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THE CONCEPT OF BUSINESS JUDGMENT

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1. INTRODUCTION

The judgments that company directors make can have significant consequences, for their companies, for those who hold stakes in companies, such as shareholders and employees and, at times, the wider community.[1] Consequently most jurisdictions impose duties on directors to guide and control the way that they act. Despite this, the courts have often refrained from holding directors liable for alleged breaches of the duties,[2] instead deferring to directors' judgments.[3] Courts have simply not been willing to substitute their judgment for that of

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1 A classic instance is Enron (at one time the seventh largest corporation in the US) which collapsed in 2001 resulting in shareholders, employees, creditors and others losing huge amounts.

2 One leading reason is that judges wish to avoid 'hindsight bias,' namely 'the tendency of decision-makers to attach an excessively high probability to an event simply because it ended up occurring.' : C Jolls, C Sunstein, and R Thaler, 'A Behavioral Approach to Law and Economics' (1998) 50 Stan L Rev. 1471 at 1523. Also, see J Parkinson, Corporate Power and Responsibility (Oxford: OUP 1993), p 94.

3 For example, see Hampson v Pr*ice's* Patent Candle Co (1876) 45 LJ Ch 437; *Harlowe's* Nominees Pty Ltd v Woodside (Lakes Entrance Oil NL) (1967) 121 CLR 483 at 493; Howard Smith Ltd v Ampol Petroleum [1974] AC 821; Re Simasko Productions Co (1985) 47 Bankr 444; Re Elgindata Ltd [1991] BCLC 959 at 993;

directors. This approach has led, in some jurisdictions, to the development of the business judgment rule (BJR), through either case law as in Delaware in the US or legislation as in Australia. While subject to different formulations across jurisdictions, this essentially provides that if a director's action or inaction can be categorised as a business judgment, the director is presumed not to be liable for what has been done or not done unless the claimant can rebut the presumption that the rule applies. This is generally an arduous task. While no such rule has been officially recognised in the UK[4] this approach has been adopted in a broad range of cases, and is not confined to situations in which directors are being sued for breaching their duty of care.[5]

Yet there has been no clear explanation in primary or secondary sources regarding what constitutes a business judgment. The article addresses this gap, by analysing the case-law in England and Wales and drawing on significant cases in Australia and Delaware. This paper is not a full comparative study of the English, Australian and US case law and we acknowledge the difficulty sometimes encountered in translating experience in one jurisdiction to another. Nevertheless developments in Australia and the US, particularly in relation to the topic at hand, can provide useful and fruitful pointers for England and Wales as these latter jurisdictions have been the prime ones where business judgment has been a primary issue in claims against directors.

Circle Petroleum (Qld) Pty Ltd v Greenslade [1998] 16 ACLC 1577. For a discussion see A Tunc, 'The Judge and the Business Man' (1986) LQR 549.

4 On social practices acquiring rule-like status see further: J Meyer and B Rowan, 'Institutionalized Organizations: Formal Structure as Myth and Ceremony' (1977) 83 American Journal of Sociology 343

5 See for example Howard Smith v Ampol Petroleum [1974] 1 ALL ER 1126 at 835 (proper purposes); Devlin v Slough Estates Ltd [1983] BCLC 497, at 503-504 (derivative action); Birdi v Specsavers Optical Group Ltd [2015] EWHC 2870 (Ch) at [246] (unfair prejudice).

To be clear the paper is not concerned with the empirical question of how boards actually function and take decisions, nor with the scope and application of the BJR, about which much has been written, but rather the foundational question of how to identify and define the legal concept of business judgment. This is important for several reasons. First, categorising a matter as a business judgment can provide directors with a powerful shield from liability which raises questions about the appropriate extent of directors' accountability. This has been a contentious issue especially since the Global Financial Crisis when, despite queries being raised over their management of banks, few directors were subject to legal action for breaching their duties to their companies.[6] It has been argued that appropriate director accountability is a necessary element in legitimising directors' exercise of power.[7] However without a better understanding of what is protected under the label of business judgment, there is a risk that this exercise of power will lose legitimacy, with a resulting loss of trust in business.

Identifying what a business judgment is, and so what kinds of actions/decisions of directors are not challengeable and those that might be, is also necessary to promote commercial certainty.[8] In addition, the lack of clarity around the concept raises the possibility that the courts may not be identifying decisions as business judgments in a principled,

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6 Though some have faced securities litigation: M Moore, 'Redressing Risk Oversight Failure in UK and US Listed Companies: Lessons from the RBS and Citigroup Litigation' (2017) 18 EBOR (forthcoming September 2017)

7 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 Journal of Management S5-S26; M Moore, Corporate Governance in the Shadow of the State, (Oxford: Hart Publishing, 2013) p 7; A Keay, Board Accountability in Corporate Governance (Abingdon: Routledge, 2015) pp 95-102.

8 For example the Australian Institute of Company Directors resisted the introduction of integrated corporate reporting because they were unsure whether decisions on the content of those reports would be business judgments covered by the BJR: Response to IIRC Consultation on Integrated Reporting (July 2013).

consistent manner. The aim of the paper is both positive and normative. First, it ascertains how the courts have defined business judgment in order to establish greater certainty about how judges approach this question. It argues that the courts appear to identify entrepreneurial judgment as business judgments. If this is not the case the paper adopts the normative position that it should be, because this provides a coherent rationale for identifying why some decisions directors take are business judgments, and others are not.

The paper is structured as follows. By way of prefatory remarks, section two explains how we identified material business judgments in England and Wales. This is not a straightforward task, as the courts do not necessarily adopt the terminology of business judgment to signify when a director's judgment will be respected. Section three analyses how the courts approach the notion of judgment. It identifies two senses of the term, one being 'the exercise of an ability', the other being 'decision'. Section four examines how the courts identify judgments as 'business' judgments. Section five argues that business judgments can be conceptualised as entrepreneurial judgments. The article finishes with concluding thoughts on the nature of business judgment.

2. IDENTIFYING BUSINESS JUDGMENT IN ENGLAND AND WALES

Determining the parameters of business judgment is difficult in England and Wales because although it has been asserted that a court 'does not interfere with the business judgment of directors in the absence of allegations of mala fides',[9] in fact the courts rarely use the term 'business judgment'.[10] More common terms are 'commercial judgment' or 'commercial

[9] Devlin v Slough Estates Ltd [1983] BCLC 497 at 503-504.

[10] For similar observations see S Cairns, Changing the Culture of Financial Regulation: A Corporate Governance Approach unpublished PhD thesis (Liverpool University, September 2014) p 148.

decision'.[11] It seems that these terms are interchangeable. For example in Merchantbridge & Co Ltd v Safron General Partner 1 Ltd the court stated that the directors had 'made a business judgment…. This was a commercial decision'.[12] At other times the courts only refer to 'judgment' as in Howard Smith Ltd v Ampol Petroleum Ltd in which Lord Wilberforce stated that the courts 'will respect (directors') judgment as to matters of management',[13] or identify issues as being a 'business matter'.[14] Consequently in order to identify when the English courts consider a matter to be a business judgment, we conducted a database search using Lexis and Westlaw for cases employing these, and similar, expressions.

The search included cases involving breach of duty of care, wrongful trading, disqualification, acting for an improper purpose, and derivative claims. We found 82 cases which used terms that indicated deferral to directors' judgment. In none of these did the courts attempt to define what they meant. Nor was this search exhaustive, as there are cases in which none of the terms are used, that involve judgments previously recognised as business judgments. Nevertheless, these provide evidence of the kinds of matters the courts conceive of as business judgments. We did not conduct a similarly extensive search in relation to the Australian and US case law as our intention was merely to examine some of the leading and most recent cases to determine general developments in those jurisdictions, as mentioned earlier. The next sections analyses the English case-law that was located, as well as some relevant US and Australian material, in more detail.

3. THE NOTION OF JUDGMENT

11 Cobden Investments Ltd v RWM Langport Ltd[2008] EWHC 2810 (Ch) at [754].

12 [2011] EWHC 1524 at [25].

13 [1974] AC 821 at 835.

14 Re City Equitable Fire Insurance Co Ltd [1925] Ch 407 at 408.

As noted in the Introduction, the courts show deference to directors' discretion in managing company affairs. The exercise of directors' discretion is often referred to as their judgments or decisions. The problem is that the notion of judgment is a 'fairly murky one.'[15] Some jurisdictions, including, as noted, the US and Australia, give specific deference to business judgments either in case law or in legislation. This focus on judgments leads us to assess what is involved in the notion of judgment, particularly as it relates to the affairs of companies and what directors do in that regard. This section identifies two meanings that can be attributed in the case law to the notion of judgment. We refer to these two meanings as 'ability' and 'decision.'

Thus judgment can mean an ability to make a considered decision or to come to sensible conclusions.[16] The word can also mean a decision made.[17] The case-law indicates that judges regularly embrace both of these aspects of judgment. In general circumstances judges will frequently use the phrase 'in my judgment' (indicating an opinion based upon ability and experience), followed by a view or conclusion of the law and/or facts, and, of course, the judgment which a judge delivers involves making a decision on a litigated issue. Judges also refer to the written judgments of other judges, which encapsulate a decision, either on the law or the facts or on both.

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15 N Tichy and W Bennis, 'Making Judgment Calls' (2007) 85 Harvard Business Review 94, p 95.

16 New Oxford Dictionary of English, (Oxford: OUP, 2001) p 989.

17 Cambridge Dictionary at : http://dictionary.cambridge.org/dictionary/english/judgment (accessed 30 January 2017). Also, see G Shaw and K Locke, 'Using Fiction to Develop Managerial Judgment' (1993) 17 Journal of Management Education 349, 352.

'The ability meaning' of judgment is not unlike the idea of reasoning or reflective thinking, and may well involve experience and being familiar with a particular field,[18] and in this case the kinds of ability that enable directors to act responsibly. In this regard the courts seem to take into account experience, as demonstrated by the reference made by the deputy judge in Re Brian D Pierson (Contractors) Ltd to the judgment of a director being based on his experience. The deputy judge said that: 'I am also very conscious that the standard to be applied is that of the reasonably prudent businessman… I must therefore give proper respect to Mr Pierson's…judgment based on experience….'[19]

It is important to note that while the emphasis might be on ability in the meaning of judgment being discussed here, judges are envisaging the ability leading to a decision, and this is evident in the above quotation from Re Brian D Pierson (Contractors) Ltd. The use of ability in relation to judgment is reflected in corporate case law that covers various types of claims, including shareholder claims that the affairs of a company have been conducted in an unfairly prejudicial manner in breach of the Companies Act 2006 s.994, applications for disqualification of directors, derivative actions brought by shareholders, proceedings brought against directors for breach of the duty of care, and liquidators' claims based on wrongful trading. In the case of Birdi v Specsavers Optical Group Ltd, an unfair prejudice claim, the judge referred to paying a director a fair rate was 'a matter for the judgment of the directors.'[20] The meaning here is that the directors had to use their ability in the process of coming to a determination about remuneration. In another unfair prejudice case, Re

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18 F Kingsbury 'Business Judgment and the Business Curriculum' (1922) 30 Journal of Political Economy 375 p 376. Also, see Shaw and Locke, ibid, at 353; J Clarke and R Holt, 'Reflective Judgement: Understanding Entrepreneurship as Ethical Practice' (2010) 94 Journal of Business Ethics 317 p 320.

19 [2001] 1 BCLC 275 at 306

20 [2015] EWHC 2870 (Ch) at [344].

Elgindata, the judge said that there was disagreement as to whether a managerial decision was, as a matter of commercial judgment, the right one to make.[21] This was also the case in F & C Alternative Investments (Holdings) Ltd v Barthelemy(No 2),[22] where Sales J that 'F & C's commercial interests were engaged by a wide range of business judgments which would have to be made by the LLP board,'[23] and later he went on to say that each director 'should bring his own judgment to bear in taking decisions in the best interests of the LLP.'[24] Finally, as far as unfair prejudice cases are concerned, in Re Jayflex Construction Ltd [25] the court held that whether spending £150,000 on refurbishing premises for the company's offices which originally cost £800,000 and for which a budget of £30,000 had been agreed, was 'commercially sensible' was a matter of judgment upon which the director had not been 'clearly wrong'.

In several disqualification cases judges have taken the view that a director was exercising judgment. For example, in Secretary of State for Business, Innovation and Skills v Chohan Hildyard J said that: 'the mere fact that a loan proves irrecoverable does not mean that it was improperly made and that the latitude allowed to directors in the exercise of their commercial judgment is broad.'[26] Again, the ability is being used to achieve an aim, namely to decide on the making of a loan. With breach of duty of care claims the only mention of judgment seems to involve the ability of the director to act. For instance, in Dovey v Corey,[27]

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21 [1991] BCLC 959 at 993-994

22 [2012] Ch 613.

23 Ibid at [167]

24 Ibid at [205]

25 [2004] 2 BCLC 145 at [58].

26 [2013] EWHC 680 (Ch) at [154].

27 [1901] AC 477 at 493

the House of Lords said that a director was able to rely on a chairman's judgment and in this context it was clearly the experience and ability of this person on which reliance was placed.[28] In another case, ARB International Ltd v Baillie, which also involved a breach of the duty of care, as one of several claims made, the court said that the director 'knew enough to do his job and, so far as material to this case, he had the experience to know when to take a view or make a business judgment.' [29] The court seemed to see experience as an important issue when business judgment is involved and found that in reaching an agreement involving the transfer of business from the director's company to another under the terms of a mid-term broker change, the director had made business judgments which had not been outside the range open to him. In the early duty of care case, Leeds Estate Building and Investment Co v Shepherd,[30] Stirling J said that the directors declared dividends without having exercised their judgment as 'mercantile men' on the estimates and statements submitted to them. Here the directors failed to use their ability/judgment properly before they made a decision.

In the wrongful trading case of Re Continental Assurance Plc, Park J said that '(s)ome of the non-executive directors felt that Mr Burrows [an executive director] would decide as a matter of business judgment not to chase a broker for outstanding debts…'[31] Here the connotation is that the directors exercised judgment (ability) before they decided not to claim the debts (the decision).

Elsewhere the classic explanation of the BJR by Delaware courts seems to suggest that only final decisions or at least those decisions or processes that lead up to the final

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28 See also Re Lands Allotment Company [1894] 1 Ch 616 at 637; Re County Marine Insurance Co (1870-71) LR 6 Ch App. 104 at 119-120.

29 [2013] EWHC 2060 (Comm) at [48].

30 [1887] LR 36 Ch D 787 at 802

31 [2007] 2 BCLC 287 at [135].

decision fall within the concept of judgment.[32] Yet there are many instances of courts referring to the ability meaning of judgment as well as the decision meaning. In Cinerama Inc v Technicolor Inc[33] the court referred to directors exercising business judgment, and in In re Walt Disney Co[34] it was said: 'Furthermore, in instances where directors have not exercised business judgment…the protections of the business judgment rule do not apply.' More recently, in In re Tyson Foods Inc[35] the judge said that the directors had failed to exercise independent business judgment by approving self-interested transactions. In this case a decision had been arrived at without ability being rendered and that appeared to be crucial in finding that the BJR rule did not apply to protect the directors.

There is evidence also in the Australian cases of courts referring to the type of judgment discussed above. For example, Robit Nominees Pty Ltd v Oceanlinx Ltd (in liq)[36] was a case that involved actions brought against administrators of an insolvent company for breaching their duty of care (administrators are treated in the same way as directors under Australian legislation). The court said that the administrators were required to weigh up the risks attending alternative courses of action and to come to a commercial decision on which

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32 See, for example, N Veasey, 'New Insights Into Judicial Deference to Directors' Business Decisions : Should We Trust the Courts' (1983-84) 39 Business Lawyer 1461 at 1464; D. Rosenberg, 'Supplying the Adverb : The Future of Corporate Risk-Taking and the Business Judgment Rule' (2009) 6 Berkeley Business Law Journal 216 at 217.

33 663 A 2d 1134 (1994)

34 907 A 2d 693 (2005) at 748

35 919 A.2d 563 (2007)

36 (2016) 111 ACSR 427

course to follow, exercising their business judgment.[37] The notion is that a decision follows from the administrators using their ability.

The second sense of judgment, 'the decision meaning', might mean a final decision to do something or could mean several decisions leading to an ultimate judgment on a matter. It can also involve a director making the conscious decision to refrain from acting,[38] something which Australian case law has often emphasised.[39] What clearly cannot be a judgment within the decision meaning of judgment is failing to discharge one's duties such as neglecting to consider an issue that requires resolution.[40] Directors must turn their minds to matters before what is done can be categorised as a judgment.[41]

There are a number of English cases involving unfair prejudice petitions and disqualification applications where judgment is taken to mean a decision. For instance, in Allmark v Burnham the deputy judge referred to the director's judgment - meaning decision - being correct: 'In the course of his evidence Mr Burnham gave a detailed…account of why he believes that his business judgment was correct in determining… that the overall trading would be more satisfactory and more profitable all round if the entirety of the bookshop…was used for the sale of books…' In Oak Investment Partners XII v Broughtwood,[42] the judge said that what the directors had done was 'a legitimate business

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37 Ibid at [245]

38 J Told, 'Business Judgment Rule : A Generally Applicable Principle?' [2015] EBLR 713, 715.

39 For example, see, ASIC v Adler (2002) 41 ACSR 72; ASIC v Rich [2009] NSWSC 1229

40 In re Citigroup Inc 964 A 2d 106 (2009) at 120; ASIC v Adler (2002) 41 ACSR 72.

41 Rales v Blasband 634 A 2d 927 at 933 (1993); ASIC v Rich [2003] NSWSC 85.

42 [2009] EWHC 176 (Ch).

judgment properly open to the management.'[43] This included a decision not to follow up on customer links because they did not reflect the company's main business objective. Similarly in Cobden Investments Ltd v RWM Langport Ltd[44] the judge said that in relation to a company running an abattoir a decision regarding the terms on which cows should be slaughtered was a matter of commercial judgment. The judge in Moordene Ltd v Trans Global Chartering Ltd,[45] said that the directors' decision to use company funds to save the company's parent, on the basis that the survival of the parent company was necessary to secure its own business, was a commercial judgment. In like manner the judge in Nicholas v Soundcraft Electronics Ltd[46] said that a decision not to take legal proceedings against its parent company in an attempt to keep the subsidiary company afloat was a business judgment that was likely to be in the interests of both companies. In another unfair prejudice case, Re Regional Airports Ltd,[47] a decision to make a rights issue was said to be a judgment of the board. The court in Re Uno plc, a disqualification case, said that a decision not to enter insolvent administration was a commercial judgment.[48] In Secretary of State for Trade and Industry v McTighe (No 2),[49] another disqualification case, the judge at first instance commented that the decision to allow a company to continue trading in a time of recession whilst not paying Crown debts was a commercial decision.

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43 Ibid at [33]

44 [2008] EWHC 2810 (Ch) at [498].

45 [2006] EWHC 1407 (Ch) at [53].

46 1993] BCLC 360 at 366. Also, see Re Macro (Ipswich) Ltd [1996] 1 WLR 145, decided on a similar basis.

47 [1999] 2 BCLC 30 at 66

48 [2004] EWHC 933 (Ch); [2006] BCC 725 at [157].

49 [1996] 2 BCLC 477

While with the decision meaning of judgment the actual making of a decision is obviously critical, there are indications from the Delaware and Australian case law that the notion of judgment is not simply limited to one final decision, such as the decision to make a takeover bid for another company or to enter a new industry. The decision to make a takeover bid, for example, is not the only part of business judgment, for business judgment also includes other actions that precipitate a final decision, such as the analysis undertaken by the directors of the takeover bid and its effect on the corporate enterprise.[50] In many cases judgment appears to include both the matters that lead up to a final decision as well as the final decision itself. The fact is that generally some of the case law indicates that making a judgment is a process. Save for very instant judgments that are made by directors without consideration of any note, something that is rare, there will be several elements to a decision, and in exercising a judgment a director is taking into account several things.

In this regard, the Delaware version of the BJR provides a presumption that in making a business decision the directors of a corporation acted on an informed basis, and so a final decision is only made at the end of a process of inquiry. Boards do not satisfy their obligation to be reasonably informed concerning the company without assuring themselves that information and reporting systems exist in the organisation that are reasonably designed to provide to senior management and to the board itself timely, accurate information sufficient to allow management and the board, each within its scope, to reach informed judgments concerning both the corporation's compliance with law and its business performance. The level of detail that is appropriate, for example, for such an information system is a question of judgment,[51] which involves the ability sense of judgment. Under the

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50 Unocal Corp v Mesa Petroleum 493 A 2d 946 (1985) at 955

51 In re Caremark International (698 A 2d 959 (1996) at 970

BJR in Delaware, directors have a duty to inform themselves, prior to making business decisions, of all material information reasonably available to them and this might include making judgments on what they ascertain from their inquiries which will lead to a final decision about a matter.[52] The US courts do look at process to ascertain whether the directors were well-informed; they focus on the decision making process and not merely the contents of the final decision.[53]

The only formal definition of business judgment available is found in the Australian Corporations Act 2001, resulting from Australia introducing in 1999 a formal business judgment rule in the mould of that extant in the United States. Section 180(3) of the Corporations Act states that business judgment means 'any decision to take or not take action in respect of a matter relevant to the business operations of the corporation.' This clearly comes within the decision meaning of the word 'judgment.' Nevertheless, it presupposes that there might be issues that pre-date the making of a final decision that are included in the concept of judgment and thus it also would support the notion that judgment can often be a process. Section 180(2) states that: 'A director or other officer of a corporation who makes a business judgment is taken to meet the requirements of subsection (1) [the duty of care]…if they… (c) inform themselves about the subject matter of the judgment to the extent they reasonably believe to be appropriate.' One would expect that informing themselves about the subject matter of the judgment could well include directors making various inquiries and

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52 Cede and Co v Technicolor Inc 634 A 2d 245 (1993).

53 Brehm v Eisner 746 A 2d 244 (2000). It has been argued that English courts also focus on process when assessing whether directors have breached their duty of care: S. Worthington, 'The Duty to Monitor: A Modern View of the Director's Duty of Care' in F. Patfield (ed), Perspectives on Company Law: 2 (London: Kluwer Law, 1997) p 97.

drawing conclusions from those inquiries as well as making decisions about the judgments of others and these might be seen as stages in the process of making a final decision or judgment.

What stands out is that 'judgment' in the sense of a decision, is not so much an event, like a final decision to enter into a sale of an asset of the company, but more of a process that leads up to a decision. The process is part of the decision and what is done leading up to the decision can be seen as part of judgment. Thus, is it possible to say that a court might assess one aspect of a series of judgments that leads to a final decision or are all of them protected from scrutiny? If a director were to undertake careful consideration of all aspects relevant to making a final judgment including taking advice, making inquiries, seeking views and generally engaging in due diligence and then he or she makes a decision which might be viewed as extraordinary given all of the things that he or she found out, and it causes the company loss, are courts going to refrain from holding the director liable? What if a director engages in several judgments before he or she makes a final decision, but one of the preliminary judgments was clearly wrong, does that mean that the director is able to be held liable? Hitherto, there does not appear to be any case law in England, the US or Australia that addresses these issues. Indeed, it is submitted that the correct explanation of many of the cases addressing business judgment is that a decision is not an unconnected event – it is a process. In the process that leads to a final decision directors will engage in inquiries and reflection at various stages before making decisions that all feed into the final decision.

Finally, in some instances the courts do not make it clear whether they are referring to judgment in the ability or decision sense. An example is Iesini v Westrip Holdings Ltd, a derivative action case, where Lewison J stated that the matters that a director, acting in

accordance with s.172, would consider in reaching a decision as to whether to authorise litigation by a company included a number of factors and that weighing these was 'essentially a commercial decision, which the court is ill-equipped to take.'[54] The judge could have been referring to the fact that courts do not have the ability to make such decisions, while directors do, or that the act of litigating or not litigating was a final decision that was effectively a commercial/business judgment that could not be reviewed. The same ambiguity exists in Re Sunrise Radio Ltd where the judge said that the price at which shares should be offered was a matter that had to remain one for the commercial judgment of the directors.[55] Perhaps a more striking example is Multinational Gas and Petrochemical Co. v Multinational Gas and Petrochemical Services Ltd[56] where Lawton LJ said that '(t)he decisions complained of…had been highly speculative and could not properly be regarded as falling within the scope of reasonable business judgment.' It is not clear whether he intended to say that the decision was a judgment but was not itself a reasonable business judgment or whether the directors had failed to exercise reasonable ability/judgment in coming to the decision.

While our focus has been on what the courts have said about business judgment it is interesting to note what has been said elsewhere, even though discussion has been thin, and particularly because what we have located mirrors what we find in the judgments. In a speech to the Westminster Business Forum in 2015 the Deputy Governor of the Bank of England, Andrew Bailey, stated that: '[W]e expect Boards to exercise good judgment in overseeing the

54 [2011] 1 BCLC 498.

55 [2010] 1 BCLC 367 at [96].

56 [1983] Ch 258 at 267

running of the firm…'[57] Clearly he saw judgment as an ability and that ability would come into play in making decisions. Management academics, Tichy and Bennis, refer to 'good judgments,' suggesting the making of decisions and then in the next sentence they refer to leaders showing consistently good judgment,[58] which involves ability. This seems to be aligned with the idea that judgment is not always seen as simply involving either of the two meanings of the word judgment, but can involve both. A director might be seen as exercising ability in taking actions that lead ultimately to a final decision about an aspect of corporate life. This seems to make sense, for one would think that a director is expected to exercise judgment in making inquiries, considering the extent of those inquiries and reaching conclusions before making a final decision about a particular matter.

The findings of their research into judgment led Tichy and Bennis to conclude that judgment does not occur in a single moment, it emanates from a process.[59] They argue that there are three parts to a judgment, and these are preparation to making a decision, the decision itself and the execution of the decision.[60] This general approach accords with Pettigrew's argument that taking a decision is not a single event, but involves a continuous decision-making process in context.[61] McNulty and Pettigrew make the point that there will be a whole range of behaviour that precedes the final decision and may impact on the form

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57 'Governance and the Role of Boards' 3 November 2015 p 3 at : http://www.bankofengland.co.uk/publications/Documents/speeches/2015/speech858.pdf (accessed, 4 July 2017).

58 n 15 above, p 94.

59 Ibid, p 95.

60 ibid p 95ff

61 A. Pettigrew, 'Studying Strategic Choice and Strategic Change. A Comment on Mintzberg and Waters : 'Does Decision get in the way?'' (1990) 11 Organization Science 6 cited in T McNulty and A Pettigrew, 'Strategists on the Board' (1999) 20 Organization Science 47 at 58.

that it takes.[62] All of this is consistent with some of the comments that have been made in the case law and discussed earlier.

4. THE 'BUSINESS' IN BUSINESS JUDGMENT

This section considers what constitutes a business judgment. This is not a straightforward enquiry because firstly the case-law is relatively silent about what capacities directors have as business-men that renders their judgment distinctively business judgments. Secondly, as explored below, whilst the courts label some decisions business judgments and not others, they do not explain on what basis they do so.

Turning to the first issue some dicta suggest that directors have a greater propensity to take entrepreneurial risks than others. Thus in Overend & Gurney Co v Gibb[63] the court commented that in the 'mercantile world…there is a great deal more trust, a great deal more speculation, and a great deal more readiness to confide in the probabilities of things, with regard to success in mercantile transactions'.[64] In Facia Footwear Ltd (in administration) v Hinchliffe, the court stated that 'the boundary between an acceptable risk that an entrepreneur may properly take and an unacceptable risk the taking of which constitutes (directors') misfeasance is not always…clear cut.'[65] In Re Sunrise Radio the judge referred to directors' 'entrepreneurial skills and instincts'.[66] This approach is similar to that adopted

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62 McNulty and Pettigrew, ibid p 58.

63 [1871-1872] LR 5 HL 480

64 Ibid at 495-496. See also Re Brazilian Rubber Plantation and Estates Ltd [1911] 1 Ch 425, 438; Re Brian D Pierson (Contractors) Ltd [2001] 1 BCLC 275 at 306.

65 [1998] 1 BCLC 218 at 228.

66 [2009] EWHC 2893 (Ch) at [6]

in Daniels v Anderson in which the New South Wales Court of Appeal referred to the need for directors to 'accept commercial risks' and display 'entrepreneurial flair' in order 'to produce a sufficient return on capital invested' [67] and to 'make business judgments…in a spirit of enterprise.'[68] While much of the case-law involves private companies, in policy documentation and academic literature the idea of directors as entrepreneurial includes those in dispersed share-ownership companies: thus the UK Corporate Governance Code that applies to listed companies states that '(t)he board's role is to provide entrepreneurial leadership of the company within a framework of prudent and effective controls which enables risk to be assessed and managed.'[69] The Institute of Directors described boards as needing to be 'entrepreneurial and (to) drive the business forward'.[70]

The idea that business judgment is concerned with risk is also reflected in Australian and US jurisprudence that addresses business judgment in the decision sense. In ASIC v Rich, for example, Austin J, stating that the Australian position mirrored the US's,[71] commented that most business judgment cases were concerned with risky or economic decisions. In the US, In re Citigroup Inc Chancellor Chandler stated that the essence of directors' business judgment involves evaluating the trade-off between risk and return.[72] The balancing exercise could involve assessing whether a single course of action is in the company's interests or

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67 (1995) 16 ACSR 607 at 658 (Clarke and Sheller JJA)

68 Ibid at 664.

69 FRC UK Code of Corporate Governance (2016) Supporting Principle to Principle A.1.

70 Standards for the Board: Improving the Effectiveness of your Board (London, 2001) p 4.

71 [2009] NSWSC 1229 at [7273] quoting P Redmond 'Safe Harbours or Sleepy Hollows: Does Australia need a Statutory Business Judgment Rule?' in I Ramsay (ed) Corporate Governance the Duties of Company Directors (Melbourne: Centre for Corporate Law and Securities Regulation, 1997) p 195.

72 964 A 2d 106 (2009)

choosing between alternative competing business policies. [73] It has also been suggested that a distinctive feature of business judgments compared with, for example, doctors' judgments, is that they involve a far greater choice of alternative courses of action, and as there is no standard practice to guide directors in this choice, they entail a higher degree of uncertainty.[74] Similarly, although investment trustees' judgments can also involve 'weighing risks and returns',[75] and although directors have been compared with trustees, directors' business judgment is not the same as that of trustees, as they can take greater risks and have greater discretion than trustees.[76]

The next question is whether all directors' decisions are business judgments. As noted earlier, s.180(3) of the Australian Corporations Act 2001 defines business judgment as 'a lawful judgment made for the conduct of the company's business operations'. In the US the BJR is applied to a 'good faith business decision' reached through a rational process.[77] These broad formulations do not address what an operational or a business decision is and one commentator has claimed that, 'Business has been defined to include all decisions that management is authorised to make.'[78] Eisenberg has argued that 'almost every business

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73 In Re Macro (Ipswich) Ltd [1994] BCC 781 at 833.

74 See F Gevurtz, 'The Business Judgment Rule: Meaningless Verbiage or Misguided Notion?' (1994) 67 Southern California Law Review 287 pp 307-309 , though he disagrees.

75 The Law Commission, Fiduciary Duties of Investment Intermediaries Law Com No 350 HC 368 (30 June 2014) p 95

76 LS Sealy, 'The Director as Trustee' (1967) CLJ 83, p 89.

77 In re Caremark International 698 A 2d 959 (1996).

78 'Conference Panel Discussion: The Business Judgment Rule' (1984) 45 Ohio State Law Journal, 629 at 630 (Tamar Frankel) .

decision is unique' [79] suggesting that attempts to identify types of business decision may be futile.

Nevertheless, this does not appear to be the approach of the courts in England and Wales. As the following discussion explains, whilst certain decisions have been clearly categorised as business judgments, there is less certainty about others.

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a) Business Judgments

In England most cases in which courts have explicitly recognised business judgments involve transactional dealings with third parties.[80] Even the preferred term of the English courts- 'commercial' judgment- incorporates the notion of commerce, which itself means 'the activity of buying and selling'[81] whereas the term business which originally meant 'busyness' has a broad modern meaning including 'commercial' activity but also 'a regular occupation, profession, or trade,' or a company or firm.[82] Similarly, in the US, In re Citigroup Inc Chancellor Chandler referred to the BJR as protecting 'business transactions', [83] whilst in Minstar Acquiring Corp v AMF Inc Judge Lowe commented that the BJR developed to protect judgments such as buying an asset or giving an employee a pay rise.[84] In Australia

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79 M Eisenberg 'The Duty of Care and the Business Judgment Rule in American Corporate Law' (1997) CFLICR 185

80 See for example, Cobden Investments Limited v RWM Langport Ltd [2008] EWHC 2810 (Ch); Moxon v Litchfield [2013] EWHC 3957 (Ch); ARB International Ltd v Baillie [2013] EWHC 2060.

81 Oxford English Dictionary at http://www.oed.com/view/Entry/37081?redirectedFrom=commercial#eid (accessed 31 July 2017)

82 Oxford English Dictionary at http://www.oed.com/view/Entry/25229?redirectedFrom=business#eid (accessed 31 July 2017)

83 964 A 2d 106 (2009) at 126

84 621 F.Supp. 1252 (1985 US Dist Ct SD New York).

meanwhile in ASIC v Rich Austin J recognised that decisions to enter into transactions for financial purposes were clearly business judgments, but it was unclear what else was covered.[85]

However the terms business/commercial judgment have also been applied to a wider, eclectic, range of decisions. In England strategic decisions to cut costs by laying off staff because of the view that there was not a market appetite for the company's products;[86] and not to follow up on opportunities that lay outside the main business objective of the company have been treated as legitimate business or commercial judgments.[87] In Re City Equitable Fire Insurance Co Ltd Romer J also stated that 'the manner in which the work of a company is to be distributed between the board of directors and the staff is a business matter to be decided on business lines.' [88] Business judgments are thus broader than purely economic decisions. The approach of the English courts seems in line with thinking elsewhere. Thus Austin J in ASIC v Rich recognised as business judgments: corporate personnel decisions, decisions to end litigation and 'setting policy goals and the division of responsibilities between the board and senior management.' Nevertheless, he quoted Redmond who referred to these as 'less explicitly business decisions.'[89] Meanwhile the Australian Companies and Securities Law Review Committee thought that judgments as to the company's goals, plans

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85 [2009] NSWSC 1229 at [7272]

86 F&C Alternative Investments (Holdings) Ltd v Barthelemy [2011] EWHC 1731 (Ch) at [167].

87 Oak Investment Partners XII v Boughtwood [2009] EWHC 176 (Ch) at [33].

88 [1925] Ch 407 at 427

89 [2009] NSWSC 1229 at [7273] quoting Redmond n 71 above, p 195. These are also business judgments in the US: Zapata Corp v Maldonado (430 A 2d 799 at 782 (1981); In re Walt Disney Co 907 A 2d 693 (2005).

and budgeting, promotion of the company's business, raising or altering capital, obtaining or giving credit, and deploying the company's personnel were business judgments.[90]

b) Business Judgments? Monitoring and Supervision

Different jurisdictions take divergent approaches to decisions related to monitoring and supervision. In Australia in ASIC v Rich Austin J stated that the discharge by directors of their 'oversight' duties, including their duties to monitor the company's affairs and to maintain familiarity with the company's financial position, does not entail business judgment because these do not involve a 'decision to take or not to take action' in respect of a matter relevant to the company's business operations.[91] Kershaw also argues that monitoring management is a 'non-decision-making' function of the board, though the information obtained by monitoring may inform decisions.[92]

Insofar as monitoring involves paying attention at board meetings and reading and understanding financial statements, then it may not involve decisions. On the other hand, in large companies, monitoring will require decisions about what systems and processes to institute to detect problems, whether these are adequate, how to respond to problems, and judgments about how interventionist supervision should be. In Delaware Chancellor Allen in In Re Caremark, described these as business judgments.[93] So in Delaware while a bad faith

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90 'Company Directors and Officers : Indemnification, Relief and Insurance' Report No 10 (1990), para 81

91 [2009] NSWSC 1229 at [7278].

92 D Kershaw, Company Law in Context: Text and Materials (Oxford: OUP, 2nd edn, 2012) p 410

93 In re Caremark International 698 A 2d 959 (1996) at [10]; See also S Bainbridge , 'Caremark and Enterprise Risk Management' (2009) 34 Journal of Corporations Law 967 p 986.

decision not to act or a failure to consider acting will breach directors' oversight duties, [94] if the failure to act is the product of a conscious and good faith decision, it is a business judgment protected by the BJR. [95]

The English courts' position is ambivalent. In ARB International Ltd v Baillie[96] Robin Knowles QC (sitting as a deputy High Court judge) found that although a director could have supervised more or differently he also held that the director was entitled to take 'a practical view' and delegate tasks to more junior staff [97] and, rather than actively supervising, 'make the assessment' that staff would seek his advice if they had questions.[98] This approach suggests that these were treated as matters of judgment.

On the other hand, in the leading case of Re Barings (No 5)[99] Jonathan Parker J found that a director's inadequate oversight involved a failure to exercise judgment and to act. The director had failed to keep himself informed about the business of the company,[100] failed to supervise, and had ignored red flags.[101] This amounted to non-management and he was consequently disqualified from acting as a director.[102] Yet the director's evidence provided a

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94 Stone v Ritter , 911 A.2d 362 (Del. 2006).

95 Graham v Allis–Chalmers Manufacturing Company 188 A2d at 130; In re Caremark International, Inc. Derivative Litigation, 698 A.2d 959 (Del. Ch. 1996); Stone v. Ritter , 911 A.2d 362 (Del. 2006). See also ALI Principles of Corporate Governance Analysis and Recommendations (1994) (March 2017 update) Comment to § 4.01(c) at para (g)

96 [2013] EWHC 2060

97 Ibid at [53]

98 Ibid at [55].

99 Secretary of State for Trade and Industry v Baker [1999] 1 BCLC 433

100 Ibid 508, 517-519

101 Ibid 522-524.

102 Ibid 528

different perspective. He claimed that the manner in which responsibilities had been apportioned between the board and others was quite deliberate and that 'it is an essential part of any investment banking organisation [that] it devolves downwards ... [I]t is a very flat management structure, and decisions can be made quickly by responsible people'.[103] He further argued that the degree of delegation was a business necessity: '[T]he only system of management which can possibly work is one which permits a high degree of delegation and de-centralisation.'[104]

This may well be ex-post rationalisation and the outcome of Barings seems clearly correct.[105] Nevertheless it demonstrates that what is categorised as a failure to exercise judgment at one point in time may be the product of earlier decisions regarding first how responsibilities should be distributed within the company, and secondly the degree of supervision that is appropriate after delegation. We have seen that whilst the status of the second is unclear, the first is a business judgment, for as Romer J stated in Re City Equitable Fire Insurance Co Ltd : 'the larger the business carried on by the company, the more numerous and the more important the matters that must of necessity be left to the managers, the accountants, and the rest of the staff'.[106]

c) Business Judgments? Decisions regarding seeking information

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103 Ibid 497

104 Ibid.

105 J Loughrey, 'The Director's Duty of Care and Skill and the Financial Crisis' in Directors Duties and Shareholder Litigation After the Financial Crisis (Cheltenham: Edward Elgar, 2012) p 23

106 [1925] Ch 407 at 409

As argued previously, decision-making is a continuous process that can require a number of decisions preceding the final decision. These include decisions regarding the amount of information directors should obtain in order to understand the nature of the company's business, and to come to properly informed decisions. Whilst Parkinson argued that 'deciding how much information to obtain, given the cost in time and money of obtaining it, in itself demands the exercise of judgment,'[107] it is unclear whether the English courts will treat these as business judgments, or matters that precede business judgments.

Some cases adopt the latter approach. In Re Paycheck, the director's failure to obtain advice from specialist insolvency practitioners led Mark Cawson QC to conclude that the director lacked information necessary to conduct a 'properly informed balancing exercise' and to 'exercise a judgment' regarding whether to continue to pay dividends.[108] In Re Sunrise Radio Ltd[109], whilst the price at which shares should be offered on a share allotment was deemed to be a matter of commercial judgment, H.H. Judge Purle QC indicated that the advice of an independent valuer should be sought before making that judgment. In contrast, in ARB International Ltd v Baillie,[110] Robin Knowles QC held that the failure to get legal advice was a matter of judgment for which the director should not be criticised, given the costs and its uncertain benefits.[111] The status of these judgments is therefore unclear.

(d) Not Business Judgments? Decisions Relating to the Constitutional Balance of Power

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107 Parkinson, n 2 above, p 112

108 [2009] BCC 37 at [268].

109 [2010] 1 BCLC 367 at [96].

110 [2013] EWHC 2060

111 Ibid, at [51].

The courts rarely opine that something is definitely not a business judgment. Our searches uncovered only one example. In Smith v Butler the suspension of a chairman by the managing director without the board's authority was 'not a commercial decision'.[112] In contrast, in Re Tottenham Hotspur plc, though business judgment was not discussed, the judge deferred to the board's views regarding whether the removal of the chief executive was in the best interests of the company.[113] However, in the former case the suspension breached the constitution and lay outside the managing director's authority, whereas in the latter 'the decision had been entrusted (to the board) under the constitution'.[114] These cases therefore concern the contractually agreed balance of power in the company. In Smith v Butler the chairman was the majority shareholder and the managing director was the minority shareholder, whose conduct sought to circumvent the protections provided by the constitution. In Re Tottenham Hotspur plc the dismissal neither breached the constitution nor the shareholders' understandings that the board would have the normal right to hire and fire.[115]

Decisions that raise issues about the constitution and/or the internal governance of company, including the relationship between the board and the general meeting, and between the majority and minority shareholders, and shareholder rights, may be distinct categories of judgment. In Smith v Butler H.H. Judge Behrens referred to *Pennington's* Company Law which drew a distinction between 'commercial matters' on the one hand, which included signing cheques, borrowing money, receiving payments of debts, giving guarantees and carrying on the company's business in the usual way and, on the other, transfers of shares in

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112 [2011] EWHC 2301 at [92].

113 [1994] 1 BCLC 655 at 660

114 Ibid.

115 Ibid at 559-660.

the company and alterations to its register of members, which are different from commercial matters.[116]

Similarly in Australia, the Company and Securities Law Review Committee thought that 'matters relating principally to the constitution of the company or the conduct of meetings within the company' were not business judgments.[117] Meanwhile Sealy has argued that the courts are willing to police directors' decisions on these matters usually through finding that such decisions amount to the abuse of power for an improper purpose,[118] but it is unclear whether this indicates that these either are not business judgments or are business judgments that courts will not defer to because of impropriety.

In sum, the case-law demonstrates that the courts do differentiate between different categories of decision. However they do not articulate why they do so, and so why a decision is a business judgment. This makes it difficult to assess whether the courts' approach is coherent, which in turn undermines certainty. However, as discussed previously, the courts characterise business judgment in the ability sense as entrepreneurial.[119] Arguably therefore business judgments in the decision sense are those that require directors to exercise entrepreneurial ability. Certainly the need to promote and shield entrepreneurial judgment is frequently cited by policy-makers and academics as a justification for the business judgment

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116 [2011] EWHC 2301 at [83] citing R Penningon, Pennington's Company Law (Oxford: OUP 8th edn, 2001) pp 147-148.

117 "Company Directors and Officers : Indemnification, Relief and Insurance" Report No 10 (1990) para 81

118 L S Sealy, 'Bona Fides and 'Proper Purposes' in Corporate Decisions' (1989) 15 Mon ULR 265 p 276. See for example Howard Smith v Ampol [1974] AC 821; Eclairs Group Limited v JKX Oil & Gas Plc [2015] UKSC 71.

119 Text at n 63 above.

rule, and for the need to defer to directors' decisions. [120] Despite this, whether business judgment can be characterised as entrepreneurial judgment has never been closely examined.

In order to assess this, it is necessary to understand what entrepreneurial judgment is. Although there are various strands of scholarship that consider what is distinctive about entrepreneurs,[121] Knight's 1921 seminal monograph Risk, Uncertainty, and Profit[122] is particularly relevant, because it focuses on the concept of entrepreneurial judgment. Furthermore it argues that entrepreneurial judgments are fundamentally about risk, which echoes discourse around business judgment and the BJR. Finally Knight addressed what entrepreneurial judgment entailed in the corporate context, including in dispersed share-

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120 See for example, J Velasco, 'A Defense of the Corporate Law Duty of Care' (2015) 40 Journal of Corporation Law 647, p 655

121 Schumpeter, for example, focuses on entrepreneurial innovation: J Schumpeter, The Theory of Economic Development: An Inquiry into Profits, Capital, Credit, Interest, and the Business Cycle (Cambridge, Massachusetts: Harvard University Press, 1934) 66, Kirzner on the ability of entrepreneurs to discover entrepreneurial opportunities: I Kirzner, Competition and Entrepreneurship (Chicago: University of Chicago Press, 1973). See also S. Alvarez and J Barney, 'Discovery and Creation: Alternative Theories of Entrepreneurial Action' (2007) Strategic Entrepreneurship J. 11.

122 F Knight, Risk, Uncertainty, and Profit (Boston : Houghton Mifflin, 1921). See also R Cantillon, Essai sur Le nature de commerce en général (London : Macmillan, 1931) pp 49-53
and the work building on Knight: C O'Kelley, 'The Entrepreneur and the Theory of the Modern Corporation' (2006) The Journal of Corporation Law 753; C O'Kelley, 'Berle and the Entrepreneur' (2010) 33 Seattle University Law Review 1141; R Emmett, 'Frank H Knight on the 'Entrepreneur Function' in Modern Enterprise' (2011) 4 Seattle University Law Review 1139; C O'Kelley, 'Coase, Knight, and the Nexus of Contracts Theory of the Firm: A Reflection on Reification, Reality, and the Corporation as Entrepreneur Surrogate' (2012) 35 Seattle University Law Review 1247; N Foss and P Klein, Organizing Entrepreneurial Judgment: A New Approach to the Firm (Cambridge: CUP, 2012).

ownership companies, unlike much writing on entrepreneurship which focuses on sole traders and start-ups.[123]

5. BUSINESS JUDGMENT AS ENTREPRENEURIAL JUDGMENT

This section first examines whether directors can exercise entrepreneurial judgment. It then examines whether viewing the directors' decision through the lens of entrepreneurial judgment provides a coherent framework for the courts' approach to directors' decisions.

a) Business Judgment And Entrepreneurial Ability

Knight identified entrepreneurs as having 'confidence in their judgment and disposition to 'back it up' in action (and) specialise in risk-taking' as well as 'superior managerial ability (foresight and capacity of ruling others)...'. [124] Entrepreneurs therefore are more willing to take risks than others and have better judgment regarding what risks are worth taking. [125]

Generally entrepreneurs are conceived of as risk bearers as well as risk takers.[126] In dispersed share-ownership companies, the separation of risk bearing, which is often assumed

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123 N Foss and P Klein, 'Introduction to a forum on the judgment-based approach to entrepreneurship: accomplishments, challenges, new directions' (2015) 11 Journal of Institutional Economics 585, 586.

124 Ibid, p 270

125 Knight distinguished between judgments dealing with risk and those dealing with uncertainty. However the term risk taking will suffice for the present discussion: see Knight n 122 above, pp 19-20. See also A Belcher, 'Something Distinctly not of this Character: How Knightian Uncertainty is Relevant to Corporate Governance' (2008) 28 Legal Studies 46, 63-66

126 Cantillon, n 122 above, pp 49-53.

to lie with the shareholders, and control, which resides with the board and management, has led to assertions that there is no entrepreneur.[127] If so, it would follow that there was no entrepreneurial judgment. Nevertheless Knight asserted that directors in these companies would exercise judgment 'as if they are entrepreneurs' (italics added).[128]

For this to be true, directors' business judgments must incorporate several elements: first, directors must exercise the same approach to risk taking as entrepreneurs. Secondly, as Knight argues, they should generally have greater skill than others to judge risks. Thirdly, as explained below, their judgments must be informed by, and designed to advance, the interests of the entrepreneurial risk-bearer. As an aside, this arguably is the company, not the shareholders, because shareholders are diversified and have limited liability and so are not fully exposed to, and have hedged the risk of, management making poor decisions.[129] In contrast the company is the risk bearer as it will bear the losses from directors' decisions and its assets are at stake.

Turning to the first element, the idea that entrepreneurs are more willing to take risks echoes the dicta of the court in Overend v Gurney that directors display a greater willingness to take risks than the general population. However entrepreneurial judgment is not concerned with risk taking per se, but with risk taking that balances risk against economic reward, taking into account the entrepreneur's exposure to the downside of the risk in question. Entrepreneurs are 'responsible' owners.[130] The classic entrepreneur is therefore Adam

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127 E Fama 'Agency Problems and the Theory of the Firm' (1980) 88 J Pol Econ 288, 289-290. For further discussion see O'Kelley's work at n 122 above.

128 Knight n 122 above , 360. See discussion in O'Kelley (2010) n 122 above, pp 1149 and generally.

129 Cf Knight ibid, pp 293, 301, 309 who considers that risk is borne by shareholders and others. See also O'Kelley (2012) n 122 above, pp 1261- 1264.

130 n 122 above, at 271.

Smith's sole trader- the butcher, the brewer, or the baker[131] whose risk taking is tempered by self-interest. It is this that drives innovation and economic growth, functions associated with the entrepreneur.[132] But the separation of ownership and control in dispersed share-ownership companies may cause directors' willingness to take risks to diverge from the entrepreneur's.

Thus on the one hand Coffee suggests that directors are more risk averse than shareholders because the impact of firm insolvency is greater for managers than for shareholders.[133] If so, directors' risk appetite could be more akin to the classic entrepreneur's than the shareholders', who are shielded from risk by diversification and limited liability. On the other hand, because directors do not own the residual value that results from their successful decisions, and because, for reputational reasons, they would not want to be associated with a failed enterprise, they could be more risk averse than the entrepreneur.

This is, as O'Kelley points out,[134] essentially an empirical debate, and the data is inconclusive.[135] However if directors approach to risk taking did diverge from the entrepreneur's, this could be addressed by, for example a BJR, if directors were too risk

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131 A Smith, The Wealth of Nations (New York: The Modern Library, 1994) Book 1 Chapter 2 p 15. See also O'Kelley (2010), n 122 above, p 1142.

132 Schumpeter, n 121 above, pp 76-78.

133 J Coffee, 'Litigation and Corporate Governance: An essay on Steering between Scylla and Charybdis' (1984) 52 Georgetown Washington Law Review 789 at 802-803. See also Parkinson, n 2 above, pp 65-67

134 O'Kelley (2006), n 122 above, p 772.

135 R Brockhaus, 'Risk taking Propensity of Entrepreneurs' (1980) 23 Academy of Management Journal 509; S Zahra, 'Governance, Ownership, and Corporate Entrepreneurship: The Moderating Impact of Industry Technological Opportunities' (1998) 39 Academy of Management Journal 1713; L Busenitz and J Barney, 'Differences between Entrepreneurs and Managers in Large Organizations: Biases and Heuristics in Strategic Decision-making' (1997) 12 Journal of Business Venturing 9.

adverse,[136] or more accountability through the duty of care if they took too much risk.[137] In any event, in England, most case-law relating to alleged directorial breaches involves director-shareholders in small closely held private companies. Although these do, in theory, have the benefit of limited liability, which could increase risk taking, many directors have personally guaranteed corporate debts, which may make their risk appetite more akin to entrepreneurs'.[138] Consequently if directors' business judgments are deferred to because they are entrepreneurial, those of owner-managers directors could deserve greater protection than those of directors in dispersed share-ownership companies.

On the other hand entrepreneurs are characterised as having greater ability to assess what risks to take than the general population. This could justify greater deference to the judgments of directors of dispersed share-ownership companies, who may be more likely to possess a superior ability to take well-judged risks than less experienced or inexperienced directors in owner-managed companies. Furthermore it could justify setting the objective standard of care in s.174 of the Companies Act 2006 at the level of the reasonably careful and competent entrepreneur, so that only judgments of this quality would receive protection from potential liability.[139]

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136 D Ibrahim, 'Intrapreneurship' (2016) 73 Washington & Lee Law Review 1741, 1772-1774.

137 Other mechanisms such as the use of stock options to align directors' and shareholder interests may encourage risk taking that discounts the downside of decisions: W Sandersand D Hambrick, 'Swinging for the Fences: The Effects of CEO Stock Options on Company Risk Taking and Performance' (2007) 50 Academy of Management Journal 1055.

138 A Hicks, 'Corporate Form: Questioning the Unsung Hero' (1997) JBL 306, 316-317.

139 There may though be other reasons for protecting directors from liability that could support a different standard. See, C Riley, 'The Company Director's Duty of Care and Skills: The Case for an Onerous but Subjective Standard' (1999) 62 MLR 697

The final issue with conceptualising directors' business judgment as entrepreneurial judgment is that, as owners of the business, entrepreneurs exercise judgment on their own behalf, and directors do not. Knight asserted that this created a fundamental difference between the judgment of even very senior 'hired managers' on the one hand, and that of 'the man of business on his own account' on the other. Whereas'(t)he former has had his task cut out for him by others and been set to perform it; the latter has cut out his own task to fit his own measure of himself and set himself at it.'[140] Entrepreneurial judgment is therefore distinctive in that it is informed by, and designed to advance, the entrepreneur's business interests. The judgment of hired managers and employees, though it may entail the exercise of a great deal of discretion, can only advance a plan designed to promote the interests of another,[141] though they may incidentally benefit from their decisions through increased remuneration or improved reputation.

Puzzlingly Knight himself did not consider that directors were hired managers,[142] but executive directors certainly are, and even non-executive directors are not in business on their own account. In any event, he thought that directors would be psychologically motivated to act like entrepreneurs because 'the 'personal' interests which our rich and powerful businessmen work so hard to promote are not personal interests at all….The real motive is the desire to excel, to win at a game'.[143] This view finds support more recently in stewardship

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140 Knight n 122, pp 297-298

141 Ibid.

142 Ibid at 297, Knight describes the hired manager who is the 'supreme head of the business' as someone other than the directors.

143 Knight n 122 above ,360. See discussion in O'Kelley (2010) n 122 above, pp 1149 and generally.

theory that holds that directors will identify with their company and so act as responsible stewards.[144]

Agency theorists disagree, arguing that because directors are not owners they will shirk and pursue their own interests. [145] Adam Smith similarly argued of directors of joint stock companies that:

> (B)eing the managers rather of other people's money than of their own it cannot well be expected that they should watch over it with the same anxious vigilance with which partners in a private company frequently watch over their own.[146]

However whilst the empirical question of how directors act has not been settled, the law imposes fiduciary duties that not only prohibit directors from pursuing their interests instead of the company's, but also a positive duty requiring directors to take decisions that are informed by the company's interests. Thus s.172 of the Companies Act 2006 stipulates that a director must 'act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole' (italics added). Section 172 is therefore targeted at directors' judgment. It requires directors not just to set aside their own interests when making judgments, but to also make judgments that are directly influenced and shaped by the company's interests. In effect the law requires directors to take decisions as if they were the entrepreneurial risk-bearer, the company.

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144 J Davis, F Schoorman and L Donaldson, 'Toward a StewardshipTheory of Management' (1997) 22 The Academy of Management Review 20.

145 M Jensen and W Meckling , 'Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure' (1976) 3 Journal of Financial Economics 305, p 313

146 Smith, n 131 above, p 800.

The reason this duty is imposed on directors and not on other hired managers and employees is because, by formally assuming the office of a director, a person undertakes, either alone or as part of the board, to act on behalf of the company.[147] The law will also impose these duties when someone exercises sufficient control over the company to count as a de facto director.[148] Thus in Holland v HMRC[149] the majority in the Supreme Court stated that a de facto director was someone who was part of the corporate governance structure of the company. In explaining what this might mean Lord Collins adopted the definition in the Cadbury Report that '(c)orporate governance is the system by which companies are directed and controlled.'[150] O'Kelley has argued that the degree of control that executive directors, such as CEOs, exercise over the firm is analogous to the control that an entrepreneur exercises over her firm;[151] similar claims can be made for de facto directors.[152] Thus the imposition of fiduciary duties, particularly s.172, on persons who take decisions that control the company, much as an entrepreneur controls the firm, (including setting its strategic direction[153]) has the effect of requiring them to exercise judgment as if they were the corporate entrepreneur.

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147 Sealy, n 76 above, p 91.

148 Re Hydrodan (Corby) Ltd (in liquidation) [1994] BCC 161 at 163; Sec of State for Trade and Industry v Tjolle [1998] 1 BCLC 333; Sec of State for Trade and Industry v Jones [1999] BCC 336 at 341. There is disagreement over whether shadow directors exercise sufficient control over the company to justify the imposition of the duty: Ultraframe (UK) Ltd v Fielding [2005] EWHC 1638 (Ch), at [1289] (Lewison J); Vivendi SA v Richards [2013] BCC 771 at [142] (Newey J)

149 [2010] UKSC 51 at [91]

150 Report of the Committee on the Financial Aspects of Corporate Governance, 1992, para 2.5

151 O'Kelley (2006) n 122 above, p 770.

152 On shadow directors see n 148 above.

153 Re Sports Management Group Ltd (In Liquidation) [2016] BPIR 1224 at [113].

The fact that courts will not defer to directors' decisions that are tainted by conflicts of interest or bad faith, is consistent with the conception of business judgment as entrepreneurial judgment. These decisions may display entrepreneurial ability in terms of risk taking and risk assessment, or even in terms of creativity and innovation, but they are not informed by, and do not advance the interests of the corporate enterprise and so should not be protected business judgments.

In sum, it is possible to conceptualise business judgment in the ability sense as entrepreneurial judgment: it is consistent with the scope and application of directors' fiduciary duties, and with the focus on risk-taking in discussions of directors' judgment.

b) Entrepreneurial Judgment and Business Decisions

Viewing business judgment as entrepreneurial judgment also provides a coherent framework for distinguishing between the decisions that directors take that are linked to the different roles they perform, and in particular the entrepreneurial role.

To explain, the Higgs Report identified directors as having distinct functions of wealth creation and monitoring. The former maps onto the entrepreneurial function, whilst the latter is key to a corporate governance role.[154] Higgs was concerned with non-executive directors, who are expected to discharge a monitoring function at board level, but these comments could also apply to executive directors who must monitor management below board level.[155] Higgs is not alone in this approach: the literature also identifies boards as

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154 Review of the Role and Effectiveness of Non-executive Directors (January 2003) para 1.12.

155 See Re Barings (No 5) [1999] 1 BCLC 433; AWA Ltd v Daniels (1992) 10 ACLC 933 at 1014.

having distinct management/strategy and monitoring roles which can be in tension with each other.[156]

Decisions that the courts classify as business judgements can be linked to the entrepreneurial role, requiring the exercise of entrepreneurial ability. Conversely decisions that the courts are more ambivalent about are less clearly entrepreneurial and more closely linked to the directors' corporate governance role.

Thus we have seen that transactional decisions have been described as core business judgments.[157] When viewed through the lens of entrepreneurial judgment, a rationale for their significance becomes clear. Given that the goal of entrepreneurial activity is 'to make money',[158] transactional decisions must be core entrepreneurial decisions: these are the main types of decision made by entrepreneurs and without them a business would not profit.[159]

Decisions that have been classified as less 'explicitly business', but treated as business judgments, are also entrepreneurial. For example as a key function for the entrepreneur is to set the direction of her business, strategic decisions are entrepreneurial.[160] Meanwhile decisions regarding to whom to recruit and delegate tasks were considered by

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156 M Eisenberg , The Structure of the Corporation-A Legal Analysis (Washington: Beard Books, 1976) pp 139-141; Parkinson, n 2 above, p 57; M Eisenberg, 'The Board of Directors and Internal Control' (1997) 19 Cardozo Law Review 237. Not everyone agrees that a tension exists between these roles: Roberts, McNulty and Stiles, n 7 above.

157 964 A 2d 106 (2009) at 126; *Minstar Acquiring Corp v AMF Inc* 621 F.Supp. 1252 (1985 US Dist Ct SD New York).

158 Knight n 122 above p 292

159 As recognised in Re Spectrum Plus Ltd [2005] 2 BCLC 269 at [95] (Lord Hope)

160 Knight, n 122 above, p 298.

Knight as the most important decision for the entrepreneur leading an organization. He described business judgment (by which he meant entrepreneurial judgment) as 'chiefly judgments of men'[161] and argued that 'the crucial decision (for the entrepreneur) is the selection of men to make decisions'.[162]

Moreover this accords with our earlier submission that directors' judgments are not always single events, but the end result of a process of judgments. If a director consistently makes good or poor decisions this indicates something about the prior judgments of those who appointed her. In sum, these decisions are directly linked, or are necessary incidents to, the wealth creation function and they do not necessarily implicate the directors' corporate governance role.

On the other hand, as noted previously, the courts are ambivalent about whether monitoring involves business judgment. It seems unlikely that it involves entrepreneurial judgment. Knight said nothing about the entrepreneur monitoring those to whom he delegates. On the contrary, he argued that the entrepreneur endeavours to appoint people who understand the limitations of their own knowledge and will take the initiative to seek advice.[163] Schumpeter meanwhile asserted that 'the function of superintendence in itself, constitutes no essential economic distinction' of the entrepreneur.[164] In other words, whilst decisions about delegation are crucial entrepreneurial decisions, and have been recognised as business judgments,[165] superintendence, or monitoring, is not intrinsic to the entrepreneurial role.

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161 Ibid p 291 and also p 297.

162 Ibid p 291.

163 Ibid , pp 295-296.

164 Schumpeter, n 121 above, p 20

165 Re City Equitable Fire Insurance Co Ltd [1925] Ch 407 at 427

Yet monitoring is a central board function in the dispersed share-ownership company. As Middleton J stated in ASIC v Healey, 'it was a core irreducible requirement of directors to be involved in the management of the company and to take all reasonable steps to be in a position to guide and monitor'.[166] In large companies, particularly if the board is primarily staffed by part-time non–executive directors, it may be the board's core function; the management/entrepreneurial function will be peripheral.[167]

Monitoring and supervision therefore are important because they fall within the board's corporate governance role. Judgments on these matters perform different functions from entrepreneurial judgments. Unlike entrepreneurial judgments, monitoring does not necessarily involve decisions about how to drive the business of the enterprise forward. While entrepreneurial judgments entail the exercise of discretion, monitoring operates as a constraint on that discretion, being directed at mitigating agency costs-that is, the risk that managers will pursue their own interests rather than the company's.[168] In addition, whilst entrepreneurial judgment involves risk-taking, following the Global Financial Crisis, and incidents such as the Deep Water Horizon disaster,[169] it has been recognised that the board needs to monitor in order to restrain excessively risky behaviour.[170] Furthermore, although decisions about assumption of risks will often be entrepreneurial as well as business judgments, much could depend on the risks involved. For example, decisions about the level of financial risk the company should undertake in order to achieve its objectives seem

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166 [2011] FCA 717 at [16].

167 Cf McNulty and Pettigrew n 61 above.

168 Eisenberg (1997), n 156 above, pp 245-247.

169 BP Oil Disaster: http://www.bbc.co.uk/news/special_reports/oil_disaster (accessed 15 August 2017).

170 FRC, Boards and Risk (2011) p 4; FRC, Guidance on Risk Management, Internal Control and Related Financial and Business Reporting (September 2014) pp 2-3.

entrepreneurial in nature. On the other hand, decisions about levels of operational risk, that is, risks arising from 'inadequate systems, management failure, faulty controls, fraud, and human error',[171] and compliance risks, that is, decisions about whether to comply with the law, are less obviously so, and the last are also not business judgments.[172] Rather these relate to the directors' monitoring and corporate governance role. [173]

In sum the courts' reluctance to recognise monitoring as involving business judgment is consistent with linking business and entrepreneurial judgment and with the claim that decisions that enlist the board's governance role are less likely to be deferred to as business judgments.

As discussed above, decisions relating to seeking information are dealt with inconsistently by the courts. Assuming these decisions are treated as judgments, whether they can be treated as business judgments or not could turn on whether the information was needed for entrepreneurial purposes, such as the valuation of an asset that the company proposes to dispose of, or for corporate governance purposes such as monitoring. The failure to make this distinction may underpin the lack of clarity about how such decisions should be approached.

Finally, the entrepreneurial/governance distinction also provides a coherent rationale for the courts' approach to internal management decisions. Decisions relating to internal management are not obviously entrepreneurial in terms of advancing the interests of the

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171 M Crouhy, D Galai, R Mark The Essentials of Risk Management (New York: McGraw Hill, 2006) p 30 cited in Bainbridge n 93 above, p 969.

172 Grimes v Donald 20 Del J Corp L 757, 771 (Del. Ch. Jan 11 1995); ASIC v Fortescue Australian Securities Metals Group Ltd [2011] FCAFC 19; (2011) 81 ACSR 563.

173 Bainbridge n 93 above, p 151 links these to monitoring though would argue they should be protected by the BJR.

enterprise in wealth creation. Rather they are more concerned with the interests of corporate constituents such as shareholders, and can raise issues of corporate governance, particularly the constitutional balance of power. However if some constitutional decisions are entrepreneurial in nature, they could be classified as business judgments.

In sum identifying whether decisions are more closely linked to the directors' entrepreneurial or corporate governance functions can provide a rationale for classifying some decisions as business judgments to which the courts will defer, and others as decisions to which they will not defer. Decisions that are considered core business judgments are comfortably linked to the entrepreneurial role and require the exercise of entrepreneurial ability. Decisions that are still considered business judgments, but intuitively recognised as 'less business' are indirectly linked to wealth creation and do not usually raise governance issues. However the more closely a decision is linked to the corporate governance function, the more reluctance courts show to classifying it as a business judgment that they will defer to. Such decisions are also less likely to require the exercise of entrepreneurial ability. Decisions will not always fall solely within either the entrepreneurial or the governance function, but will rather lie along a spectrum between the two: this will create disagreement about their classification and treatment. Nevertheless the concept of business judgment advanced here provides a framework for a principled debate regarding how such disagreement should be resolved.

CONCLUSION

Business judgment is an ill-defined but nuanced concept. We found that the courts utilise two meanings of the term judgment. One defines it in terms of experience and ability, the second in terms of decisions. It has been argued that when the courts consider what distinctive abilities directors have, they think of entrepreneurial ability. Meanwhile the courts

tend to categorise as business judgments decisions that can be linked to the directors' entrepreneurial role; those that are not so categorised, or about which there is ambivalence, are more likely to be linked to the corporate governance role, and not connected, or less so, to the entrepreneurial role. Consequently identifying business judgment with entrepreneurial judgment fits with judicial practice and provides a means of identifying and differentiating between the different types of decisions that directors take.

This analysis opens up important avenues for future research. For example the question of whether the manner in which the courts conceive judgment and the decision-making process is an accurate reflection of how directors and boards actually function in practice needs exploration. A concept that diverges from boardroom reality could be problematic in terms of its utility and legitimacy as a mechanism for promoting director accountability, or for shielding directors from accountability.

Again the question of whether directors do in fact exercise entrepreneurial judgment, whether it is desirable for them to do so, and the relevance of context, requires investigation. Directors in dispersed share-ownership companies may be less risk adverse than, but have similar skills in assessing risk as, the classic entrepreneur. The reverse may be true in owner-managed companies. If neither group actually display entrepreneurial qualities it may be necessary to reconsider the basis for protecting their judgments. This is not to suggest that their decisions should necessarily be subject to greater review: rather that the question of how to approach different types of directors' judgments needs more nuanced consideration. This includes considering whether it is desirable to apply judicial deference to decisions that are entrepreneurial in nature, rather than non-entrepreneurial decisions. This article establishes a new framework for that debate: by identifying that the courts do distinguish between different judgments, and by offering a principled basis for these distinctions, it suggests that

the rationales for protecting or scrutinising different types of judgments could vary in nature and weight, something that previous academic discussion has not addressed.

Attaching the label business judgment to almost everything directors do, or alternatively using the business judgment label to simply signal that the court will not review a judgment, or impose liability, obfuscates these differences. It is also unhelpful: it leads to the perception that the immunity from accountability provided by judicial deferral to directors' decisions arises due to the directors' office, and it creates a degree of uncertainty concerning for what directors will be accountable. 'Director exceptionalism' is not easy to defend in a society increasingly concerned with the accountability of powerful actors. Focusing attention on the nature and social utility (or otherwise) of directors' judgments constructively reframes the debate.