appropriate in England. Ultimately, the challenge in regulating directors' liabilities for breach of duty of care lies in putting in place sufficient incentives for boards to take their monitoring functions seriously, but not at the expense of spending disproportionate amounts of time, effort and money in achieving those goals.

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Declaration of conflicting interest

The author declares that there are no conflicts of interest.

Notes

1. [2007] 2 BCLC 287.
2. [2011] 1 BCLC 498.
3. In this paper, 'companies legislation' in England refers to the UK Companies Act 2006 and its predecessor provisions, as well as Company Directors Disqualification Act 1986 and Insolvency Act 1986.
4. [2011] FCA 717.
5. See 'Criteria for the defence of reliance on professional advice' below.
6. See e.g. Katz (2011); see also Hill (2012).
7. For example Lowry (2012).
8. (2009) 256 ALR 199 (Gzell J, Supreme Court of NSW); reversed by the Court of Appeal of NSW on the ground relating to the obligation of the regulator to conduct its case appropriately but the decision of Gzell J was ultimately upheld on appeal to the High Court of Australia in *ASIC v Hellicar* [2012] HCA 17.
9. [2009] FCA 1586; reversed on appeal [2011] FCAFC 19 but the Federal Court decision was reversed on further appeal to the High Court of Australia in [2012] HCA 39.
10. Australian Corporations Act 2001 (Corporations Act), s. 180.
11. For example, see Lowry (2012).
12. See *Dovey v Cory* [1901] AC 477 (holding that a director of a company who agreed to the payment of dividends that, it later transpired, were unlawful because of a previously undetected fraud was not liable for breach of duty to the company if he relied on the judgement, information and advice of others whose integrity, skill and competence he had no reason for suspecting).
13. [1925] Ch 407.
14. See *Re City Equitable Fire Insurance Co Ltd* [1925] Ch 407 at 427:

    > In order, therefore, to ascertain the duties that a person appointed to the board of an established company undertakes to perform, it is necessary to consider not only the nature of the company's business, but also the manner in which the work of the company is in fact distributed between the directors and the other officials of the company, provided always that this distribution is a reasonable one in the circumstances, and is not inconsistent with any express provisions of the articles of association. In discharging the duties of his position thus ascertained a director must, of course, act honestly; but he must also exercise some degree of both skill and diligence. To the question of what is the particular degree of skill and diligence required of him, the authorities do not, I think, give any very clear answer. It has been laid down that so long as a director acts honestly he cannot be made responsible in damages unless guilty of gross or culpable negligence in a business sense.

15. Company Directors Disqualification Act 1986, ss 6 and 8. Care is taken to note that a disqualification order on the ground of unfitness of office does not necessarily mean that the director is negligent. See *Re Barings (No. 5)* [1999] 1 BCLC 433 at 486 (holding that in considering the question of unfitness the court had to have regard, among other things, to 'any misfeasance or breach of any fiduciary or other duty' by the respondent in relation to the company, and it was not a prerequisite of a finding of unfitness that the respondent should have been guilty of misfeasance or breach of duty in relation to the company). See also *Re Landhurst Leasing* [1999] 1 BCLC 286.
16. Insolvency Act 1986, s. 214(4).
17. [1991] BCLC 1028.
18. [1994] 1 BCLC 561 at 563 (Hoffmann J held that 'In my view, the duty of care owed by a director at common law is accurately stated in s 214(4) of the Insolvency Act 1986').
19. See Company Law Review Steering Group (1999: para. 7.16); Company Law Review Steering Group (2001: ch. 3).
20. See *Peter Michael Brumder v Motornet Service and Repairs Ltd* [2013] EWCA 195, at [46], per Beatson LJ: 'The first part, in section 174(2)(a) [of the Companies Act 2006] ... sets the floor. The second part of the definition, in section 174(2)(b), will displace it where the particular director under consideration has greater knowledge, skill and experience than may reasonably be expected.'
21. See Arnold (2013: [14.26]). See also Davies (London: 432–434).
22. Cadbury (1992) (the 'Cadbury Report'). The Cadbury Report was initiated by the Financial Reporting Council, the London Stock Exchange and the accountancy profession, after a series of financial scandals involving large British companies.
23. The Cadbury Report recommended that UK large listed companies adopt the Code of Best Practice, which stated that boards should have non-executive directors that are of sufficient calibre that their views would carry significant weight in the board's decisions and that a majority of non-executive directors should be independent.
24. Company Law Review Steering Group (2000: para. 3.71).
25. For example, *Re Exchange Banking Co, Flitcroft's Case* (1882) 21 Ch D 519. See *Re Kirbys Coaches Ltd* [1991] BCC 130, Hoffmann J at 131; *Bairstow and Others v Queens Moat Houses plc* [2001] 2 BCLC 531; *Re In a Flap Envelope Co Ltd (in Liq)* [2003] BCC 487.
26. Breach of s. 180 of the Corporations Act can lead to a civil penalty order (s. 1371E), a disqualification order (s. 206C) or a compensation order (s. 1317H).
27. *ASIC v Rich* [2009] NSWSC 1229.
28. See *ASIC v Adler* (2002) 41 ACSR 72 at [372], citing *Daniels v Anderson* (1995) 37 NSWLR 436; 16 ACSR 607 per Powell JA at NSWLR 603; see also *ASIC v Maxwell* (2006) 59 ACSR 373 at [99].
29. See *Daniels v Anderson*, *ibid*.; *Commonwealth Bank of Australia v Friedrich* (1991) 5 ACSR 115.
30. See *ASIC v Rich*, above n. 27 at [7205]–[7206].
31. Section 189 of the Corporations Act requires that the reliance was made: (i) in good faith; and (ii) after making an independent assessment of the information or advice, having regard to the director's knowledge of the corporation and the complexity of the structure and operations of the corporation.
32. Corporations Act, s. 588G.
33. The defences include where the director had reasonable grounds to believe, and did so believe, that someone was competent, reliable and responsible for providing adequate information about the company's solvency, and the director expected, on the basis of this information, that the company was solvent and would remain solvent: Corporations Act, s. 588H.
34. *Re Produce Marketing Consortium Ltd* (1989) 5 BCC 569.
35. See e.g. Keay and Murray (2005).

36. *Equitable Life Assurance Society v Bowley* [2003] EWHC 2263 (Comm) at [41].
37. Above n. 1.
38. *Ibid*. at [258] (giving examples of 'basic' accounting principles, which include claims incurred but not reported (IBNR); the directors are also expected to be able to look at the company's accounts and, 'with the guidance which [the directors] could reasonably expect to be available from the finance director and the auditors, to understand them. They would be expected to be able to participate in a discussion of the accounts, and to ask intelligent questions of the finance director and the auditors'). The exception was the finance director but the action was settled against him and was not the subject matter of the judgment.
39. Above n. 2.
40. [2008] 2 BCLC 332. This was a case where the director sought advice on his actions pursuant to the Proceeds of Crimes Act 2002, an area which was regarded as a specialist area.
41. *Ibid*. at [33]–[38].
42. [2001] BCC 38.
43. Cases include *Secretary of State for Business Enterprise and Regulatory Reform v Poulter* [2009] BCC 608; *Weavering Capital v Peterson* [2012] EWHC 1480; *Kotonou v Secretary of State for Business, Enterprise and Regulatory Reform* [2010] EWHC 19 (Ch); and *Re Skyward Builders plc* [2002] All ER (D) 367. For example, in *Weavering Capital v Peterson*, the director did not even bother to find out the scope of the auditor's mandate, let alone rely on the auditor's advice. In *Kotonou*, a disqualification case, the advice was given only after the wrongful trading had taken place. In *Re Skyward*, notwithstanding the array of solicitors and accountants employed by the company, the advisers were not given the appropriate instructions and the director did not rely on any of the professional advisers.
44. [2001] 1 BCLC 547.
45. [2003] EWHC 999 (Ch).
46. *Ibid*. at [239].
47. For example *Norman v Theodore Goddard*; *D'Jan of London*.
48. An example is *AG (Manchester) Limited* [2008] EWHC 64 (Ch) (finance director who is a qualified accountant was held to have acted below the standard of care by failing to put in place corporate measures that would ensure that relevant information was brought to the full board).
49. Above n. 1 at [389]. Cf Keay (2009: [8.115]).
50. For other examples of no reliance or unreasonable reliance, see *ASIC v Sydney Investment House Equities* [2008] NSWSC 1224 at [270] and [421] (finding that there was no reliance). See *The matter of Cummings Engineering Holdings Pty Ltd* [2014] NSWSC 250 (solicitor advised that the severance payments were legally permissible under the Corporations Act but the court held that the directors had to consider not only whether the payments were legal but the wider interests to the company and the fact that there was a conflict of interest). See also *ASIC v Citrofresh International (No. 2)* [2010] FCA 27 (a case of misleading disclosure by the company as to the effectiveness of a particular medical product and the director was not entitled to rely on advisers advising on corporate governance or public relations and who did not have any technical or scientific expertise).
51. [2013] FCA 1342.
52. The provision that is alleged to have been breached is s. 601FD(1)(b) of the Corporations Act; while the court held that the duty of care under s. 601FD(1)(b) and s. 180(1) correspond, the standard of care under s. 601FD(1)(b) will often be 'higher' and the case is instructive as to what amounts to unreasonable reliance.
53. Above n. 51 at [261]–[268] and [312]–[322].
54. *Ibid*. at [563].

55. Above n. 28; appeal dismissed [2003] NSWCA 131.
56. [2012] NSWSC 1276.
57. Above n. 28 at [307].
58. Above n. 56 at [2473]–[2475].
59. Above n. 28.
60. Above n. 27 at [7207].
61. Above n. 28.
62. The director's obligation under s. 344 of the Corporations Act is to 'take all reasonable steps' to comply, or secure compliance, with Part 2 M.3 (which deals with financial reports, directors' reports, audit, reporting to members and lodgement with ASIC). They are under the same duty with respect to the financial records which the entity must keep under Part 2 M.2. If they fail to take all reasonable steps to comply or secure compliance, they contravene the Corporations Act.
63. The directors were also held to have contravened the Corporations Act, s 344 and s. 601FD(1)(b) (which mirrors s. 180 as regards responsible entities of registered schemes, of which there were several in CNP and CER corporate groups).
64. Above n. 4 at [16]–[17].
65. Section 189, the statutory provision on reliance, was not cited in the judgment.
66. Above n. 4 at [569] and [579]. Cf Golding (2012) (arguing that the case should have been decided on the ground that there were two significant red flags in the case actually known to the directors, the first being the debt maturity profile and the second being the fact that the note to the accounts was directly inconsistent with the debt maturity profile).
67. Above n. 4 at [421]–[433].
68. Above n. 4 at [288], holding that the directors were not expected to have a working knowledge of all of the accounting standards or even a working knowledge of AASB 101 (presentation of financial statements) or AASB 110 (events after reporting period).
69. Enforcement actions were also brought against other officers involved in the management, including its chief financial officer and general counsel, under s. 180 of the Corporations Act.
70. The relevant provisions were s. 1001A(2) of the Corporations Act read with listing rule 3.1 (in respect of failure to disclose the DOCI information), s. 995 of the Corporations Act (engaging in conduct that was misleading or deceptive or was likely to mislead or deceive) and s. 999 of the Corporations Act (making false or misleading statements). This kind of enforcement action has been described as the 'stepping stone' approach by Herzberg and Anderson (2012). ASIC first establishes an action against the company for contravention of the Corporations Act, and if successful, ASIC brings a further action against the directors for contravention of the statutory duty of care by exposing the company to the risk of criminal prosecution, civil liability or significant reputational damage.
71. [2012] 12 HCA 17 at [281]–[282].
72. Above n. 9.
73. The court construed the statements to be only to the effect that the company was of the opinion that it had the binding contracts and that the opinion was honestly held, so there was no breach.
74. It was held that the focus should be what was conveyed to the intended audience, and since Fortescue had announced that it had binding construction contracts, and had not disclosed that the contracts were merely 'framework agreements' and not actual construction contracts, the statements were misleading.
75. The High Court held that the announcement only conveyed to Fortescue's investors a statement of what Fortescue had done and intended would happen in the future. There was no further message to an 'ordinary or reasonable' investor about whether the contracts were open to legal challenge in Australia, what

the effect of the contracts was, should the parties later disagree about performance, or the ultimate enforceability of the contracts.

76. See Hill (2012). See also Lowry (2012); Solaiman (2013); Hargovan (2009).
77. At first instance, Rogers J held that reliance on others is only unreasonable if the circumstances are so plain, manifest and simply appreciated that no one with any degree of prudence would rely on the advice that is given. However, the Court of Appeal decision explicitly rejected this view.
78. See *Daniels v Anderson*, n. 28 above at 670.
79. Corporations Act, s. 344 requires a director 'to comply with, or to secure compliance with, Part 2 M.2 or 2 M.3'. Part 2 M.2 of the Corporations Act relates to financial records, which the corporation is obliged to keep. Part 2 M.3 deals with financial reports, including the annual directors' report and audit.
80. See n. 70 and accompanying text above.
81. See *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821 at 832 ('There is no appeal on merits from management decisions to courts of law; nor will courts assume to act as a kind of supervisory board over decisions within the powers of management honestly arrived at'). See also *Fisher v Cadman* [2006] 1 BCLC 499 at [95] and *F&C Alternative Investments (Holdings) v Barthelemy* [2011] EWHC 1731 (Ch) at [254] (in the context of unfair prejudice petitions, it was emphasised that the courts will not second-guess management decisions). This is also described as the business judgment doctrine. The Law Commission and Scottish Law Commission (1999: 53) recommended not to introduce the statutory defence of the business judgment rule on the grounds that it was not necessary (since the courts already do not second-guess commercial decisions) and that it would be too difficult to formulate such a principle without making it too narrow or rigid.
82. Such as *Roberts v Frohlich* [2011] 2 BCLC 625 at [108].
83. It is not clear whether liability of the director to the company is strict or otherwise. See *Holland v HMRC* [2010] UKSC 51. (Lord Hope held that there were two lines of authorities; in the first line of authorities, the directors are strictly liable, subject to the possibility of statutory relief under s. 1157 of the Companies Act 2006 if he has acted honestly and reasonably and the court decides that he ought fairly to be excused. In the second line of authorities, the director is only liable if he knew or ought to have known of the misapplication. Even though it was unnecessary to express a concluded view on this issue, Lord Hope preferred the strict liability approach.)
84. For examples of dishonesty and self-dealing which defeat relief under s. 1157, see *Bairstow and Others*, n. 25 above; *Cooks v Green* [2009] BCC 204; and *Re In A Flap Envelope*, above n. 25.
85. See *Barings plc v Coopers & Lybrand* [2003] Lloyd's Rep IR 566 at [1128]; *Re D'Jan of London Ltd*, above n. 18.
86. [2008] EWHC 2200 (Ch); reversed on other grounds in *Holland v HMRC* [2009] EWCA Civ 625; [2010] UKSC 51.
87. See above n. 26.
88. See Hill (2012).
89. [2007] NSWSC 1330.
90. (2009) 76 ACSR 67.
91. See the discussion above on *Re Continental Assurance (No. 4)*, above n. 49 and accompanying text.
92. UK Companies Act 2006, s. 463 provides for a safe harbour in that the directors are only liable to the company if they knew or are reckless as to whether the statement was false or misleading or knew the omission to be dishonest in respect of the directors' report and directors' remuneration report.
93. For example Lowry (2012).
94. See Parkinson (1993: 112) (rebutting the argument that directors should be sole arbiters as to the appropriateness of their working methods and shareholders would be unwise to trust the directors to do the right

thing if left alone). See also Worthington (1997: ch. 11) (arguing that the courts examine the adequacy of the information base and the decision-making strategy itself, and not the substantive merits of the decision itself, drawing the analogy with the policy/operational distinction found in administrative law).

95. Cf *Healey*, above n. 4 at [182]: ‘The determination of what constitutes due care and skill in any particular field of endeavour, and the assessment of whether it has been breached in a particular case, does not occur in a vacuum. A court assessing those questions, whether they arise in the context of directors’ standards of due care and diligence under s. 180 of the Act, or in the context of negligence by a medical professional, typically receives evidence from others engaged in that field of endeavour. For instance, acceptable practice is relevant in determining the standard of care, but not decisive.’
96. The issuer may take out an action against the director or alternatively there may be a derivative action against the errant director under Part 11 of the Companies Act 2006. Whether the director is subject to criminal sanctions or civil penalties is outside the scope of this paper. For a discussion on criminal and quasi-criminal enforcement, see Gullifer and Payne (2011: [10.4.2]).
97. An issuer whose securities are listed on a regulated market (defined to include the London Stock Exchange and AIM) is civilly liable to third parties who have relied on the false or misleading statements or omissions under s. 90A of the Financial Markets and Services Act 2000, read with Schedule 10A, only if, among other things, the relevant person discharging managerial responsibility within the issuer knew or is reckless as to the accuracy of the statement or knew the omission to be a dishonest concealment of a material fact. While the issuer should not be subject to any liability to a third party under the safe harbour set out in s. 90A, the issuer will be liable if it has assumed responsibility to a particular person for a particular purpose as to the accuracy of the statement or completeness of the information: see Schedule 10A, para. 7(3).
98. This situation has arisen in the US. For example, in connection with Bank of America’s acquisition of Merrill Lynch in late 2008, Bank of America (BOA) allegedly committed material non-disclosures to BOA’s shareholders by failing to state the true state of its knowledge of the financial state of affairs of Merrill Lynch prior to obtaining the approval of BOA’s shareholders; the financial state of Merrill Lynch was worse than the market had anticipated. BOA and its directors argued that they had acted on legal advice of BOA’s lawyers, who allegedly advised that the specific disclosures were not required: see *Securities and Exchange Commission v Bank of America Corporation* 2010 US Dist. LEXIS 15460, 22 February 2010.
99. The Financial and Services Markets Act 2000 does not expressly impose such a duty on the director to be responsible for the issuer’s corporate disclosures.
100. While non-executive directors may potentially rely on D&O insurance for losses arising from culpable acts or omissions committed in the insured’s capacity as a director, such cover may not be available if the company is bringing the action against the director and the policy excludes insured versus insured claims. Further, the UK Companies Act 2006 restricts the availability of indemnity; for example, exemptions provided by the company of directors from liability are void (Companies Act 2006, s. 232(1)). Subject to certain exceptions, an indemnity in favour of the director by the company is void if it relates to a liability incurred by him (as director) in connection with his negligence or default see Companies Act, s. 234(2).

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