



Would A Business Judgment Rule Help Directors Sleep Better At Night?

Insights Sharing By Low Chee Keong

Associate Professor in Corporate Law, CUHK Business School, Hong Kong

A CONVERSATION ON MAKING GOOD BUSINESS JUDGMENT

PANELLISTS



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INTRODUCTION

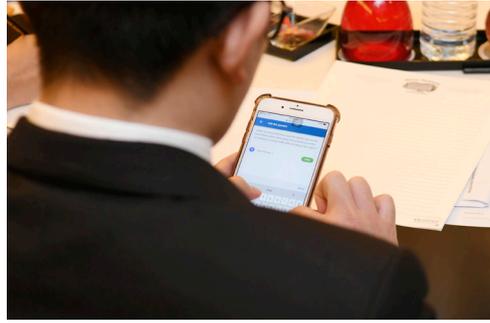
**PowerTalk by Institute of Corporate Directors Malaysia (ICDM)
17 December 2018, Kuala Lumpur, Malaysia**

The PowerTalk is a platform for inspiring conversations around local, regional and global board effectiveness. The series of talks aim to create an environment where business leaders from diverse backgrounds can exchange ideas, share insights and discover new perspectives that can lead to actionable outcomes that help shape the future.

The Institute of Corporate Directors Malaysia (ICDM) organised its second PowerTalk, featuring Chee Keong (CK) Low, an Associate Professor in Corporate Law at CUHK Business School in Hong Kong with research interests in issues pertaining to corporate governance and the regulatory framework of capital markets.

This executive summary takes you through the key points presented by CK, shedding light on the statutory Business Judgment Rule and its role in allowing directors to make calculated risk-taking without being second-guessed and holding directors accountable for their mistakes.

This document also captures the salient points from a panel discussion featuring CK, Philip T.N.Koh, Senior Partner at Mah-Kamariyah & Philip Koh, and Datuk Yvonne Chia, Chairman of Standard Chartered Bank Malaysia. The session was moderated by Kamarul Bahrin Haron, Deputy Editor-in-Chief at Astro Awani.



POWERTALK BY CHEE KEONG LOW

Making Sense of the Business Judgment Rule in Malaysia

- Increased liability exposure
- Directors are not infallible
- Business Judgment Rule: 3 existing approaches
- Interpreting the Malaysian provision

Can the Business Judgment Rule in Malaysia provide directors with adequate protection when alleged to have breached their duty of care?

Based on his research as well as drawing from his experience serving as a member on various regulatory panels, Associate Professor Chee Keong (CK) Low of CUHK Business School offered his views on the statutory Business Judgment Rule to an audience of corporate directors in Malaysia.

INCREASED LIABILITY EXPOSURE

Directors are regarded as a front-line 'gatekeeper' for good corporate governance and are continually subject to ever increasing scrutiny with much of the reforms centred upon a regulatory philosophy of keeping them on the 'straight and narrow', often by compelling them to 'Do X', 'Do Y' and/or 'Do Z'.

This approach presumes that legislators and regulators have the inherent ability to subject business decisions to systematic analysis and fails to recognise that such decisions often involve intangible and intuitive insights, especially with the increasing complexity and sophistication of commercial activities.

CK explains that the standard of care expected of directors takes into account not just what a reasonable person might do in a particular situation but also any special abilities that the individual director possesses. While delegation and reliance is essential in ensuring the efficiency and effectiveness of the business process, a key question is the extent to which a director can delegate its functions to and rely on the advice from the person(s) entrusted with this responsibility.

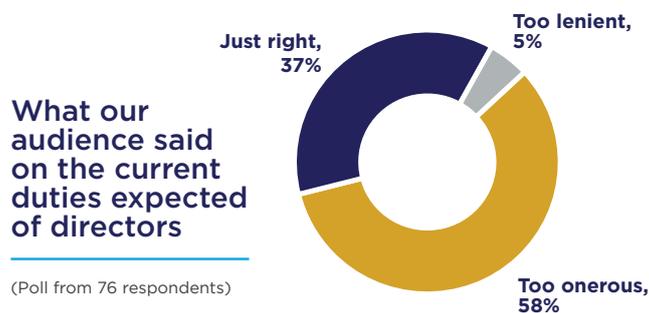
DIRECTORS ARE NOT INFALLIBLE

Indeed, the courts have held that directors have a 'core, irreducible requirement to be involved in the management of the company

and to take all reasonable steps to guide and monitor', and that this duty is 'greater than that of simply representing a particular field of experience or expertise.' The courts have increasingly imposed upon directors the duty to exercise independent judgment as 'slavish reliance is not acceptable, and the obtaining of outside advice does not absolve directors from exercising their judgment on the basis of such advice.'

However, one must question whether these standards have become so onerous as to disincentivise otherwise qualified individuals from joining corporate boards.

According to CK - if properly interpreted - the Business Judgment Rule which was enacted in 2007 can 'balance the scales' for directors by rewarding entrepreneurship through the making of prudent, reasonable and informed decisions while penalising those who cut corners.



BUSINESS JUDGMENT RULE: 3 EXISTING APPROACHES

The Business Judgment Rule is a legal principle which grants directors fair protection from lawsuits relating to corporate matters if it is found that they have acted in good faith. CK highlights the importance of noting that it is a statutory compromise of two competing policy objectives. "On one hand, you want to make sure directors have the flexibility to exercise

their entrepreneurial spirit for the development of the company. On the other, in terms of corporate governance, it tries to hold directors accountable for any uninformed mistakes or misjudgements."

The Business Judgment Rule provision incorporated in the Malaysian Companies Act is based on its Australian counterpart which was itself adopted from an American model. Thus, before interpreting the Malaysian provision and to better understand the Business Judgment Rule in general, it is crucial to note the salient differences between the three models currently being practiced in the United States and Australia.



“ Malaysia should embrace a hybrid model for its Business Judgment Rule, adopting the best practices in Australia as well as the formulation by the American Law Institute (ALI) to achieve an appropriate balance between allowing calculated risk-taking by directors and holding directors accountable for their mistakes. ”

CHEE KEONG LOW, ASSOCIATE PROFESSOR IN CORPORATE LAW, CUHK BUSINESS SCHOOL, HONG KONG

1. The common law in the state of Delaware

In Delaware, the court takes a presumption that in making a business decision, the directors of a corporation has acted on an informed basis, in good faith and in the honest belief that the action was taken in the best interests of the corporation. Given the use of this presumption in Delaware, it is incumbent on the plaintiff shareholder to ‘rebut the presumption by introducing evidence either of director self-interest, if not self-dealing, or that the directors lacked good faith or failed to exercise due care.’

2. American Law Institute (ALI) formulation

The ALI formulation provides a safe harbour where directors have the burden of establishing the presence of the elements of the Business Judgment Rule. However, once they do so, the payoff is significantly greater as the director concerned would have sailed into an impregnable harbour against litigation arising from a ‘failed’ business decision. Based on ALI formulation, the courts would not have to hold plenary hearings or trials if the directors can prove all these elements: (1) an affirmative or independent judgement; (2) must be informed with some care (not due care); (3) an absence of disabling conflict of interest; (4) a rational basis for the decision; and (5) good faith.

3. Section 180 of the Australian Corporations Act

The Australian parliament enacted the Business Judgment Rule in 1999 based upon the ‘safe harbour’ of the ALI formulation with some salient differences, including a definition of “rational belief” which states that “the director’s belief that the judgment is in the best interests of the corporation is a rational one unless the belief is one that no reasonable person in their position would hold.” Significantly, the courts have held that a director can invoke the Business Judgment Rule if he shows that he arrived at the business judgment after a reasoning process ‘whether or not the reasoning process was convincing to the judge and therefore reasonable in an objective sense.’ However, it is for the defendant director to bear the onus of proof in establishing his subjective ‘rational belief’ in order to derive the benefit under the Business Judgment Rule.

INTERPRETING THE MALAYSIAN PROVISION

The Business Judgment Rule in Malaysia substantially mirrors its Australian counterpart with one key distinction, which is the replacement of the word “rationally” with “reasonably” in section 214(d). CK highlights that while these two words may be used interchangeably in most circumstances, they may nonetheless hold different meanings in certain specific situations. In his opinion, a ‘reasonable’ expectation imposes a higher standard or requirement than a ‘rational belief’ as the latter allows for a subjective assessment of what the directors thought at the time of making the decision.

The Australian provision may be the source of Malaysia’s Business Judgment Rule but CK opines that we should not restrict ourselves to a consideration of the Australian jurisprudence only and allows for an interpretation based on a “hybrid Australian-ALI” approach.

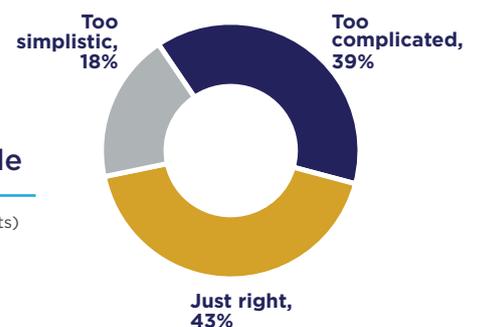
By adopting the best practices in both jurisdictions, corporate law in Malaysia will achieve an appropriate balance between allowing for (1) calculated risk-taking by directors on the one hand and (2) potential lawsuits by the company and/or shareholders should directors fall short of reasonable expectations on the other.

In fact, CK elucidates that this approach had been applied by Judge Nallini Pathmanathan in 2010 in *Petra Perdana Berhad v Tengku Dato’ Ibrahim Petra bin Tengku Indra Petra & Ors*. Her Ladyship set down some reference points for assessment; and they were: (a) the importance of the business judgment that is to be made; (b) the time available for obtaining information; (c) the costs related to obtaining information; (d) the director’s confidence in exploring the matter; (e) the state of the company’s business at that time and the nature of the competing demands on the board’s attention; and (f) whether or not the information is available to the director.

This approach may mean that directors will effectively have ‘two bites of the cherry’ since they can first try to avail themselves of a ‘safe harbour’ which is impregnable to lawsuits but should they fail they still have the option of adducing evidence to show that they have fulfilled the standard of care expected of them as set out in section 213(2). However, it must be emphasised that the key in determining whether protection under the Business Judgment Rule applies is through a close scrutiny of the decision-making process and not the general state of knowledge of the directors.

What our audience said about the Business Judgment Rule

(Poll from 70 respondents)



DIALOGUE

Making Good Business Judgment

- Take systemic actions against abuses
- Hire the right CEO
- Pay attention to the decision-making process
- A safe way out
- Competence, fresh minds & plurality

An associate professor, a lawyer and a corporate chairman offer their views on what can help directors make better decisions.

Philip T. N. Koh, Senior Partner at Mah-Kamariyah & Philip Koh and Datuk Yvonne Chia, Chairman of Standard Chartered Bank Malaysia joined CK on stage, offering their respective inputs on the statutory Business Judgment Rule and answering some questions from the audience. The dialogue was moderated by Kamarul Bahrin Haron, Deputy Editor-in-Chief at Astro Awani.

TAKE SYSTEMIC ACTIONS AGAINST ABUSES

Malaysia has one of the world's most robust and forward-looking rules and regulations. Nonetheless, in view of recent corporate scandals involving high level officials, corporate governance and accountability of leadership in Malaysia seems to be still missing the mark. Datuk Chia opines that while the law is sound, actions against abuses are not being executed accordingly. Hence, a more stringent system is critical to ensure penalties are enforced upon those who violate the regulations. Koh also believes that having an effective institutional structure helps minimise delinquencies. CK, however, cautions that, while there should be a strict process in penalising those who cut corners, we must maintain a regulatory focus on empowering the majority of directors who act in good faith.

HIRE THE RIGHT CEO

Datuk Chia adds on that the first step in ensuring good corporate governance is to hire the right Chief Executive Officer (CEO). "Once you have the right CEO with the right ethics and moral standards above and beyond his or her technical competence, your life as an executive director will be so much easier," she says. When in a collective board, many people tend to follow the herd. Therefore, it is extremely important to have a CEO who respects checks and balances, recognises the diversity and thoughts of the board, and someone who has the ability and the courage to ensure standards of corporate governance are enforced.

PAY ATTENTION TO THE DECISION-MAKING PROCESS

Koh emphasises that it is critical for directors to pay close attention to the process in which they derive their business decisions, and that minutes of meeting are extremely crucial because they will be used as evidence in the courts. "It is in your decision-making where you will be scrutinised if there is a lawsuit," he shares. He then further elucidates that the lawsuit usually comes about when there is a change of board or there is a fallout between joint venture partners who decide that it is time to remove certain board members and review every transaction they might have done. Therefore, it is crucial for directors of companies to establish a robust process to ensure they have all the information they need to make the best, informed judgment.

A SAFE WAY OUT

When asked about empowering directors to stand up against corrupt directors who have powerful connections, CK says that the law is abundantly clear on the actions that need to be taken when one faces such circumstances; however, people are more inclined to stay silent. "If you look at the Companies Act, one thing that the directors can do, if they feel so motivated, is that they can resign; and they can actually state reasons for why they resign." Nonetheless, he highlights that there is a need to amend the provisions in the Companies Act to protect the directors because the only time they can state reasons is based on their discussion with the board; and board matters are confidential to the board. "How do you breach your confidentiality and at the same time have transparency?" CK argues. The provisions are therefore essential to ensure the directors who stand up to the right things do not risk getting sued in return.

COMPETENCE, FRESH MINDS & PLURALITY

In ensuring good business judgment, the panel agrees that the board needs to include people with suitable competence. Industry knowledge is an integral part of a director's overall duties to the board. It is no longer acceptable for a director to sit on a corporate board with no understanding of that sector. Having fresh perspectives from the younger members is also crucial in today's board as most companies are going through a digital transformation largely driven by the youth. Diversity and plurality contribute to the enrichment of board discussions and thus help produce better decisions.

“ The first step in ensuring good corporate governance is to hire the right Chief Executive Officer (CEO) who respects checks and balances, recognises the diversity and thoughts of the board, and has the ability and the courage to ensure standards of corporate governance are enforced. ”



ACTIONABLE OUTCOMES

Moving Forward

- **1 FAMILIARISE THE BOARD WITH THE STATUTORY BUSINESS JUDGMENT RULE.**

It can potentially 'balance the scales' for directors by rewarding entrepreneurship through the making of prudent, reasonable and informed decisions while penalising those who cut corners.
- **2 EMBRACE A HYBRID MODEL**

for the Malaysian provision of the Business Judgment Rule. It seeks to recognise the director's authority to make decisions without being second-guessed while ensuring that the director remains accountable.
- **3 HIRE THE RIGHT CEO WITH THE RIGHT ETHICS AND HIGH MORAL STANDARDS.**

It is the first step in ensuring good corporate governance.
- **4 PAVE THE WAY FOR GOOD BUSINESS JUDGMENT AT BOARD LEVEL.**

Ensure the board is competent, diverse and equipped with the appropriate industry knowledge.
- **5 ESTABLISH A ROBUST DECISION-MAKING PROCESS.**

Ensure that the directors have the appropriate information to make informed judgments.
- **6 ENSURE MINUTES OF MEETINGS ARE ACCURATELY DOCUMENTED.**

It will be presented as evidence in courts if the Business Judgment Rule is invoked.
- **7 TAKE ACTIONS AGAINST VIOLATIONS.**

A stringent system is critical to ensure penalties are enforced upon those who violate the regulations, thus minimising delinquencies.

“ It is in your decision-making where you will be scrutinised, if there is a lawsuit. ”