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Keay, A, Loughrey, J, McNulty, T, Okanigbuan, FA and Stewart, A (2020) Reviewing Directors' Business Judgements: Views from the Field. Journal of Law and Society, 47 (4). pp. 639-665. ISSN 0263-323X

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Reviewing Directors' Business Judgements: Views from the Field

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Okanigbuan,+ Ms Abigail Stewart**

Directors take decisions that can have significant impacts on others as illustrated by the global financial crisis and the collapse of Thomas Cook Group plc. Yet many academics argue that courts should not review or impose liability on directors for poor business judgments. These arguments often rely on untested empirical assumptions about directors' behaviour and attitudes. Through semi-structured interviews and focus groups with directors, company secretaries, and others we explored their responses to the prospect of judicial review of directors' business judgment. Our findings challenge orthodox thinking: many directors supported some form of review and the impact of review may not be as great as the literature predicts, nor necessarily detrimental. The debate about whether courts should review directors' business judgment should therefore move away from reliance on negative empirical assumptions about the impact of review, to clearly articulating, and engaging with, normative positions that underpin opposition to, and support for, review.

INTRODUCTION

The global financial crisis and high profile corporate collapses, such as BHS Ltd and Carillion plc, resulted in much public criticism of directors. Directors have been required to explain themselves before parliamentary committees and rebuked by politicians and a hostile media.¹ The policy response has been a renewed focus on corporate governance reform. In 2018, Grant Thornton stated

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¹ For example, Business, Energy and Industrial Strategy and Work and Pensions Committees, Oral evidence: Carillion, HC 769 6th February 2017

<<http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/work-and-pensions-committee/carillion/oral/78103.pdf>>

that ‘(t)he UK is witnessing a battle to restore trust in business...Governance is more in the spotlight than at any time since the “Maxwell years”’.² However, importantly for this paper, in contrast to ‘the Maxwell years’, the conduct for which directors have been criticised is not, in general, fraud and siphoning off corporate assets, but business decisions that had disastrous outcomes, albeit in some instances allegedly as a result of greed, an overly short-termist perspective, and a disregard for the interests of a broader range of stakeholders than shareholders.³ This led to demands for individual accountability of those in charge of companies that, whilst not always explicit, often seem directed to some form of legal accountability.⁴ Yet directors have faced little legal accountability in the civil courts for poor business judgments that underpin recent corporate collapses.⁵ The Government has often shied away from legislative measures directed at such accountability, asserting that the existing regime for enforcing directors’ duties ‘works’.⁶ This has resulted in a disjunction between on the one hand populist debate, which has focused on the lack of ex post sanctioning of public company directors, and, on the other, Government initiatives, which, outside the financial sector, has largely focused on soft law, disclosure, market discipline and, insofar as hard law sanctioning goes, measures that are most likely to target private company directors.⁷

² Grant Thornton, *Corporate Governance Review 2018*, 3.

³ K. Burgess, ‘Carillion’s board: misguided or incompetent? The directors ticked all the good governance boxes, yet the contractor still collapsed’ *Financial Times*, 17 January 2018.

⁴ For example Parliamentary Commission on Banking Standards, *Changing Banking For Good*, HL 27-I, (12 June 2013), 10

⁵ M. Moore, ‘Redressing Risk Oversight Failure in UK and US Listed Companies: Lessons from the RBS and Citigroup Litigation’ (2017) 18 *European Business Organizations Rev.* 733, at 736-737.

⁶ *Insolvency and Corporate Governance: Government Response* (August 2018) 26.

⁷ Small Business and Enterprise Reform Act 2015 Pt 9; Financial Reporting Council, *The Wates Corporate Governance Principles for Large Private Companies* (December 2018).

Some have argued that this is because debates over corporate governance reform in the wake of crises are often captured by elite corporate actors and their representatives.⁸ Yet many academics agree that directors should not be exposed to the risk of greater liability for business decisions, often grounding their normative arguments on untested empirical assumptions about the behaviour, understandings and attitudes of those involved. For example, it is often argued that imposing liability upon directors for business judgments will deter able people from becoming directors, or will encourage defensive decision-making.⁹ Yet there have been no studies of directors' responses to the prospect of review and liability and whether these accord with the predictions of the literature. This paper makes a novel contribution to this debate. Through a series of semi-structured qualitative interviews and focus groups it investigates the views of those most directly involved, namely directors, company secretaries and legal practitioners who have advised, or acted for or against directors. Whilst directors can be sanctioned for breaches of the criminal law, or for breaching their fiduciary duties, this paper focuses on attitudes to the prospect of judicial review of business judgments that could lead to civil or administrative liability, for example in shareholder derivative litigation, or litigation brought on the company's behalf by liquidators, or in disqualification proceedings brought by the Insolvency Service.

Empirical research has 'to test our basic assumptions about the world.'¹⁰ To this end we explored whether our interviewees' worldview and experience supported the dominant view in the literature that favours directors' business judgments not being reviewed in the courts. We found that

⁸ M. Price et al, 'From Cadbury to Kay: Discourse, intertextuality and the evolution of UK Corporate Governance' (2018) 31 *Accounting Auditing & Accountability J* 1542; See also M. MacLean et al, *Business Elites and Corporate Governance in France and the UK* (2006) 47; C. Woll, 'Politics in the Interest of Capital: A Not-so-Organized Combat' (2016) 44 *Politics & Society* 373.

⁹ L. Johnson, 'Unsettledness in Delaware Corporate Law : Business Judgment Rule, Corporate Purpose' (2013) 38 *Delaware J. of Corporate Law* 405; A. Gurrea-Martinez, 'Re-Examining the Law and Economics of the Business Judgment Rule' (2018) 18 *J. Corporate Law Studies* 417, at 422.

¹⁰ A. Dignam and P. Oh, 'Disregarding the Salomon Principle: An Empirical Analysis, 1885-2014' (2019) 39 *Oxford J. Legal Studies* 16, at 19.

although interviewees shared reservations regarding the courts' capacity to conduct review, most, though by no means all, nevertheless supported the idea of review. Our findings indicate that the empirical assumptions upon which many orthodox objections to review are based, are contestable and cast doubt on whether the impact of increased judicial scrutiny of directors' decisions would be as great as predicted. The study also challenge assumptions that this impact would necessarily be detrimental, because even when interviewees agreed on the effects of review, opinions diverged on whether these effects were positive or negative. These responses highlight that how one interprets and weighs empirical claims is not a value neutral exercise, but a normative one.

This article is organised as follows. It first examines the literature against review of, and the imposition of liability upon, directors for business judgments. The next section sets out the rationales for exploring the views of directors, company secretaries and legal practitioners, and the methodology adopted. Following this, we present and analyse the data. The paper concludes by considering how our findings can augment the debate about judicial review of business judgments.

THE ARGUMENTS AGAINST JUDICIALLY REVIEWING DIRECTORS' BUSINESS JUDGMENTS

The main academic arguments against review of directors' business judgments by the courts can be broadly divided into two categories: (i) objections based on the role of the courts and (ii) objections based on the impact on directors and decision-making. These will be considered in turn, but they are only sketched due to space constraints. It should be noted that much of the literature discussed is American, as the majority of publications in this area are American. However arguments about whether directors' business judgment should be reviewed are generally equally applicable in both the US and the UK and, indeed, to other jurisdictions.

1. The Role of the Courts

(a) Court review lacks legitimacy

An American court has said that the institutional competence of boards of directors should be trusted in preference to that of courts in relation to business decisions.¹¹ Importantly, according to many, when directors make decisions they know that they might be removed or not re-elected, or they may encounter discipline from the markets, whereas judges are not usually subject to such consequences when pronouncing on matters that were before directors.¹² Directors are in fact more accountable than judges. If directors make the wrong decisions they can be held accountable in multifarious ways, such as to the board, shareholders, the markets, and they could even have to give account to a court.¹³ In contrast judges are arguably not accountable to anyone. They are appointed until they attain a certain age. They can only be removed on very limited grounds. The only mechanism that might constitute one of accountability is that of appeal at which time a judge's decision can be said to be wrong.

(b) Jurisdiction to Review Excluded/Limited

It has been argued that shareholders have agreed through the terms of the articles of association to delegate decision-making power to boards and so decisions of boards should only be

¹¹ *W. Pont-Pepperell Inc v. J.P. Stevens & Co* 542 A.2d 770 at 780 (Del Ch 1988).

¹² See, L. Johnson, 'Corporate Officers and the Business Judgment Rule' (2005) 60 *Business Lawyer* 439, at 457. D. Fischel, 'The Business Judgment Rule and the Trans Union Case (1985) 40 *Business Lawyer* 1437, at 1443; M. Legg and D. Jordan, 'The Australian Business Judgment Rule after ASIC v Rich: Balancing Directors' Authority and Accountability' (2014) *Adelaide Law Rev.* 417.

¹³ See S. Bainbridge, 'The Business Judgment Rule as Abstention Doctrine' (2004) 57 *Vanderbilt Law Rev.* 83, at 122.

subject to judicial review in limited cases, such as in self-dealing situations.¹⁴ Actual agreement by shareholders is impossible in large companies, but it is nevertheless argued that as rational beings shareholders would be willing to agree by contract ex ante to refrain from impugning the reasonableness of directors' business judgments, and one should treat such a hypothetical agreement as binding.¹⁵ Although directors' business judgments may lead to bad consequences for many reasons, shareholders knowingly take this risk when they appoint the directors.¹⁶ Shareholders will actually want directors to take greater risks as these may well produce greater benefits. It is in the shareholders' interests that the law does not incentivise a cautious approach to decision-making.¹⁷ Easterbrook and Fischel assert that the very thing that is behind the business judgment rule, a rule of law that protects directors' judgments from review by the courts, is an acknowledgment that shareholder value would be lower if directors' decisions were subjected to review.¹⁸ This accords with the often advocated notion that there should be limited judicial intrusion into private sector business decision-making.¹⁹ These arguments are normative in nature and treat companies as private institutions, disregarding any wider impact directors' decisions may have.

(c) Judges lack experience and ability

¹⁴ D. Telman, 'The Business Judgment Rule, Disclosure and Executive Compensation' (2007) 81 *Tulane Law Rev.* 829 at 840, 850.

¹⁵ Bainbridge, *op.cit.*, n. 13, p. 115.

¹⁶ B. Black, 'The Principal Fiduciary Duties of Boards of Directors' 4 April 2001, Third Asian Roundtable on Corporate Governance, Singapore at 6 <<http://www.oecd.org/daf/ca/corporategovernanceprinciples/1872746.pdf>>

¹⁷ *Joy v. North* 692 F. 2d 880 at 885 (1982).

¹⁸ *The Economic Structure of Corporate Law*, (1991) 93.

¹⁹ American Law Institute, *Principles of Corporate Governance: Analysis and Recommendations*, 1994, 176.

Many commentators argue that judges are not business experts and so not able to review directors' decisions.²⁰ Fischel for example states the frequently espoused line that: 'Courts ... do not possess the experience, expertise, or information necessary to make complicated business decisions.'²¹ It has also been suggested that judges do not have the expertise to assess business judgments as the quality of a judgment cannot always be evaluated on the basis of results, and that judges 'lack an intangible "sense" of the specific circumstances confronting a business.'²² Directors' decisions may lead to bad results for many reasons and it is likely that courts are not able to ascertain whether this was due to bad business judgments.²³ According to Oesterle, judges lack business experience and 'clever lawyers and paid experts will ably add to the confusion.'²⁴ Rosenberg has said that 'the real problem with reviewing bad decisions by corporate directors...is that courts will sometimes get it wrong in determining how and why directors got it wrong.'²⁵

Bainbridge has maintained that judges suffer from information asymmetry, as courts might not be apprised of all the necessary information for making a decision, due to time and cost, which impedes them in making a fair decision about what directors did.²⁶ In contrast Easterbrook and Fischel argue that with disclosure in the litigation brought against directors, judges have access to more information, and more time to consider the issue confronting directors, than directors will

²⁰ For example, B. Cheffins in *Company Law: Theory, Structure and Operation* (1997), 543; F. Treim, 'Judicial Schizophrenia in Corporate Law : Confusing the Standard of Care with the Business Judgment Rule' (2007) 24 *Alaska Law Rev.* 23 at 28.; D. Osterle, 'Corporate Directors' Personal Liability for 'Insolvent Trading in Australia, 'Reckless Trading' in New Zealand and 'Wrongful Trading' in England : A Recipe for Timid Directors, Hamstrung Controlling Shareholders and Skittish Lenders' *Company Directors' Liability for Insolvent Trading*, ed. I. Ramsay (2000) 38.

²¹ D. Fischel, 'The Corporate Governance Movement' (1982) 35 *Vanderbilt Law Rev.* 1259, at 1288. See also Bainbridge, *op.cit.*, n. 13, p. 119; E. Posner, 'A Theory of Contract Law Under Conditions of Radical Judicial Error' (2000) 94 *Northwestern University Law Rev.* 749, at 758.

²² Johnson, *op.cit.*, n. 9, p. 456.

²³ Black, *op.cit.*, n 16.

²⁴ Osterle, *op.cit.*, n. 20, p. 38.

²⁵ D. Rosenberg, 'Supplying the Adverbs : The Future of Corporate Risk-Taking and the Business Judgment Rule,' 10 < <https://www.baruch.cuny.edu/.../documents/BriloffPrizeFac08-DavidRosenberg.doc>>.

²⁶ Bainbridge, *op.cit.*, n. 13, pp. 118-20.

have had, and thus judges should not pronounce on what directors decided;²⁷ the judges are in a much better position *ex post*. This presents the possibility of a no-win situation for judicial review. If judges have too little information they are not competent, but the same conclusion is drawn if we say that they have a lot of information.

Other commentators suggest problems with the disposition, rather than expertise or ability of judges. Bainbridge argues that judges will shirk, that is, decide cases with minimal effort, when encountering claims against directors, because of bounded rationality, the complexity of many cases, and hindsight, and they will embrace short-cuts.²⁸ In litigation brought by liquidators when the company is insolvent, it has been contended that the judges' sympathy will be with the trade creditors who have suffered losses and against the directors who oversaw the company's demise.²⁹ The suggestion appears to be that the courts will hold directors liable as a matter of course because the judges have seen the unfortunate consequences of the directors' judgment, which can be far-reaching.

Whilst these appear to be empirically grounded objections to the courts' capacity to review directors' decisions, they are contestable. For example as Fischel points out, the argument that judges are not qualified to evaluate business judgments does not address the fact that the same judges are regarded as being able to deal with other complex commercial disputes.³⁰

(d) Hindsight bias

It has been widely stated that if judges review directors' business judgments there is the danger that they will make decisions based on hindsight bias. 'Hindsight bias' is the tendency to 'assign an

²⁷ Op cit., n. 18, p. 100.

²⁸ Bainbridge, op.cit., n. 13, p. 119.

²⁹ Osterle, op.cit., n. 20, p.38. Also, see H. Butler and L. Ribstein in 'Opting Out of Fiduciary Duties: A Response to the Anti-Contractarians' (1990) 65 *Washington Law Rev.* 1, at 56.

³⁰ Op.cit., n. 12, p. 1438.

erroneously high probability of occurrence to a probabilistic event simply because it ended up occurring.³¹ Persons who know the outcome of a particular event can exaggerate the extent to which the outcome could have been foreseen.³² They ‘tend to assign an erroneously high probability of occurrence to a probabilistic event simply because it ended up occurring.’³³ Judges hear cases about directors’ business judgments well after those judgments were made and very often the unfortunate consequences of those judgments are adduced in evidence. This, it is argued, will have an effect on judges in that they may well regard such outcomes as foreseeable and thus able to be prevented.³⁴ There are clear comments from several English cases that demonstrate that judges are alive to the fact that they must not use hindsight in coming to their decisions.³⁵ For instance, in *Re Sherborne Associates Ltd*, the judge expressed the view, frequently cited subsequently, that it is dangerous to assume that ‘what has in fact happened was always bound to happen and was apparent.’³⁶

(e) *Directors and Decision-making*

³¹ Bainbridge, op.cit., n. 13, p. 114. Also, see H. Arkes and C. Shipani, ‘Medical Malpractice v the Business Judgement Rule: Differences in Hindsight Bias’ (1994) 73 *Oregon Law Rev.* 587, at 588; W. Allen, J. Jacobs and L. Strine, ‘Realigning the Standard of Review of Director Due Care with Delaware Public Policy: A Critique of *Van Gorkom* and Its Progeny as a Standard of Review Problem’ (2002) 96 *Northwestern University Law Rev.* 449, at 455.

³² Arkes and Shipani, id. p.588.

³³ Bainbridge, op.cit., n. 13, p. 114 referring to C. Jolls et al, ‘A Behavioral Approach to Law and Economics’ (1998) 50 *Stanford Law Rev.* 1471, at 1523.

³⁴ J. Mannolini ‘Creditors’ Interest in the Corporate Contract: A Case for the Reform of our Insolvent Trading Provisions’ (1996) 6 *Australian J. of Corporate Law* 14, at 38; Cheffins, op.cit., n. 20, p. 543; Bainbridge, op.cit., n. 13, p. 114; J. Farrar, ‘Corporate Governance, Business Judgment and the Professionalism of Directors’ (1993) 6 *Corporate and Business Law J.* 1, at 22; Allen et al, op.cit., n. 31, p. 454.

³⁵ For example, see *Ball v. Hughes* [2017] EWHC 3228 (Ch), [85]-[86]; *Wessely v. White* [2018] EWHC 1499 (Ch), [42].

³⁶ [1995] B.C.C. 40, 54. See also Lewison J. in *Secretary of State for Trade and Industry v. Goldberg* [2004] 1 B.C.L.C. 597, 613 making the same point in relation to an assessment of a director’s conduct in an application under the Company Directors’ Disqualification Act 1986.

(i) *Impact on Directors*

It is often claimed that if judges review directors' business judgments this will discourage people, especially good well-qualified people, from accepting directorships.³⁷ There has been some anecdotal evidence to the effect that people are now more wary about becoming directors, because of concerns about potential risks of liability and this will be exacerbated if directors' business judgments can be judicially reviewed.³⁸

Whilst these arguments are based on empirical claims, a related normative argument is that it is unfair to expose directors, particularly non-executive directors (NEDs), to significant liabilities arising from good faith decisions, given that there is great discrepancy between, on the one hand, the potential risk to directors' personal finances if they are found liable for a judgment, (assuming they are not protected by insurance), and, on the other, the reward they secure from remuneration.³⁹ It is also said to be unfair to hold NEDs to account for board decisions when the information they need to assess the decision may have been withheld from them by the executives upon whom they must rely.⁴⁰ It is argued that Directors and Officers Insurance (D&O)⁴¹ would not necessarily neutralise these risks: damages awards could exceed policy limits;⁴² cover can be subject to

³⁷ Arkes and Shipani, *op. cit.*, n. 31, p.624; D. Arsalidou, 'Objectivity versus Flexibility in civil law jurisdictions and the possible introduction of the business judgment rule in English law' (2003) 14 *Company Lawyer* 5, at 5.

³⁸ F. Gibb, 'Directors chilled by the fear of financial liability' *The Times*, 23 September 2003; R. Baldwin, 'The New Punitive Regulation' (2004) 57 *Modern Law Review* 351, at 362; K. Vijayraghavan et al, 'More independent directors take the exit fearing legal scrutiny,' *Economic Times*, 21 June 2019:

<https://economictimes.indiatimes.com/news/company/corporate-trends/more-independent-directors-take-the-exit-fearing-legal-scrutiny/articleshow/69883746.cms?from=mdr>.

³⁹ Allen et al, *op.cit.*, n. 31, p. 455.

⁴⁰ D. Kershaw, *The Foundations of Anglo-American Corporate Fiduciary Law* (2018) 55.

⁴¹ V. Finch, 'Personal Accountability and Corporate Control: The Role of Directors' and Officers' Liability Insurance' (1994) 57 *Modern Law Review* 880; J. Tarr, 'Directors' and officers' insurance: recent critical issues in Australia and New Zealand' (2016) *J. of Business Law* 1.

⁴² Arkes and Shipani, *op. cit.*, n. 31, pp. 619-620.

exclusions, for example where directors are also shareholders and are sued by their companies;⁴³ and insurance cannot protect against the effects of disqualification. In addition greater review of business judgments by the courts could lead to insurance becoming unavailable or too expensive.⁴⁴

(ii) *Impact on Decision-making*

Linked to the above is the argument that if directors perceive that judges can review their decisions they will feel as if the courts are looking over their shoulders and will be more cautious in taking risks.⁴⁵ It will make them more concerned about protecting their own positions than taking on risk, and lead to directors failing to maximise wealth for the benefit of shareholders.⁴⁶ They will be less inclined to embrace risks in pursuing aggressive strategies which are likely to foster economic growth and less willing to take their companies into new markets, develop new products or adopt rational business risks.⁴⁷

This tendency to risk aversion could be increased by the fact that directors of large private companies and public companies may not hold any shareholding, or relatively few shares, in their companies. As they will therefore obtain no direct, major benefit from engaging in certain kinds of

⁴³ R. Merkin, 'Directors' and Officers' Insurance and the Global Financial Crisis' (2009) 118 *J. of the British Insurance Law Association* 2, at 10.

⁴⁴ Arkes and Shipani, *op. cit.*, n.31, pp. 619-620.

⁴⁵ M. Eisenberg, 'The Duty of Care of Corporate Directors and Officers' (1989) 51 *University of Pittsburgh Law Rev.* 945, 964.

⁴⁶ B. Manning, 'The Business Judgment Rule and the Director's Duty of Attention: Time for Reality' (1984) 39 *Business Lawyer* 1477, 1491; H. Glasbeek, 'More Direct Director Responsibility: Much Ado About...What?' [1985] *Can Bus. Law J.* 416, at 421; Osterle *op.cit.*, n. 20.

⁴⁷ M. McMurray, 'Special Project Director and Officer Liability, An Historical Perspective on the Duty of Care, the Duty of Loyalty, and the Business Judgment Rule', (1987) 40 *Vanderbilt Law Rev.* 605, at 617; Telman, *op.cit.*, n. 14, p. 840.

risk, they are likely to be more cautious than shareholders about assuming these risk.⁴⁸ Thus a judicial standard of review that too severely imposes liability on directors for unwise decisions may exacerbate a tendency toward ‘sub-optimal risk acceptance’ and deter socially desirable decisions that could produce greater profits.⁴⁹ Some limited empirical research supports these fears, finding that judicial scrutiny in relation to business decisions smothers growth in those sectors with high-growth opportunities.⁵⁰ It has also been found that insurance may mitigate or eliminate these effects.⁵¹

Judicial review might also increase costs and produce a less efficient use of company resources. If judges regularly review directors’ judgments, it is likely that directors will engage in more monitoring, such as greater record-keeping, so as to risk-minimise. This means that transaction costs will be higher which will reduce shareholder dividends. This is not favoured by many contractarians who take the view that higher transaction costs are likely to prevent resources being put to the most allocatively efficient use (the maximum productive use of resources).⁵²

EXPLORING THE VIEWS OF MARKET ACTORS: STUDY DESIGN AND METHODS

In a series of semi-structured qualitative interviews and focus groups undertaken with directors, company secretaries and legal practitioners between August 2017 and November 2018, we explored interviewees’ views regarding whether courts should review directors’ business judgments and the potential impact on directors of review. There were several rationales for this. First, as

⁴⁸ Johnson, op. cit. n. 9.

⁴⁹ *Gagliardi v. Trifoods Int'l, Inc.*, 683 A.2d 1049, 1052 (Del. Ch. 1996); Allen et al, op.cit., n. 31, p. 455; A. Gurrea-Martinez, op. cit. n. 9, p. 421.

⁵⁰ Y. Grinstein and S. Rossi, ‘Good Monitoring, Bad Monitoring’ (2016) 20 *Rev. of Finance* 1719.

⁵¹ J. Ho Hwang and B. Kim, ‘Directors and Officers Liability Insurance and Firm Value’ (2018) 85 *J. of Risk and Insurance* 447.

⁵² A. Keay, ‘Wrongful Trading and the Liability of Company Directors: A Theoretical Perspective’ (2005) 25 *Legal Studies* 431.

discussed, a number of arguments against review are based upon assumptions about how review would impact on directors and directors' decision-making. However no research has been conducted exploring what directors' attitudes to review are, or what they report the impact of review has been or would be. If directors confirm the predictions in the literature this would tend to support arguments against review, but if they do not then these arguments are weakened.

Understanding the normative views of market actors regarding judicial review of business judgment is important for other reasons. The views of directors, and their advisors can influence policy and laws governing business, including proposals concerning directors' accountability for their decisions. The existence of such influence has long been assumed.⁵³ It is visible in the extent to which Government responses to policy consultations accept the views of the business community,⁵⁴ but it can be also less visible as illustrated by the remarks of this FTSE 100 Company Secretary:

... when we designed the 2006 Act ...so that there was a possible right to bring a derivative action ...there was a real worry that there would be a plethora of US attorneys coming over. So that was why the two-stage approach was put into the Companies Act to make sure that there were no frivolous claims being brought against directors.... We sat with officials and put all that in. Now that maybe has worked too well. (FGCS4)⁵⁵

⁵³ R. Brady, *Business as a System of Power* (1943); C. Lindblom, 'The Market as Prison' (1982) 44 *J. of Politics* 324; P. Gourevitch and J. Shinn, *Political Power and Corporate Control: The New Global Politics of Corporate Governance* (2005).

⁵⁴ See for example Department for Business, Energy and Industrial Strategy, *Government Response: Corporate Governance Reform* (August 2017) 53-62 and *Corporate Governance and Insolvency: Government Response* (August 2018) 5-6 and generally.

⁵⁵ FG: focus group participant; CS: Company Secretary/General Counsel. 4: fourth focus group of company secretaries. Other acronyms: D: director; (Int.): international experience of US and/or Australia; LP: legal practitioner; H: headhunter.

This interviewee was not publicly associated with the Company Law Review Steering Group whose work led to the Companies Act 2006, yet described having a material influence over codifying the derivative action that permits shareholders to bring actions on the company's behalf against directors for breach of their duties which could have led to greater review of directors' decisions by the courts.

Whilst directors of unlisted public companies, private companies, and owner-managers are unlikely to have the same ability to influence public policy, their normative views count for other reasons. They are more likely to face judicial scrutiny for poor decisions, often through disqualification for unfitness proceedings under section 6 of the Company Directors' Disqualification Act 1986. Judicial practice in such cases could be influenced by assumptions about the business community's position on the legitimacy and fairness of review. This is not to suggest that judges' decision-making would be directly affected but rather, as Kershaw argues:

Judges cannot divorce components of their personality formed by strong societal and political consensus from their judging practice. These components form their taken-for-granted expectations both of the directorial role and the accountability function of corporate law and regulation.⁵⁶

These expectations are likely to be informed, at least partly, by the generally negative academic commentary regarding the impact and legitimacy of review, and so it is important to know whether these reflect the views of the business community.

Participants were selected using purposive sampling, aiming for a mix of directors from large public UK FTSE listed companies,⁵⁷ other public companies, and private companies,

⁵⁶ Kershaw, *op cit.*, n. 40, p. 58

⁵⁷ A share index composed of the 100 largest UK companies listed on the London Stock Exchange according to market capitalization.

including owner-managed companies.⁵⁸ Interviewees included executive directors and NEDs, board chairs, directors who had experienced court challenges to their decisions, and people with experience of being directors in England and Wales and either Australia and/or the US, in order to explore directors' responses to contrasting legal approaches to reviewing directors' decisions. Unlike the UK, Australia and the US have a business judgment rule of law, which protects directors' judgments from review by the courts, but whilst in the US this has resulted in directors' good faith business judgments being largely immune from court review, in Australia a pro-active corporate regulator has pursued actions against directors for negligence in a number of high profile cases.⁵⁹

We also spoke with company secretaries/in-house counsel and external legal advisors. These groups can influence policy-making in corporate governance and directors' response to the prospect of review. There was no discernible difference in response between these groups and directors to the prospect of judicial review and liability. Finally we explored the views of two board head hunters to ascertain whether they predicted, or had seen in the financial sector, any impact on board recruitment as a result of greater director accountability.

Interviewees came from a wide variety of sectors and industries including the financial sector. The last was of particular interest since we hypothesised that financial sector reforms, such as the Senior Managers Regime (SMR), may have focused directors' minds on the issue of personal liability, thus providing an insight into how directors respond to a real prospect of review and accountability for board decisions.⁶⁰ A mix of approaches were utilized to reach interviewees: advertising through industry groups; letters and emails; and, as the study went on, personal recommendations. Contacts were also made through two meetings organised through a regional

⁵⁸ M. Miles and A. Huberman, *Qualitative Data Analysis: a Sourcebook of New Methods* (1984).

⁵⁹ For example, *ASIC v Rich* [2009] NSWSC 1229; (2009) 236 F.L.R. 1; *ASIC v Healey* [2011] FCA 717; *ASIC v Mariner Corporation Ltd* [2015] FCA 589; *ASIC v Cassimatis (No 9)* [2018] FCA 385.

⁶⁰ Financial Services and Markets Act 2000 Pt 5; For an account of the SMR see I. Chiu, 'Regulatory duties for directors in the financial services sector and directors' duties in company law: bifurcation and interfaces' (2016) 6 *J. of Business Law* 465, at 478-481.

professional network covering ten company secretaries in medium sized enterprises and a national professional network involving twenty four company secretaries of large FTSE 350 companies.

We conducted 24 interviews with directors, four with legal practitioners and two each with company secretaries and head-hunters.⁶¹ There were five director focus groups that included chairs, and three involving seventeen company secretaries/general counsel. Six current FTSE 100, five current FTSE 250, and nine other public company directors took part, together with 23 private company directors. However, the directors interviewed held, or had previously held, positions in more than one type of company. Of the 29 company secretary participants, 14 were based in FTSE 100 companies. In total we reached 110 people.

To gauge reactions to real cases, we developed case-studies based on: cases in which the courts have reviewed or declined to review business decisions;⁶² one based on Royal Bank of Scotland's takeover of ABN-Amro; and one on Carillion Plc. Participants were not told what the case-studies related to nor what the outcome of the cases had been. These provided a focus for discussion and mitigated the risk of biased responses designed to show the interviewees in a good light. We also sought to mitigate social desirability bias by assuring anonymity.⁶³ Case-studies were supplemented by semi-structured questions on the desirability and impact of review that were informed by the arguments in the literature canvassed above. This enabled us to observe and record the approaches participants took to judicial review, and the rationalisations they adopted.

NVivo, a qualitative data analysis computer software package, was used to support the organization and coding of the data. We combed transcripts identifying words, phrases, terms and descriptions used to describe judicial review and scrutiny, taking into account normative considerations as these emerged in discussion. Thereafter, data were coded to develop emerging

⁶¹ As part of our larger study we also interviewed eight judges and two investor groups.

⁶² For example *Secretary of State for Trade and Industry v. Baker (No 5)*[1999] 1 B.C.L.C. 433 (UK) and *Vines v. ASIC* [2007] 62 A.C.S.R. (Aust).

⁶³ D.L. Paulhus, 'Two-component models of socially desirable responding'. (1984) 46(3) *J. of Personality and Social Psychology* 598.

categories and themes around normative arguments. The second step of our analysis involved developing these emerging themes into three first order categories evidencing various normative arguments namely: (i) those supporting judicial deference to directors' business judgment and so non-review of business judgment; (ii) those opposing liability in respect of directors' business judgement; and (iii) those supporting judicial review and liability for business judgment.

Moving iteratively between these and emerging patterns in our data, further conceptual themes began to develop into second order themes.⁶⁴ In relation to the first order categories (i) and (ii), that concerned opposition to liability for and/or review of business judgments, these second order themes related to the dangers of hindsight and judges' lack of business experience, directors reluctance to take board positions, and risk averse business practices. These are discussed in turn in the next section. In relation to first order category (iii), which concerned arguments in support of judicial review and liability, second order themes reflected issues such as societal demands for accountability, deterring poor conduct, and promoting governance best practice. These matters feature throughout this article and inform our conclusions. Whilst our coding was informed by the literature, this approach enabled us to identify matters not covered in the literature, as well as to develop a deeper understanding of existing views.

FINDINGS

1. Legitimacy/Permissibility of Review

The first thing to note is that most directors supported some form of review and some said that it is legitimate in principle, and indeed necessary, for the courts to review directors' decisions. As one director said, if it is assumed that a court cannot review a directors' business judgment: 'that is the

⁶⁴ K. Eisenhardt, 'Building Theories from Case Study Research' (1989) 14 *Academy of Management Rev.* 532.

get out of all get outs, isn't it?' (FGD-3). There was however a range of opinion regarding first, what would trigger review and second, when liability should be imposed.

Regarding the first, directors considered that judicial scrutiny was legitimate when decisions: led to the insolvency of the company; impacted on stakeholders other than shareholders, particularly creditors, and to a lesser extent, employees; had serious, particularly non-economic, impacts; or were seen to raise public interest implications, such as, for example, the decisions of bank directors', because of the systemic risk that banks and financial institutions pose.

A number of directors felt that the quality and integrity of the decision-making process was more likely to be compromised in insolvency situations because of the pressures under which such decisions were made, and also when the interests of stakeholders conflicted with shareholders, because of that conflict, and that this justified such decisions being more closely scrutinised. As one director said: 'those sorts of situations with other stakeholders involved ...should trigger a review because in many cases that (longer term) thinking doesn't get done' (FGD2 (SME)). There were lower levels of support for review when only shareholders were affected, echoing the contractarian position that shareholders assume the risk of poor decisions and are sufficiently protected by other governance and disciplinary mechanisms. One director explicitly said: 'It's someone else's money isn't it? If it's just the shareholders they took their risk didn't they? Whereas in the case of other stakeholders like pensions say- that wasn't protected sufficiently' (D18).

Directors were less clear about why they supported review when decisions had severe consequences such as physical injury and death, or (less commonly) resulted in very large economic losses, particularly to non-shareholders. Review was often simply described as 'the right thing to do' with one director describing it as 'natural justice... a societal justice' (FGD3). However directors were very conscious of public anger as a result of the financial crisis and major corporate collapses, and the subsequent lack of legal accountability, and this may have caused some-though by no means all- to perceive a need for review when decisions had a significant impact. As one stated 'the biggest problem the politicians face, that nobody got XXX for what was clearly cavalier

actions, you know ridiculous. ... We should have a process here that is a proper judicial process' (D11). Another said 'I think that when there are failures it is helpful for there to be from time to time somebody strung up for something' (D8). Several interviewees referred to the need for review arising from the fact that directors occupy very responsible roles and manage other people's money. As one put it, it was appropriate for people who were well-rewarded and given 'a big role' to be held accountable (D21). These statements find echoes in the academic literature on the need for accountability of boards in order to legitimise the discretionary power they wield.⁶⁵ Importantly, though, directors did not think that accountability through review would, or should, necessarily lead to liability. Rather 'it might be reasonable for a judge to take a look' but 'it could be judged that people have tried their best' and there would be no liability (D18). Others said that judicial review would give directors the opportunity to show they had done 'the right thing' and be exonerated.

There were differing views regarding when liability should be imposed. Respondents initially focused on imposing liability for decisions that led to breaches of the criminal law, or health and safety regulation. There was also strong support for liability for decisions involving conflicts of interest and/or a failure to act in good faith in the interests of the company. However there was also support for liability for honest but 'incompetent' decisions: it was felt that directors should not be able to get away with 'cavalier' and 'slack decisions' or careless disregard for their responsibilities.

Yet views varied on what counted as cavalier behaviour that would warrant being penalized. Many directors did not support review of the substance of a decision and of whether the risk taken by directors was reasonable, but did consider that decisions could attract liability when there had been a failure in the decision-making process, such as a failure to seek advice, or to ensure that the

⁶⁵ J. Roberts, T. McNulty and P. Stiles, 'Beyond Agency Conceptions of the Work of the Non-Executive Director: Creating Accountability in the Boardroom' (2005) 16 *British J. of Management* S5-S26; M. Moore, *Corporate Governance in the Shadow of the State*, (2013) 7; A. Keay, *Board Accountability in Corporate Governance* (2015) 95-102.

information required to make a particular decision was available, or when directors failed to think matters through. Interviewees who adopted this position tended not to distinguish between decisions that went wrong because of external market conditions and intervening events, over which directors had no control, and those that went wrong because of risks that directors knew, or ought to have known about, and nevertheless chose to run. This influenced their views that directors could not be fairly held responsible for the outcome of decisions provided they had been taken after an adequate decision-making process. The question of whether the degree of risk taken was reasonable or unreasonable was irrelevant. As D5(Int) said: 'If you've done everything correctly, then the decision's the right decision as far as I'm concerned.'

But other interviewees were happy for courts to undertake substantive review of whether the risk that directors took was reasonable. One director stated: 'I have no problem with a regime which holds people accountable for decisions they make that are disastrous and they should have known that or could have ...reasonably known that at the time' (D11). Others referred to review being permitted for irrational decisions or decisions involving excessive risk taking. Thus one described supporting liability for 'undue business risks', defining these as 'something that seriously puts at risk the business, the employees and the shareholders or customers as well' (D23). Another said that:

(I)t's not good enough to say 'oh well, you know we've made the best decision and we obviously didn't intend it to be a bad outcome, but it just was.' I think no, you have to do more than just have good intent. You've actually got to demonstrate that you have been thorough and you know what a reasonable person would expect when you're making material decisions (D7(Int.)).

Those who supported substantive review were more likely to focus on the impact of directors' decisions on others. So, one director, opining that that there was nothing about directors'

decisions that rendered them immune from review, stated ‘I can’t see why there should be...they do make decisions all the time which affect the lives of a lot of people’ (D11). Another similarly said: ‘I don’t see why a judge shouldn’t take a look at a business decision...When there are absolutely huge decisions that are affecting vast numbers of people, and serious amounts of money, I think it’s quite reasonable to go to a court of law’ (D5 (Chair)). In contrast other directors who adopted a more limited position regarding when review should occur were more likely to focus on the impact of review and liability on directors alone.

2. *The Capacity of the Courts to Review*

Three distinct concerns about the courts emerged that mirrored those articulated in the academic literature, namely: that judges a) lacked business knowledge; b) lacked business acumen and c) were unable to place themselves in the business context at the time that the decision was made.

Only a small minority thought that judges lacked the business knowledge to enable them to assess business decisions. Others considered that ‘they’re quite bright some of those guys and they understand business quite well.’ (FGD5(Chairs)). Arguably this is the weakest objection to review, as judges in the Business and Property Courts and Commercial Courts of England and Wales frequently review decisions in complex areas in which they have no prior knowledge, including complex commercial disputes.⁶⁶

More thought that judges did not have the ‘subjective mindset’ of business people making decisions- that they were not ‘business savvy’. This was more to do with having the right disposition, rather than with knowledge. It is not entirely clear what exactly judges lacked in this respect, whether it is that they did not share the same approach to risk, or whether it referred to a

⁶⁶ For example, see *Madoff Securities International Securities Ltd v Raven* [2013] EWHC 3147 (Comm); *Allen v Bernhard* [2019] EWHC 2885 (Ch); *Sharp v Blank* [2019] EWHC 3096 (Ch).

lack of skill based on experience, or lack of certain abilities. Since directors are not necessarily trained and may not necessarily have any particular skill, it seems more likely that this refers to a different type of disposition, probably to risk. This links into the idea explored elsewhere that a distinctive feature of directors (and their decisions) is that they are entrepreneurial risk-takers.⁶⁷

The third reservation was that given the pressures and dynamics of business decision-making, it is very difficult for judges to put themselves in the position of a decision-making director. A director of a large company, who had lost a case involving review of their decision, commented that whilst the judge was extremely clever and could understand highly technical detail in a specialist area, he could not understand how decisions were made in complex organizations (D19). Another said: 'if you were the judge, how can you or anybody actually define how it felt at that very time that the decision was made? It's the environment that you are in at that time, which I don't think any draft minute or transcript could ever actually define properly' (D24). Other directors referred to the large range of matters that directors have to deal with within a limited time. This worry is closely linked to concerns about hindsight that we explore next, because as a result of such pressures 'a decision may have taken a minute and a half and you might spend a week analysing it in court' (FGD5(Chairs)). These responses may be shaped by self-serving normative positions regarding the desirability of judges reviewing directors' decisions, particularly in the case of directors who had no experience of judicial proceedings. Directors could also have been influenced by their legal advisors and company secretaries, whose views in turn could reflect those in the literature. Nevertheless the responses drew out features of directors' decision-making that could render it challenging for courts to review.

Second, a very small number of directors who had lost court cases or had been subject to adverse regulatory investigations were hostile to any judicial review of business decisions, and dismissed the capacity of the courts to conduct such review. Their responses could be explained by

⁶⁷ F. Knight, *Risk, Uncertainty, and Profit* (1921) 360; A. Keay and J. Loughrey, 'The Concept of Business Judgment' (2019) 39 *Legal Studies* 36, 49-52.

the psychology of accountability: experiments suggest that when people are held to account after an event, this can entrench their commitment to their previous course of action even if it is demonstrably incorrect.⁶⁸ This does not necessarily mean their views should be dismissed but it suggests that directors are less likely to accept that judicial review is legitimate when they are held personally liable.

3. Hindsight

A significant number of interviewees expressed concerns about hindsight bias. It was the most voiced concern in relation to review. The difficulty with this objection is that hindsight is an element that is present in much of what judges do. In many different kinds of cases judges employ some element of hindsight. This raises the question as to whether there is something particular about business judgment that renders hindsight bias a particular risk, compared with that which arises in relation to other types of decision that courts may review.

As to this, a number of directors and company secretaries emphasised the uncertain environment within which directors take decisions. This meant that, at the time of making a decision, directors might not have all the relevant facts or the time to consider them. Yet their decision would be analysed a substantial time later, at comparative leisure by courts which are likely to have all relevant facts. Furthermore, the adverse impact of business decisions often developed over time, incrementally and would be felt in the future, sometimes years later. As one director said:

⁶⁸ P. Tetlock, L. Skitka and R. Boettger, 'Social and Cognitive Strategies for Coping with Accountability: Conformity, Complexity, and Bolstering' (1989) *57 J. of Personality and Social Psychology* 632, at 633.

Now a lot of things that happen in corporations actually take months or years to mature. And you can't necessarily see, at a moment in time, all the connections. And then what happens is the weeds actually grow to become huge ugly things. Then everyone is saying, 'Wasn't that obvious? Didn't you see that happening?' (D4((Int.))

However there does not appear to have been a strong view that hindsight should mean that judges must always defer to directors' business judgments. Some directors viewed hindsight as a problem if it was used to assess whether directors had taken an undue risk, but not in the context of judicial review of whether the process that led to a decision was appropriate, possibly because there was perceived to be less uncertainty regarding what constituted a proper decision-making process.

4. Impact on decision-making

Our data supports the arguments canvassed in the literature that review of directors' decision-making could lead to more risk averse decisions. Directors who had faced legal accountability for decisions reported being 'more cautious' as a result. One described being:

more questioningany sort of financial information that is produced has to be on time and has to be questioned incredibly thoroughly. So the whole sort of rigour and slightly less trusting approach to information.... I am going to ask many more questions about it, perhaps than I would have before. (D19)

Another described how high profile cases brought against public company directors in Australia had caused Australian boards to become 'more conservative' and slower to make decisions. It was reported that the prospect of personal accountability in financial services as a result of the SMR regime had led to NEDs asking more questions. Directors also described that review by courts had,

or would, lead to boards seeking more legal, management consultant, and brokers' advice. These effects were felt even though many directors have D&O insurance that would protect them from the financial consequences of liability for business judgments.⁶⁹

However opinions were divided regarding whether these changes would be positive or negative. Some considered that review would lead to sub-optimal risk taking, but others thought it could lead to decisions that focused more carefully on, and were better informed about, risk.

Thus a director who was very strongly opposed to review worried that:

(C)ompanies and boards would get more risk averse. There are more downsides (than upsides to a decision) so behaviour would skew, skew that way. The process of value creation would be impacted because decisions would be made in a different way, they would take longer and less risk would be taken. (D8(Int.))

Yet he went on to say 'it would probably force a much more granular assessment of downside risk and more forensic analysis of whether those risks are appropriately managed and rewarded in terms of return.' Similarly many directors thought that increased attention to the disadvantages of a proposed initiative would improve decision-making. As one said: '(q)uite often when you find bad decisions that are questionable, part of the bad decision is the fact that 'all we looked at was the potential upside, we didn't even look at the potential downside'' (FGD3).

It seems likely that if boards seek more advice and focus more on the downside of proposals, they will decide not to take certain courses of action that they might previously have proceeded with. Whilst this could be viewed as creating greater risk averseness, an alternative interpretation is that boards' risk appetites could remain largely the same but, as a result of being better informed and scrutinising proposals more carefully, directors would be better placed to detect

⁶⁹ Merkin op cit., n. 43.

when decisions fell outside the parameters of that risk appetite. Certainly it seems desirable that boards should properly identify and consider the downsides of a proposal even if it leads to some proposals being abandoned.

Our data also raises the possibility that judicial review might not have a significant impact on levels of risk taking because: financial services directors already feel under intense regulatory pressure; other public company directors are keenly aware that their decisions could be scrutinised by shareholders, the media and social media, and 'the court of public opinion'; and private company directors are alive to the potential for decisions to be scrutinised by liquidators and the courts should things go wrong. Several public company directors reported that, in response to these pressures, boards had already changed their decision-making practice to seek more information and challenge more. As one director with long experience of being an executive and a NED within the FTSE 100 said:

far more attention is paid to the risk of decisions...I would say probably 15 years ago when you prepared board papers for non execs to review, the risk of the failure of the deal was a long way down the priority list. It was all about the strategic advantages ...Nowadays the risk analysis, what if it goes wrong.....That part has definitely strengthened the process.
(D10(Int.)).

Others thought that over-confidence would lead directors to dismiss the possibility that they would make poor decisions, or that any effect on risk taking would be short-term because directors who acted in risk-averse ways and inhibited their company's ability to compete, would be removed. Another interviewee argued that there would not be fewer decisions because '(d)oining nothing is not, in many instances, an option'(D11). Whilst taking action carries risk, failing to act carries a real risk of destroying the business. For this reason, 'boards worry... about not making decisions and about making a decision... boards are always confronting this' (D11).

Risk aversion aside, there were concerns that fear of review would consume valuable amounts of directors' time, and deflect them from dealing with important issues, all of which would add to company costs. The fact that financial services directors suggested that more of their time was spent on compliance than strategy, because of concern about regulatory liability, lends credence to these concerns. This could be exacerbated if, as a result of courts being more willing to review decisions, people were encouraged to initiate more actions against directors: dealing with such proceedings would be hugely disruptive for the company and involve the expenditure of company time and money. Whilst these are serious concerns, they apply to other forms of corporate litigation, including securities litigation, and to other people and institutions facing litigation, and it is unclear why they should have particular force in the context of holding directors accountable for the reasonableness of their decisions.

The negative aspects of litigation also need to be weighed against potentially positive outcomes. Other directors and legal practitioners thought that greater judicial scrutiny could make directors more aware of their duties, that their interests and their company's were not one and the same, encourage longer term thinking, and focus directors' minds on the consequences of their decisions. Some directors advanced the possibility that poor decisions could be influenced by (unconscious) ulterior motives such as greed, reputation-building, ego, and the desire to look successful, and the prospect of review might temper these effects and lead to better decisions

5. Impact on directors personally and professionally

As the literature anticipates, some directors considered that greater scrutiny of directors' decisions by the courts could deter individuals from taking up positions as directors. For many this was more a prediction than reporting from experience. Nevertheless a number of financial services directors indicated that they had moved, or were planning on moving, into unlisted companies because of the

personal accountability introduced by the SMR. An Australian director also indicated that he had moved from being a listed company director into the private sector in response to legal and regulatory scrutiny of public company directors.

On the other hand, a financial services director commented:

In banking I know there are a lot of ‘well no one wants to be on a board of a bank. They will never want to take a... role at that level’, but then they do. (D18).

Furthermore directors in our study who had experienced litigation in respect of their decisions had not ceased to be directors. One who worked with boards disputed that directors would be deterred because they ‘all believe it is never going to happen to them’ (D4(Int)). Meanwhile despite the presence of the business judgment rule in the US, a common law rule devised as a safety harbour for directors making business judgments,⁷⁰ US directors reported that, one way or another, their business judgments were challenged and scrutinised through litigation. Yet they continued to be directors, which again suggests that the deterrent effect of review may be overstated. However these directors reported that even unmeritorious cases tended to be settled before trial, which reduced the prospects of being held personally liable for judgments, and so possibly the deterrent effect of litigation. This is common in Australia could also occur in the UK, should directors’ business judgments become more widely reviewed.⁷¹ D&O insurance against the financial consequences of liability for business judgments could also blunt any deterrent effects of review . A number of our interviewees emphasised the importance of D & O insurance in influencing

⁷⁰ M. Eisenberg ‘The Duty of Care and the Business Judgment Rule in American Corporate Law’ (1997) *Company Financial and Insolvency Law Rev.* 185.

⁷¹ V. Morabito, *An Empirical Study of Australia's Class Action Regimes, Fifth Report* (July 2017) <<http://dx.doi.org/10.2139/ssrn.3005901>> p 30

directors' decisions to take up positions. However, as a US director, pointed out, litigation against directors in the UK has a higher media profile and greater reputational consequences than litigation in the US where litigation was seen simply as a 'cost of doing business'. We found that UK directors were highly concerned about the impact on their reputations should things go wrong, and so litigation involving UK directors could have a greater deterrent effect than in the US, and one that D&O insurance would not remove.⁷²

Nevertheless the data more clearly indicated that, rather than abandoning the role of director, individuals were instead avoiding particular sectors or companies, namely financial services and public listed companies. The reason was not solely, and possibly not predominantly, concern over personal liability, but lack of job satisfaction. Thus in financial services an increased focus on compliance at board level as a result of increased regulation, and a reduced focus on strategy, and improving company performance had decreased job satisfaction and led to directors considering their positions. Job satisfaction was also the reason that individuals continued to act as directors despite discouraging media and political criticism of directors. As one said:

They are not doing it because they are risk averse, (given media, political criticism and shareholder activism)... They actually want to do it because they enjoy the stimulation of being in a company that does have decisions and a strategy to review and they feel they can help and contribute. (D10)

Job satisfaction has not previously been recognised in the business judgment literature as important but it appears from our research to be very significant in influencing whether directors take up or retain positions. This omission raises the possibility that the literature has not correctly calibrated the deterrent effect of judicial review. High levels of job satisfaction could mitigate the

⁷² R. Gold, 'Compensation's Role in Deterrence' (2016) 91 *Notre Dame Law Rev.* 1997.

deterrent effect resulting from the prospect of judicial scrutiny. Conversely decreased job satisfaction resulting from poorly designed regulation or other factors could exacerbate such an effect. Interestingly directors reported that their lawyers were more alarmed by the risks of being a director than the directors themselves, possibly because, research suggests, lawyers tend to exaggerate legal risks and are more risk averse than business people.⁷³

Some interviewees considered that a deterrent effect could have positive consequences, by opening up places on boards to under-represented groups. As one director commented it could change ‘the type of voice around the table maybe’ (D8(Int.)). Headhunters supported this, describing how boards ‘eighty percent of the time, ninety five percent of the time, (recruit) the usual suspects... versus somebody who has got critical thinking skills’, despite the fact that ‘there are people out there looking for roles and not getting them’ (H1). However concerns were raised that this could lead to a detrimental lack of experience at board level.

Several directors also propounded the view that judgments should be reviewed so as to deter incompetent people from becoming directors, with one NED supporting review on the basis that many directors are ill-prepared for the roles they take on. A concern with professionalism emerged, with a number of interviewees considering that review would improve standards amongst directors as a whole. One NED said, ‘if directors are never going to be held to account then they can do what they like, completely risk-free, then you will never improve probity and professionalism’ (D3). Another considered that review would improve the quality of directors to the benefit of society. Concern was expressed that if poor conduct is not reviewed this could reflect badly on directors as a group. Another director said, ‘We actually don’t want the irresponsible people out there because it’s not helping any of us’ (D23). Because of these concerns, several directors were keen to develop some of the trappings of a profession, namely agree minimum standards of education and behaviour in order to be a director and the policing of directors’ conduct. In the absence of a professional body

⁷³ D.C. Langevoort and R.K. Rasmussen, ‘Skewing the Results: The Role of Lawyers in Transmitting Legal Rules’ (1997) 5 *California Interdisciplinary Law J.* 375.

with the power to discipline and remove incompetent directors from circulation, they looked to the courts to discharge these functions.

6. *Fairness to Directors*

Several interviewees expressed concern about the fairness of reviewing directors' decisions. Whilst it was not considered unfair to hold incompetent directors accountable, incompetence was a quality that *other* directors possessed. It was not a quality that attached to one-off poor decisions. This was a potentially self-interested response given that interviewees acknowledged that they themselves could make, or had made, poor decisions. As one said: 'The problem is the courts never review the 49 decisions out of 50 that you actually get right. They'll look at the one that was wrong. So where's the balance in that?' (D12(Int.)). Even when liability was not imposed, a legal practitioner who represented directors in relation to financial services regulation, and who was not opposed to liability for poor business decisions, nevertheless noted the great stress and anxiety caused by regulatory investigations to people who were 'honest and hard-working.' (LP3).

The difficulty with these arguments is that they apply to anyone who is sued for negligence and directors are no more hardworking or altruistic than, for example, doctors who can certainly be sued, and often for one poor decision after making many right decisions. In addition psychological literature demonstrates that people assess fairness from a self-interested perspective,⁷⁴ and in line with this we found that fairness-based objections to liability tended to focus on its impact on directors' interests and did not take into account the interests of those affected by directors' decisions.

⁷⁴ D. Messick and K. Sentiss, 'Fairness and Preference' (1979) 15 *J. of Experimental Social Psychology* 418; I. Rodriguez-Lara and L. Garrido, 'Self-interest and fairness: Self-serving choices of justice principles' (2012) 15 *Experimental Economics* 158.

The interviews did identify one potentially distinguishing factor relating to directors, namely the role of reputation. Many interviewees emphasised the value of reputation to directors. Some argued that directors were sufficiently sanctioned by the damage to their reputation caused by the consequences of a poor decision, such that further sanctioning through liability would be unfair. If directors do pay a higher price than other groups when their reputation is damaged, this could provide a rationale for giving them greater protection from liability. However much depends on the purpose of liability. If it is retributive or deterrent, then further sanctioning directors for poor business judgment through legal liability may be both inefficient-because the fear of reputational loss from poor decisions is a sufficient deterrent-and unfair because legal liability in addition to such reputational loss is an excessive sanction. D&O insurance could address these concerns in part, by protecting directors from the financial consequences of liability but these arguments would still hold when review of business judgments led to directors being disqualified, or if litigation carries adverse reputational effects additional to those suffered as a result of the original poor decision. However reputational loss is not a sufficient remedy if the purpose of review is compensatory, and some directors may not have a reputation that they are worried about losing or may not experience any reputational damage absent court review and sanction.

The most common concern was that it was unfair to hold NEDs liable when things went wrong. A common refrain was that directors -particularly NEDS- were not paid very much for the role they undertook, and that the money did not compensate for exposure to increased risk of liability. A lawyer agreed that the consequences for directors of liability for their business decisions was disproportionate. Several interviewees argued that it would be unfair to hold NEDs to account for poor decisions because they need to rely on executives for information, and may not therefore have the full information necessary to properly assess a decision. This objection may not apply with the same force to decisions around process, such as what information to seek prior to making a decision, and what degree of questioning and challenge is appropriate. It also raises the possibility that it would not be considered unfair to hold executives liable for substantively poor decisions as

they should have all the necessary information to make the decision. There was indeed a strong feeling that NEDs should be treated differently to executive directors, though a number of interviewees were concerned about the impact this might have on collective responsibility and collective decision-making that can function to eliminate foolish decisions.

CONCLUSION

A number of findings from this study augment or challenge existing thinking regarding the desirability of the courts reviewing directors' business judgments. A key finding is that, from a normative perspective, directors considered that the courts could, and should, review directors' business judgments. Given that interviewees were keenly aware of public anger with directors, we surmise that they see judicial accountability as a means of addressing that anger, not because it would necessarily lead to the imposition of more liability on directors, but rather because it would signal that directors are not immune from accountability and also because it would permit directors to explain and justify what they do.

Many thought that review should be confined to the process leading to the decision, rather than the substantive reasonableness of the decision. This is consistent with the approach taken to reviewing business judgment elsewhere, including in the US, where a decision will be immune from review if taken after a proper process, in good faith, and in the absence of conflict of interest.⁷⁵ However, others were comfortable with substantive review and most interviewees did not consider that review by the courts was unfair to directors.

Both those who favoured limited review on process grounds alone, and those who argued that review was unfair to directors, tended to focus on the interests and perspective of directors

⁷⁵ *In re Caremark International* 698 A. 2d 959 (Del, 1996); *Stone v Ritter* 911 A.2d 362 (Del, 2006); *In re General Motors CA No 962-VCG, 2015*, Del Ch LEXIS 179 (Del, 2015); *Melbourne Mun. Firefighters' Pension Trust Fund v. Jacobs*, 2016 Del. Ch. LEXIS 114, 21-22 (Del, 2016).

alone, disregarding the impact that directors' decisions can have on others. They did not explain why directors should be treated differently from people whose decisions and actions are subject to judicial review, particularly in negligence actions.

However interviewees did hint at some reasons for treating directors' differently. For example, fewer directors supported review when only shareholders were impacted by decisions, which may reflect the fact that shareholders are seen as voluntarily taking the risk of negligent decisions when they invest in the company and appoint directors.⁷⁶ Interviewees also referred to the pressure that directors are under when they take decisions, and to the reputational penalty that directors will have paid as a result of a poor decision. Yet whether directors can be distinguished from other groups on these grounds is debateable. For example the decision to invest in a company is a voluntary decision but so is the decision to hire a lawyer or agree to a medical procedure,⁷⁷ so we cannot differentiate directors from other professionals on that basis. Again persons in other occupations must also make decisions under pressure, such as barristers in the middle of a hearing, and surgeons who sometimes have to respond to some reaction from the patient's body when in the throes of operating on someone.⁷⁸

In any event views that focus on directors' interests alone cannot be conclusive regarding what is fair or legitimate in this context. Deciding what is fair involves balancing competing interests and deciding whose should prevail: in this case those of directors and those affected by their decisions.⁷⁹ Our data suggests that taking account of other interests can shape what is perceived of as fair: notably, those interviewees who supported substantive review were more likely to attach importance to the impact of directors' decisions on a wider group of stakeholders.

⁷⁶ See K. Davis, 'Once More the Business Judgment Rule' (2000) *Wisconsin Law Rev.* 573, at 574-575.

⁷⁷ Telman, *op.cit.*, n. 14, p. 853.

⁷⁸ Davis *op.cit.*, n. 76, p. 581

⁷⁹ R. Mokal, 'On Fairness and Efficiency' (2003) *66 Modern Law Rev.* 452, at 466.

The research also highlighted a number of gaps in the literature. More consideration needs to be given to the role of reputation in the context of judicial review of business judgment. Given that other professionals can also experience reputational hurt as well as liability from an adverse court judgment, one question is whether the value of reputation to directors is greater than these other groups, so as to provide a reason for giving directors greater protection from review. Another is whether legal liability for business judgments will have any reputational impact over and above that produced by poor decisions and if so, whether this is fair or efficient which, as suggested previously, will in turn be influenced by whether the purpose of liability is deterrence or compensation.⁸⁰

An important omission is the failure by the literature to factor into its analysis that many directors enjoy being directors and gain job satisfaction from their work. In addition directors may not conduct a rational risk-benefit analysis of the risks of remaining in post due to over-confidence in their own competence, and in any event are more likely to be willing to take this risk than others. The neglect of these factors in the literature has led to the conclusion that review of business judgment will lead to directors leaving companies in droves, but our data suggests that this is not the case. Directors are likely to remain in post provided that they believe that they are competent and they continue to enjoy what they do. Thus the risk that directors will be deterred from taking up positions is likely to be overstated.

One concern though is that if D&O insurance became unavailable or restricted as a result of more judicial review of directors' judgments, this could deter people from taking up director roles. The US experienced a crisis in its D&O market in the 1980s caused in part by *Smith v Van Gorkom*, a

⁸⁰ On reputation and director liability generally see: E Rock, 'Saints and Sinners Saints and Sinners: How Does Delaware Corporate Law Work?' (1997) 44 *UCLA Law Rev.* 1009; D Skeel, 'Shaming in Corporate Law' (2001) 149 *University of Pennsylvania Law Rev.* 1811 at 1832-35; R. Shapira, 'A Reputational Theory of Corporate Law' (2015) 26 *Stanford Law & Policy Rev.* 1; Gold, op cit., n. 72.

judgment that imposed personal liability on directors for business decisions.⁸¹ This is something that would need to be monitored. However there are structural factors in the UK that make it presently unlikely that litigation against UK directors will rise to similar levels as in the US or even Australia. For example, the UK has no general corporate regulator that could take actions against directors for poor business judgments, the courts are reluctant to grant leave to shareholders who bring derivative actions against directors and, unlike the US, do not entertain litigation during corporate takeovers.⁸² Furthermore despite increasing levels of litigation against directors in Australia, the impact on the D&O insurance market is contested.⁸³

Finally interviewees identified positive impacts that could result from some people being deterred from being directors, such as more diversity in the pool of directors as a result of positions becoming available, and incompetent directors being deterred from taking up roles. Similarly whilst our data supports claims that review of business judgements could lead to more cautious decision-making, opinion was divided as to whether this was desirable or not. In contrast whilst the academic literature speaks broadly and loudly on the cost that review would precipitate, there is little or no consideration of possible benefits. The presumption appears to be that a review of business judgments could only be a negative thing for directors, and probably for their companies and shareholders. The literature does not engage in any cost-benefit analysis, something that is advocated frequently when considering any issue.⁸⁴ Yet our findings indicate that directors see positive elements in reviews by judges of directors' decisions both from a normative and an empirical perspective. This is an important contribution to the field that calls for those engaging in a

⁸¹ C. Hartman and P. Rogers, 'The Influence of *Smith v. Van Gorkom* on Director's and Officer's Liability' (1991) 58 *J. of Risk and Insurance* 525.

⁸² A Keay, 'Assessing and rethinking the statutory scheme for derivative actions under the Companies Act 2006' (2016) 16 *J. of Corporate Law Studies* 39; *R v Panel on Take-overs and Mergers, ex parte Datafin plc* [1987] Q.B. 815.

⁸³ Australian Law Reform Commission Integrity, *Fairness and Efficiency—An Inquiry into Class Action Proceedings and Third-Party Litigation Funders Final Report*, Report 134 (2018)

⁸⁴ For example, see S. Schwarcz, 'Excessive Corporate Risk-taking and the Decline of Personal Blame' (2016) 65 *Emory Law J.* 533, at 556. Compare Fischel, *op.cit.*, n 12, p. 1439.

theoretical analysis of review to re-consider the traditional line of thinking. The literature opposing review currently relies heavily on empirical predictions about the adverse impact of review that our research suggests is overstated. One explanation for this is that normative positions regarding the legitimacy and fairness of review have influenced the weight attached to empirical claims about impact of review. To avoid this, and to take forward and develop the debate in this field, future research must engage in a more transparent discussion about the normative underpinnings of arguments for and against review by the courts of directors' business judgments.