THE DIRECTOR'S DUTY OF CARE: *A COMPARATIVE ANALYSIS OF DELAWARE AND SINGAPORE LAWS*

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I. INTRODUCTION

In a typical corporation,[1] the board of directors is charged with the function of managing the corporation's business. The power to manage the corporation carries with it a duty to act in the best interest of the corporation. This translates into a duty to exercise care and to remain loyal to the corporation at all times. While the concept of a duty of care is universal, the degree of care expected of a director varies in different jurisdictions.

This paper provides a comparative analysis of a director's duty of care under the laws of the State of Delaware in the United States and the Republic of Singapore. The author first introduces the general principles developed under these two jurisdictions. Thereafter, both Delaware and Singapore laws are applied to fact scenarios taken from three Delaware cases to illustrate similarities and differences in the approaches adopted by the two jurisdictions. Finally, the author provides an overall comparative analysis and some recommendations for improvement to Singapore law.

II. SEPARATION OF OWNERSHIP AND CONTROL

The separation of ownership and control in large public corporations owes its origins to the increase in the scale and complexity of businesses. As businesses expand, two things were required in increasing quantities:

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1. The words "corporation" and "company" are used interchangeably in this paper.

funds and specialized management. However, funds and skills are rarely concentrated in the same hands. Therefore, ownership and control are separated with ownership of the businesses being concentrated in the hands of those who possess funds (shareholders) and management in the hands of those who have managerial skills (directors).

In this corporate setup, directors function as agents of the shareholders. As with every principal-agent relationship, there is a need for the principal to monitor the agent's activities to ensure that the agent exercises due care. Therefore, a duty of care has been developed by the courts and imposed on directors. If a director breaches this duty, thereby causing losses to the shareholders, the shareholders can bring a suit in court against the director.

The question then is: to what extent should courts intervene in directors' decision making? While it may be beneficial to scrutinize directors' actions to ensure that the required level of care is exercised, too much intervention can produce adverse consequences. The following discussion will illustrate that the courts are aware of the need to strike a balance between monitoring directors' actions and trusting them to make proper business decisions with minimal judicial intervention.

III. GENERAL APPROACH

In the United States, a corporation is generally governed by the statute of the state in which it is incorporated. While incorporators have the choice of any state, a vast majority of large U.S. corporations are incorporated in the state of Delaware. Delaware's prominence as the domicile of large corporations has resulted in its having one of the most developed and litigated corporation laws in the United States. In view of this, Delaware jurisprudence is chosen for discussion in this paper.

A. Delaware Courts

1. The Business Judgment Rule

The Delaware court exercises prudence in dealing with shareholder suits against directors. It adheres to a principle of corporate governance called the "Business Judgment Rule" which has been part of the American common law for at least one hundred and fifty years. The business judgment rule operates as a shield to protect directors from liability for their decisions. Under this rule, the court will refuse to second-guess decisions by directors as long as they were informed, disinterested and independent when they made the decision. Thus, within this set of circumstances, the rule insulates directors from shareholder suits. It operates as a presumption favoring directors that must be rebutted by the plaintiffs in a suit.

If however, it is shown that any of the three conditions is not present, the presumption is rebutted and the business judgment rule becomes inapplicable. The court will then proceed to scrutinize the directors' decision. At this stage, the directors must prove "intrinsic fairness" in their business decision, failing which they will be liable for their breach of duty and for damages caused by their wrongdoing.

The rationale of the business judgment rule can be summarized as follows:

First, it encourages innovation and risk-taking by directors for the benefit of the corporation. Generally speaking, directors are more risk averse than shareholders.[2] If their decision making were open to attack in every shareholder suit, directors would exercise even more caution in making decisions and may compromise on business opportunities in order to protect themselves from liability. The business judgment rule thus serves to prevent the directors from being excessively prudent to the detriment of the corporation. It helps align the interests of shareholders and directors.

Second, the rule supports the concept of separation of ownership and control which is essential to large complex corporations. If there were no such rule, shareholders could easily substitute their or the courts' business judgment with that of the directors' by bringing an action in court. This would defeat the very purpose of placing managerial responsibilities in the hands of directors who have specialized management skills.

Third, it has been suggested that judges recognize that they are not "business experts" and thus not as qualified as directors to decide complex business issues. The weakness of this proposition can be seen from cases where judges show no hesitation in deciding issues involving complex medical, engineering or design issues. The proposition is weakened further when one considers cases such as *Zapata Corp. v. Maldonado*[3] where the

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2. Unlike shareholders who diversify their risks through investments in different corporations, directors have their jobs and reputation tied to the corporation. A more detailed discussion of directors' risk aversion is provided later. *See* discussion *infra* Part IV.

3. 430 A.2d 779 (Del. 1981)

Delaware Supreme Court held unequivocally that commercial issues which feature prominently in business decision-making are not "beyond the judicial reach" of the Delaware Court of Chancery.[4] Perhaps a more plausible explanation is that, unlike directors who are supervised in their decision-making through contractual or market mechanisms,[5] judges who sit on the bench and rule on business decisions are not subject to any such monitoring devices. Therein lies the danger of excessive judicial intervention in business decision making.

2. Duty of care

The business judgment rule is closely linked with the fiduciary duties a director owes to the corporation. In order to claim the protection of the rule, the director must be informed, disinterested and independent. The requirement of being disinterested and independent means that a director must display loyalty to the corporation. This duty of loyalty is an extremely important facet of corporation law in which it ensures that a director will always act in the best interests of the corporation. However, for the purpose of this discussion, the focus will be on the first requirement, that of being informed, a condition analogous to the fiduciary duty of care.

Delaware has no statutory definition of the standard of care expected of directors. However, dictum in a 1963 Delaware Supreme Court decision states that "directors of a corporation, in managing the corporate affairs are bound to use that amount of care which ordinarily prudent men would use in similar circumstances."[6] This statement creates an expectation that courts are to use a strict test to judge if a director has fulfilled his duty of care. However, subsequent decisions have established a lower minimum standard which directors must comply with in order to escape liability. This apparent inconsistency has led some commentators to argue that the

4. The Delaware Supreme Court based this on the fact that the lower Court of Chancery "regularly and competently deals with fiduciary relationships, disposition of trust property, approval of settlements and scores of similar problems."

5. Examples of contractual mechanisms which supervise directors' actions are executive compensation packages which link the salary of the director to the performance of the corporation or which reward the director with shares of the corporation. The reputation market and the threat of not being re-elected also serve as market mechanisms to ensure that directors act in the best interests of the corporation.

6. Graham v. Allis-Chalmers Manufacturing Co., 188 A.2d 125, 130; 1963 Del. LEXIS 127, 10; 41 Del. Ch 78, 84.

traditional phrasing of the duty is intended "primarily as an inspirational statement" which is not necessarily a "liability creating rule".[7]

The "liability creating rule" referred to above was later established by the Delaware Supreme Court in the landmark decision of *Smith v. Van Gorkom*.[8] In that case, the court deferred to its earlier decision of *Aronson v. Lewis*[9] and held:

> The business judgment rule exists to protect the full and free exercise of the managerial power granted to Delaware directors .... The rule itself is a presumption that in making a business decision, the directors of the 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 corporation.. ..
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> The determination of whether a business judgment is an informed one turns on whether the directors have informed themselves "prior to making a business decision, of all material information reasonably available to them". The directors' duty to exercise an informed business judgment is in the nature of a duty of care.... In *Aronson v. Lewis*, we stated that. . . "under the business judgment rule director liability is predicated upon concepts of gross negligence". We again confirm that view. We think the concept of gross negligence is also the proper standard for determining whether a business judgment reached by a board of directors was an informed one.[10]

Therefore, it is clear that under Delaware law, "gross negligence" is the level at which liability attaches.

One final but important point remains to be discussed. It concerns exculpation from liability for breach of the duty of care. The Delaware General Corporation Law ("DGCL") allows a corporation to include in its certificate of incorporation a provision eliminating or limiting the personal

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7. *See*, WILLIAM A. KLEIN, & JOHN C. COFFEE JR, BUSINESS ORGANIZATION AND FINANCE, LEGAL AND ECONOMIC PRINCIPLES 139 (4th ed. 1990).
8. 488 A.2d 858 (Del. 1985).
9. 473 A.2d 805 (Del. 1984).
10. *See supra* note 8.

liability of a director for monetary damages for breach of his duty of care.[11] This means that shareholders can agree at the outset not to hold their directors personally responsible if they should fail to exercise due care. While this may appear too large a concession to directors, it should be remembered that even with such an agreement, the shareholders have alternative remedies against the errant director. First, they can seek an injunction if the act is deemed grossly negligent. Second, they can refuse to re-elect the director. Third, at the extreme, they can remove the director before expiration of his term by ordinary resolution.[12]

B. Singapore Courts

Unlike the Delaware courts, the Singapore courts have not developed the equivalent of a "business judgment rule" to deal with shareholder suits against directors. The Singapore approach has been to refer to statutory rules as well as English and Australian cases on directors' duties. However, policy considerations similar to those underlying the business judgment rule have been enunciated by the English and Australian courts, and through their reliance on such decisions,[13] the Singapore courts would be alerted to the importance of such business considerations.[14]

1. Duty of Care

The primary source of statutory corporation law in Singapore is the Companies Act (Cap. 50) ("CA"). The CA is modeled on the Australian Uniform Companies Act of 1961 which in turn evolved from the UK

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11. Section 102(b)(1)(7) provides that ". . . . the certificate of incorporation may also contain . . . a provision eliminating or limiting the personal liability of a director . . . for monetary damages for breach of fiduciary duty as a director, provided that such provision shall not eliminate or limit the liability of a director (i) for any breach of the . . . duty of loyalty . . . (ii) for acts or omissions not in good faith or which involve intentional misconduct of a knowing violation of the law . . . (iv) for any transaction from which the director derived an improper personal benefit . . . ."

12. Section 141(k) of the DGCL allows shareholders of corporations with classified boards to remove a director with cause by ordinary resolution. One would expect gross negligence on the part of the director to be sufficient cause. In any event, removal by ordinary resolution without cause is permitted as long as it is provided for in the certificate of incorporation.

13. Singapore's reliance on Australian and English cases is discussed in Part III (B)(1), *infra*.

14. Despite this, it would appear that in the final analysis, such policy considerations play an insignificant role in influencing the outcome of cases. *See* discussion *infra* Parts IV and V.

Companies Act of 1948. Due to this common ancestry, Singapore courts rely extensively on cases decided in both Australia and England.[15]

Section 157(1) of the CA provides that "A director shall at all times act honestly and use reasonable *diligence* in the discharge of duties of his office".[16] This section has no counterpart in English legislation; rather, it is derived from a similar provision in Australian legislation. This statutory rule does not purport to be an exhaustive statement of a director's duties as subsection (4) provides further that the section is "in addition to and not in derogation of any other rule of law relating to duty or liability of directors or officers of a company." These words are a direct reference to English common law and equitable rules relating to the duties and liabilities of directors.[17]

The word "diligence" in Section 157(1), read together with English common law rules, impose on a director the duty to exercise care, skill and diligence. The duty of care and diligence under Singapore law differs from the Delaware approach in two significant ways:

First, until recently, the prevalent view held that there was no single standard of care, but a subjective one depending on the particular director's expertise, experience and qualifications.[18] However, in recent Australian and English cases, an objective element has been introduced so that a director is required to exhibit the level of care and diligence reasonably expected of him taking into consideration the functions which he performs in the corporation.[19]

Second, the duty of care imposed on a director is a duty not to be negligent, one similar to that imposed under the tort of negligence. This

15. It should be noted, however, that while English and Australian cases serve as very persuasive authorities, they are not binding precedents. The Singapore court is free to depart from them especially if local policy considerations necessitate a different approach to the law.

16. Emphasis added.

17. Singapore's reception of English common law can be traced to the period during which Singapore was a colony of the British empire. By virtue of the 1826 Second Charter of Justice and the 1909 Civil Law Act (Section 5), certain areas of English law were received as the applicable law in Singapore. The application of such English law was subject to modification or adaptation as necessitated by local circumstances. In 1993, the Application of English Law Act was passed to limit the reception of English law. By virtue of section 3 of this Act, English cases decided after November 12th 1993 which would otherwise have been received under the Civil Law Act, do not become part of the law in Singapore.

18. *See* Bryne v. Baker [1964] VR 443, 450, in which the Supreme Court of the State of Victoria in Australia interpreted the English decision of Re City Equitable Fire Insurance Co Ltd [1925] 1 Ch 407 (High Court affirmed by the Court of Appeal) as having laid down a subjective test.

19. *See* Walter CM Woon, Company Law 305 (2nd ed. 1997); Daniels v. Anderson (1995) 16 A.C.S.R. 607 (Court of Appeal, New South Wales) *avail. in* LEXIS - AUST/AUSRPT at 69.

means that ordinary negligence even if not amounting to "gross negligence" will render a director liable for breach of his duty as director.

The following extracts from English and Australian cases establish this rule of law. According to the opinion of Judge Neville J in the English High Court decision of *Re Brazilian Rubber Plantations and Estates Ltd,*

> [A director] is not, I think, bound to take any definite part in the conduct of a company's business, but so far as he does undertake it, he must use reasonable care in its dispatch. Such reasonable care must, I think be measured by the care an ordinary man might be expected to take in the same circumstances on his own behalf.[20]

And, per Clarke and Cheller JJA in the Australian decision of *Daniels v. Andersen,*

> In our opinion the concept of negligence which depends ultimately 'upon a general sentiment of moral wrongdoing for which the offender must pay' (*Donoghue v. Stevenson* [1932] AC 562 at 580) can adapt to measure appropriately in the given case whether the acts or omissions of an entrepreneur are negligent . . . . We are not impressed by this perceived barrier against imposing on directors a duty of care at common law . . . . The law of negligence can accommodate different degrees of duty owed by people with different skills but that does not mean that a director can safely proceed on the basis that ignorance and a failure to inquire are a protection against liability for negligence . . . .
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> [A Director is bound] to take reasonable care in the performance of the office. As the law of negligence as developed, no satisfactory policy ground survives for excluding directors from the general requirement that they exercise reasonable care in the performance of their office. A Director's

20. [1911] 1 Ch 425, 437.

> fiduciary obligations do not preclude the common law duty of care.[21]

Academic writers in Singapore confirm that reasonable person and negligence standards are used to determine if a director is liable for breach of his duty.[22]

Finally on the issue of exculpation from liability, the CA contrasts greatly with the DGCL in that it expressly prohibits any prior contract which exempts a director from liability for breach of the duty of care.[23]

2. Policy Considerations

As early as 1869, the English court recognized that shareholders were ultimately responsible for the wise or unwise appointments of their directors. Therefore, save for instances of dishonesty, the court was disinclined to interfere with the way in which directors managed the corporation. The attitude was that, "however ridiculous and absurd the conduct of the directors, it was the company's misfortune that such unwise directors were chosen."[24]

The Australian court has also acknowledged the role of directors as entrepreneurs and realized that it must not act to discourage this entrepreneurial spirit. In the decision of *Daniels v. Anderson*,[25] the Court of Appeal of New South Wales stated:

> The Courts have recognized that directors must be allowed to make business judgments and business decisions in a spirit of enterprise untrammeled by the concerns of a conservative investment trustee. Any entrepreneur will rely upon the variety of talents in deciding whether to invest in a business venture. These may include legitimate but ephemeral, political

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21. (1995) 16 A.C.S.R. 607 (Court of Appeal, New South Wales); *available* in LEXIS - AUST/AUSRPT at 68-71

22. *See* WALTER CM WOON, COMPANY LAW 304 (2nd ed. 1997) ("A Director should take as much care in the affairs of his company as he would reasonably take in his own affairs. If he acts in relation to his company in a manner that no reasonable man would employ in relation to his personal affairs, the company has a right to complain.")

23. This provision is discussed exhaustively in Parts IV(B) and V *infra*.

24. Turquand v. Marshall (1869) 4 Ch App 376, 386 (Court of Appeal in Chancery England).

25. (1995) 16 A.C.S.R. 607 (Court of Appeal, New South Wales) *available in* LEXIS - AUST/AUSRPT at 67

> insights, a feel for future economic trends, trust in the capacity of other human beings. Great risks may be taken in the hope of commensurate rewards.

This is a clear acknowledgment by the court that, in exercising its judicial supervision of directors' decision making, it must not discourage the entrepreneurship spirit displayed by them.

Taking the cue from the Australian and English courts, the Singapore court, in deciding whether directors have exhibited the required level of care, should similarly take into account policy considerations such as the society's need to encourage risk taking by directors. Moreover, the Singapore court is fully aware that shareholders have mechanisms to replace careless directors which are less expensive and disruptive to society than the legal process. Seen from this perspective, the Singapore court, in looking to Australian and English cases for guidance, should be reminded of the benefits of refraining from excessively interfering with directors' decision-making even though there is no business judgment rule in Singapore.

In the specific area of takeovers, policy considerations can also be gleaned from the Singapore Code on Takeovers and Mergers ("Code"). This Code, which was issued by the Minister for Finance pursuant to Section 213(17) of the CA, is important despite its non-statutory nature. It represents the collective opinion of professionals on the proper standard of conduct to be observed by directors and other persons in takeover or merger situations. While details of the Code will be discussed later, it is pertinent to note here that if directors depart from the prescribed level of conduct, they are subject to private or public censure by the Singapore Securities Industry Council.[26] Moreover, in the event that the Council discovers evidence of a criminal offense during its proceedings, it will recommend to the Attorney-General that the offender be prosecuted. Therefore, in determining whether a director has breached his duties, the provisions of the Code feature prominently. A breach of its provisions would weigh heavily against the director.

26. The Securities Industry Council, which is made up of representatives from the Singapore government, the Monetary Authority of Singapore and the private sector, administers and enforces the Code. The Council's duty is to enforce good business standards.

IV. Analysis of Factual Situations

The author will now attempt to show the differences and similarities between the approach of the two courts through actual fact scenarios of three Delaware cases. In each case, the reasoning of the Delaware court will be analyzed. Following that, the author will postulate how a Singapore court would have ruled if faced with the same facts.

A. *Smith v. Van Gorkom*[27]

This case involved a class action brought by shareholders of Trans Union Corporation ("Trans Union") challenging a merger of Trans Union into a subsidiary of Marmon Group, Inc. controlled by the Pritzker family. The merger was negotiated at arms' length with no allegation that the directors' decision was tainted by a conflict of interest. Van Gorkom, the chairman who had negotiated the merger was an attorney and certified public accountant who had many years of experience with the corporation and owned a substantial block of stock. The economic rationale for the merger was obvious: Trans Union possessed valuable tax credits that it could not use but that could be sold to the bidder through a merger. The terms of the merger provided shareholders with $55 in cash per share, shares which were previously trading in the mid-$30's, a premium of approximately fifty percent.

The Delaware Court of Chancery, relying on the business judgment rule, dismissed the action summarily. On appeal, the Delaware Supreme Court reversed the judgment by a three-two majority after finding the directors grossly negligent in failing to exercise sufficient deliberation before approving the price of the cash-out merger. The business judgment rule did not apply and the case was remanded to the lower court for a determination of damages.

The court found gross negligence on the following facts: the merger was initiated and negotiated by Van Gorkom without consultation with the other directors of Trans Union. Although the chief financial officer ("CFO") had previously undertaken a study (not specifically to determine the fair value of the corporation) showing a price range of between $55 and $65 per share, Van Gorkom neglected to read it and did not make it available for the board meeting during which the merger was approved.

27. 488 A.2d 858 (Del. 1985).

The board meeting was attended by other directors who were not informed prior to the meeting that the merger was to be discussed. During the meeting, they neither saw nor requested to view the merger documents. As to the fairness of the price, they did not call for an independent evaluation study by an external investment banker nor did they ask the CFO to prepare any study of the corporation's intrinsic value. Instead, they relied solely on Van Gorkom's twenty minute oral presentation of the merger. He offered no analysis of the recommended $55 price and did not reveal that it was he who had suggested the price in the first place. When the CFO informed the other directors that $55 was "in the range of a fair price" but "at the beginning of the range", no director sought further information from him. The board finally approved the merger after a meeting that lasted only two hours even though they had another thirty-six hours under the Pritzker offer to make their decision.

How would a Singapore court have ruled?

In accordance with Section 157(1) of the CA, each director must "use reasonable diligence in the discharge of duties of his office". In their respective capacities as directors of a large public corporation, and when confronted with such an important issue as a cash-out merger, each director is expected to exhibit reasonable care in deciding whether to approve the cash-out merger.[28] He must take such care as "an ordinary man might be expected to take in the same circumstances on his own behalf."[29]

The actions and omissions of the directors would be carefully scrutinized by a Singapore court to determine if they acted with the required amount of care. The court would have referred to the Singapore Code on Takeovers and Mergers.[30] General Principle 6 of the Code requires directors to seek "competent independent advice" on the merits of the offers that they have received. Accordingly, the failure of the Trans Union directors to obtain independent advice on the fairness of the price would be considered by the court as a factor indicating a lack of due care. Chairman Van Gorkom would be found guilty of negligence based on this fact as well as the other facts highlighted by the Delaware court.

28. The author is postulating that the Singapore court would reject the traditional subjective test in favor of the objective test suggested by recent English and Australian cases. *See* text accompanying note 18.

29. *Re Brazilian Rubber Plantations and Estates Ltd.* [1911] 1 Ch 425.

30. *See* text accompany note 26.

As for the non-executive directors (the outside directors), a different approach would have been taken. Specifically, reference to the Australian decision of *Daniels v. Anderson*[31] would have been made. In that case, the corporation set up a foreign exchange operation ("FX operation") which was run by a single person, Koval. Concerned about the high risk FX operation, the Board laid down general policies and rules regarding its operation. The non-executive directors sought verification from the corporation's external auditors and management that the policies were observed and all was in order. They were assured that everything was above board. In fact, the FX operation was severely mismanaged and substantial losses were incurred. The trial judge, Rogers CJ held that, although the CEO who was also chairman of the board was negligent, the non-executive directors were not negligent. In his view they were entitled to place reliance on management and the auditors to ensure that the policies were adhered to. On appeal, the Court of Appeal upheld the finding that they were not negligent.[32]

Based on this case, the Singapore court would have recognized the need of the non-executive Trans-Union directors to rely on Van Gorkom, especially since Van Gorkom had extensive experience in managing the corporation. Similarly, adopting the stand taken by the Australian court, the Singapore court would probably have found it justifiable for the non-executive directors to rely to a limited extent on secondary sources such as financial reports and prevailing market prices to gauge the value of the corporation. Therefore, the fact that the offer price was about fifty percent higher than the prevailing market price would be a factor that could reasonably be considered by them. It is pertinent to note that these factors which would be significant in the eyes of the Singapore court, are the bases on which several American academics have criticized the judgment of the

31. (1995) 16 A.C.S.R. 607 (Court of Appeal, New South Wales); *available* in LEXIS - AUST/AUSRPT.

32. It should be noted that the Court of Appeal appeared to have adopted a stricter standard for non-executive directors than the trial judge. While they agreed on the overall assessment of the facts that the non-executive directors were not negligent, they did not think them as blameless as the trial judge did. They queried whether, during one particular short period, the non-executive directors should have done more than they did. *See* Roman Tomasic, *Modernising the Rules of Corporate Governance-The AWA case on appeal*, 1995 AJCL LEXIS 43 (arguing that the Court of Appeal was "sceptical of the conclusion of the trial judge" in making the finding of fact that the non-executive directors were not negligent, "but nevertheless as an appeal court, felt it should accept them."

Delaware court.[33]

Notwithstanding the above, the Singapore court would have found on an assessment of all facts that the non-executive directors were negligent. In order to be absolved from all liability, the non-executive directors must have done all they could reasonably do in the circumstances.

Unlike the directors in *Daniels v. Anderson*, the directors here did not seek verification from external investment bankers or auditors on the fairness of the price, although it was open to them to do so. This failure would weigh heavily against them in view of the Singapore Code on Takeovers and Mergers which requires directors to seek independent advice.[34] They did not properly consult the corporation's CFO nor probe further when he stated that the price was at the beginning of the fair range. As for their reliance on Van Gorkom, they could have inquired further to ascertain the basis of his recommendations, instead of taking at face value his twenty minute presentation. Overall, they probed far less than they could have done before approving the offer price. The facts of *Daniels v. Anderson* would have been distinguished and the non-executive directors held negligent in failing to exercise reasonable care.

33. *See* Daniel R. Fischel, *The Business Judgment Rule and the Trans Union* case, 40 BUS. LAW. 1437 (1985); Bayless Manning *Reflections and Practical Tips on Life in the Boardroom after Van Gorkom*, 41 BUS. LAW. 1 (1985); Jonathan R. Macey & Geoffrey P. Miller, *Trans Union Reconsidered*, 98 YALE L.J. 127 (1988). The criticisms can be identified as making two main points:

First, the court is criticized for not giving sufficient consideration to the fifty percent premium included in the offer price.

The author's view is that this criticism treads on dangerous grounds because it hits at the heart of the business judgment rule. It is clear that the judges were not concerned with determining for themselves the intrinsic value of the corporation or whether $55 constituted a fair price. Instead, they were investigating the *process* by which the directors arrived at the decision. They therefore looked at *how* the decision was made. If the courts focused on the premium offered by the bidder, it would be tantamount to actually making a judgment on the merits of the business decision, something which goes directly against the purpose of the business judgment rule. To suggest that the court should have given more weight to the premium would be asking the court to ignore the business judgment rule shield which has traditionally protected the directors.

It was unfortunate for the directors in Trans Union that deference to the business judgment rule cost them an unfavorable judgment. However, it is surely to the benefit of directors as a body for courts to adhere to the rule and refrain from investigating the merits of every litigated business decision.

Second, it has been argued that it was reasonable for the directors to rely on Van Gorkom because he was the chairman and had many years of experience with the corporation. He was the most knowledgeable and, being the largest shareholder, had every incentive to make the best deal. In the author's opinion this justifies some reliance, but not total reliance on Van Gorkom. This is discussed further in the subsequent paragraphs in the main text.

34. *See* text accompanying notes 26 and 30.

B. *In re Dataproducts Corporation Shareholders Litigation*[35]

The former shareholders of Dataproducts Corporation ("Dataproducts") challenged the merger of Dataproducts with another corporation. They claimed, *inter alia*, that the directors had breached their fiduciary duty of care by announcing the merger price before news of the corporation's favorable earnings results were released. In so doing, they caused the merger price to appear more attractive than it actually was.

The Delaware Court of Chancery dismissed the claim[36] by virtue of Article Fifteenth of Dataproducts' certificate of incorporation which read:

> A Director . . . shall not be personally liable to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a director, except that this Article Fifteenth shall not eliminate or limit a Director's liability (i) for any breach of the director's duty of loyalty . . . (ii) for acts or omissions not in good faith or which involve international misconduct . . . ."[37]

The effect of Article Fifteenth was to exempt the directors from personal liability for breach of their duty of care. Since this article was expressly permitted under the DGCL,[38] it was upheld by the court. The court did not proceed further on the claim.[39]

How would a Singapore Court have ruled?

In direct contrast to the DGCL, the Singapore CA expressly nullifies any prior agreement purporting to exempt a director from liability for breach of his duty of care. Section 172(1) of the CA states:

> Any provision whether in the articles or in any contract with a company or otherwise, for exempting any officer . . . from, or indemnifying him against, any liability which by law would

35. 1991 Del. Ch. LEXIS 149.
36. The claim was also dismissed on another ground which is not relevant for our discussion.
37. 1991 Del. Ch. LEXIS 149. *12
38. *See* text accompanying note 11.
39. The plaintiff also made several other allegations which the court did investigate substantively.

> otherwise attach to him in respect of any negligence . . . shall be void.

This provision applies to directors since the definition of "officer" includes directors. In accordance with this statutory provision, the Singapore court would have declared Article Fifteenth void. It would then have proceeded to investigate the alleged breach of the duty of care.

C. *Canal Capital Corporation v. French*[40]

The plaintiff, a stockholder of Canal Capital Corporation ("Canal") brought an action charging the defendant directors with, *inter alia*, breach of the fiduciary duty of care. The directors had caused Canal to enter into investment advisory contracts with two corporations ("IA Cos") which were controlled by one of the directors.[41] Under the contracts, the IA Cos had complete authority over Canal's investment portfolio. After losses were incurred in the first year, the directors did not cancel the contracts with the IA Cos; although they had the power to do so at all times.

The Delaware Chancery Court held that the directors did not breach their fiduciary duty of care by contracting out the function of making investment decisions. The ability to cancel the contracts meant that the directors maintained control over the IA Cos. Assuming they exercised due care when selecting the corporations, they had not breached their duty. As to the decision of continuing the investment contracts notwithstanding the losses, this came within the purview of the business judgment rule and would not be "second-guessed" by the court.

How would a Singapore court have ruled?

While Singapore law allows directors to delegate their functions, a Singapore court would have approached the issue differently. Here again, the decision of *Daniels v. Anderson*[42] would have served as persuasive authority.[43]

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40. 1992 Del. Ch LEXIS 133.
41. Allegations were also made that the directors breached their duty of loyalty.
42. (1995) 16 A.C.S.R. 607 (Court of Appeal, New South Wales).
43. The importance of this case is supported by the numerous academic commentaries on it. For example, *see* Roman Tomasic, *Modernising the Rules of Corporate Governance-The AWA case on appeal*, 1995 AJCL LEXIS 43, commenting that, "given the breadth of the majority view in this

In *Daniels v. Anderson*, the court scrutinized in great detail the level of control which Hooke (the CEO and director) had over Koval, the officer in charge of the FX operation. Taking into consideration the risky nature of foreign exchange dealing, the court imposed a strict standard of care on Hooke. Hooke's appointment of his general manager and chief financial officer (who were general financial experts) to oversee the FX operation was deemed inadequate because they were not specialists in foreign exchange dealing. The court held Hooke to have been required to establish a proper system of internal controls and maintain a proper record of books with which to supervise Koval's activities. Hooke was found negligent in failing to do so.

On the facts of *Canal*, a Singapore court would have expected the directors to exercise a high level of care with respect to investment decisions since such matters also involve high risk. Although the directors of Canal delegated the function to professional bodies (a factor in their favor as compared to Hooke who failed to do so), a Singapore court referring to the Australian judgment would have expected the directors to retain some control over the IA Cos' investment decisions.[44] At the very least, they should have set up a system with which to effectively oversee the investment decisions made by the IA cos. The ability to assess the performance of the IA Cos would have been deemed even more vital after losses were incurred in the first year.

Simply retaining the power to cancel the contracts while giving the IA Cos free reign over investment decisions would not suffice in the eyes of a Singapore court. More would be expected of a director who is duty bound to exercise "reasonable care" and who does not have the protection of the business judgment rule.

V. COMPARATIVE ANALYSIS

It is clear from the above discussion that while similarities exist

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NSW Court of Appeal decision and its reliance upon leading authorities from other common law jurisdictions, the AWA decision may have wider implications in the Asia-Pacific region").

44. *Id.*, at 3 (describing this case as one stating that "directors should not be able to avoid liability merely by claiming that they had delegated responsibility for matters affecting the corporation . . . to outside experts, especially when directors had been put on notice that the company was facing problems").

between the approaches of the Delaware and Singapore courts, the differences are even more significant.

The Delaware Court supports limited judicial intervention through the business judgment rule which is presumed to apply unless rebutted.[45] In determining whether a director has breached his duty of care, the court attaches liability only when there is gross negligence. Even then, the director can be exempted from personal liability if the corporation's charter contains a clause to that effect. Such a clause is expressly permitted in Delaware statutory law.

As for the Singapore Court, owing to the absence of an equivalent business judgment rule, there appears to be no reservation in investigating the merits of the director's business decision. While policy considerations favoring less judicial intervention have been enunciated, they have not played a significant role in influencing the court's approach. Instead, the Court meticulously investigates every act of the director to determine if he was negligent. More significantly, the standard of negligence that results in liability is ordinary negligence and not gross negligence. If a director is shown to be negligent, he cannot rely on any prior agreement exempting him from liability. Such an agreement, even if incorporated into the corporation's charter, will be rendered void under Section 172(1) of the CA. It should be noted though, that section 172(1) does not prevent shareholders from agreeing *after* the breach to release the director from liability for *that specific breach.*[46] However, it has been suggested that in the case of a forbearance to sue, the unanimous decision of all shareholders must be obtained.[47] A director who is proven to be negligent will find it extremely difficult to obtain the understanding of all the shareholders. In contrast with Delaware law, the law of Singapore appears strict and unforgiving.

The Australian Court has attempted to justify a high expectation of directors[48] by maintaining that there is adequate protection for directors under another provision of Australian law. The relevant law is Section 1318 of their Corporations Law. A court is empowered to relieve a

45. The burden is on the plaintiffs to show that the rule does not apply because the directors were not informed, interested or independent.

46. The reasoning is that, notwithstanding section 172(1) of the CA which prohibits prior blanket exemptions, a corporation still retains its right to elect not to sue the negligent director.

47. *See* WALTER CM WOON, COMPANY LAW 229 (1st ed. 1988).

48. *See* text accompanying note 19.

director from liability if he acted honestly and, having regard to all the circumstances, ought fairly to be excused from negligence. The author agrees that this section affords significant protection. A director who is negligent, though not grossly negligent, and who did not profit from his breach might well be excused.

Unfortunately, such is not the position for Singapore. Section 391 of the CA which is equivalent to the Australian provision, has an additional requirement. In addition to acting honestly, the director must have acted "reasonably" as well.[49] If a director is judicially determined to be negligent, it would be almost impossible to satisfy the requirement of reasonableness. Hence, the section does not protect directors who are honest but guilty of ordinary negligence.

VI. RECOMMENDATIONS

The consequence of imposing a high standard of care with no allowance for honest mistakes increases directors' risk aversion. Directors, especially those in management positions, have much at stake in the corporation. If the business fails, directors will not only lose their jobs but suffer a loss in reputation. The loss in reputation hurts them significantly as it diminishes future prospects of securing good jobs and lowers the salary that they can command. Unlike professional advisors like auditors who serve many firms, directors serve only one or, at most, a few firms, and are not able to spread their risk of liability. These factors all contribute to a director's risk aversion. This risk aversion is enhanced if directors know that their decisions can be easily challenged by shareholders through court action.

Excessive risk aversion by directors works to the detriment of shareholders. Shareholders cannot reap good returns on their investments if directors are too cautious, as projects with the potential for high returns usually carry high risk. Alternatively, even if directors do invest in risky high-yield projects, these will be done only after excessive defensive measures are taken. These measures usually take the form of overinvesting in information or consultation which in turn translate into higher transaction costs to be ultimately borne by shareholders.

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49. Section 391 provides that a director may be relieved from liability if "he has acted honestly and reasonably and... having regard to the circumstances... ought fairly to be excused".

More importantly, society as a whole will suffer. The growth of corporations and the industry will be stifled by undue conservatism in business decision making. If the economy of a country is to develop, its business community must display entrepreneurial flair and accept commercial risks to produce a sufficient return on capital invested.

The Singapore government has recognized the need for its businessmen and women to display a "spirit of entrepreneurship". In order to sustain the high growth rate of its economy, it has called on the Singaporean business community to be entrepreneurial, innovative and competitive.[50] Policies have been implemented to induce this form of behavior. For example, the Government has approved the establishment of a new University, specializing in management education. Named the "Singapore Management University", its mission is to "develop entrepreneurial, knowledgeable and responsible men and women capable of leading in a dynamic global environment."[51] Another significant move has been the revision of the bankruptcy laws to create a less hostile environment for unsuccessful ventures. In 1995, when the new Bankruptcy Act was enacted, a more liberal regime for bankruptcy discharges was put into place. The objective for this change is to "encourage entrepreneurship", especially in cases whereby bankruptcy arises from "misfortune rather than malpractice."[52]

In line with this move, the Singapore Parliament[53] should consider revising section 391 of the CA to remove the "acting reasonably" requirement. In so doing, leniency can be displayed towards an honest director who, in an effort to expand the corporation's business, acts without the requisite level of caution. If hasty decisions are made out of a desire to secure an opportune business opportunity for the corporation, the court should be given discretion to excuse the director. By creating such a safety

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50. In April 10, 1999, it was reported in the Singapore Straits Times that the Government was launching an $1 billion US$ Technopreneurship Investment Fund to attract more venture capitalists into Singapore. This was viewed as one aspect of a broadly based strategy to encourage entrepreneurship and to change attitudes towards risk and failure.

51. The Official Mission Statement of the University is "[t]o be a world-class university for education and research, with stimulating and diverse programs to develop entrepreneurial, knowledgeable and responsible men and women capable of leading in a dynamic environment," as reported at its website at <u>http://www.smu.edu.sg.</u>

52. *See* Official Assignee & Public Trustee of Singapore, *A guide to the New Bankruptcy Act 1995*, issued by the Official Assignee & Public Trustee Office of Singapore.

53. The Singapore Parliament is the legislative body of the government.

net for honest directors, a director would be assured enough to assume risks to benefit the corporation.

In addition, the Singapore courts would do well to observe the approach taken by the Delaware court. It is no coincidence that the Delaware legal system exists side by side with an extremely vibrant US business community. The attitude of the court has no doubt contributed to the existence of a developed and mature business environment.

The author does not advocate that the Singapore court adopt the standard of "gross negligence" for, in her view, a director who is entrusted with a high level of power should be required to exhibit a commensurate level of care. Since sufficient proximity exists between the director and the shareholders, the duty of care under the tort of negligence which attaches liability for ordinary negligence should be imposed.

However, a move towards moderating the level of judicial intervention through the business judgment rule is recommended. As previously discussed, the business judgment rule serves an important function of encouraging directors to assume commercial risks which are justified by legitimate business concerns. The benefits of this rule should be tapped by Singapore.

Obviously, the importation of the business judgment rule requires careful planning in light of the significant differences that already exist between Singapore and Delaware law. As a preliminary suggestion, the author would recommend the adoption of the presumption contained in the rule. With this presumption, a court cannot interfere with the merits of a business decision unless the plaintiff shows cause why the rule should not apply. Such an approach accords some respect to a director's decision and implicitly recognizes the difficulties and risks inherent in directors' decision-making. It will create a conducive and less stifling business environment for the development of a Singaporean "entrepreneurial spirit."

VII. CONCLUSION

There is no right or wrong approach to the law. Although the Delaware and Singapore courts approach a director's duty of care differently, each court does so to suit the needs of its society. However, as the needs of society change with time, each court has a duty to adapt its approach accordingly. It is hoped that in line with the government's call for entrepreneurship, the Singapore legislative body and court will take up the challenge of modifying their approach in the manner that has been suggested. Such a move will ensure Singapore's continued economic growth in the twenty-first century.