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THE BUSINESS OF JUDGING DIRECTORS' BUSINESS JUDGMENTS IN SINGAPORE COURTS*

Making business decisions is a risky business. When carrying out their management obligations, directors have to make difficult business decisions which involve weighing uncertain risks and potential benefits to the company. As such, as with any other human lapses, it is inevitable that some of these decisions will turn out to be detrimental to the company. The contentious issue then is whether directors should be held personally liable for their (poor) decisions. This reflects the tension between providing directors with the leeway to make risky but potentially profitable management decisions for the company and holding directors accountable for their actions. The prevalent attitude taken by courts has always been one of not second-guessing business decisions on hindsight. Some countries have gone even further by enacting a formal "business judgment rule" which shields directors from liability if they were well informed, and made these decisions in good faith and in the absence of any conflict of interest. Although Singapore courts have recognised that they should be slow to interfere with commercial decisions, Singapore has not yet followed an emerging global trend of enacting a formal business judgment rule. Rather, it has a more informal business judgment rule. This paper utilises a comparative lens to examine the different formulations of the business judgment rule in leading corporate law jurisdictions and evaluate their effectiveness in protecting directors from personal liability. It argues that the impact of a business judgment rule depends not only on the specific formulation of it but also on the larger corporate governance framework (or, more generally, the context) present in different jurisdictions. Remaining cognisant of the importance of context, this paper then examines the various factors that may justify the adoption (or rejection) of a formal business judgment rule. Finally, the contextual considerations and reasons for adoption or rejection are discussed and applied to the Singapore context to determine if Singapore should indeed adopt a formal business judgment rule. Ultimately, it is suggested that Singapore should enact a specific format of a statutory business judgment rule as this would promote a

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more favourable environment for doing business by bolstering the perception (if not the reality) of increased certainty in the law regulating business decisions in Singapore's boardrooms. This is especially so considering the rising level of derivative actions in Singapore.

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I. Introduction

1 Being a director is highly esteemed, and it is clear that this position is not just another step up the corporate ladder of success. Indeed, directors are in the most important management position in a company. With management authority delegated to directors, the role of directors is to make and implement decisions to supervise the performance of the company. Indeed, s 157A(1) of the Singapore Companies Act[1] provides that the "business of a company shall be managed by, or under the direction or supervision of, the directors". This is why directors owe fiduciary duties and duties of care, skill and diligence to the company: they have a wide scope of authority and stand in a position of trust and responsibility.

2 While there is great efficiency and certainty in having directors solely engaging in corporate decision-making, there is also a pressing need for accountability. There is thus an inherent competing tension between the need to protect directors' authority and discretion to make decisions and the need to hold directors accountable for these decisions.[2] As Nobel laureate economist Kenneth Arrow stated, "the power to hold to account is ultimately the power to decide"; hence, directors cannot be held accountable without having some of their authority diminished.[3] However, courts have been generally reluctant to interfere with the business judgments of directors as it is seen that the boardroom, rather than the courtroom, is more suitable for reviewing

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1 Cap 50, 2006 Rev Ed.

2 Stephen M Bainbridge, "The Business Judgment Rule as Abstention Doctrine" (2004) 57 Vand L Rev 83 at 84.

3 Stephen M Bainbridge, "The Business Judgment Rule as Abstention Doctrine" (2004) 57 Vand L Rev 83 at 103–104, citing Kenneth J Arrow, *The Limits of Organization* (New York: Norton, 1974) at p 78.

business decisions.[4] Therefore, the business judgment rule is the courts' way of establishing a proper mix of efficiency and accountability, and is a necessary extension of this separation of ownership and control in a company.[5]

3 Although there are different formulations of the business judgment rule, the essence is that courts will not second-guess directors' decisions if the directors were well informed, not in a conflict of interest and acting in the company's best interests when making those decisions.[6] This corresponds with what Arrow said about accountability taking the "form of 'management by exception', in which authority and its decisions are reviewed only when performance is sufficiently degraded from expectations".[7] There have been differing sentiments to the business judgment rule, with only some countries adopting it.[8] Even among these countries, there have been different methods of incorporating the business judgment rule into the law of corporate governance. While some countries like Australia and Germany have codified the business judgment rule, other countries like the US, Japan and Canada have decided to develop the business judgment rule through judge-made law.[9]

4 In Singapore, there is no formal business judgment rule either by statute or case law. Instead, Singapore adopts a more informal version of the business judgment rule.[10] Hence, this article aims to critically discuss whether there is a need for Singapore to adopt a formal business judgment rule.

5 The balance of this article will proceed as follows. First, the rationales and theories behind the business judgment rule will be

4 Stephen M Bainbridge, "Director Primacy in the Courts" in *The New Corporate Governance in Theory and Practice* (New York: Oxford University Press, 2008) at p 111.

5 Stephen M Bainbridge, "Director Primacy in the Courts" in *The New Corporate Governance in Theory and Practice* (New York: Oxford University Press, 2008) at p 111.

6 Joseph Hinsey IV, "Business Judgement and the American Law Institute's Corporate Governance Project: The Rule, the Doctrine, and the Reality" (1984) 52 Geo Wash L Rev 609 at 610.

7 Stephen M Bainbridge, "The Business Judgment Rule as Abstention Doctrine" (2004) 57 Vand L Rev 83 at 109, citing Kenneth J Arrow, *The Limits of Organization* (New York: Norton, 1974) at p 78.

8 Countries such as the UK and Singapore have not adopted the rule. Refer to paras 51–58 below for further discussion of the lack of a formal business judgment rule in the UK and Singapore.

9 Refer to paras 24–58 below for further discussion of the business judgment rule in the countries mentioned.

10 Hans Tjio, "The Rationalisation of Directors' Duties in Singapore" (2005) 17 SAcLJ 52 at 64.

discussed.[11] Next, the various models of the business judgment rule in different jurisdictions will be examined.[12] The different factors which influence these countries to adopt varying models of the business judgment will then be analysed. In addition, the arguments for and against a formal business judgment rule will be examined in detail in the Singapore context to determine if Singapore should adopt one of the models of the business judgment rule or maintain its current position.[13] In the conclusion, this article will argue that Singapore should adopt a codified version of the Delaware formulation of the business judgment rule as this model strikes the proper balance between the two paramount and competing concepts of efficiency and accountability.[14]

II. Definition of the business judgment rule

A. Theories behind the business judgment rule

6 There are two competing notions of the business judgment rule. The first theory is that the business judgment rule is a substantive standard of liability.[15] The business judgment rule will not apply if the courts find that the directors have breached their duties of care.[16] The rule, so conceived, entails "some objective review of the quality of the [board's] decision".[17]

7 The other theory is that the business judgment rule is an abstention doctrine.[18] Unlike the substantive standard of liability, the business judgment rule in the abstention doctrine does not state the director's scope of liability.[19] Instead, it is a presumption that the courts will not adjudicate on the merits of directors' decisions[20] unless the

11 See paras 6–23 below.
12 See paras 24–58 below.
13 See paras 59–86 below.
14 See paras 87–95 below.
15 Stephen M Bainbridge, "The Business Judgment Rule as Abstention Doctrine" (2004) 57 Vand L Rev 83 at 90.
16 Stephen M Bainbridge, "The Business Judgment Rule as Abstention Doctrine" (2004) 57 Vand L Rev 83 at 94–95.
17 Stephen M Bainbridge, "The Business Judgment Rule as Abstention Doctrine" (2004) 57 Vand L Rev 83 at 91.
18 Stephen M Bainbridge, "The Business Judgment Rule as Abstention Doctrine" (2004) 57 Vand L Rev 83 at 95.
19 Stephen M Bainbridge, "The Business Judgment Rule as Abstention Doctrine" (2004) 57 Vand L Rev 83 at 87.
20 Stephen M Bainbridge, "The Business Judgment Rule as Abstention Doctrine" (2004) 57 Vand L Rev 83 at 87.

directors did not abide by "appropriate decision-making procedures".[21] The plaintiff bears the heavy burden of rebutting this presumption.[22]

8 It is submitted that the business judgment rule is better treated as an abstention doctrine as a substantive standard of liability doctrine could easily make judicial intervention a norm.[23] Under the substantive standard of liability doctrine, the business judgment rule does not shield directors who fall short of the expected standard of care.[24] On the other hand, under an abstention doctrine approach, the business judgment rule precludes the plaintiff from contesting the very issue of whether the director had fallen short of the standard of care expected of her.[25] This means that litigation is cut off before the court can even review the merits of the director's decisions.[26]

9 These two competing conceptions of the business judgment rule are present in US case law.[27] *Shlensky v Wrigley*[28] ("*Shlensky*") remains the classic illustration of the abstention doctrine approach[29] while *Cede & Co v Technicolor, Inc*[30] ("*Cede*") demonstrates the trend of treating the business judgment rule as a substantive standard of liability.[31] In *Cede*, although the court started off with explaining how the board of directors has management authority to run the company, it deviated from this attitude of non-interference with business decisions by stating that the business judgment rule is intended to "preclude a court from imposing itself *unreasonably* on the business and affairs of a corporation" [emphasis added].[32] The court then identified the directors'

21 D A Jeremy Telman, "The Business Judgment Rule, Disclosure, and Executive Compensation" (2007) 81 Tul L Rev 829 at 837.
22 Stephen M Bainbridge, "The Business Judgment Rule as Abstention Doctrine" (2004) 57 Vand L Rev 83 at 87.
23 Stephen M Bainbridge, "The Business Judgment Rule as Abstention Doctrine" (2004) 57 Vand L Rev 83 at 127.
24 Stephen M Bainbridge, "The Business Judgment Rule as Abstention Doctrine" (2004) 57 Vand L Rev 83 at 94.
25 Stephen M Bainbridge, "The Business Judgment Rule as Abstention Doctrine" (2004) 57 Vand L Rev 83 at 95.
26 D A Jeremy Telman, "The Business Judgment Rule, Disclosure, and Executive Compensation" (2007) 81 Tul L Rev 829 at 832.
27 Stephen M Bainbridge, "The Business Judgment Rule as Abstention Doctrine" (2004) 57 Vand L Rev 83 at 89.
28 95 III App 2d 173 (App Ct, 1968).
29 Stephen M Bainbridge, "The Business Judgment Rule as Abstention Doctrine" (2004) 57 Vand L Rev 83 at 95.
30 634 A 2d 345 (Del Sup Ct, 1993).
31 Stephen M Bainbridge, "The Business Judgment Rule as Abstention Doctrine" (2004) 57 Vand L Rev 83 at 90.
32 *Cede & Co v Technicolor, Inc* 634 A 2d 345 at 360 (Del Sup Ct, 1993). *Contra Smith v Van Gorkom* 488 A 2d 858 at 872 (Del Sup Ct, 1985) (stating that the business judgment rule is intended to "protect and promote the full and free exercise of the managerial power granted to Delaware directors").

various breaches of their duties of care and concluded that the plaintiff had successfully rebutted the applicability of the business judgment rule.[33]

10 In contrast, in *Shlensky*, the court held that it would not review the merits of directors' decisions unless the directors were alleged to be involved in "fraud, illegality, or conflict of interest".[34] As such allegations were absent from the plaintiff's complaints, the court upheld the business judgment rule by dismissing the plaintiff's claim.[35] Therefore, under the abstention doctrine in *Shlensky*, the function of the business judgment rule is to prevent courts from adjudicating on whether the defendant directors had breached their duties of care in the first place.[36]

11 More recent decisions which embrace this abstention doctrine include *Kamin v American Express Co*[37] ("*Kamin*"). In *Kamin*, even though the board of directors had made an ostensibly wrong decision of declaring dividends of shares it owned instead of selling them, the court dismissed the claim of the plaintiff shareholders,[38] stating that:[39]

> The directors' room rather than the courtroom is the appropriate forum for thrashing out purely business questions which will have an impact on profits, market prices, competitive situations, or tax advantages.

Since the board had gone through the proper decision-making process, the business judgment rule prevented the court from reviewing the directors' decision.[40]

12 Subsequently, in *Brehm v Eisner*[41] ("*Brehm*"), the Delaware Supreme Court also expressly rejected the plaintiff's argument that the directors will not be protected under the business judgment rule if it is shown that the directors failed to exercise "substantive due care":[42]

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33 Stephen M Bainbridge, "The Business Judgment Rule As Abstention Doctrine" (2004) 57 Vand L Rev 83 at 94.

34 Stephen M Bainbridge, "The Business Judgment Rule As Abstention Doctrine" (2004) 57 Vand L Rev 83 at 97.

35 Stephen M Bainbridge, "The Business Judgment Rule As Abstention Doctrine" (2004) 57 Vand L Rev 83 at 97.

36 Stephen M Bainbridge, "The Business Judgment Rule as Abstention Doctrine" (2004) 57 Vand L Rev 83 at 101.

37 383 NYS 2d 807 (Sup Ct, 1976), affirmed in 387 NYS 2d 993 (App Div, 1976).

38 Stephen M Bainbridge, "The Business Judgment Rule As Abstention Doctrine" (2004) 57 Vand L Rev 83 at 98.

39 *Kamin v American Express Co* 383 NYS 2d 807 at 812–813 (Sup Ct, 1976).

40 Robert J Rhee, "The Tort Foundation of Duty of Care and Business Judgment" (2013) 88 Notre Dame L Rev 1139 at 1150.

41 746 A 2d 244 (Del Sup Ct, 2000).

42 *Brehm v Eisner* 746 A 2d 244 at 247 (Del Sup Ct, 2000).

> [C]ourts do not measure, weigh, or quantify directors' judgments and do not even decide if they are reasonable in the [decision-making] context. Due care by directors in the decision-making context is process due care only; it is not substantive due care.

13 Ultimately, if Singapore considers adopting a business judgment rule, it should reflect that of an abstention doctrine to better carry out the purposes of the rule.

B. Rationales for the business judgment rule

14 The most frequently noted rationale for the business judgment rule is the incompetence of courts to review business decisions.[43] In an often-cited decision of *Joy v North*,[44] the US Court of Appeal for the Second Circuit expressly justifies the business judgment rule as such:[45]

> [C]ourts recognize that after-the-fact litigation is a most imperfect device to evaluate corporate business decisions. The circumstances surrounding a corporate decision are not easily reconstructed in a courtroom years later, since business imperatives often call for quick decisions, inevitably based on less than perfect information. The entrepreneur's function is to encounter risks and to confront uncertainty, and a reasoned decision at the time made may seem a wild hunch viewed years later against a background of perfect knowledge.

There is definitely information asymmetry as judges know less than the directors about the specifics of each and every firm.[46]

15 However, some commentators have argued that while this is a strong rationale for the business judgment rule, it is not an entirely accurate and holistic explanation for the rule as the business arena is not the only complex issue that judges have to grapple with. For example, it can be similarly said that judges are inadequate in medical knowledge, yet there is no "medical judgment rule".[47] In fact, judges have more prior

43 Carlos Andrés Laguado Giraldo, "Factors Governing the Application of the Business Judgment Rule: An Empirical Study of the US, UK, Australia and the EU" (2006) 111 Vniversitas 5 at 121, available at <http://www.juridicas.unam.mx/publica/librev/rev/vniver/cont/111/cnt/cnt5.pdf> (accessed February 2016).

44 692 F 2d 880 (2nd Cir, 1982).

45 *Joy v North* 692 F 2d 880 at 886 (2nd Cir, 1982).

46 Stephen M Bainbridge, "The Business Judgment Rule as Abstention Doctrine" (2004) 57 Vand L Rev 83 at 119.

47 Stephen M Bainbridge, "Director Primacy in the Courts" in *The New Corporate Governance in Theory and Practice* (New York: Oxford University Press, 2008) at p 121.

corporate experience than medical experience.[48] That said, while expert decisions in other fields can be examined by checking whether there was proper application of the correct practices, business decisions cannot be easily verified as uncertainty is at the heart of management. There is simply "no objective standard by which the correctness of the corporate decision may be measured".[49] Indeed, a distinct accepted methodology for what a director should do when confronted with a particular situation is lacking.[50] Rather, each director's decision is based on her "actions, inactions, perceptions, questions, judgments, initiatives".[51] Hence, a director cannot be expected to predict the consequences of her decisions with utmost accuracy and precision.[52] In contrast, in a medical negligence case, judges can refer to general guidelines on how a doctor should act when faced with various medical situations.[53] This is because medical outcomes, unlike business outcomes, abide by objective scientific principles.[54]

16 The desirability of managerial risk-taking is another justification for the business judgment rule. Courts do not want to deter directors from taking necessary risks in business operations.[55] Ultimately, rational shareholders, as owners of the company, would prefer risky projects with high expected profits because the principle of limited liability protects them from being personally liable for debts incurred.[56] As such, shareholders effectively pass on a portion of such business risks to creditors.[57] In fact, while shareholders are insulated

48 Stephen M Bainbridge, "Director Primacy in the Courts" in *The New Corporate Governance in Theory and Practice* (New York: Oxford University Press, 2008) at p 122. See also William T Quillen & Michael Hanrahan, "A Short History of the Delaware Court of Chancery – 1792–1992" (1993) 18 Del J Corp L 819 at 841–865 (describing in detail the backgrounds of Delaware's chancellors in the 20th century where there was major corporate litigation).

49 Annette Greenhow, "The Statutory Business Judgment Rule: Putting the Wind into Directors' Sails" (1999) 11(1) Bond LR 4 at 52.

50 Hal R Arkes & Cindy A Schipani, "Medical Malpractice *versus* the Business Judgment Rule: Differences in Hindsight Bias" (1994) 73 Or L Rev 587 at 624.

51 Hal R Arkes & Cindy A Schipani, "Medical Malpractice *versus* the Business Judgment Rule: Differences in Hindsight Bias" (1994) 73 Or L Rev 587 at 626.

52 Hal R Arkes & Cindy A Schipani, "Medical Malpractice *versus* the Business Judgment Rule: Differences in Hindsight Bias" (1994) 73 Or L Rev 587 at 627.

53 Hal R Arkes & Cindy A Schipani, "Medical Malpractice *versus* the Business Judgment Rule: Differences in Hindsight Bias" (1994) 73 Or L Rev 587 at 625.

54 Hal R Arkes & Cindy A Schipani, "Medical Malpractice *versus* the Business Judgment Rule: Differences in Hindsight Bias" (1994) 73 Or L Rev 587 at 626.

55 Hal R Arkes & Cindy A Schipani, "Medical Malpractice *versus* the Business Judgment Rule: Differences in Hindsight Bias" (1994) 73 Or L Rev 587 at 623.

56 Stephen M Bainbridge, "The Business Judgment Rule As Abstention Doctrine" (2004) 57 Vand L Rev 83 at 111.

57 Stephen M Bainbridge, "The Business Judgment Rule As Abstention Doctrine" (2004) 57 Vand L Rev 83 at 111. See, however, Stephen M Bainbridge, "Much Ado

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from the "downside risks of corporate activity",[58] they capture most of the "upside" gains earned by the company on risky projects[59] when they "receive dividends and capital gains on their investments".[60] This explains why shareholders prefer risky projects with high returns.[61] Again, in *Joy v North*, the court stated that:[62]

> [B]ecause potential profit often corresponds to the potential risk, it is very much in the interest of shareholders that the law not create incentives for overly cautious corporate decisions … Shareholders can reduce the volatility of risk by diversifying their holdings. In the case of the diversified shareholder, the seemingly more risky alternatives may well be the best choice since great losses in some stocks will over time be offset by even greater gains in others … A rule which penalizes the choice of seemingly riskier alternatives thus may not be in the interest of shareholders generally.

17 For instance, if there are two projects, Projects A and B, and Project A has a 90% chance of yielding $2,000 while Project B has a 20% chance of yielding $10,000, shareholders would want directors to pick Project B instead as it has an expected value of $2,000 compared to Project A which has an expected value of $1,800. On the other hand, if directors are not protected by the business judgment rule, they will pick

about Little? Directors' Fiduciary Duties in the Vicinity of Insolvency" (2007) 1 J Bus & Tech L 335 at 357–358:

> [C]reditors can protect themselves *ex ante* either by negotiating contractual limitations on corporate behavior, such as restrictions on the types of projects in which the firm may invest, or by negotiating for a share of the up-side, such as through the use of convertible debt securities. Alternatively, creditors can force shareholders to internalize those risks by charging a higher interest rate that compensates the creditor for the higher risk of default. Indeed, the distinguishing characteristic of voluntary creditors (as opposed to involuntary creditors) is that they can allow for the risk of default in the initial contract with the corporation. Lenders, for example, factor in the risk of default in calculating the interest rate. Thus, it matters little to the lender if an individual corporation goes bankrupt (assuming diversification of risk). Although the lender will sustain a loss as a result of the transaction with the bankrupt corporation, it will recoup that loss through the interest rate it receives from other borrowers. In this way, voluntary creditors pass on the risk of default to the shareholders, even in a system of limited liability.

58 Stephen M Bainbridge, "The Business Judgment Rule as Abstention Doctrine" (2004) 57 Vand L Rev 83 at 111.

59 *Gagliardi v Trifoods International, Inc* 683 A 2d 1049 at 1052 (Del Ch, 1996).

60 Ronald M Green, "Shareholders as Stakeholders: Changing Metaphors of Corporate Governance" (1993) 50 Wash & Lee L Rev 1409 at 1415.

61 Stephen M Bainbridge, "The Business Judgment Rule as Abstention Doctrine" (2004) 57 Vand L Rev 83 at 111.

62 *Joy v North* 692 F 2d 880 at 886 (2nd Cir, 1982).

Project A as these directors will incur a higher risk of personal liability when they take on risky projects and thus are more risk-averse.[63]

18 That said, even with the business judgment rule, any increase in shareholders' wealth from successful risk-taking could be eroded by the losses incurred by directors' carelessness if they do not properly consider their decisions.[64] In addition, shareholders' preference for judicial abstention of business decisions only holds true if the board of directors is motivated to maximise profits for the company. If the directors are fraudulent or dishonest, rational shareholders would prefer judicial review of such business decisions.[65]

19 Furthermore, after the 2008 global financial crisis caused by directors undertaking too many extremely risky projects, there is now more caution about the whole notion of risk-taking.[66] It has been argued that it is not desirable for directors to be encouraged to take too much risk; hence, directors should face a higher risk of potential personal liability to urge them to think carefully before making decisions.[67] This is especially because "directors serve as one of the primary, and possibly final, checks on misbehavior" within the firm.[68]

20 Another justification for the business judgment rule is that it protects directors from being liable for honest misjudgments.[69] This will encourage people to step up to the responsibility of being directors.[70] However, there are a few assumptions present in this justification. The first is that directors' compensation would not increase if directors' risk liability increases.[71] This assumption might not be realistic as directors

63 Todd M Aman, "Cost-benefit Analysis of the Business Judgment Rule: A Critique in Light of the Financial Meltdown" (2010–2011) 74 Alb L Rev 1 at 13.

64 Todd M Aman, "Cost-benefit Analysis of the Business Judgment Rule: A Critique in Light of the Financial Meltdown" (2010–2011) 74 Alb L Rev 1 at 14.

65 Stephen M Bainbridge, "Director Primacy in the Courts" in *The New Corporate Governance in Theory and Practice* (New York: Oxford University Press, 2008) at p 123.

66 Todd M Aman, "Cost-benefit Analysis of the Business Judgment Rule: A Critique in Light of the Financial Meltdown" (2010–2011) 74 Alb L Rev 1 at 4.

67 Todd M Aman, "Cost-benefit Analysis of the Business Judgment Rule: A Critique in Light of the Financial Meltdown" (2010–2011) 74 Alb L Rev 1 at 20.

68 Todd M Aman, "Cost-benefit Analysis of the Business Judgment Rule: A Critique in Light of the Financial Meltdown" (2010–2011) 74 Alb L Rev 1 at 21.

69 Robert G Heim, *Going Public in Good Times and Bad: A Legal and Business Guide* (New York: American Lawyer Media Publishing, 2002) at pp 174–175.

70 Robert G Heim, *Going Public in Good Times and Bad: A Legal and Business Guide* (New York: American Lawyer Media Publishing, 2002) at p 175.

71 Todd M Aman, "Cost-benefit Analysis of the Business Judgment Rule: A Critique in Light of the Financial Meltdown" (2010–2011) 74 Alb L Rev 1 at 14.

could always demand extra compensation,[72] thereby passing some of the cost from increased risk liability to the consumers.[73] However, it might not be efficient if shareholders cannot use the protection from risk liability as a form of compensation for directors. This is because directors are more risk-averse when it concerns their own personal liability and would want to get more compensation for their increased liability risk.[74] Shareholders are conversely more efficient risk-takers as they can "diversify away much of the risk (*ie*, uncertainty as to future outcomes) associated with acts of their agents, the corporation's officers and directors".[75] Therefore, shareholders may find it cheaper to compensate directors through protection from risk liability rather than giving them other forms of compensation.[76] The second assumption is the absence of directors' liability insurance. This is also not very realistic as companies usually buy liability insurance for the directors.[77] This protects directors from being personally liable, notwithstanding the increased liability risk.

21 Also, it can be argued that even without the business judgment rule, market forces will motivate directors to act carefully as the price of their companies' shares will decrease if they make any careless decisions. When that happens, directors might lose their jobs if the shareholders vote them out or if their companies are taken over.[78]

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72 Todd M Aman, "Cost-benefit Analysis of the Business Judgment Rule: A Critique in Light of the Financial Meltdown" (2010–2011) 74 Alb L Rev 1 at 15. See also Donald C Langevoort, "The Human Nature of Corporate Boards: Law, Norms, and the Unintended Consequences of Independence and Accountability" (2001) 89 Geo LJ 797 at 818:

> Most of the costs of subjecting directors to increased liability risk are well recognized: overprecaution, refusals of good people to serve, demands for increased insurance, indemnification rights, and compensation for the residual risk.

73 Todd M Aman, "Cost-benefit Analysis of the Business Judgment Rule: A Critique in Light of the Financial Meltdown" (2010–2011) 74 Alb L Rev 1 at 16. See also Richard Craswell, "Passing on the Costs of Legal Rules: Efficiency and Distribution in Buyer-seller Relationships" (1991) 43 Stan L Rev 361 at 361 (noting that the "extent of such pass-ons will vary from market to market, depending on the shape of the supply and demand curves").

74 Todd M Aman, "Cost-benefit Analysis of the Business Judgment Rule: A Critique in Light of the Financial Meltdown" (2010–2011) 74 Alb L Rev 1 at 16.

75 Peter V Letsou, "Implications of Shareholder Diversification on Corporate Law and Organization: The Case of the Business Judgment Rule" (2001) 77 Chi-Kent L Rev 179 at 182.

76 Todd M Aman, "Cost-benefit Analysis of the Business Judgment Rule: A Critique in Light of the Financial Meltdown" (2010–2011) 74 Alb L Rev 1 at 17.

77 Dan W Puchniak & Masafumi Nakahigashi, "Japan's Love for Derivative Actions: Irrational Behavior and Non-economic Motives As Rational Explanations for Shareholder Litigation" (2012) 45 Vand J Transnat'l L 1 at 20.

78 Todd M Aman, "Cost-benefit Analysis of the Business Judgment Rule: A Critique in Light of the Financial Meltdown" (2010–2011) 74 Alb L Rev 1 at 18.

22 Nevertheless, there is still another important justification for the business judgment rule. This is the theory of bounded rationality, where behavioural economics "contends that the limitations of human cognition often result in decisions that fail to maximize utility".[79] All decision makers have inherent limits in their abilities to collate and process all available information and are unable to come up with an entirely perfect solution to problems or accurately predict the possible outcomes of their decisions.[80] Judges are no exception.[81] However, on the other hand, the board of directors is better able to overcome these limitations by making decisions as a team.[82] As such, judicial review of such business decisions could be detrimental to the way a board functions by destroying its "efficiency and synergy". Instead, a board's own internal monitoring and other factors such as "mutual motivation" and "peer pressure" are more effective.[83] Thus, the paramount purpose of the business judgment rule is to minimise judicial interference in the affairs of the boardroom, restricting it only to situations where the synergy among directors has broken down, such as in "fraud and self interested transactions, when members usually act alone betraying the other members".[84]

23 Lastly and most importantly, the business judgment rule allows for business certainty in decision-making as "directors can feel more confident, if they meet certain requirements, that their decisions will not be scrutinized after the fact".[85]

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79 Stephen M Bainbridge, "The Business Judgment Rule As Abstention Doctrine" (2004) 57 Vand L Rev 83 at 118.

80 Stephen M Bainbridge, "The Business Judgment Rule As Abstention Doctrine" (2004) 57 Vand L Rev 83 at 118.

81 Stephen M Bainbridge, "The Business Judgment Rule As Abstention Doctrine" (2004) 57 Vand L Rev 83 at 120.

82 Stephen M Bainbridge, "The Business Judgment Rule As Abstention Doctrine" (2004) 57 Vand L Rev 83 at 125:

> Such teams may well make decisions that are superior to those made by individuals acting alone. Individuals are subject to the constraints of bounded rationality and the temptations to shirk or self-deal. Group decision making responds to bounded rationality by creating a system for aggregating the inputs of multiple individuals with differing knowledge, interests, and skills.

83 Carlos Andrés Laguado Giraldo, "Factors Governing the Application of the Business Judgment Rule: An Empirical Study of the US, UK, Australia and the EU" (2006) 111 Vniversitas 5 at 125, available at <http://www.juridicas.unam.mx/publica/librev/rev/vniver/cont/111/cnt/cnt5.pdf> (accessed February 2016).

84 Carlos Andrés Laguado Giraldo, "Factors Governing the Application of the Business Judgment Rule: An Empirical Study of the US, UK, Australia and the EU" (2006) 111 Vniversitas 5 at 125, available at <http://www.juridicas.unam.mx/publica/librev/rev/vniver/cont/111/cnt/cnt5.pdf> (accessed February 2016).

85 Mark Byrne, "Directors to Hide from a Sea of Liabilities in a New Safe Harbour" (2008) 22(3) *Australian Journal of Corporate Law* 255 at 268.

III. Different formulations of the business judgment rule

24 During the major review of the Singapore Companies Act in 2011, the Singapore Ministry of Finance Steering Committee referred to company law legislation in leading jurisdictions such as the US, the UK, Australia and Canada. Hence, this article shall compare and contrast the business judgment rule (or lack thereof) in these jurisdictions. Germany and Japan, two of the largest economies in the world which have recently applied a business judgment rule, will also be examined to see how the rule has influenced corporate governance in these countries. Examining the rule in these two countries will also provide a civil law perspective on the business judgment rule.

A. The US

25 The model of the business judgment rule in the US shall serve as the primary lens to analyse the business judgment rule in various jurisdictions. This is because the US is the jurisdiction where the genesis of the rule can be found. In addition, the economic prowess of the US allows it to influence global norms. This makes it the primary paradigm in international corporate governance today.

26 There are two formulations of the business judgment rule in the US,[86] namely the Delaware business judgment rule and the American Law Institute ("ALI") formulation contained in the ALI's *Principles of Corporate Governance*[87] ("ALI Principles"). Neither of these formulations has been codified. This is noted by the ALI, which stated that there are "no statutory formulations of the business judgment rule".[88]

27 The ALI formulation of the business judgment rule in s 4.01(c) of the ALI Principles states that a director and her business decision will be insulated from judicial review if she (a) was "not interested in the subject of the business judgment"; (b) was "informed with respect to the subject of the business judgment to the extent [she] reasonably believes to be appropriate under the circumstances"; and (c) rationally believes

86 Douglas M Branson, "A Business Judgment Rule for Incorporating Jurisdictions in Asia?" (2011) 23 SAcLJ 687 at 691.

87 The American Law Institute, *Principles of Corporate Governance: Analysis and Recommendations* vol 1 (St Paul, Minnesota: American Law Institute Publishers, 1994).

88 The American Law Institute, *Principles of Corporate Governance: Analysis and Recommendations* vol 1 (St Paul, Minnesota: American Law Institute Publishers, 1994) at p 173. See also Fred W Triem, "Judicial Schizophrenia in Corporate Law: Confusing the Standard of Care with the Business Judgment Rule" (2007) 24 Alaska L Rev 23 at 36–37 (noting that "the ALI formulation of the BJR has been adopted by some state courts – but not codified by their respective legislatures").

that the business judgment [was] in the best interests of the corporation".[89] The highest courts in several US states have accepted the ALI formulation.[90] Despite this, there is much criticism about the ALI formulation.

28 First, the issue of whether the director was informed to the extent that she thinks is appropriate will require the court to look at the amount of information possessed by the director at the time of making the decision.[91] Hence, instead of presuming an informed decision, the ALI formulation turns it into a prerequisite which directors have to satisfy before being able to enjoy protection under the business judgment rule.[92] Second, the term "rationally believes" has both an objective and subjective component. A director must actually believe that his business decision is in the best interests of the company and this belief must be rational. As such, the court might have to examine the thought processes of the director to see if the decision had a rational basis.[93] All these could be a backdoor for the court to challenge directors' decisions.[94]

29 However, the ALI has definitely carefully considered the above and has valid reasons as to why the business judgment rule is formulated in this particular way. First, the ALI wants to encourage directors to "put themselves in a position to make as informed and careful a decision as circumstances permit".[95] Furthermore, it is conceded that while directors might be under an urgent time frame and thus be compelled to take the risk of "not having all relevant facts

89 The American Law Institute, *Principles of Corporate Governance: Analysis and Recommendations* vol 1 (St Paul, Minnesota: American Law Institute Publishers, 1994) at p 179.

90 Douglas M Branson, "A Business Judgment Rule for Incorporating Jurisdictions in Asia?" (2011) 23 SAcLJ 687 at 691.

91 William J Carney, "Section 4.01 of the American Law Institute's Corporate Governance Project: Restatement or Misstatement?" (1988) 66(2) Wash U L Q 239 at 272.

92 William J Carney, "Section 4.01 of the American Law Institute's Corporate Governance Project: Restatement or Misstatement?" (1988) 66(2) Wash U L Q 239 at 272.

93 The American Law Institute, *Principles of Corporate Governance: Analysis and Recommendations* vol 1 (St Paul, Minnesota: American Law Institute Publishers, 1994) at p 179.

94 Demetra Arsalidou, "Objectivity *versus* Flexibility in Civil Law Jurisdictions and the Possible Introduction of the Business Judgment Rule in English Law" (2003) 24(8) Comp Law 228 at 232.

95 William J Carney, "Section 4.01 of the American Law Institute's Corporate Governance Project: Restatement or Misstatement?" (1988) 66(2) Wash U L Q 239 at 273.

concerning a proposed transaction",[96] this is taken into account already as the directors' decision to "accept the risk of incomplete information" will still be protected under the business judgment rule so long as they reasonably believe "such informational risk taking to be appropriate under the circumstances".[97] Factors to decide if such belief is "appropriate under the circumstances" include the importance of the business decision to made, the time and costs taken to obtain the relevant information, and the "nature of competing demands for the board's attention".[98] Second, the ALI also notes that a "rational" basis is already much wider than a "reasonableness" test[99] and provides enough protection to directors whose decisions might not be reasonable but are still not so far "removed from the realm of reason".[100] Indeed, it is submitted that a "rational" basis test is already a much more lenient standard than a "reasonable" basis as directors only need to show a plausible basis for making their decisions.[101] There is no reason to protect irrational business decisions which are completely removed from the realm of reason.[102]

30 The Delaware courts also apply a "rational" belief test by reiterating that "the board's decision will be upheld unless it cannot be 'attributed to any rational business purpose'".[103] Indeed, this aspect is

96 The American Law Institute, *Principles of Corporate Governance: Analysis and Recommendations* vol 1 (St Paul, Minnesota: American Law Institute Publishers, 1994) at p 178.

97 The American Law Institute, *Principles of Corporate Governance: Analysis and Recommendations* vol 1 (St Paul, Minnesota: American Law Institute Publishers, 1994) at p 178.

98 The American Law Institute, *Principles of Corporate Governance: Analysis and Recommendations* vol 1 (St Paul, Minnesota: American Law Institute Publishers, 1994) at p 178.

99 The American Law Institute, *Principles of Corporate Governance: Analysis and Recommendations* vol 1 (St Paul, Minnesota: American Law Institute Publishers, 1994) at p 180.

100 The American Law Institute, *Principles of Corporate Governance: Analysis and Recommendations* vol 1 (St Paul, Minnesota: American Law Institute Publishers, 1994) at p 181.

101 Douglas M Branson & Low Chee Keong, "Balancing the Scales: A Statutory Business Judgment Rule for Hong Kong?" (2004) 34 HKLJ 2 at 8.

102 The American Law Institute, *Principles of Corporate Governance: Analysis and Recommendations* vol 1 (St Paul, Minnesota: American Law Institute Publishers, 1994) at p 181.

103 *In re The Walt Disney Co Derivative Action* 906 A 2d 27 at 74 (Del Sup Ct, 2006). See also E Norman Veasey, "On Corporate Codification: A Historical Peek at the Model Business Corporation Act and the American Law Institute Principles through the Delaware Lens" (2011) 74 Law & Contemp Probs 95 at 101 (stating that the term "rationally believes" as used in The American Law Institute, *Principles of Corporate Governance: Analysis and Recommendations* vol 1 (St Paul, Minnesota: American Law Institute Publishers, 1994) is "consonant with Delaware law").

treated as primarily geared towards analysing the directors' decision-making process, rather than looking at the specific content of the decision.[104] The Delaware formulation, as generally affirmed in the landmark case of *Aronson v Lewis*,[105] is stated in the language of presumption that:[106]

> [I]n making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company. Absent an abuse of discretion, that judgment will be respected by the courts. The burden is on the party challenging the decision to establish facts rebutting the presumption.

31 While the elements of both the Delaware and ALI formulations are the same, the Delaware formulation places the burden of proof on the plaintiff shareholder. On the other hand, the directors have the burden of establishing that they satisfy the elements of the ALI formulation before being able to enjoy the protection of the rule.[107] Nevertheless, the Delaware presumption could be rebutted and directors might need to go through a full trial to prove that they should not be held liable.[108]

32 It must be noted that the Delaware formulation mirrors the abstention doctrine more closely than the ALI formulation. This is because while the Delaware formulation states a presumption against judicial review of directors' duty of care claims, the directors bear the burden of proving that they fulfil the elements under the ALI formulation. The lack of a presumption against judicial review "magnifies the potential mischief" of the elements of the rule as courts could in fact be invited to substantially review business decisions.[109] However, that said, the Delaware courts have not been very consistent in applying the abstention doctrine. The Delaware courts tend to alternate being the two competing doctrines. Indeed, some years after *Cede* was decided on the basis of a substantive standard of liability, an abstention doctrine of the business judgment rule was strongly articulated in

104 E Norman Veasey, "On Corporate Codification: A Historical Peek at the Model Business Corporation Act and the American Law Institute Principles through the Delaware Lens" (2011) 74 Law & Contemp Probs 95 at 103.

105 473 A 2d 805 (Del Sup Ct, 1984).

106 *Aronson v Lewis* 473 A 2d 805 at 812 (Del Sup Ct, 1984).

107 Douglas M Branson, "A Business Judgment Rule for Incorporating Jurisdictions in Asia?" (2011) 23 SAcLJ 687 at 692.

108 Douglas M Branson, "A Business Judgment Rule for Incorporating Jurisdictions in Asia?" (2011) 23 SAcLJ 687 at 692–693.

109 Michael P Dooley, "Two Models of Corporate Governance" (1992) 47 Bus Law 461 at 478.

Brehm.[110] Yet, subsequently, the court in *McMullin v Beran*[111] reaffirmed the *Cede* approach that the business judgment rule is rebutted by a showing that the directors breached their duty of care.[112] Thus, the cycle continues.[113]

33 Some commentators argue that the US Model Business Corporation Act[114] ("MBCA") is a third formulation of the business judgment rule in US.[115] This has met with much criticism, and it is submitted that the standard of care codified under the MBCA is not the same as the business judgment rule.[116] Under s 8.30(a)(2) of the MBCA, a director is to discharge her duties "with the care an ordinarily prudent person in a like position would exercise under similar circumstances". This stated standard of care is one of due care whereas the business judgment rule is a standard of review (or, indeed, abstention of review).[117] A standard of care states how directors should conduct themselves when making a business decision while a standard of review is the court's way of determining whether to hold directors liable for their business decisions.[118] The tension between the standard of care of

110 Stephen M Bainbridge, "The Business Judgment Rule as Abstention Doctrine" (2004) 57 Vand L Rev 83 at 91, fn 45.

111 765 A 2d 910 at 917 (Del Sup Ct, 2000):

> The business judgment rule 'operates as both a procedural guide for litigants and a substantive rule of law'. Procedurally, the initial burden is on the shareholder plaintiff to rebut the presumption of the business judgment rule. To meet that burden, the shareholder plaintiff must effectively provide evidence that the defendant board of directors, in reaching its challenged decision, breached any one of its 'triad of fiduciary duties, loyalty, good faith or due care'. Substantively, 'if the shareholder plaintiff fails to meet that evidentiary burden, the business judgment rule attaches' and operates to protect the individual director-defendants from personal liability for making the board decision at issue.

112 Stephen M Bainbridge, "The Business Judgment Rule as Abstention Doctrine" (2004) 57 Vand L Rev 83 at 95, fn 67.

113 Stephen M Bainbridge, "The Business Judgment Rule as Abstention Doctrine" (2004) 57 Vand L Rev 83 at 91, fn 45. See generally David A Skeel, Jr, "The Unanimity Norm in Delaware Corporate Law" (1997) 83 Va L Rev 127 at 130 (arguing that Delaware's "unanimity norm" magnifies the likelihood of "cycling" and cycling-like effects – that is, of shifts by the supreme court from one doctrinal approach to another").

114 US Model Business Corporation Act Annotated (American Bar Association, 3rd Ed, 2005 Supp).

115 See, *eg*, R Franklin Balotti & James J Hanks, Jr, "Rejudging the Business Judgment Rule" (1993) 48 Bus Law 1337 at 1337–1339 (explaining the three positions of the business judgment rule).

116 Fred W Triem, "Judicial Schizophrenia in Corporate Law: Confusing the Standard of Care with the Business Judgment Rule" (2007) 24 Alaska L Rev 23 at 38.

117 Douglas M Branson, "A Business Judgment Rule for Incorporating Jurisdictions in Asia?" (2011) 23 SAcLJ 687 at 688.

118 Fred W Triem, "Judicial Schizophrenia in Corporate Law: Confusing the Standard of Care with the Business Judgment Rule" (2007) 24 Alaska L Rev 23 at 30.

directors and the standard of judicial review of business decisions is hinged on the difference between law as a "system of sanctions" and law as an "expression of community ideals".[119] While the business judgment rule is a standard of review which qualifies the circumstances in which liability is found, the duty of care informs directors of the highest level of care they should aspire to.[120]

B. Australia

34 Being largely based on but not "a slave to" the ALI formulation, the Australians were the first to codify the business judgment rule.[121] The codification was done under s 180(2) of its Corporations Act.[122] According to the Explanatory Memorandum to the Australian Corporate Law Economic Reform Program Bill 1998 which introduced the statutory business judgment in Australia, s 180(2) protects directors from "personal liability for breaches of the duty of care and diligence in relation to honest, informed and rational business judgments".[123]

35 Like the US, s 180(3) of the Corporations Act defines "business judgment" to mean a "to take or not take action in respect of a matter relevant to the business operations of the corporation". Section 180(2) states that the directors' business decisions meet the statutory requirements and their equivalent common law duties of care and diligence if four criteria are satisfied. The first criterion under s 180(2)(a) is that the directors made the "judgment in good faith for a proper purpose". It has been argued that the requirement for the judgment to have been made for a proper purpose diminishes some of the utility of the business judgment rule as it introduces an open-ended inquiry which the courts have to grapple with.[124] The second criterion under s 180(2)(b) is that the directors did not have a "material personal interest in the subject matter of the judgment". The third criterion under s 180(2)(c) is that the directors informed themselves about the "subject matter of the judgment to the extent they reasonably believe to be appropriate". The fourth criterion under s 180(2)(d) is that the "directors rationally believe[d] that the judgment [was] in the best interests of the

119 *Comparative Corporate Governance: The State of the Art and Emerging Research* (Klaus J Hopt *et al* eds) (Oxford: Clarendon Press, 1998) at p 329.

120 *Comparative Corporate Governance: The State of the Art and Emerging Research* (Klaus J Hopt *et al* eds) (Oxford: Clarendon Press, 1998) at p 329.

121 Douglas M Branson, "A Business Judgment Rule for Incorporating Jurisdictions in Asia?" (2011) 23 SAcLJ 687 at 709.

122 Corporations Act 2001 (Cth).

123 Corporate Law Economic Reform Program Bill 1998: Explanatory Memorandum at para 4.2.

124 Douglas M Branson, "A Business Judgment Rule for Incorporating Jurisdictions in Asia?" (2011) 23 SAcLJ 687 at 710.

corporation". Like the ALI formulation, but unlike the Delaware rule, s 180(2) appears to place the burden on the directors to establish these four elements.[125]

36 This statutory business judgment rule has met with some criticism from the Australian judges.[126] Indeed, some have doubted the usefulness of s 180(2), as they argue that a breach of the duty of care would most probably negate the applicability of the business judgment rule in s 180(2).[127]

37 However, in the case of *Australian Securities & Investments Commission v Rich*,[128] where the Australian Securities & Investments Commission ("ASIC") brought proceedings against One.Tel Ltd's former directors, Austin J clarified the meaning of s 180(2) and noted that s 180(2) was capable of defending directors from liability.[129] In his judgment, Austin J focused on s 180(2)(d), a controversial element under the Australia's statutory business judgment rule. Similar to the US, s 180(2)(d) provides that a director must rationally believe that the judgment was in the best interests of the company. However, s 180(2)(d) goes on to state that the director's belief that the "judgment is in the best

125 *Australian Securities & Investments Commission v Rich* [2009] NSWSC 1229 at [7269]–[7270]:

> The question whether the plaintiff or the defendant bears the onus of proving the ingredients of s 180(2) is an important one that will eventually need to be resolved at the appellate level. With some hesitation in light of the US approach, I have reached the conclusion that the Australian statute casts the onus of proving the four criteria in s 180(2) on the defendants. …
>
> As revealed in the Explanatory Memorandum, paras 6.1–6.10, the purpose of the introduction of a business judgment rule was (generally speaking) to ensure that directors and officers are not discouraged from taking advantage of opportunities that involve responsible risk-taking. Casting the onus of proof of the elements of the defence on the director or officer is not necessarily incompatible with that purpose, because it may happen in practice that the evidential burden can be shifted to the plaintiff relatively easily, if the defendant addresses the statutory elements in his or her affidavit, though the price to be paid is that the defendant is exposed to cross-examination on those matters.

It must be noted that para 6.10 in the Explanatory Memorandum to the Corporate Law Economic Reform Bill 1998 had actually stated that the proposed "subsection 180(2) acts as a rebuttable presumption in favour of directors". The Australian legislature will need to resolve this issue to make it clear who will bear the burden of proof to determine the four criteria under s 180(2) of the Australian Corporations Act 2001.

126 John H Farrar, "Issues of Classification, Solvency and Business Judgment and the Dangers of Legal Transplants" (2011) 23 SAcLJ 745 at 759.

127 Renee M Jones & Michelle Welsh, "Toward a Public Enforcement Model for Directors' Duty of Oversight" (2012) 45 Vand J Transnat'l L 343 at 375.

128 [2009] NSWSC 1229.

129 John H Farrar, "Issues of Classification, Solvency and Business Judgment and the Dangers of Legal Transplants" (2011) 23 SAcLJ 745 at 759.

interests of the corporation is a rational one unless the belief is one that no reasonable person in their position would hold". With that, ASIC submitted that the business judgment rule only applies to decisions that are reasonable. Austin J rejected ASIC's submissions and held that the business judgment rule would lose its workability if it only applied to decisions which are reasonable. He then went on to state that the legislators had intended to follow the US position, such that the phrase "rationally believes" protects directors from liability for business judgments that might not be reasonable.[130]

38 It is suggested that Austin J's interpretation is correct because if ASIC's submissions were accepted, the business judgment rule would not have been able to give directors much protection from personal liability.[131] However, it cannot be denied that this is a strained interpretation as Austin J is in fact saying that when the legislators used the word "reasonable", they did not mean an objective reasonableness standard which is the usual meaning of the word.[132]

39 With the Australian business judgment rule closely resembling the ALI formulation, it appears that the Australian rule embraces more of the substantive standard of liability doctrine (and not the abstention doctrine). This is especially so because directors have the burden of proving that they satisfy the elements of the rule before being protected from personal liability.

C. Canada

40 Although Canada does not have a statutory business judgment rule, Canadian courts have articulated a US type of business judgment rule in their cases.[133] In *People's Department Stores Inc v Wise*,[134] the court noted that:[135]

> It might be tempting for some to see unsuccessful business decisions as unreasonable or imprudent in light of information that becomes available *ex post facto*. Because of this risk of hindsight bias, Canadian

130 Michael Legg & Dean Jordan, "The Australian Business Judgment Rule after *ASIC v Rich*" (2010) 269 Co LN 1 at 3.

131 Michael Legg & Dean Jordan, "The Australian Business Judgment Rule after *ASIC v Rich*" (2010) 269 Co LN 1 at 4.

132 Michael Legg & Dean Jordan, "The Australian Business Judgment Rule after *ASIC v Rich*" (2010) 269 Co LN 1.

133 Ann M Scarlett, "Imitation or Improvement? The Evolution of Shareholder Derivative Litigation in the United States, United Kingdom, Canada and Australia" (2011) 28 Ariz J Int'l & Comp L 569 at 607.

134 [2004] 3 SCR 461.

135 *People's Department Stores Inc v Wise* [2004] 3 SCR 461 at [64].

> courts have developed a rule of deference to business decisions called the 'business judgment rule', adopting the American name for the rule.

41 However, the Canadian business judgment rule differs from the US rule in that the Canadian courts will examine both the decision-making process and the content of the decision itself to ascertain whether the decision is actually reasonable.[136] This is evident in the case of *UPM-Kymmene Corp v UPM-Kymmene Miramichi Inc*,[137] where the court held that:[138]

> Courts are entitled to consider the content of their decision and the extent of the information on which it was based and to measure this against the facts as they existed at the time the impugned decision was made. Although Board decisions are not subject to microscopic examination with the perfect vision of hindsight, they are subject to examination.

This suggests that the Canadian courts are more willing to review directors' decisions than the US courts. Hence, the Canadian business judgment rule resembles more of the substantive standard of liability doctrine.

D. Japan

42 Japan first adopted the business judgment rule in the recent Supreme Court case of *Apamanshop*.[139] This case confirms the applicability of the business judgment rule in the Japanese context as previously, the rule was only applied in the lower courts and was not (and still is not) codified in the Japanese corporate law.[140]

43 The Supreme Court asserted that a director will be protected from liability if her decision can be reasonably concluded from the facts and was not irrational when compared to what a reasonable director would decide in that particular business situation. The court then went on to distinguish the director's process of decision-making and the

136 Ann M Scarlett, "Imitation or Improvement? The Evolution of Shareholder Derivative Litigation in the United States, United Kingdom, Canada and Australia" (2011) 28 Ariz J Int'l & Comp L 569 at 608.

137 [2002] 214 DLR (4th) 496 (SC Ont), affirmed [2004] 250 DLR (4th) 526 (CA Ont).

138 *UPM-Kymmene Corp v UPM-Kymmene Miramichi Inc* [2002] 214 DLR (4th) 496 at [153].

139 Case No 2009 ju 183 (15 July 2010) (SC) (Japan).

140 Dan W Puchniak & Masafumi Nakahigashi, "Corporate Law – Business Judgment Rule – Derivative Action – Supreme Court, 15 July 2010: '*Apamanshop*' with Comment" in *Business Law in Japan – Cases and Comments: Intellectual Property, Civil, Commercial and International Private Law: Writings in Honour of Harald Baum* (Moritz Bälz *et al* eds) (Alphen aan den Rijn, The Netherlands: Kluwer Law International, 2012) at pp 220–221.

content of her decision.[141] The director's decision-making process will be analysed by gauging whether the director had reasonably weighed up the relevant facts and sought lawyers' advice before coming to the decision. Regarding the content of the decision, the court will adopt a more fact-specific approach to see if the director's decision was "significantly unreasonable".[142]

44 It has been argued that the Supreme Court in *Apamanshop* appeared to engage in a detailed review of the reasonableness of the substance or merits of the directors' decisions. The court's readiness to scrutinise the reasonableness of the substance (and not only process) of the directors' decisions is distinct from that in the US.[143] This could mean that the Japanese business judgment rule might not offer nearly as much protection for directors as expected.[144] This is because if a director's decision was reasonable, then there would be no need for the business judgment rule as reasonable decisions would not attract liability in the first place.[145]

45 While this might be so, when viewed more broadly, the idiosyncrasies of Japan's wider corporate governance framework could

141 Dan W Puchniak & Masafumi Nakahigashi, "Corporate Law – Business Judgment Rule – Derivative Action – Supreme Court, 15 July 2010: '*Apamanshop*' with Comment" in *Business Law in Japan – Cases and Comments: Intellectual Property, Civil, Commercial and International Private Law: Writings in Honour of Harald Baum* (Moritz Bälz *et al* eds) (Alphen aan den Rijn, The Netherlands: Kluwer Law International, 2012) at p 221.

142 Dan W Puchniak & Masafumi Nakahigashi, "Corporate Law – Business Judgment Rule – Derivative Action – Supreme Court, 15 July 2010: '*Apamanshop*' with Comment" in *Business Law in Japan – Cases and Comments: Intellectual Property, Civil, Commercial and International Private Law: Writings in Honour of Harald Baum* (Moritz Bälz *et al* eds) (Alphen aan den Rijn, The Netherlands: Kluwer Law International, 2012) at p 222.

143 Dan W Puchniak & Masafumi Nakahigashi, "Corporate Law – Business Judgment Rule – Derivative Action – Supreme Court, 15 July 2010: '*Apamanshop*' with Comment" in *Business Law in Japan – Cases and Comments: Intellectual Property, Civil, Commercial and International Private Law: Writings in Honour of Harald Baum* (Moritz Bälz *et al* eds) (Alphen aan den Rijn, The Netherlands: Kluwer Law International, 2012) at p 222.

144 Dan W Puchniak & Masafumi Nakahigashi, "Corporate Law – Business Judgment Rule – Derivative Action – Supreme Court, 15 July 2010: '*Apamanshop*' with Comment" in *Business Law in Japan – Cases and Comments: Intellectual Property, Civil, Commercial and International Private Law: Writings in Honour of Harald Baum* (Moritz Bälz *et al* eds) (Alphen aan den Rijn, The Netherlands: Kluwer Law International, 2012) at p 224.

145 Dan W Puchniak & Masafumi Nakahigashi, "Corporate Law – Business Judgment Rule – Derivative Action – Supreme Court, 15 July 2010: '*Apamanshop*' with Comment" in *Business Law in Japan – Cases and Comments: Intellectual Property, Civil, Commercial and International Private Law: Writings in Honour of Harald Baum* (Moritz Bälz *et al* eds) (Alphen aan den Rijn, The Netherlands: Kluwer Law International, 2012) at p 222.

ultimately result in Japanese directors receiving as much protection as their US counterparts for their business decisions.[146] First, Japan's discovery rules are not as extensive as that in US and shareholders usually find it hard to collect evidence to prove directors' liability.[147] Second, directors are often not held accountable as most directors of Japanese companies are executives of the company with almost no supervision from independent directors to make outsiders aware of possible breaches of directors' duties or cause the company to pursue breaches of directors' duties.[148]

46 As the Japanese courts look quite closely at the business decisions of directors, it could be said that their business judgment rule is one of a substantive standard of liability. This is a reminder that a formal business judgment rule does not axiomatically equate to a strong rule. In Japan, although a formal business judgment rule is present, the Japanese courts still seem to be adjudicating on the reasonableness of directors' business decisions. Hence, whether the courts actually adopt an abstention doctrine or a substantive level of liability approach determines whether the rule effectively protects directors from personal liability. A valuable lesson to be gained from Japan is that it is insufficient to just examine the business judgment rule to determine how it will affect directors' liability. The amount of protection and discretion that directors enjoy may rely ultimately on other factors in the larger corporate governance framework. This causes the actual impact of the business judgment rule to differ from jurisdiction to jurisdiction.

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146 Dan W Puchniak & Masafumi Nakahigashi, "Corporate Law – Business Judgment Rule – Derivative Action – Supreme Court, 15 July 2010: '*Apamanshop*' with Comment" in *Business Law in Japan – Cases and Comments: Intellectual Property, Civil, Commercial and International Private Law: Writings in Honour of Harald Baum* (Moritz Bälz *et al* eds) (Alphen aan den Rijn, The Netherlands: Kluwer Law International, 2012) at p 224.

147 Kenji Utsumi, "The Business Judgment Rule and Shareholder Derivative Suits in Japan: A Comparison with those in the United States" (2001) 14 NY Int'l L Rev 129 at 165.

148 Kenichi Osugi, "What is Converging? Rules on Hostile Takeovers in Japan and the Convergence Debate" (2007) 9 Asian-Pac L & Pol'y J 143 at 154. This is unlike the situation in US, where since the 1980s there has been an increase in the number of independent directors on the boards of companies. In Japan, the amendment of the Japanese Commercial Code in 2002 allowed Japanese companies to adopt a US style of independent board committees. However, this did not find favour among Japanese companies, with less than 3% of Japan's listed companies adopting the suggestion: Dan W Puchniak, "Delusions of Hostility: The Marginal Role of Hostile Takeovers in Japanese Corporate Governance Remains Unchanged" (2009) 14 *Journal of Japanese Law* 89 at 117. In addition, within the few companies which adopted such a US-style board, their supposedly independent directors are frequently still from another company in the same corporate group: Kenichi Osugi, "What is Converging? Rules on Hostile Takeovers in Japan and the Convergence Debate" (2007) 9 Asian-Pac L & Pol'y J 143 at 154.

E. Germany

47 Section 93(1) of the German's Stock Corporation Act[149] states that:[150]

> In conducting business, the members of the management board shall employ the care of a diligent and conscientious manager. They shall not be deemed to have violated the aforementioned duty if, at the time of taking the entrepreneurial decision, they had good reason to assume that they were acting on the basis of adequate information for the benefit of the company.

All the elements of the US business judgment rule seem to be present in Germany's version. First, a decision is needed. Second, the directors need to have "good reason to assume that they were acting on the basis of adequate information".[151] "Good reason" seems similar to the US requirement of a "rational basis", but it is debatable as to whether "good reason" is more demanding. Third, the directors cannot be in a conflict of interest as they must act "for the benefit of the company".[152] However, while the German formulation is the same as the ALI formulation, it is unlike the Delaware rule, as under s 93(2) of the Stock Corporation Act, the burden of proof is on the defendant-director to establish due care.[153] That is, the German business judgment rule is not in the form of a presumption like that of the Delaware formulation.[154] Before German directors can enjoy the protection of the business judgment rule, they have to demonstrate that they were not in a conflict of interest and made their decisions based on sufficient information.[155]

48 In addition, Germany's formulation includes an additional element that directors must not engage in excessive risk-taking.[156] The Bundesgerichtshof (the highest German court in civil matters) held in *ARAG/Garmenbeck, Entscheidungen des Bundesgerichtshoffs in*

149 Stock Corporation Act of 1965 (Germany) (as amended in 2010).

150 Norton Rose Translation, dated 1 December 2011.

151 Douglas M Branson, "A Business Judgment Rule for Incorporating Jurisdictions in Asia?" (2011) 23 SAcLJ 687 at 711.

152 Douglas M Branson, "A Business Judgment Rule for Incorporating Jurisdictions in Asia?" (2011) 23 SAcLJ 687 at 711.

153 Franklin A Gevurtz, "Disney in a Comparative Light" (2007) 55 Am J Comp L 453 at 468.

154 Cornelius Wilk, "US Corporation Going European? – The One-tier Societas Europaea (SE) in Germany" (2012) 35 Suffolk Transnat'l L Rev 31 at 65.

155 Cornelius Wilk, "US Corporation Going European? – The One-tier Societas Europaea (SE) in Germany" (2012) 35 Suffolk Transnat'l L Rev 31 at 66.

156 Wulf A Kaal & Richard W Painter, "Initial Reflections on an Evolving Standard: Constraints on Risk Taking by Directors and Officers in Germany and the United States" (2010) 40 Seton Hall L Rev 1433 at 1461.

Zivilsachen[157] that a director and her decision will not be protected by the business judgment rule if "the ability to take conscious business risks by management has been irresponsibly overstretched".[158] It could be argued that the US business judgment rule, by requiring directors to act on an informed basis, already excludes from protection directors who engage in excessive risk-taking.[159] However, *In re Citigroup Inc Shareholder Derivative Litigation*[160] proved otherwise. The Delaware Chancery court held that the directors were protected by the business judgment rule even though the losses incurred were due to exposure to risky subprime debts.[161] As such, it appears that directors are protected less under German law.

49 This difference will become more evident if both the German and US approaches to a similar fact situation are compared.[162] In *In re The Walt Disney Co Derivative Action*,[163] the Delaware courts exonerated the directors who paid their outgoing number two executive (who contributed little to the company in his one year of tenure) around $130m.[164] On the other hand, in a similar case of *Mannesmann* litigation,[165] the German Federal Supreme Court held the directors liable for paying their outgoing chief executive officer (who helped the shareholders earn more than $50bn during his term of employment) approximately $17m.[166] It is submitted that the main difference lies in the courts' degree of deference towards directors' decisions.[167]

157 BGHZ 135, 244 (Ger); ZIP 883 (Ger).

158 Wulf A Kaal & Richard W Painter, "Initial Reflections on an Evolving Standard: Constraints on Risk Taking by Directors and Officers in Germany and the United States" (2010) 40 Seton Hall L Rev 1433 at 1465.

159 Wulf A Kaal & Richard W Painter, "Initial Reflections on an Evolving Standard: Constraints on Risk Taking by Directors and Officers in Germany and the United States" (2010) 40 Seton Hall L Rev 1433 at 1465–1466.

160 964 A 2d 106 (Del Ch, 2009).

161 Wulf A Kaal & Richard W Painter, "Initial Reflections on an Evolving Standard: Constraints on Risk Taking by Directors and Officers in Germany and the United States" (2010) 40 Seton Hall L Rev 1433 at 1466.

162 Franklin A Gevurtz, "Disney in a Comparative Light" (2007) 55 Am J Comp L 453 at 453.

163 906 A 2d 27 (Del Sup Ct, 2006), affirming 907 A 2d 693 (Del Ch, 2005).

164 Franklin A Gevurtz, "Disney in a Comparative Light" (2007) 55 Am J Comp L 453 at 453.

165 Bundesgerichtshof (Federal Court of Justice) (21 December 2005) 3 StR 470/04, NJW (Neue Juristische Wochenschrift) 2006 522 (FRG 2005).

166 Franklin A Gevurtz, "Disney in a Comparative Light" (2007) 55 Am J Comp L 453 at 453.

167 Franklin A Gevurtz, "Disney in a Comparative Light" (2007) 55 Am J Comp L 453 at 454.

50 The German courts are more willing to second-guess directors' decisions as compared to the Delaware courts.[168] This is apparent from how the German courts show greater doubt towards the ability of its directors to look to the interests of the company when making business decisions.[169] Indeed, s 111(1) of the Stock Corporation Act mandates that there must be a supervisory board to supervise the management board. By contrast, Delaware does not require such a two-tier management structure. However, some companies in the US do try to construct an equivalent of Germany's two-tier board by having a board with majority independent directors or delegating important decisions which involve conflicts of interest to committees of independent directors. Even so, the Delaware courts tend to defer more strongly to such independent directors' decisions than the German courts towards their own supervisory boards.[170] In fact, if a business decision is approved by a board consisting of majority independent directors, the Delaware courts will usually rule that the business judgment rule will be applicable to protect the board and its decision.[171] All these comparisons suggest that the German business judgment rule is one of a substantive standard of liability.

F. The UK

51 Unlike the other jurisdictions mentioned above, the UK has no formal business judgment rule either by statute or case law. However, although the UK has no formal business judgment rule, the English courts have generally upheld the judicial policy of minimum intervention in business decisions.[172] In *Howard Smith Ltd v Ampol Petroleum Ltd*,[173] the court held that:[174]

> [S]uch a matter as the raising of finance is one of management, within the responsibility of the directors … it would be wrong for the court to substitute its opinion for that of the management, or indeed to question the correctness of the management's decision, on such a question, if *bona fide* arrived at. There is no appeal on merits from

168 Franklin A Gevurtz, "Disney in a Comparative Light" (2007) 55 Am J Comp L 453 at 464–465.

169 Franklin A Gevurtz, "Disney in a Comparative Light" (2007) 55 Am J Comp L 453 at 470.

170 Franklin A Gevurtz, "Disney in a Comparative Light" (2007) 55 Am J Comp L 453 at 471.

171 Franklin A Gevurtz, "Disney in a Comparative Light" (2007) 55 Am J Comp L 453 at 472.

172 Carlos Andrés Laguado Giraldo, "Factors Governing the Application of the Business Judgment Rule: An Empirical Study of the US, UK, Australia and the EU" (2006) 111 Vniversitas 5 at 125, available at <http://www.juridicas.unam.mx/publica/librev/rev/vniver/cont/111/cnt/cnt5.pdf> (accessed February 2016).

173 [1974] AC 821.

174 *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821 at 832.

> management decisions to courts of law: nor will courts of law assume to act as a kind of supervisory board over decisions within the powers of management honestly arrived at.

52 In analysing whether the UK should codify the business judgment rule, the UK Law Commission noted that since courts do not interfere with management decisions made in good faith or judge these decisions with hindsight bias, a statutory business judgment rule should only be adopted if there is empirical research to illustrate that directors were concerned about the statutory statement of the duty of care, with the standard of care having evolved from the traditional subjective standard to one of a more objective standard,[175] or that having such a rule would improve directors' standard of conduct.[176] However, empirical research showed that only approximately one-third of the 804 respondents favoured the traditional subjective test.[177] Furthermore, the respondents stated that the UK was less litigious than the US and the introduction of a more objective standard of care would not result in a surge of shareholder litigation.[178]

53 In addition, even if the Australian or US business judgment rule is adopted, it might not serve any purpose as courts would still need to examine management decisions to decide if directors had a "rational basis" for believing that the decisions were in the best interests of the company (especially if the substantive review approach rather than the abstention doctrine is followed).[179] This in effect invites the courts to review business decisions on hindsight to decide if they had a "rational basis" and is tantamount to courts moving from "a bright-light rule that virtually precluded judicial examination of the business judgments of

175 United Kingdom, The Law Commission, The Scottish Law Commission, *Company Directors: Regulating Conflicts of Interests and Formulating a Statement of Duties – A Joint Consultation Paper* (Consultation Paper No 261; Discussion Paper No 105) (London: Her Majesty's Stationery Office, 1999) at para 5.29.

176 United Kingdom, The Law Commission, The Scottish Law Commission, *Company Directors: Regulating Conflicts of Interests and Formulating a Statement of Duties – A Joint Consultation Paper* (Consultation Paper No 261; Discussion Paper No 105) (London: Her Majesty's Stationery Office, 1999) at para 5.24.

177 United Kingdom, The Law Commission, The Scottish Law Commission, *Company Directors: Regulating Conflicts of Interests and Formulating a Statement of Duties – A Joint Consultation Paper* (Consultation Paper No 261; Discussion Paper No 105) (London: Her Majesty's Stationery Office, 1999) Appendix B, Empirical Research Report, s 7.

178 United Kingdom, The Law Commission, The Scottish Law Commission, *Company Directors: Regulating Conflicts of Interests and Formulating a Statement of Duties – A Joint Consultation Paper* (Consultation Paper No 261; Discussion Paper No 105) (London: Her Majesty's Stationery Office, 1999) at para 5.26.

179 Demetra Arsalidou, "Objectivity *versus* Flexibility in Civil Law Jurisdictions and the Possible Introduction of the Business Judgment Rule in English Law" (2003) 24(8) Comp Law 228 at 232.

directors to a rule that invites such examination".[180] Courts' second-guessing of business decisions increases the risk of directors' personal liability[181] and could impede the board from functioning optimally.[182] However while this might be so, this loss of efficiency could be offset by efficiency gains from the greater motivation to invest in information to ensure that the decision made is rational.[183]

54 Lastly, it was also argued that to get protection under the business judgment rule, directors might set aside too much time to decision-making so that their decisions appear well informed. While detailed records on meetings and questioning of management might lead one to think that the decision made was well informed, the truth might be vastly different.[184] Indeed, it was cautioned that:[185]

> Staged like a good play, such proceedings may evoke a recitation of the required emotions on the part of the actors that, in the final analysis, when the stage lights dim, have only been an illusion. Nothing is gained by such a charade. Entertaining, maybe; shareholder value-enhancing, absolutely not.

G. Singapore

55 Similarly in Singapore, there is no formal business judgment rule. However, the judicial attitude is also one of reluctance to interfere with business decisions. In *ECRC Land Pte Ltd v Ho Wing On Christopher*,[186] the court held that:[187]

> The court should be slow to interfere with commercial decisions taken by directors. It should not, with the advantage of hindsight, substitute its own decisions in place of those made by directors in the honest and reasonable belief that they were for the best interests of the company, even if those decisions turned out subsequently to be money-losing ones.

180 William J Carney, "The ALI's Corporate Governance Project: The Death of Property Rights" (1993) 61 Geo Wash L Rev 898 at 925.

181 *Comparative Corporate Governance: The State of the Art and Emerging Research* (Klaus J Hopt *et al* eds) (Oxford: Clarendon Press, 1998) at p 327.

182 *Comparative Corporate Governance: The State of the Art and Emerging Research* (Klaus J Hopt *et al* eds) (Oxford: Clarendon Press, 1998) at p 319.

183 *Comparative Corporate Governance: The State of the Art and Emerging Research* (Klaus J Hopt *et al* eds) (Oxford: Clarendon Press, 1998) at p 327.

184 Demetra Arsalidou, *The Impact of Modern Influences on the Traditional Duties of Care, Skill and Diligence of Company Directors* (Boston: Kluwer Law International, 2001) at p 169.

185 Charles M Elson, "The Duty of Care, Compensation, and Stock Ownership" (1995) 63 U Cin L Rev 649 at 682–683.

186 [2004] 1 SLR(R) 105.

187 *ECRC Land Pte Ltd v Ho Wing On Christopher* [2004] 1 SLR(R) 105 at [49].

This was elaborated in *Vita Health Laboratories v Pang Seng Meng*[188] ("*Vita Health*"), where the court stated that directors should "not be coerced into exercising defensive commercial judgment, motivated largely by anxiety over legal accountability and consequences".[189]

56 Similarly, in *Cheong Kim Hock v Lin Securities*,[190] the court approved of Lord Greene MR's holding in *Re Smith and Fawcett Ltd*,[191] that:[192]

> They [referring to directors] must exercise their discretion *bona fide* in what they consider – not what a court may consider – is in the interests of the company and not for any collateral purpose.

While the above is based on the courts' analysis of the directors' fiduciary duties under s 157 of the Singapore Companies Act and the business judgment rule is primarily targeted towards shielding directors from liability when breaching their duties of care, it is still necessary to determine how local courts look at whether directors are acting in the best interests of the company. This is because these decisions articulate the courts' general view towards second-guessing directors' business decisions. Indeed, it is artificial to segregate the analysis of fiduciary and negligence duties. One just needs to look at the US business judgment rule, where one of the elements is whether the directors had a rational basis for believing that the business judgment was in the best interests of the company. In fact, it was pointed out that when deciding whether directors have acted in the best interests of their company, there could be an overlap between the directors' duty of care and their fiduciary duties.[193]

57 However, it must be noted that in *Intraco Ltd v Multi-Pak Singapore Pte Ltd*[194] ("*Intraco*"), the court stated that there was still an objective test to directors' duties. The test was whether:[195]

> … an honest and intelligent man in the position of the directors, taking an objective view, could reasonably have concluded that the transactions were in the interests of the [company].

188 [2004] 4 SLR(R) 162.
189 *Vita Health Laboratories v Pang Seng Meng* [2004] 4 SLR(R) 162 at [17].
190 [1992] 1 SLR(R) 497.
191 [1942] 1 Ch 304.
192 *Cheong Kim Hock v Lin Securities* [1992] 1 SLR(R) 497 at [26] (citing *Re Smith and Fawcett Ltd* [1942] 1 Ch 304 at 306).
193 J S McLennan, "Duties of Care and Skill of Company Directors and Their Liability for Negligence" (1996) 8 S Afr Mercantile LJ 94 at 94–95.
194 [1994] 3 SLR(R) 1064.
195 *Intraco Ltd v Multi-Pak Singapore Pte Ltd* [1994] 3 SLR(R) 1064 at [29].

That said, as *Intraco* concerned multiple companies within a same group, the objective test in *Intraco* can be argued to be limited to this particular scenario only.

58 In sum, it is clear that Singapore courts respect business decisions. However, *Intraco* suggests that directors may be required to have an objective belief in the best interests of the company. Hence, Singapore's informal business judgment rule is definitely weaker than the abstention doctrine in the Delaware formulation. That said, it is debatable whether the informal rule in Singapore is much weaker than the substantive standard of liability doctrine. This is especially so when it appears that Japan's substantive standard of liability doctrine is tantamount to not having a business judgment rule. Nevertheless, the absence of a business judgment rule does provide much less certainty for Singapore directors.

IV. Factors influencing different models of the business judgment rule and their relevance to Singapore

59 If one looks closely at the above comparative analysis, it does seem logical that there is a framework of three models of application of the business judgment rule, based on the different ways in which countries have recognised the existence (or lack thereof) of the business judgment rule and the various degrees of perception of certainty that directors are provided with when managing the company. The three different models are namely the high, medium and low models of application of the rule. The high model is the statutory business judgment rule incorporated into positive law and which provides the highest perception of certainty. The medium model develops the elements of the rule through case law. The low model is the absence of a formal business judgment rule, but the courts generally recognise the function of such a rule and articulate a doctrine of not second-guessing business decisions. This low model provides the lowest perception of certainty.[196] Accordingly, the high model of application is exemplified by the Australian and German statutory business judgment rule. The different formulations of the business judgment rule developed by the courts in the US, Japan and Canada represent the medium model of application. Finally, Singapore and the UK apply the low model of application.

196 Carlos Andrés Laguado Giraldo, "Factors Governing the Application of the Business Judgment Rule: An Empirical Study of the US, UK, Australia and the EU" (2006) 111 Vniversitas 5 at 147, available at <http://www.juridicas.unam.mx/publica/librev/rev/vniver/cont/111/cnt/cnt5.pdf> (accessed February 2016).

60 With all these models in mind, it must be noted that there is no specific endpoint model in corporate governance, and countries should adapt the available models to fit their particular legal system.[197] This is the path dependence theory which posits that there is a need to look at the different corporate structures to determine why countries diverge in their adoption of the various models.[198] As such, there is a need to identify the factors influencing the different variations of the business judgment rule and apply them to the Singapore context to gauge whether a formal business judgment rule is necessary for Singapore.

61 There are four factors which influence the adoption of the various models of application of the business judgment rule. They are: (a) the standard of care and skill expected of directors; (b) the circumstances under which directors are found negligent; (c) the intensity of shareholder derivative actions; and (d) the suitability of the court's discretionary power of relief as a substitute for the business judgment rule. These various factors will be examined below to see how they influence countries to adopt or disregard a formal business judgment rule.

A. Standard of care and skill expected of directors

62 One of the factors influencing the adoption of a formal business judgment rule is the standard of care and skill expected of directors in the respective jurisdictions. It seems that countries with a more objective standard of care will have a business judgment rule. Indeed, this was the primary reason for the adoption of the business judgment rule in Australia.[199] In the leading Australian case of *Daniels v Anderson*,[200] the court held that the law has moved on since *Re City Equitable Fire Insurance Co, Ltd*,[201] where directors are now subjected to an objective test and are not allowed to use the lack of knowledge to exercise the requisite amount of care as a defence.[202]

197 Dan W Puchniak, "The Japanization of American Corporate Governance? Evidence of the Never-ending History for Corporate Law" (2007) 9 Asian-Pac L & Pol'y J 7 at 15.

198 Lucian Arye Bebchuk & Mark J Roe, "A Theory of Path Dependence in Corporate Ownership and Governance" (1999) 52 Stan L Rev 127 at 134.

199 Jean J Du Plessis, "Open Sea or Safe Harbour? American, Australian and South African Business Judgment Rules Compared: Part 2" (2011) 32(12) Comp Law 377 at 378.

200 [1995] 37 NSWLR 438.

201 [1925] 1 Ch 407.

202 Mark Byrne, "Do Directors Need Better Statutory Protection when Acting on the Advice of Others?" (2008) 21 *Australian Journal of Corporate Law* 238 at 243.

63 Similarly, US has an objective standard of care under s 8.30(a)(2) of its MBCA where the director must discharge her duties with the same care as an ordinarily prudent person in like position.[203] Similar wording is present in s 122(1)(b) of Canada's Business Corporation Act[204] which states that directors are required to "exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances". There have been suggestions that the phrase "in comparable circumstances" indicates the adoption of the common law subjective standard of care, skill and diligence.[205] However, the Supreme Court of Canada put paid to such suggestions in *People's Department Stores Inc v Wise* by holding that the standard of care expected of directors is an objective one.[206]

64 Germany also has an objective standard of care and skill.[207] The test for the standard of care in Germany is that "of a man in a leading position as the manager of other people's property in a specific enterprise".[208] Ineptitude or inexperience is not an excuse for escaping liability.[209] However, although Germany's duty of care is very strict, actions against directors who fail to comply with the standard are rare.[210] Nonetheless, this did not stop Germany from adopting a business judgment rule.

203 Ann M Scarlett, "Imitation or Improvement? The Evolution of Shareholder Derivative Litigation in the United States, United Kingdom, Canada and Australia" (2011) 28 Ariz J Int'l & Comp L 569 at 609. See also Hal R Arkes & Cindy A Schipani, "Medical Malpractice *versus* the Business Judgment Rule: Differences in Hindsight Bias" (1994) 73 Or L Rev 587 at 610 (noting that s 8.30(a)(2) of the US Model Business Corporation Act imposes an objective standard of the reasonable man test).

204 RSC 1985, c C-44.

205 Ann M Scarlett, "Imitation or Improvement? The Evolution of Shareholder Derivative Litigation in the United States, United Kingdom, Canada and Australia" (2011) 28 Ariz J Int'l & Comp L 569 at 609.

206 *People's Department Stores Inc v Wise* [2004] 3 SCR 461 at [22].

207 Demetra Arsalidou, "Objectivity *versus* Flexibility in Civil Law Jurisdictions and the Possible Introduction of the Business Judgment Rule in English Law" (2003) 24(8) Comp Law 228 at 229.

208 Demetra Arsalidou, "Objectivity *versus* Flexibility in Civil Law Jurisdictions and the Possible Introduction of the Business Judgment Rule in English Law" (2003) 24(8) Comp Law 228 at 229.

209 Demetra Arsalidou, "Objectivity *versus* Flexibility in Civil Law Jurisdictions and the Possible Introduction of the Business Judgment Rule in English Law" (2003) 24(8) Comp Law 228 at 229.

210 Demetra Arsalidou, "Objectivity *versus* Flexibility in Civil Law Jurisdictions and the Possible Introduction of the Business Judgment Rule in English Law" (2003) 24(8) Comp Law 228 at 230. Refer to n 260 below for a more detailed explanation.

65 That said, it must be noted that although the UK has an objective standard of care for its directors,[211] it does not have a formal business judgment rule. Hence, it would appear that it is too simplistic to merely look at the standard of care to determine if countries should adopt the rule. Nonetheless, this article will still go on to examine how local courts view the standard of care of directors, as it definitely does seem logical that it is more essential to have a business judgment rule if the standard of care is objective.

66 Local courts have adopted the objective standard of duty of care as expounded in *Daniels v Anderson*. In *Lim Weng Kee v Public Prosecutor*[212] ("*Lim Weng Kee*"), the court held that:[213]

> The law hence stands as thus … standard of care and diligence expected of a director is objective, namely, whether [she] has exercised the same degree of care and diligence as a reasonable director found in [her] position.

This standard of care will not be lowered to cater to any director's lack of knowledge or experience but can be raised if the director holds herself out to possess or in fact she possesses some special knowledge or experience.[214] From Singapore's objective standard of care, it seems that Singapore should indeed adopt a model of the business judgment rule.

67 This is especially so considering that *Lim Weng Kee* stated that the objective test applies equally to both the civil and criminal offences under s 157, Singapore's statutory duty of care.[215] Criminal liability might reduce the number of qualified professionals who are willing to become directors as they may face being imprisoned for up to a year under s 157(3)(*b*). Furthermore, directors' insurance in Singapore cannot cover the resulting fines and sanctions from criminal prosecutions.[216]

68 It can be argued that in the first place, it is difficult to find a director liable for negligence. Indeed, in Singapore, cases on directors' duty of care comprise only 3% of the total number of cases against directors from 1975 to 2003.[217] This suggests that it is not easy to prove

211 Tamo Zwinge, "An Analysis of the Duty of Care in the United Kingdom in Comparison with the German Duty of Care" (2011) 22(2) ICCLR 31 at 33.
212 [2002] 2 SLR(R) 848.
213 *Lim Weng Kee v Public Prosecutor* [2002] 2 SLR(R) 848 at [28].
214 *Lim Weng Kee v Public Prosecutor* [2002] 2 SLR(R) 848 at [28].
215 *Lim Weng Kee v Public Prosecutor* [2002] 2 SLR(R) 848 at [30].
216 Companies Act (Cap 50, 2006 Rev Ed) ss 172(B)(1)(*a*) and 172(B)(1)(*b*).
217 Corporate Governance and Financial Reporting Centre, National University of Singapore Business School, National University of Singapore, *A Study of Cases Against Directors in Singapore (Based on Historical Data)* (April 2004)

(*cont'd on the next page*)

that a director has breached her duty of care.[218] One reason is that courts are better at picking up "more culpable wrongdoing" than negligence liability.[219] In Australia, it is difficult to find a case where the director was found to have breached her duty of care only and not accompanied by breaches of her other duties.[220] Similarly, in the US, for the past 150 years, there have also been only a few cases in which directors were found solely negligent, without being tainted by any illegality, fraud or conflict of interest.[221] As such, in any case, the business judgment rule would not have protected these directors.

69 In addition, another reason for the few cases on directors' negligence liability is that there might be difficulties proving causation, particularly in larger companies, where it is necessary to prove that the loss suffered by the company was caused by the defendant director's actions.[222] This is especially since there could be various factors present in the unpredictable business context,[223] and it can be hard to quantify the losses.[224] Nonetheless, it is not impossible for courts to still impose liability on directors. In *Vita Health*, the managing director had misstated the accounts, making them look more favourable to attract investors to purchase his shares. The court held that the company was still entitled to substantial damages even though it had not actually suffered losses.[225] Since the director had misled the investors, he was held to the misstatements as if they were true. Equity "deemed done that which ought to be done" and the damages received by the company would then "feed into share prices in a manner determined by the investors".[226] It is important to note that V K Rajah JC (as he then was) stated that only in a fraudulent case would the wrongdoer be liable for all losses, including consequential losses.[227] As such, it can be seen that

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at p 10, available at <http://bschool.nus.edu.sg/Portals/0/images/CGFRC/docs/DnO_archival_data_report.pdf> (accessed February 2016).

218 Corporate Governance and Financial Reporting Centre, National University of Singapore Business School, National University of Singapore, *A Study of Cases against Directors in Singapore (Based on Historical Data)* (April 2004) at p 12, available at <http://bschool.nus.edu.sg/Portals/0/images/CGFRC/docs/DnO_archival_data_report.pdf> (accessed February 2016).

219 Hans Tjio, "Enhancing Corporate Disclosure" [2009] Sing JLS 332 at 360.

220 Joanna Bird & Jennifer Hill, "Regulatory Rooms in Australian Corporate Law" (1999) 25 Brook J Int'l L 555 at 563.

221 Alan R Palmiter, *Corporations: Examples & Explanations* (New York: Aspen Publishers, 4th Ed, 2003) at p 197.

222 Demetra Arsalidou, *The Impact of Modern Influences on the Traditional Duties of Care, Skill and Diligence of Company Directors* (Boston: Kluwer Law International, 2001) at p 151.

223 Hans Tjio, "Enhancing Corporate Disclosure" [2009] Sing JLS 332 at 348.

224 Hans Tjio, "Enhancing Corporate Disclosure" [2009] Sing JLS 332 at 360.

225 Hans Tjio, "Enhancing Corporate Disclosure" [2009] Sing JLS 332 at 356.

226 Hans Tjio, "Enhancing Corporate Disclosure" [2009] Sing JLS 332 at 357.

227 Hans Tjio, "Enhancing Corporate Disclosure" [2009] Sing JLS 332 at 357.

causation rules will only be relaxed if there is a finding of bad faith on the part of the director, as in *Vita Health*.[228] In usual negligence liability cases, the causative link could still be hard to establish.[229]

70 Nonetheless, the above analysis does not detract from the rationale of the business judgment rule, which is to provide certainty for directors when making decisions as the courts will not be allowed to intervene if the conditions of the rule are fulfilled. One must also be reminded that in spite of the rarity of directors being found liable for breaching their negligence duty, the US and Australia still adopted the business judgment rule.

B. Circumstances under which directors are found negligent

71 Another factor which might be relevant is the circumstances under which directors are found liable for negligence liability. This could affect the applicability of a business judgment rule.

72 For instance, one reason why the UK does not have a formal business judgment rule is because UK directors are more frequently alleged to be liable for omissions and not commissions.[230] Omissions refer to directors failing to prevent harm to the company while commissions refer to directors deciding whether to authorise a certain

228 Hans Tjio, "Enhancing Corporate Disclosure" [2009] Sing JLS 332 at 360.

229 Demetra Arsalidou, *The Impact of Modern Influences on the Traditional Duties of Care, Skill and Diligence of Company Directors* (Boston: Kluwer Law International, 2001) at p 114.

230 Demetra Arsalidou, *The Impact of Modern Influences on the Traditional Duties of Care, Skill and Diligence of Company Directors* (Boston: Kluwer Law International, 2001) at p 173. See Paul L Davies & Sarah Worthington, *Gower and Davies' Principles of Modern Company Law* (London: Sweet & Maxwell/Thomson Reuters, 9th Ed, 2012) at p 522 (noting that "nearly all decided English cases have arisen out of alleged failures by directors to act or to act effectively"). See also Bayless Manning, "The Business Judgment Rule and the Director's Duty of Attention: Time for Reality" (1984) 39 Bus Law 1477 at 1494, which stated that:

> … in major part the life and activity of the boardroom does not consist of taking affirmative action on individual matters; it is instead a continuing flow of supervisory process, punctuated only occasionally by a discrete transactional decision. In corporate litigation tomorrow, arising out of the debris of a company that has failed, the charge that will be leveled at the directors is that they were 'negligent' in that they passively stood by without taking affirmative action about this or that. If that is the charge, then by existing definitions the business judgment rule would not be available to protect the director. That would mean, astonishingly, that, given the realities of the way boards operate, the business judgment rule would not operate at all in respect of fully ninety percent of what directors are actually engaged in.

transaction or course of action.[231] This becomes clear when one examines the facts in the majority of UK cases,[232] from the well-known case of *Re Brazilian Rubber Plantations & Estates Ltd*[233] ("*Re Brazilian*"), where the traditional subjective standard of care was espoused, to more recent cases of *Re D'Jan of London*[234] ("*Re D'Jan*") and *Bishopsgate Investment*, which marked the development of an objective standard of care.[235] In *Re Brazilian*, the directors contracted to purchase a plantation in Brazil. They had allegedly relied on a fraudulent report without making proper enquiries and examination, and did not even repudiate the contract when they discovered the fraud.[236] Similarly, in *Re D'Jan* and *Bishopsgate Investment*, the directors had signed documents without checking their accuracy.[237] Generally, the business judgment rule requires the director to have turned her mind to the business matter.[238] Omissions will not be protected under the rule unless it is based on a conscious decision not to act.[239] Therefore, in any case, the enactment of a business judgment rule would not help protect such directors in the UK.

73 Singapore's situation appears to be different. The leading negligence cases are all that of commissions. In the landmark case of *Lim Weng Kee*, the director was found liable for permitting jewellery to be released to a customer without proper redemption.[240] Similarly, in *Jurong Readymix Concrete Ptd Ltd v Kaki Bukit Industrial Park Pte Ltd*[241]

231 Charles R T O'Kelley & Robert B Thompson, *Corporations and Other Business Associations: Cases and Materials* (Gaithersburg: Aspen Law & Business, 3rd Ed, 1999) at pp 272–273.

232 Demetra Arsalidou, *The Impact of Modern Influences on the Traditional Duties of Care, Skill and Diligence of Company Directors* (Boston: Kluwer Law International, 2001) at p 151.

233 [1911] 1 Ch 425.

234 [1994] 1 BCLC 561.

235 Demetra Arsalidou, *The Impact of Modern Influences on the Traditional Duties of Care, Skill and Diligence of Company Directors* (Boston: Kluwer Law International, 2001) at p 33.

236 Demetra Arsalidou, *The Impact of Modern Influences on the Traditional Duties of Care, Skill and Diligence of Company Directors* (Boston: Kluwer Law International, 2001) at p 20.

237 Demetra Arsalidou, *The Impact of Modern Influences on the Traditional Duties of Care, Skill and Diligence of Company Directors* (Boston: Kluwer Law International, 2001) at pp 28–29.

238 Michael Legg & Dean Jordan, "The Australian Business Judgment Rule after *ASIC v Rich*" (2010) 269 Co LN 1 at 3.

239 Dennis J Block, Nancy E Barton & Stephen A Radin, *The Business Judgment Rule: Fiduciary Duties of Corporate Directors* (Englewood Cliffs, New Jersey: Prentice Hall Law & Business, 3rd Ed, 1989) at p 12.

240 Tan Cheng Han, *Walter Woon on Company Law* (Singapore: Sweet & Maxwell Asia, 3rd Ed, 2009) at p 295.

241 [2000] 3 SLR(R) 1.

and *Townsing Henry George v Jenton Overseas Investment Pte Ltd*,[242] the wrongdoer directors were found liable for issuing an unnecessary guarantee[243] and wrongfully paying a sum of money respectively.[244] These three leading cases are commissions as the directors had made decisions to perform a certain course of action which resulted in the companies making losses.

74 That said, there is doubt whether in spite of the requirement that a decision is needed, the cases actually uniformly support this. There is very little discussion on this particular requirement in the corporate governance literature.[245] Also, practically speaking, the line between inaction due to "sheer inattention" and that premised on a conscious decision not to act is hard to distinguish and s 8.31(a)(2)(iv) of the MBCA reflects this by stating that an inaction can still create liability in the case of "a sustained failure of the director to be informed" or "other material failure of the director to discharge the oversight function".[246] However, while this might be so, the existing legislation and case law in the various countries which have business judgment rules still state that there is a requirement of there being a business judgment. In any case, this problem is not very significant in Singapore as the duty of care cases here comprise mostly of commissions and hence would warrant the protection of a formal business judgment rule.

75 Another consideration which might influence the adoption of the business judgment rule is that, unlike the US and Germany, the UK and Singapore have the notion of shadow and *de facto* directors.[247] As such, a greater range of individuals working in the company could be liable for breaching the duty of care expected of directors. This further strengthens the position of adopting a business judgment rule to allow those working in companies to engage in business activities confidently and with certainty, without fear of personal liability.

242 [2007] 2 SLR(R) 597.

243 Tan Cheng Han, *Walter Woon on Company Law* (Singapore: Sweet & Maxwell Asia, 3rd Ed, 2009) at pp 295–296.

244 *Townsing Henry George v Jenton Overseas Investment Pte Ltd* [2007] 2 SLR(R) 597 at [63].

245 Bayless Manning, "The Business Judgment Rule in Overview" (1984) 45 Ohio St LJ 615 at 623.

246 Alan R Palmiter, *Corporations: Examples & Explanations* (New York: Aspen Publishers, 4th Ed, 2003) at p 204.

247 Andreas Cahn & David C Donald, *Comparative Company Law: Text and Cases on the Laws Governing Corporations in Germany, the UK and the USA* (Cambridge/New York: Cambridge University Press, 2010) at p 342.

C. Intensity of shareholder derivative actions

76 The derivative action is a corporate governance mechanism which is of paramount importance in the enforcement of directors' duties and, in turn, in determining the extent to which, in practice, directors' business judgments will be scrutinised. As such, the intensity of shareholder derivative actions has a bearing on whether it is necessary to have a business judgment rule. It is submitted that the higher the intensity of shareholder derivative actions, the more necessary it is to adopt a business judgment rule.

77 Although most countries allow for shareholder derivative actions, there might be more incentive for shareholders to pursue derivative actions in particular countries. For example, the US has a business judgment rule mainly because the threat of shareholders' derivative actions against directors is very much alive in the US.[248] This is because lawyers in the US tend to encourage shareholders to bring these derivative actions against directors as US lawyers get a substantial amount of contingency fees when they represent the interests of shareholders.[249] Conversely, because of the presence of the "loser pays" rule, it is less profitable to pursue a derivative action in countries like the UK, Canada, Australia[250] and Germany.[251] The risk of having to pay the opponent's costs and attorney's fees deters shareholders from filing such actions.[252]

248 Carlos Andrés Laguado Giraldo, "Factors Governing the Application of the Business Judgment Rule: An Empirical Study of the US, UK, Australia and the EU" (2006) 111 Vniversitas 5 at 127, available at <http://www.juridicas.unam.mx/publica/librev/rev/vniver/cont/111/cnt/cnt5.pdf> (accessed February 2016).

249 Carlos Andrés Laguado Giraldo, "Factors Governing the Application of the Business Judgment Rule: An Empirical Study of the US, UK, Australia and the EU" (2006) 111 Vniversitas 5 at 128, available at <http://www.juridicas.unam.mx/publica/librev/rev/vniver/cont/111/cnt/cnt5.pdf> (accessed February 2016).

250 Ann M Scarlett, "Imitation or Improvement? The Evolution of Shareholder Derivative Litigation in the United States, United Kingdom, Canada and Australia" (2011) 28 Ariz J Int'l & Comp L 569 at 622.

251 Brian R Cheffins & Bernard S Black, "Outside Director Liability across Countries" (2006) 84 Tex L Rev 1385 at 1425.

252 Brian R Cheffins & Bernard S Black, "Outside Director Liability across Countries" (2006) 84 Tex L Rev 1385 at 1425. See also Dan W Puchniak & Harald Baum, "The Derivative Action: An Economic, Historical and Practice-oriented Approach" in *The Derivative Action in Asia: A Comparative and Functional Approach* (Dan W Puchniak, Harald Baum & Michael Ewing-Chow eds) (Cambridge/New York: Cambridge University Press, 2012) at p 85, where it was noted that in Germany, there is a serious dearth of derivative litigation as first, under s 148 of its Stock Corporation Act of 1965, Germany's derivative action is only available for fraud and/or gross breaches of the duty of care. Second, the plaintiff shareholder needs to have at least 1% or £100,000 of issued capital to be able to have standing to sue.

78 That said, the lack of financial benefit to pursue derivative actions does not entirely prevent a large number of derivative actions from occurring.[253] One such example is Japan, where although there is the presence of a "loser pays" rule,[254] the number of derivative actions has surged from a handful *per* year in the early 1990s to a high level matching that of the US.[255] Three main groups of litigants, namely members of the *kabunushi onbuzuman* (a social activist group), the *sokaiya* (a branch of the Japanese mafia) and environmental activists, have been the primary drivers of derivative actions in Japan.[256] Hence, while Japan's financial incentive to pursue a derivative action does not match that of the US, other non-economic factors have contributed to its thriving derivative actions.[257] Regardless of the motive for derivative actions in Japan, the surge in the number of derivative actions could be the reason why Japan's Supreme Court accepted the applicability of the business judgment rule.[258]

79 Similarly in Singapore, there is not much of a financial incentive to pursue a derivative action with its "loser pays" rule.[259] In addition, before the recent amendments, the additional restriction under s 216 of the Singapore Companies Act was that the statutory derivative action is not applicable to Singapore-incorporated companies that are listed for quotation or quoted on a securities market, whether in Singapore or overseas, and this made it even harder to bring a derivative action in

253 Dan W Puchniak & Masafumi Nakahigashi, "Land of the Rising Derivative Action: Revisiting Irrationality to Understand Japan's Unreluctant Shareholder Litigant" in *The Derivative Action in Asia: A Comparative and Functional Approach* (Dan W Puchniak, Harald Baum & Michael Ewing-Chow eds) (Cambridge/New York: Cambridge University Press, 2012) at p 130.

254 Dan W Puchniak & Masafumi Nakahigashi, "Japan's Love for Derivative Actions: Irrational Behavior and Non-economic Motives as Rational Explanations for Shareholder Litigation" (2012) 45 Vand J Transnat'l L 1 at 28.

255 Dan W Puchniak & Masafumi Nakahigashi, "Japan's Love for Derivative Actions: Irrational Behavior and Non-economic Motives as Rational Explanations for Shareholder Litigation" (2012) 45 Vand J Transnat'l L 1 at 31.

256 Dan W Puchniak & Masafumi Nakahigashi, "Japan's Love for Derivative Actions: Irrational Behavior and Non-economic Motives as Rational Explanations for Shareholder Litigation" (2012) 45 Vand J Transnat'l L 1 at 54.

257 Dan W Puchniak & Masafumi Nakahigashi, "Japan's Love for Derivative Actions: Irrational Behavior and Non-economic Motives as Rational Explanations for Shareholder Litigation" (2012) 45 Vand J Transnat'l L 1 at 8.

258 Dan W Puchniak & Masafumi Nakahigashi, "Corporate Law – Business Judgment Rule – Derivative Action – Supreme Court, 15 July 2010: '*Apamanshop*' with Comment" in *Business Law in Japan – Cases and Comments: Intellectual Property, Civil, Commercial and International Private Law: Writings in Honour of Harald Baum* (Moritz Bälz *et al* eds) (Alphen aan den Rijn, The Netherlands: Kluwer Law International, 2012).

259 Dan W Puchniak, "The Derivative Action in Asia: A Complex Reality" (2013) 9 Berkeley Bus LJ 1 at 19.

public companies.[260] Hence, it could be argued then that there was no need to enact a formal business judgment rule to control the number of derivative actions. However, the Ministry of Finance accepted the recommendation that the statutory derivative action in s 216A is applicable to Singapore-incorporated companies that are listed for quotation or quoted on a securities market, whether in Singapore or overseas.[261] Therefore, the argument that Singapore does not need a formal business judgment rule due to its restricted shareholder derivative actions is substantially diminished.

80 Indeed, even before the draft bill was passed in 2014, the level of derivative actions has risen substantially in Singapore. Almost half of the total number of derivative actions in Singapore have in fact taken place in the past few years.[262] This greatly supports the idea of an enactment of a formal business judgment rule in Singapore.

D. Unsuitability of court's discretionary power of relief as substitute for business judgment rule

81 The fourth factor is the availability of statutory provisions enabling courts to relieve directors from liability. If such statutory provisions are available, then it might not be necessary to have a business judgment rule. In Germany, since there is no such provision for the courts to excuse directors' liability,[263] this could be one reason why Germany requires a business judgment rule. Indeed, it has been argued that s 1157 of the UK Companies Act 2006[264] provides similar relief as the business judgment rule; hence, there is no need for a formal business judgment rule in England.[265]

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260 Dan W Puchniak, "The Derivative Action in Asia: A Complex Reality" (2013) 9 Berkeley Bus LJ 1 at 23.

261 Singapore Ministry of Finance's Responses to the Report of the Steering Committee for Review of the Companies Act (3 October 2012) at p 37 (Recommendations 2.29 and 2.30).

262 Dan W Puchniak & Wee Meng Seng, "Singapore Derivative Actions: Mundanely Non-Asian, Intriguingly Non-American and at the Forefront of the Commonwealth" in *The Derivative Action in Asia: A Comparative and Functional Approach* (Dan W Puchniak, Harald Baum & Michael Ewing-Chow eds) (Cambridge/New York: Cambridge University Press, 2012) at p 355. See also pp 352 and 360 where it was stated that this increase in derivative action in Singapore debunks the "Asian reluctant litigant theory" that Singaporeans, characterised by their Asian family bonds, will avoid suing each other for monetary compensation.

263 Brian R Cheffins & Bernard S Black, "Outside Director Liability across Countries" (2006) 84 Tex L Rev 1385 at 1429.

264 c 46.

265 Carlos Andrés Laguado Giraldo, "Factors Governing the Application of the Business Judgment Rule: An Empirical Study of the US, UK, Australia and the EU"

(*cont'd on the next page*)

82 Definitely, the court's power to relieve directors from liability can be said to be broader than the business judgment rule. This is because while an honest director who did not make an informed decision can be relieved of liability by the courts, she will not be protected under the business judgment rule as the rule requires directors to look at information reasonably available to them.[266]

83 Singapore courts also have this equivalent power of relief under s 391 of Singapore's Companies Act. Just like the UK, Singapore's s 391 requires directors to have acted not only honestly but also reasonably. It is noted that this requirement of reasonableness might be difficult to fulfil if a director is found negligent.[267] However, as *per JSI Shipping Pte Ltd v Teofoongwonglcloong*,[268] the court held that relief can be granted to a negligent director if the negligence was merely "technical or minor in character".[269] It is worth noting that while Australian courts are also empowered to relieve directors from liability under s 1318 of the Australian Corporations Act, this did not preclude Australia from adopting a statutory business judgment rule.

84 One main reason why the UK's s 1157 is said to be a substitute for the business judgment rule is because English courts have ruled that s 1157 can relieve a director of criminal liability.[270] This is not the case in Australia[271] and Singapore. As stated in *Re IDEAGLOBAL.COM Ltd*,[272] s 391 does not apply to criminal proceedings.[273] Section 391's inapplicability to criminal liability is of special concern as s 157 imposes both civil and criminal liability.

85 Notwithstanding the wider scope of the UK's s 1157, it is submitted that there are still numerous problems with the court's discretionary relief which prevents it from being a perfect substitute for a business judgment rule. First, the court's power to relieve directors

(2006) 111 Vniversitas 5 at 136, available at <http://www.juridicas.unam.mx/publica/librev/rev/vniver/cont/111/cnt/cnt5.pdf> (accessed February 2016).

266 Steven Wong, "Forgiving a Director's Breach of Duty: A Review of Recent Decisions" *University of Melbourne* (6 May 2009) at p 5, available at <http://law.unimelb.edu.au/__data/assets/pdf_file/0006/1709772/58-stevenwong_essay_6_May_20091.pdf>.

267 Pearlie Koh, "An Issue of Abolition – Section 391 of the Companies Act" (2003) 15 SAcLJ 306 at 314.

268 [2007] 4 SLR(R) 460.

269 *JSI Shipping Pte Ltd v Teofoongwonglcloong* [2007] 4 SLR(R) 460 at [164].

270 Tan Cheng Han, *Walter Woon on Company Law* (Singapore: Sweet & Maxwell Asia, 3rd Ed, 2009) at p 347.

271 Tan Cheng Han, *Walter Woon on Company Law* (Singapore: Sweet & Maxwell Asia, 3rd Ed, 2009) at p 347.

272 [2000] 1 SLR(R) 804.

273 *Re IDEAGLOBAL.COM Ltd* [2000] 1 SLR(R) 804 at [34].

from liability is based on a court's discretion. This definitely does not provide the same amount of certainty as a business judgment rule as directors have little guidance about the exact circumstances in which this judicial discretion may be exercised.[274] On the other hand, if there is a formal business judgment rule, the court will be obliged to consistently apply the rule provided the prerequisites are met.

86 Second, the discretionary relief applies only after a breach of duty has been found. In contrast, the business judgment rule prevents liability from arising in the first place. As such, the court's discretion to waive directors' liability after actually finding them liable does not help in preserving directors' reputations[275] and might discourage them from taking up directorships. Therefore, the limitations of such a discretionary relief renders a formal business judgment rule necessary.

V. Should Singapore adopt a formal business judgment rule?

87 Evidently, as seen above, there is no one factor which conclusively determines if a country should adopt a business judgment rule. Each jurisdiction has its own unique socio-economic and legal characteristics which influence its decision of whether to adopt a formal business judgment rule.

88 It is obvious, though, that decision-making in the boardroom is not a clear-cut black and white scenario. Rather, it is in various shades of grey. As such, there is a clear tension between efficiency in respecting directors' business decisions and the scope of judicial review.[276] Accordingly, with the business judgment rule only protecting directors provided certain conditions are met, the rule strikes a crucial balance between the need to ensure that directors comply with their basic standards of care and the equally important need of allowing them to take certain necessary risks.

89 In Singapore, courts have already expressed a reluctance to judge directors' business decisions on hindsight. Thus, the notion of a

274 Steven Wong, "Forgiving a Director's Breach of Duty: A Review of Recent Decisions" *University of Melbourne* (6 May 2009) at p 6, available at <http://law.unimelb.edu.au/__data/assets/pdf_file/0006/1709772/58-stevenwong_essay_6_May_20091.pdf>.

275 Steven Wong, "Forgiving a Director's Breach of Duty: A Review of Recent Decisions" *University of Melbourne* (6 May 2009) at p 6, available at <http://law.unimelb.edu.au/__data/assets/pdf_file/0006/1709772/58-stevenwong_essay_6_May_20091.pdf>.

276 Demetra Arsalidou, *The Impact of Modern Influences on the Traditional Duties of Care, Skill and Diligence of Company Directors* (Boston: Kluwer Law International, 2001) at p 166.

formal business judgment rule is definitely not incompatible with the judicial attitude and approach of the courts in Singapore. Currently, Singapore's informal business judgment rule is a weak one, and a formal business judgment rule (based on the abstention doctrine) would strengthen it with its added certainty for directors by allowing directors to clearly determine the circumstances in which their business judgments will be protected.[277] A formal business judgment rule does this by sounding a "cautionary note that an error in judgment or a mistake – in the sense of a decision that does not turn out as one hoped – does not automatically equal negligence".[278] Hopefully, this would result in an optimal level of appropriate commercial risk-taking within a framework of efficient accountability.

90 In addition, with Singapore's objective standard of care applying to both civil and criminal liability, and accompanied by the rising level of derivative actions, a formal business judgment rule should be adopted to lessen the onerous demands on directors in Singapore. Section 391 simply does not offer sufficient protection for Singapore directors.

91 A high statutory model of the business judgment rule should be adopted as a medium judge-made model would be equally susceptible to the same uncertainties experienced in the absence of a business judgment rule.[279] Indeed, the uncertainties brought about by the Delaware courts' inconsistent applications of the abstention and substantive standard of liability doctrines is a good reason why the rule should be contained in legislation instead. This is because a business judgment rule should not only protect directors from liability but also provide the essential guidelines on what directors should do to avoid liability.[280]

92 Certainly, while Singapore courts have been seemingly reluctant to second-guess business decisions, there has not been any clarification on the extent of protection directors have under the informal business judgment rule. In fact, as mentioned above, cases such as *Intraco* suggest

277 Demetra Arsalidou, *The Impact of Modern Influences on the Traditional Duties of Care, Skill and Diligence of Company Directors* (Boston: Kluwer Law International, 2001) at p 167.

278 Franklin A Gevurtz, "The Business Judgment Rule: Meaningless Verbiage or Misguided Notion?" (1994) 67 S Cal L Rev 287 at 293.

279 Australia, Australian Institute of Company Directors, *Duty of Care and the Business Judgment Rule* (Australia: The Department of Treasury, 1997) Executive Summary at para 3, available at <http://www.companydirectors.com.au/Director-Resource-Centre/Policy-on-director-issues/Policy-Submissions/1997/Duty-of-Care-and-the-Business-Judgement-Rule> (accessed February 2016).

280 Jean J Du Plessis, "Open Sea or Safe Harbour? American, Australian and South African Business Judgment Rules Compared: Part 2" (2011) 32(12) Comp Law 377 at 378.

that directors may be required to have an objective belief in the best interests of the company.[281] Such judicial uncertainty about directors' liability correspondingly results in much uncertainty for directors in the amount of risk-taking to undertake when carrying out their duties. As such, codifying a business judgment rule which clearly and unequivocally provides a presumption against reviewing directors' business decisions will clarify the position at common law. In addition, it will hopefully provide an incentive for boards to implement effective corporate governance practices to promote a transparent and responsible business decision-making process.

93 Ultimately, even if the codification might lead to a certain level of uncertainty as the courts could inevitably adjudicate on the merits of the directors' decisions (as seen in Australia), the perception of certainty rather than certainty itself would still foster confidence in directors to engage in a suitable amount of risk-taking to drive the economy. An imperfect rule could actually garner more perfect results than if there were no such rule at all.

94 Codifying the Delaware formulation is a good model to emulate as the business judgment rule is a presumption under the Delaware formulation. This treats the business judgment rule as an abstention doctrine which, as discussed above,[282] is the better theory of the business judgment rule. The presumption ensures that courts abstain from reviewing directors' decisions, yet still allows shareholders a leeway to rebut the presumption. Also, the Delaware formulation avoids the difficulties of applying the "proper purpose" test embodied by the Australian business judgment rule.

95 When codified, the Delaware form of the business judgment rule would provide the highest level of certainty and is compatible with Singapore's aim to foster a pro-business environment. Ultimately, even if no certainty is guaranteed, the perception of certainty will be sufficient for now.

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281 Refer to paras 55–58 above for discussion on *Intraco Ltd v Multi-Pak Singapore Pte Ltd* [1994] 3 SLR(R) 1064.

282 See paras 6–13 above.