Directors' Duties of Care, Skill and Diligence: An Analysis of Some Developments in Malaysia†

Sujata Balan,* Saw Tiong Guan,** Sarah Tan Yen Ling***

Abstract

In 2007, the Malaysian Companies Act 1965 was amended to incorporate new provisions to deal with directors' duties of care, skill, and diligence and their powers of delegation and reliance on information provided by others. In addition, a 'business judgment rule' was inserted into the Act. This article examines, from the Malaysian perspective, the origins of these novel provisions, their contents, the need for enacting them and their likely impact on business processes and managerial decisions made by company directors in Malaysia.

I. INTRODUCTION

There is a growing trend towards better corporate governance in Malaysia. Since the implementation of key legislation such as (amongst others) the Malaysian Code of Corporate Governance (MCGG) introduced in 2000 and amended in 2007, the 2007 amendment to the Malaysian Companies Act (the Act) and the Financial Services Act 2013, there has been a shift in the focus of corporate governance towards a more accountable business environment. In 2007, the Malaysian Companies Act 1965("the Act") was amended to incorporate provisions to deal with director's duties of care, skill, and diligence and their powers of delegation and reliance on information provided by others. The standard of care expected of a director has evolved from a previously silent self-regulated position, relying heavily on the assumption of honesty and reasonable diligence, to a more structured system.

In addition, a complementary provision was inserted into the Act, namely a 'business judgment rule', intended to protect directors from liability for their business judgments, provided that certain requirements are fulfilled. The old position prior to the amendment took the view that courts substituted their inexperience in the world of commerce for the assumption of good faith by directors. This position operated on the presumption that independent and more business-savvy directors with extensive commercial knowledge could be relied on to act honestly and rationally.

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† This article is dedicated to the late Professor Dato' P. Balan who was a source of wise counsel and great inspiration.

* Senior Lecturer, Faculty of Law, University of Malaya, Kuala Lumpur, Malaysia
** Senior Lecturer, Faculty of Law, University of Malaya, Kuala Lumpur, Malaysia
*** Lecturer, Faculty of Law, University of Malaya, Kuala Lumpur, Malaysia

This article discusses these two pertinent developments in Malaysia,[1] examines the origins of these novel provisions, their contents, the need for enacting them and their (likely) impact on company directors in Malaysia. It also intends to demonstrate that the courts are no longer leaving the question of sound business judgements squarely on the dictates of commerce. Current changes in the law are skewing directors towards taking more reasonable and considered decisions for the benefit of the company.

II. THE ENGLISH AND AUSTRALIAN HERITAGE

Malaysia's bond with English company law began in the last quarter of the nineteenth century when the legislature of the Straits Settlements[2] enacted its first Companies Ordinance based on the Companies Act 1862 of England. The current legislation on companies in Malaysia, the Companies Act 1965, is based on the Uniform Companies Act 1961 of Australia, also a descendant of English legislation on companies. The Malaysian Act is not a Code and a substantial part of the law in Malaysia is derived from case law. English case law on companies applies in Malaysia by reason of s 3 of the Malaysian Civil Law Act 1956 which provides that English common law and equity as they stood on the cut-off dates specified in the Act apply in so far as the local circumstances of the states of Malaysia and their respective inhabitants permit.[3] The cut-off dates are: (a) 7 April 1956 for West Malaysia, (b) 12 December 1949 for Sarawak, and (c) 1 December 1951 for Sabah. As a result of this strong link with English law, cases on company law decided before the cut-off dates continue to apply in Malaysia,[4] while English cases decided after the cut-off dates are not binding but are of persuasive authority. Another outcome of this link with English law is the enduring interest in Malaysia about new developments in the company law in England and other common law jurisdictions to which English company law jurisprudence has travelled. Australian case law has no binding effect in Malaysia although they are highly persuasive. Scattered references to Australian case law can be found in many Malaysian decisions.[5]

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1 The *Companies (Amendment Act) 2007* (Act A1299), the Act through which these amendments were achieved, also made other significant changes regarding directors' duties. For a discussion of these changes, see Balan, Sujata and Lingam, S.T,'The Effects of the Companies (Amendment) Act 2007 on Directors' Duties in Malaysia: Some Observations',(2007) 5(2)*Asia Law Review*, pp 115-163 and Mohammad Rizal Salim, 'Company Law Reform in Malaysia: The Role and Duties of Directors'(2009) *International Company and Commercial Law Review*, p 142.

2 At that time the Straits Settlements comprised Penang and Malacca and the island of Singapore.

3 For further discussion of the reception of English Law in Malaysia under the *Civil Law Act 1956* see Wan Arfah Hamzah, *A First Look at the Malaysian Legal System* (Oxford Fajar, 2009) pp 115 - 149; Sharifah Suhanah Syed Ahmad, *Malaysian Legal System* (2nded, Butterworths Asia, 2007) pp 177 – 196; and Wu Min Aun, *The Malaysian Legal System* (2nded, Longman, 1999) pp 89 – 144.

4 *PJTV Denson (M) Sdn Bhd* v *Roxy (Malaysia) Sdn Bhd* [1980] 2 MLJ 136, *Ng Pak Cheong* v *Global Insurance Co Sdn Bhd* [1995] 1 MLJ 64 and *The Board of Trustees of the Sabah Foundation &Ors v Datuk Syed Kechik bin Syed Mohamed & Anor* [2008] 5 MLJ 469 are examples of cases where English law on the fiduciary duties of a director was applied by the Malaysian courts.

5 See for instance *Tan Guan Eng* v *BH Low Holdings Sdn Bhd* [1992] 1 MLJ 105, *Lim Hean Pin* v *Thean Seng Co Ltd* [1992] 2 MLJ 10,*Gula Perak Sdn Bhd* v *Agro Products (M) Sdn Bhd* [1989] 1 MLJ 442, *Cepatwawasan Group Bhd & Anor v Tengku Dato' Kamal Ibni Sultan Sir Abu Bakar& 17 Ors* [2008] 2 MLJ 915 and *Pioneer Haven Sdn Bhd v Ho Hup Construction Co Bhd & Anor and other appeals* [2012] 3 MLJ 616.

III. DIRECTORS' DUTIES: DEVELOPMENT OF THE LAW IN THE PAST TWO CENTURIES

A. Dynamic growth of company law did not include the law relating to directors' duties of care, skill and diligence

A general observation that may be made of company law in England and other common law jurisdictions is that it has, in the form of either statutes or case law, developed and advanced at a tremendous pace in the past two centuries.[6] A striking feature of this dynamic growth was the evolution of strict principles governing directors' fiduciary duties to their companies, a development achieved mainly through the unrelenting efforts of judges to ensure that directors acted honestly and did not use their position to feather their own nests. Despite the vibrant growth of *this* aspect of company law, negligible attention was given, until recently, to the development of a closely connected area to directors' fiduciary duties – the duties of care, skill and diligence that directors owe to their companies. Until the closing years of the twentieth century little judicial attention was displayed in England and other common law jurisdictions to evolve clear principles regarding this subject. The cases display reluctance by the courts to enter the boardroom and cast their judgment over management or risk-taking decisions of directors, probably because it was a function for which judges are inadequately trained and ill-equipped to decide.[7]

This lack of judicial enthusiasm to develop this area of the law may have stemmed mainly from the fact that most directors were part-time directors without any contractual obligations to the companies they served. Further the office of director was not recognised as a profession, or as a profession which required its holder to display specific skills.[8] Most of them were elected not because of their qualifications, skills or commercial acumen but because of the respectable and influential positions that they enjoyed in society. The end result of all these was that the courts refrained from applying the strict standard of care, skill or diligence imposed upon trustees or agents or employees to company directors and, until recent years, set lenient standards for directors.

A lack of zeal to develop this area of law was also displayed by the legislature. Until recently, the legislature had failed to demonstrate any visible eagerness to advance the law in this area by statutory involvement. In recent years, the demands of modern commerce, the increased emphasis on good governance and the calls for stricter standards from law reformers, have compelled the legislatures of many countries to enact special provisions to deal with the subject of directors' duties of care and skill. Two examples

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6 An item of evidence of this tremendous growth is the massive size of the present Companies Act 2006 of the United Kingdom and the Corporations Act 2001 of Australia.

7 See *Gower's Principles of Modern Company Law* (4thed, London: Stevens & Sons, 1979) at pp 602-604 for a vivid account of the disinclination of the courts to impose a stricter degree of skill and diligence. Whilst referring to the difficulty faced by judges in examining boardroom decisions Gower commented (at p 602):

> Whereas their training and experience made them well-equipped to adjudicate on questions of loyalty and good faith, they move with less assurance among complicated problems of economics and business administration. Hence they display an understandable reluctance to interfere with the directors' business judgment-a reluctance of which many examples will be found throughout the whole area of company law.

8 See *Farrar's Company Law* (4thed, London: Butterworths, 1998) at pp 391-2.

are the relevant provisions enacted in the United Kingdom in 2006 by the Companies Act 2006[9] and in Malaysia by the Companies (Amendment) Act 2007 (Act A1299).[10] These provisions are discussed below.

B. The case of Re City Equitable Fire Insurance Co Ltd : A brief revisit

For about seven decades, English law on directors' duties of care and skill was influenced by Romer J's celebrated dictum in the1925 case of *Re City Equitable Fire Insurance Co Ltd*.[11] It was generally assumed that the dictum also applied in Malaysia, although there is no direct judicial authority on this point.

In the course of his judgment, Romer J made a survey of the leading cases on the subject and expressed the view that the legal position regarding directors' duties of care, skill and diligence was reflected in three propositions.[12] A brief analysis of each these propositions is a helpful prologue for a proper exposition of the new statutory developments that will be examined in the later parts of this article.

The first proposition dealt with a director's duty of skill. His Lordship said:

> A director need not exhibit in the performance of his duties a greater degree of skill than may reasonably be expected from a person of his knowledge and experience.[13]

This proposition, which prescribed a subjective element ('be expected from a person of his knowledge and experience'), has been the subject of constant criticism by judges and commentators.[14] The skill required of a director was linked to his 'knowledge and experience'. It can be seen that this subjective standard favoured a director with little or

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9 See section 174 of the *Companies Act 2006*.

10 A new provision, s 132(1A), was inserted into the *Companies Act 1965* by the *Companies (Amendment) Act 2007*.

11 [1925] Ch 407. In this case, a company went into winding up after it lost an enormous sum of money. The losses were caused mainly by the deliberate fraud and other "nefarious activities" of its managing director, G.L. Bevan. The defendants in this case were Bevan's trusting colleagues on the board. They were all part-time directors. The liquidator (the plaintiff) of the company sought to make them liable for some of the losses. The plaintiff alleged that the losses were caused by the defendants' negligence, although the plaintiff admitted they were all honest individuals. The directors escaped liability because of article 150 of the company's articles of association which protected them from liability. Such a clause will be invalid today. See for example, s 140 of the Malaysian *Companies Act 1965* and s 232 of the United Kingdom *Companies Act 2006*.

12 Professor John Farrar classifies Romer J's views into four propositions. See Farrar, Director's Duties of Care, Issues of Classification, Solvency and Business Judgment and the Dangers of Legal Transplants, (2011) 23 SAcLJ 745 at 00 747-750.

13 [1925] Ch 407 at p 428.

14 See for instance High Level Finance Committee Report on Corporate Governance (Malaysia) Ch 6 paras 2.2.51-2.2.65;*Daniels and Ors v Anderson and Ors*(1995)16 ACSR 607 at p 659 (New South Wales Court of Appeal). But critics of *Re City Equitable Fire Insurance Co Ltd* may have misread Romer J's first proposition. See Hicks, 'Directors' Liability for Management Errors', (1994) 110 *Law Quarterly Review* p 390 for a thought-provoking analysis of the case.

no knowledge and experience.[15] A director with less skill and experience had a higher prospect of escaping liability for negligence than his or her counterpart who had greater skill and experience. The subjective standard was in fact a strong dissuasion for directors to improve their knowledge, skill, experience and professionalism as they will then be required to perform and carry out their duties on a higher standard.

It is not clear from Romer J's judgment whether the first proposition applied to both part-time and full-time salaried directors. The defendants before his Lordship in *Re City* were all part-time directors and it is highly probable that the learned judge had in mind a part-time director. It is submitted that even in the nonchalant era in which *Re City* was decided this lenient proposition could not have applied to the skill expected from full-time salaried directors.[16]

English case law began to move away from Romer J's subjective standard in the closing years of the twentieth century. This move culminated in the enactment of s 174 of the Companies Act *2006*, a provision which adopts a new and stricter two-fold objective/subjective test and which is crafted to apply to both part-time and full-time salaried directors. The legislature in Malaysia has inserted a similar statutory provision in s 132(1A) of the Companies Act 1965 in 2007 and this will be further discussed below.

Romer J's second proposition dealt with a director's duty of diligence. His Lordship said:

> A director is not bound to give continuous attention to the affairs of his company. His duties are of an intermittent nature to be performed at periodical board meetings, and at meetings of any committee of the board upon which he happens to be placed. He is not, however, bound to attend all such meetings, though he ought to attend whenever in the circumstances he is reasonably able to do so.[17]

This proposition was meant to reflect the law as it stood in 1925 and it is fairly certain that Romer J must have intended it to apply to a part-time director of his day. The indulgent

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15 *In re Brazilian Rubber Plantations and Estates Ltd* [1907] 1 Ch 425 Neville J made the following remarks *(obiter)* about a director of a rubber company (at p 437):

> He may undertake the management of a rubber company in complete ignorance of everything connected with rubber, without incurring responsibility for the mistakes which may result from such ignorance; while if he is acquainted with the rubber business he must give the company the advantage of his knowledge when transacting the company's business.

16 See also the views expressed in Gower and Davies, *Principles of Modern Company Law* (8th ed, London: Sweet and Maxwell, 2008) at p 489.

17 [1925] Ch 407 at p 429.

attitude in the second proposition is reflected in the relevant case law of the later part of the nineteenth century.[18]

It is apparent that Romer J's second proposition would be inappropriate for full-time or executive directors of his time, who would have been expected to give their full attention to the companies in which they serve as directors. Further, it may not be an appropriate standard for the present day's non-executive or independent director, even though such a director is a part-time official. As the years passed after the *Re City* case, the importance of the role played by non-executive, part-time or independent directors in achieving effective corporate governance has become a feature of emphasis in many jurisdictions. Although such directors need not give full-time attention to the affairs of the company, they must take active steps to understand the company's structure, its constitution, its business operations, its internal controls and keep themselves informed of its affairs. Further, although they are a part-time directors, greater diligence may be demanded of them in attending meetings.[19]

Romer J's third proposition dealt with delegation of the duties of a director. His Lordship said:

> In respect of all duties that having regard to the exigencies of business and the articles of association, may properly be left to some other official, a director is, in the absence of grounds of suspicion, justified in trusting that official to perform such duties honestly.[20]

This third proposition is, as a general rule, true today as it was in 1925 and may apply to both executive and non-executive directors. Except in the case of very small companies it is impossible for a board of directors to discharge their duties without delegating some of the duties to its skilled managers and employees. It is inevitable that directors will need to rely on those persons, and on persons who supply them with information, to be

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[18] For example, in *Re Denham & Co* (1883) 25 Ch D 752 a director did not attend board meetings for four years. He was held to be not personally responsible for fraudulent reports and balance sheets issued and passed by his fellow directors. In *Re Cardiff Savings Bank, The Marquis of Bute's Case* [1892] 2 Ch 101 the Marquis was described as the President of a bank which had seventeen trustees and thirty-seven managers. During his lifetime he attended only one meeting of the company, that is, a meeting of the bank's trustees and managers in 1869 and for more than two decades thereafter, took no part in the affairs of the bank. The bank suffered severe losses when the negligent manner in which it was managed enabled one of its officers to perpetrate frauds on the bank. These events ultimately caused the winding-up of the bank. Stirling J rejected an attempt by the liquidator to seek compensation from the Marquis, stating, in an oft-quoted dictum (at p109):

> But neglect or omission to attend meetings is not in my opinion, the same thing as neglect or omission of a duty which ought to be performed at those meetings. If, indeed he had had the knowledge or notice of either that no meetings of trustees or managers were being held, or that a duty which ought to be discharged at those meetings was not being performed, it might be right to hold that he was guilty of neglect of the duty.

[19] It is worth noting that under article 72(f) of Table A (that is, the model set of articles provided under the Fourth Schedule of the *Companies Act 1965* and which is adopted by many companies in Malaysia), the office of a director shall become vacant if the director is, without the permission of his fellow directors, absent for six months from board meetings held during the said six months.

[20] [1925] Ch 407 at p 429.

honest and efficient. In the words of Halsbury LC in the case of *Dovey v Cory*:[21] 'The business of life could not go on if people could not trust those who are put into a position of trust for the express purpose of attending to details of management.' At common law the justification for directors' trusting a person to whom they had delegated their duties or a person who provides them with information would depend on the circumstances of each case. Among the factors relevant are the provisions in the company's articles regarding delegation of duties/responsibilities, whether the duty delegated was in fact delegable, the needs and exigencies of the business, the absence of grounds of mistrust or suspicion regarding the official's competence and honesty, and the absence of personal negligence on the part of the director in the selection of the delegate. The third proposition would not protect directors if they had placed unjustifiable or 'unquestioning reliance'[22] on a delegate to discharge the function or duty delegated. Directors should not assume that their power of delegation entitles them to abdicate all responsibility for supervision.[23]

IV. THE DEPARTURE FROM THE SUBJECTIVE YARDSTICK IN RE CITY EQUITABLE FIRE INSURANCE CO LTD AND THE ADOPTION OF A TWOFOLD 'OBJECTIVE/ SUBJECTIVE' STANDARD OF CARE

A. Section 214(4) of the Insolvency Act 1986 of the United Kingdom and its dual objective/subjective standard

A significant development in United Kingdom, which will subsequently have an important effect on Malaysian company law, was the enactment of s 214(4) of the Insolvency Act 1986, a provision related to wrongful trading. Under the provision a pertinent factor to establish a director's liability for wrongful trading is whether the facts which the director of a company ought to have known or ascertained, the conclusions which he ought to have reached and the steps which he ought to have taken, are those which would be known, or ascertained, or reached, or taken by '*a reasonably diligent person having both-(a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the same functions as are carried by that director in relation to the company, and (b) the general knowledge, skill and experience that director has*'(writer's emphasis).

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21 [1901] AC 477 at p 486.

22 Per Langley J in *Equitable Life Insurance Society* v *Bowley and others* [2004] 1 BCLC 180 at p 189. See also the case of *Dochester Finance Co Ltd and another* v *Stebbing and others* [1989] BCLC 498 where two non-executive directors of the company, P and H, left its management to S, another director. No board meetings of the company were held. P and H made infrequent visits to the company's office. They signed a number of cheques in blank. The cheques were misused by S. The court held that P and H were negligent in providing S with cheques signed in blank. Foster J noted (at p 505) that: 'Apart from that they not only failed to exhibit the necessary skill and care in the performance of their duties as directors, but they also failed to perform any duty at all as directors of Dorchester'.

23 This subject has witnessed some case law activity in England in recent years. See Mayson, French and Ryan, *Company Law* (22nd ed, Oxford: OUP, 2005) at pp 519-520 and Gower and Davies, (note 16 above), pp 491-4 for a discussion of the recent case law development in England.

The standard prescribed in the section has two limbs. The first is the objective standard which every director must meet to escape liability for wrongful trading. However, a director who has satisfied this objective standard may still be liable if he or she does not satisfy the subjective standard prescribed in the second limb of the provision, if it is applicable to the director. This subjective standard is based on the additional knowledge, skill and experience of the director, if he or she has any. As will be seen below, the enactment of s 214(4) of the Insolvency Act 1986 had important consequences for the United Kingdom and Malaysia.

B. Judicial rejection in the United Kingdom of the 'subjective' standard as set out in Re City Equitable Fire Insurance Co Ltd and the adoption of an 'objective/subjective' yardstick

In England, another important event occurred in 1991 when Hoffman J accepted without argument, a submission from counsel appearing for one of the defendants in *Norman* v *Theodore Goddard*[24] that the test for whether a director has satisfied the standard of care owed to his company 'was accurately stated in section 214(4) of the Insolvency Act 1986'.[25] Three years later, the same judge in *Re D'Jan of England Ltd*[26] once again accepted this twofold objective/subjective standard set out in s 214(4) as a provision which correctly states the common law on the subject.[27]

In 1998 the Law Commission of England and Wales and the Scottish Law Commission described these new developments as 'a remarkable example of the modernisation of the law by judges'.[28] However it must be pointed out, with respect, that this new approach had an unusual and somewhat controversial feature in that it advocated the application to the common law duty of care, a standard enacted by statute for the specific purpose of wrongful trading.[29]

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[24] [1991] BCLC 1028.

[25] *Ibid* at pp 1030-1031.

[26] [1994]1 BCLC 561.

[27] In this case, a proposal form signed by a director for fire insurance for his company contained a material misrepresentation. Subsequently, a fire occurred at the company's premises and its stock was destroyed. The insurers repudiated the policy and denied liability for the loss on account of the misrepresentation. Later the company went into liquidation and the liquidator brought proceedings against the director alleging that the director was negligent in signing the proposal form. Hoffman LJ held that the director was negligent and went on to note ([1994]1 BCLC 561 at p 563):

> In my view, the duty of care owed by a director at common law is accurately stated in s 214(4) of the *Insolvency Act 1986*… Both on the objective test, and having seen [the director concerned], on the subjective test, I think that he did not show reasonable diligence when he signed the form. He was therefore in breach of his duty to the company.

Hoffman LJ also held that this was an appropriate case for the court to exercise its discretion in favour of the defendant-director under s 717 of the *Companies Act 1985* of England which empowered the court to relieve a director wholly or in part from liability in certain specified circumstances if the court considered that the director concerned had acted reasonably and ought fairly to be excused. A similar provision is found in s 354 of the Malaysian *Companies Act 1965*.

[28] See the Consultation Paper No 153, 'Company Directors: Regulating Conflicts of Interest and Formulating a Statement of Duties' (London: Stationery Office, 1998) (para 13.19 at p 283). The Paper is available online at <http://www.justice.gov.uk/lawcommission/areas/649.htm>.

[29] See Farrar, (note 8 above), p 395. See also Mayson, French and Ryan, (note 23 above), pp 518-9.

C. Australia

In Australia in the nineteen-nineties (1990s) the traditional approach to directors' duties of skill, care and diligence was seriously challenged in the *AWA* litigation,[30] which demonstrated a remarkable and unconventional new approach in this area of the law.[31] The majority in the Court of Appeal of New South Wales (Clarke and Sheller JJA) were of the opinion that the subjective standard used in the older cases were out-dated and, more significantly, that directors' liability for breach of the duty of care could be founded in the common law tort of negligence.[32] In the view of the majority:[33]

> We are of the opinion that a director owes to the company a duty to take reasonable care in the performance of the office. As the law of negligence has developed, no satisfactory policy ground survives for excluding directors from the general requirement that they exercise reasonable care in the performance of their office. A director's fiduciary obligations do not preclude the common law duty of care.

The legal position in Australia became more certain when it codified this area of the law. The current position is found in s 180(1) of the Corporations Act 2001 which reads:

> (1) A director or other officer of a corporation must exercise their powers and discharge their duties with the degree of care and diligence that a reasonable person would exercise if they:
> (a) were a director or officer of a corporation in the corporation's circumstances; and
> (b) occupied the office held by, and had the same responsibilities within the corporation as, the director or officer.[34]

It can be seen that s 180(1) lays down a standard of care and diligence which is not linked to subjective elements. It is measured against whata "reasonable person" would exercise if he or she occupied the actual position held by the director and had the same responsibilities associated with that position in "the corporation's circumstances".[35] Obviously the phrase "the corporations' circumstances" is a wide term and may include a number of items, for example, the category, size, nature, financial status of the company concerned as well the contents of its constitution.[36] A criticism that can made of s 180(1) is that whilst it refers

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30 *AWA Ltd* v *Daniels and Ors*(1992) 10 ACLC 933 (Rogers CJ (Comm D)) and *Daniels and Ors v Anderson and Ors*(1995)16 ACSR 607; (1995) 13 ACLC 614 (New South Wales Court of Appeal).

31 See Professor Farrar's illuminating analysis of the *AWA* case in Farrar, Directors' Duties of Care, (2011) SAcLJ 745 at pp 752-753.

32 [1995] 16 ACSR 607 at p 656.

33 *Ibid* at p 668.

34 Section 180 (1) is a civil penalty provision (see section 1317E and *Australian Securities and Investment Commission*v *Flugge* [2008] VSC 473, at 556-8).

35 Austin and Ramsey, *Ford's Principles of Corporation Law* (13thed, Australia: Butterworths, 2007) pp 389-395 contains useful case law examples and illustrations where s 180(1) and the corresponding provisions that it replaced were applied

36 See *Australian Securities and Investment Commission* v *Rich* (2009) NSWSC 1229, at part [7201] of Austin J's judgment.

to the standard for "care and diligence" it makes no mention of the standard for the skill required of a director,[37] causing the legal position regarding this subject to be unclear.[38]

A related development in Australia is the enactment of a business judgment rule as a possible defence for directors where it is alleged that they had breached s 180(1). This matter is dealt with in part 8 below.

V. CODIFICATION OF THE LAW RELATING TO DIRECTORS' SKILL, CARE AND DILIGENCE IN THE UNITED KINGDOM

In 1998, the Law Commission of England and Wales and the Scottish Law Commission issued a joint Consultation Paper entitled 'Company Directors: Regulating Conflicts of Interest and Formulating a Statement of Duties'[39] and invited respondents to comment on the Paper's proposal to state a director's duty of care and skill in statutory form. The Consultation Paper offered for the consideration three options regarding the standard of care, skill and diligence that was to be stated in a statutory provision. They were (i) a subjective test based on the traditional standard in *Re City*; (ii) a dual objective/ subjective standard as illustrated by s 214(4) of the Insolvency Act 1986;[40] and (iii) a purely objective standard, namely, a duty to exercise the care, skill and diligence of a reasonable person having both the general knowledge, skill and experience that may reasonably be expected of a person carrying out the same functions as are carried out by that director in relation to the company.

The Commissions' Report[41] indicates that the majority of the respondents rejected the subjective test in the first option and the purely objective test in the third option. The majority of those who rejected the first option were of the opinion that a subjective

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37 It will be seen that in 2006, the United Kingdom adopted a dual objective-subjective standard for directors' duty of care, skill and diligence in s 174 of the *Companies Act 2006*. Malaysia followed suit in 2007 by inserting into its *Companies Act 1965* a similar provision (s 132(1A)) on this subject. Both provisions deal expressly with a director's duty of care, skill and diligence.

38 See a valuable discussion in Austin and Ramsey, Ford's Principles of Corporation Law (13th ed, Australia: Butterworths, 2007) at p 389. See also Professor Farrar's comments on the subject of skill in Farrar, Directors' Duties of Care, (2011) SAcLJ 745 at 751.

39 The Consultation Paper (LCCP 153)(London: Stationery Office, 1998) is available online at <http://www.lawcom.gov.uk> under the section 'Closed Consultations'. The Paper is hereafter referred to in this article as 'Consultation Paper (LCCP 153)'. An outcome of this exercise was the Commissions' Report also entitled 'Company Directors: Regulating Conflicts of Interest and Formulating a Statement of Duties' (Law Com 261) (Scot Law Com No173)(London: Stationery Office, 1999, Cm 4436).
The Commissions' project was not meant to be 'a self-contained exercise'. It aimed to contribute to a wider Company Law Review undertaken by the British Government's Department of Trade and Industry ("DTI"). This article does not deal with DTI's review exercise which began in 1998 (for more information on this exercise, see DTI, *Company Law Reform: Modern Company Law for a Competitive Economy*) and culminated in the DTI's Final Report in two volumes (URN 01/943, 2001). The Final Report led to the British Government's production of a White Paper and ultimately to the passing of the *Companies Act 2006* by the British Parliament. See Gower and Davies, (note 16 above) pp ci-cii and 55-57 for a brief account of this development and some of its associated literature.

40 See part IV above for a discussion of this provision.

41 Report, Law Com 261 (Cm 4436, 1999).

test would impose too low a standard for contemporary commerce.[42] The respondents who opposed the purely objective test in the third option thought that such a standard would not be appropriate for skilled directors, as directors with particular skills should be expected to utilise such skills.[43] The Report also states that the vast majority of the respondents preferred the dual objective/subjective standard proposed in the second option and supported its codification in statutory form. The dual standard was preferred as it duly took into account differing levels of a director's skill, knowledge and experience.[44]

The Report recommended that a director's duty of care, skill and diligence should be enacted in statutory form and that the standard should be judged by an objective/subjective test, having regard to the functions of the particular director and the circumstances of the company.[45] This recommendation of the Law Commissions contributed to the enactment of s 174 of the Companies Act 2006,[46] which is a simplified and neater version of s 214(4) of the Insolvency Act 1986.[47]

VI. DIRECTORS' DUTIES OF CARE, SKILL AND DILIGENCE IN MALAYSIA

A. Section 132 of the Companies Act 1965 before its repeal

Section 132(1) of the Malaysian *Companies Act 1965* was, before its repeal and replacement by other provisions under the Companies (Amendment) Act 2007, an incomplete and somewhat reluctant attempt by legislature to enact a statutory provision to deal with a director's duties to his or her company. The said provision imposed a general obligation on a director 'to act honestly and use reasonable diligence in the discharge of his duties'. A director who breached the duties stated under section 132(1) would commit a criminal offence. The section, a reproduction of s 124 of the Australian Uniform Companies Act 1961 had its genesis in 1958 when it was inserted into the Victorian Companies Code.[48] While the section imposed duties of honesty and 'reasonable diligence', it made no reference to a director's duty of care or the standard required for such a duty. Whilst referring to this omission in s 107 of the Victorian Companies Code, the Full Victorian

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42 *Ibid*, para 5.13-5.17 at pp 50-51.

43 *Ibid.*

44 *Ibid.*

45 *Ibid,* para 15.20 at p 51.

46 See also the United Kingdom White Paper on Company Law Reform (Cmnd 6456, 2005).

47 Section 174 reads as follows:
Duty to exercise reasonable care, skill and diligence **E+W+S+N.I.**
(1) A director of a company must exercise reasonable care, skill and diligence.
(2) This means the care, skill and diligence that would be exercised by a reasonably diligent person with—
(a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company, and
(b) the general knowledge, skill and experience that the director has.
For an illuminating discussion on the codification of the duty of care, skill and diligence in s 174 of the Companies Act 2006, see Tamo Zwinge, "An analysis of the duty of care in the United Kingdom in comparison with the German duty of care", (2011) *International Company and Commercial Law Review*, p 33.

48 See *Daniels and Ors v Anderson and Ors* (1995)16 ACSR 607, 660 (New South Wales Court of Appeal).

Court in *Byrne* v *Baker*[49] noted that: 'What the legislature by the subsection is demanding of honest directors is diligence only; and the degree of diligence demanded is what is reasonable in the circumstances and no more.' There was no opportunity for Malaysian courts to apply s 132(1) of the Companies Act 1965 in a case involving directors' duties of care and skill. It was generally assumed until 2007[50] that the common law as elucidated in the *Re City* case concerning this area of the law applied in Malaysia.[51]

B. Adoption of an objective/subjective standard in Malaysia

In late 1997, a financial storm swept across Asia causing economic turbulence in many Asian countries. In Malaysia one of the effects of this Asian financial crisis was the increased urgency of the need for a strong and effective corporate governance regime to protect companies in times of economic turmoil. It led to the appointment of a High Level Finance Committee on Corporate Governance in 1998 by the Malaysian Government. The Committee reported in 1999 and its Report is a well-researched and thought-provoking document. A part of the Report deals with law reform. Suggestions were made for amendments to the Companies Act 1965 as measures to achieve greater and stricter corporate governance. Significantly, on the subject of directors' duties of care, skill and diligence, the Report rejected the old subjective standard of the common law. In this regard, the Report stated emphatically that s 132(1) 'should NOT[52] be amended to clarify that the standard of care imposed is with reference to the particular circumstances of the director'.[53] In August 2006, another Malaysian institution, the Corporate Law Reform Committee,[54] issued its Consultative Document 5 entitled 'Clarifying and Reformulating the Directors' Role and Duties'.[55] With regard to the subject of directors' duties of care, skill and diligence, the Committee put forward a proposal that the dual objective/subjective standard as proposed for the United Kingdom be accepted.[56] The Committee chose to recommend an objective/subjective standard based on the UK model instead of the Australian provision in s 180(1) of the *Corporations Act 2001*. This was because the UK approach clearly proposed that actual knowledge and experience of the director

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49 (1964) VR 443 at p 452.

50 That is, until the adoption of a dual objective/subjective standard by s 132(1A) of the *Companies (Amendment Act) 2007* of Malaysia.

51 See for instance *Abdul Mohd Khalid* v *Dato Haji Mustaffa Kamal* [2003] 5 CLJ 85 where the case of *Re City Equitable Fire Insurance Company Co Ltd* was referred to. See also *Ho Hup Construction Company Bhd v Bukit Jalil Development Sdn Bhd & Ors* [2012] 1 CLJ 649.

52 The Committee's emphasis.

53 Chapter 6 of the Committee's Report at para 2.2.65. The words 'standard of care imposed is with reference to the particular circumstances of the director' refers to the subjective standard stated in *Re City Equitable Fire Insurance Co Ltd*: see the Corporate Law Reform Committee Consultative Document 5 entitled 'Clarifying and Reformulating the Directors' Role and Duties', Section C: Clarifying and Reformulating the Directors' Role and Duties, para 3.8.

54 The Corporate Law Reform Committee was established in 2003 by the Malaysian Government to review Malaysia's corporate laws. The Committee's Final Report bearing the title *Review of the Companies Act 1965-Final Report* was issued in 2008 and is available at <http://www.ssm.com.my/en/docs/CRLC>.

55 Hereafter referred to as CLRC, Consultative Document 5.

56 CLRC, Consultative Document 5, Section C, para 3.9, page 48.

concerned be taken into account as an addition to the minimum standard.[57]About 70% of the individuals and institutions who submitted responses to the Committee supported the proposal.[58] The upshot of this was that Companies Act 1965 was amended in 2007 to add a specific provision, s 132(1A), which adopts the objective/subjective standard as prescribed in s 174 of the Companies Act 2006 of the United Kingdom. Section 132(1A) reads:

> A director of a company shall exercise reasonable care, skill and diligence with-
> (a) the knowledge, skill and experience which may reasonably be expected of a director having the same responsibilities; and
> (b) any additional knowledge, skill and experience which the director in fact has.

It is pertinent to note that by virtue of the general definition of the term "director" in s 4 (the definition section of the Act) the new provision applies to a shadow director,[59] an alternate or substitute director. In addition s 132(6) casts a wider net by stating that *for the purposes of the new provision* the term "director" includes the "chief executive officer, the chief operating officer, the chief financial controller or any other person primarily responsible for the operations or financial management of a company, by whatever name called".

It was pointed out earlier that the standard created by the new s132(1A) has an objective and a subjective limb. Some further comment on the two limbs is pertinent where this standard is applied to a director's duty of care, skill and diligence. The objective component in limb (a) creates a standard that 'looks at the notional knowledge and experience that may reasonably be expected of a person *in the same position* as the director'.[60] Its wording allows for flexibility and is able to take into account the specific position of the director concerned. While it has the advantage of being able to cater for executive, non-executive and independent directors and directors of large and small companies, does the provision take into consideration the reality that not all directors have a similar or requisite experience and know-how? This becomes pertinent in a family-owned company where the board of directors may be appointed from siblings and off-spring of the owner or main shareholders of the company. Such persons may not necessarily have the requisite "knowledge, skill and experience expected of a director having the same responsibilities". Such circumstances are not uncommon in Malaysian companies. Malaysia has a unique corporate ownership structure, not unlike its developing neighbours; characterised by crossholdings, a high percentage of ownership concentration

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57 *Ibid*, para 3.8

58 CLRC, *Responses and Comments Received on Consultative Document 'Clarifying and Reformulating the Directors Role and Duties'*.

59 A Malaysian decision which considered the meaning of the term "shadow director' under the Companies Act 1965 is *Cepatwawasan Group Bhd & Anor v Tengku Dato' Kamal Ibni Sultan Sir Abu Bakar & 17 Ors* [2008] 2 MLJ 915.

60 See Report of the Law Commission of England and Wales and the Scottish Law Commission entitled 'Company Directors: Regulating Conflicts of Interest and Formulating a Statement of Duties' (Law Com 261) (Scot Law Com No173) (London: Stationery Office, 1999, Cmnd 4436) (para 5.7 at p 48), in the context of its proposal to codify the English position. The Report is available online at <http://www.justice.gov.uk/lawcommission/publications/company-director-regulating-conflicts-of-interestformatting-a-statement.htm>.

and dominant family-owned, owner-managed or government linked characteristics.[61] It has been reported that approximately 40% (out of a total of 238 Malaysian companies reviewed) were dominated and held by a single shareholder.[62] A more recent report went further to suggest that of the top 150 Malaysian companies reviewed, on average the largest shareholders held a strong and persuasive 43% share of the company.[63] Family businesses have been reported to contribute more than half the Gross Domestic Product in Malaysia[64] and it has even been said that the boards of family-owned companies are commonly dominated by family members or close family friends, with few truly independent directors.[65]

In Malaysia as with many Asian countries, cultural values, family and personal connections carry much influence, often giving rise to charges of nepotism and cronyism in Asia. Commercial transactions and business deals are often based on personal ties, trust and relationships. While it may be said company laws work well in Anglo-American environments where the theory of agency (which ensures that company directors and shareholders' interests are aligned to ensure a profit-making entity) management and business in Malaysia (as in most of Asia) consider these cultural values and relationships as equally if not more important.[66] Family businesses in particular do not necessarily prescribe to 'open' concepts of corporate governance, instead their business habits and practices are often ingrained in the 'old-ways' of doing things; based on practices and culture inherited from their founders.[67]

While culture, family ties and values make up one aspect of doing business in Malaysia, family businesses do recognise that to remain competitive, strong corporate governance practices are still required.[68]

Returning to the objective standard as contained in the first limb of the provision, it may be said that it is the minimum benchmark which every director must satisfy. Therefore in a Malaysian and perhaps Asian context, directors appointed on a basis other than his or her experience and expertise, must take cognisance of the objective standard they are required to satisfy. Where a director has additional knowledge, skill, experience or expertise, he or she must meet an increased subjective standard set out in

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61 See generally, Claessens, S et.al. (2000)"The Separation of ownership and control in East Asian Corporations", Journal of Financial Economics, 58 pp 81-112; Thillainathan R (1999) "Corporate Governance and Restructuring in Malaysia – A Review of Markets, Mechanisms, Agents and the Legal Infrastructure", World Bank/OECD Survey of Corporate Governance.

62 *Ibid*, Claessen S et.al (2000)

63 Tam and Tan (2007) "Ownership, Governance and Firm Performance in Malaysia", *Corporate Governance: An International Review*, 15(2) pp 208-222.

64 Nuig CYK, (2002) "Asian Family Businesses: From Riches to Rags?" Malaysian Business, 2:27.

65 Meng SC (2009) "Are these Directors Truly Independent?" The Edge, January 17.

66 Helen Anderson (ed), "Directors' Personal Liability for Corporate Fault: A Comparative Analysis" (2008) (Netherlands: Kluwer Law International) p187.

67 Ow-Yong, K & Cheah KG (2000), "Corporate Governance Codes: A comparison between Malaysia and the UK", Corporate Governance: An International Review 8(2): 125-132.

68 Although one study suggests that family firms tend to be reluctant to appoint independent directors for fear of losing control of the board, or are generally afraid of new ideas, viewpoints or simply new ways to doing things. See generally Ward JL (1991), "Creating Effective Boards for Private Enterprises", (San Francisco: Jossey-Bass)

limb (b) (the second limb). A person elected or appointed to the board of directors may possess special skill, knowledge, experience or expertise. Indeed, in some situations he or she may be elected or appointed because the company hopes to rely upon and benefit from his or her skill, knowledge, experience or expertise. Such a director is expected to use this skill, knowledge, experience or expertise whilst serving as a director of the company. Thus, if a lawyer is appointed to a board, the standard applied to him or her must have regard to his or her legal knowledge, experience and expertise in cases where this director participates in a board decision which is related to law. There is no unfairness to such a person if the law expects him or her to use the special/additional knowledge and experience that he or she possesses.[69] However this subjective criterion in the second limb need not be considered if a director does not meet the minimum objective yardstick in the first limb of the section.

In the ultimate analysis, the codification of the law in s 132(1A) will certainly benefit directors and their legal advisers as it brings a higher degree of certainty to this area of law relating to directors. Significantly, the enactment of s 132(1A) puts to an end to the uncertainties in Malaysia regarding the application of the first two propositions stated by Romer J in *Re City Equitable Fire Insurance Co Ltd.*[70] The enactment of s 132(1A) in Malaysia is a fair compromise to meet the demands of modern times. The complexities of contemporary companies and their transactions demand higher standards of care, skill and diligence from directors and it is submitted that the standard required by s 132(1A) is acceptable for this purpose.

Be that as it may, while the provision places a benchmark duty on all directors it would be a fair point to note that inexperienced directors[71] who might not be able to meet the minimum objective test may well be advised to take certain precautionary measures. Needless to say, an immensely practical step for inexperienced directors is to equip themselves with a rudimentary understanding of their duties, rights and liabilities as a company director. There are courses in Malaysia organised by the Securities Commission and the Malaysian Association of Company Directors (MACD), amongst others, that promote such knowledge and awareness. Studies have demonstrated that directors with higher education and training are better and more adept at handling the problems and challenges that arise in the course of business.[72] In family owned companies where directors may be concerned about being presumed as a 'free-rider', additional educational background could go some way to consider business strategies or investment evaluation decisions that need to be made, thus negating the presumption.[73] In addition,

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69 See the arguments to the contrary in Professor Farrar's *Directors' Duties of Care* (2011) SAcLJ 745 at 751.

70 See above at 3(a), (b) and (c).

71 Bearing in mind that the functions and responsibilities of a director are unlike those at managerial positions. The responsibilities or a director are unique to his position and appointment. It is also recommended under the Malaysian Code on Corporate Governance (Revised 2007) that directors possess the requisite skills, knowledge and experience for the job.

72 Sebora TC, and Wakefield MW (1998), "Antecedents of Conflict or Business Issues in Family Firms", Journal of Entrepreneurship Education 1:2-18.

73 Castillo J and Wakefield MW (2006), "An Exploration of Firm Performance Factors in Family Businesses: Do Families Value on the "Bottom Line"?", Journal of Small Business Strategy 17(2): 37-51.

these directors could also consider delegating and/or obtaining professional advice either internally or externally, as is allowed under law thereby alleviating the heavy burden of the responsibility. The right of a director to delegate his or her duties/responsibilities and to rely on information supplied by others is discussed in part 7 below.

VII. DELEGATION AND RELIANCE ON INFORMATION PROVIDED BY OTHERS

In recent years, a question which has arisen in some jurisdictions is whether there should be a codification of the common law principles on a director's right to delegate his or her duties/responsibilities and to rely on information supplied by others. In the United Kingdom, the question was raised in 1998 when a joint Consultation Paper[74] was issued by the Law Commission of England and Wales and the Scottish Law Commission. The majority of the responses received by the Commissions on the issue were not in favour of codification of the common law principles concerning this area of the law and preferred its development to be left to the courts.[75] On its part, the Commissions were of the view that the law was still developing and thus, the setting out of detailed instances in a statute when a director may rely on a third party 'are likely to be too restrictive and fail to deal with a situation in which a director should be able to rely on another'.[76] In addition, empirical research carried out on behalf of the Commissions did not indicate 'undue concern'[77] amongst directors about the twin topics of delegation and reliance on information provided by others. The upshot of this exercise was a recommendation by the Commissions that it was not necessary for a codification of the law on this subject.

Australia chose to legislate on the subject. As a result of the Corporate Law Economic Reform Program Act 1999 new statutory provisions were introduced allowing delegation by directors.

In Malaysia, the High Level Finance Committee Report on Corporate Governance had in 1999,[78] recommended that the directors' power to delegate and the rule that directors may rely on the information provided by others, be put in statutory form.[79] A similar proposal was made in August 2006 by Malaysia's Corporate Law Reform Committee.[80] A majority of the individuals and institutions who submitted responses to the Committee supported this proposal.[81] In 2007 the Companies Act 1965 was amended by inserting into it provisions relating to the subjects of directors' right of delegation and reliance on information provided by others. These provisions are discussed below.

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74 The Consultation paper was entitled 'Company Directors: Regulating Conflicts of Interest and Formulating a Statement of Duties'. For more details of the Consultation Paper see note 39 above.

75 Report, Law Com 261 (Cm 4436), para 5.34 at p 55.

76 *Ibid*, para 5.36 at p 55.

77 *Ibid,* para 5.37 at p 55.

78 See also part VI of the article.

79 See Ch 6 paras 3.1.1-3.1.4 at pp 140-1 of the Report.

80 In its Consultation Document 5 referred to in part 6 above. See p 52 para 3.16 of the Document.

81 CLRC, *Responses and Comments Received on Consultative Document 'Clarifying and Reformulating the Directors Role and Duties'.*

A. Delegation of duties/responsibilities

Two new subsections (based on similar provisions in the Australian Corporations Act 2001 and the New Zealand Companies Act 1993) were added as subsections to s 132 of the Malaysian Companies Act 1965 to deal with the subject of delegation of duties/ responsibilities. The first, s 132(1F), reads:

> Except as is otherwise provided by this Act, the memorandum or articles of association of the company or any resolution of the board of directors or shareholders of the company, the directors may delegate any power of the board of directors to any committee to the board of directors, director, officer, employee, expert or any other person and where the directors have delegated any power, the directors are responsible for the exercise of such power by the delegatee as if such power had been exercised by the directors themselves.

Section 132(1F) must be read together with its counterpart s 132(1G). Although s 132(1F) states that 'the directors are responsible for the exercise of such power by the delegatee as if such power had been exercised by the directors themselves', s 132(1G) provides that they would not be accountable for their delegatee's misdeeds if they can show that:

(a) they believed on reasonable grounds at all pertinent times that the delegatee would use the power delegated in conformity with the duties of the director under the Companies Act 1965 and the company's constitution, and

(b) the directors believed on reasonable grounds and in good faith and after making a proper enquiry (where the circumstances indicated that there was a need for an investigation) that the delegatee was reliable and competent to effect the power delegated.

These new statutory provisions are useful to inform directors about the extent of a director's powers of delegation but do not appear to add anything new to the existing principles at common law that a director's exercise of the power of delegation must be responsible, honest and informed. It may also be noted that subsections (1F) and (1G) are not a complete codification of the common law on the subject. They omit to state the common law rule that the power to delegate is subject to reasonable supervision or monitoring by the directors. However, this omission will not dissuade the courts from holding that directors must take some practical step to monitor or supervise the implementation of the functions delegated unless the circumstances indicate that supervision may be reasonably excused.

B. Reliance on information provided by others

If directors are unable to rely on others to obtain information, they would be forced to spend a great deal of their time verifying many items of information that comes before them in the discharge of their duties. The ensuing delay and its negative effect on the functions of the board need no further elaboration.[82] The need for allowing directors to rely on others in order to obtain information was dealt with by both the High Level

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[82] See High Level Finance Committee Report on Corporate Governance, Ch 6, para 3.1.3 at p 140.

Finance Committee Report on Corporate Governance[83] and the Corporate Law Reform Committee.[84] In 2007 the Companies (Amendment) Act 2007 inserted a new subsection (1C) to s 132 of the Companies Act 1965 to deal with this subject. The new provision, which is based on s 138 of the New Zealand Companies Act 1993, provides that a director may rely on information, professional or expert advice, opinions, reports or statements including financial statements or other financial data prepared, presented or made by the persons mentioned in the subsection. Amongst the persons mentioned are: (i) an officer of the company whom the director believes on reasonable grounds to be reliable and competent in respect of the matters concerned and (ii) any other person retained by the company in connection with matters involving skills or expertise, where the directors believe on reasonable grounds that the matters concerned are within that persons' professional or expert competence.[85] Reliance is deemed to have been made on reasonable grounds where it is made in good faith and after the director has made an independent assessment of the information, advice, opinion, report, statement or financial data having regard to his knowledge of the company and the complexity of its structure and operation.

Section 132(1C) is important in that it informs directors that they may rely on information provided by others but total abrogation of responsibility, or unquestioning reliance or reliance without inquiry where inquiry is warranted or reliance without independent assessment of the information, will not protect them from liability. Secondly those involved in training and advising directors about the law on this subject will find that they have a simpler task to carry out because they do not have to refer to intricate common law principles concerning the subject.

VIII. THE BUSINESS JUDGMENT RULE IN MALAYSIA

A. The business judgment rule

A primary responsibility of the board of directors of a commercial company is to enhance the prosperity of its business. However, commercial endeavours and risk-taking invariably go hand in hand and every business venture has its prospects as well as its hazards. At times an honest business decision of directors may prove to be a grave error of judgment which causes severe loss to the company. As a measure of protection for directors, a 'business judgment rule' has emerged in certain jurisdictions. The rule shields directors from liability for a business judgment that has gone wrong if they had exercised an informed judgment with responsibility, honesty and in the best interest of the company. In many states in America this so-called 'safe harbour' principle was developed by judicial

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83 *Ibid*.

84 See Consultative Document 5, CLRC, paras 3.10 – 3.15 at pp 49-52.

85 Other persons stated in the subsection includes: (i) another director concerning matters within that directors' authority or (ii) any committee of the board (on which the delegating director did not serve) concerning matters within that committee's authority.

doctrine and has been described as 'a judicial gloss on duty of care standards that sharply reduces exposure to liability'.[86]

B. United Kingdom

In the United Kingdom, the Law Commissions did not recommend the enactment of a statutory business judgment rule on the ground that there was no need for such a rule. English courts have shown a traditional disinclination to review bona fide commercial decisions of directors. In the words of Dillon J in *Devlin* v *Slough Estates Ltd*:[87] 'The court does not interfere with the business judgment of directors in the absence of allegations of mala fides'.[88]

In part of this article reference was made to the Consultation Paper issued in 1998 by the Law Commissions of England and Wales and the Scottish Law Commission.[89] This Consultation Paper invited respondents to comment on whether this traditional reluctance of English courts to interfere with the business judgments of directors should be enacted in statutory form, assuming that the objective/subjective standard recommended by the Paper in respect of directors' duties of care, skill and diligence,[90] is also adopted. The Commission was of the view that there would be a need for the rule if there was evidence that directors were apprehensive about the proposed enactment of the new and stricter objective/subjective standard for directors' duties of care, skill and diligence. The Commissions' Report issued in 1999 indicates that the majority of the responses received were not in favour of enacting a business judgment rule in statutory form.[91] Most of those who were against the enactment of such a rule pointed out that the courts already respect bona fide business judgments under the common law. The Report also points out that an empirical research carried out on behalf of the Commissions did not reveal any particular concern amongst directors about the introduction of the new objective/subjective standard of care.[92] Consequently the Commissions' Report did not recommend the enactment of a business judgment rule.[93] Therefore, the current Companies Act 2006 of the United Kingdom does not contain any provision on the subject.

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86 The American Law Institute, *Principles of Corporate Governance: Analysis and Recommendations* (1994), cited and discussed in the Report of the Law Commission of England and Wales and the Scottish Law Commission headed 'Company Directors: Regulating Conflicts of Interest and Formulating a Statement of Duties', para 5.22 at p 52. See note 39 above for more details about the Report.

87 [1983] BCLC 497, 504.

88 See also *Dovey* v *Cory* [1901] AC 477 at p 488. A forceful statement that indicates the common law's unwillingness to second guess directors' business decisions is that of the Privy Council in *Howard Smith Ltd* v *Ampol Ltd* [1974] AC 821 at p 832 as follows: 'There is no appeal on merits from management decisions to courts of law; nor will courts of law assume to act as a kind of supervisory board over decisions within the powers of management honestly arrived at.'

89 See note 39 above for more details of the Consultation Paper.

90 See part 5 above for a discussion of directors' duties of care, skill and diligence.

91 Report, Law Com 261 (Cm 4436) para 5.26-5.27 at p 53.

92 *Ibid,* para 5.29 at p 53.

93 *Ibid.*

C. Australia

In Australia a business judgment rule in statutory form was introduced by Corporate Law Economic Reform Program Act 1999. This was after it was considered and recommended by various committees such as the Standing Committee on Legal and Constitutional Affairs in 1989, Companies and Securities Law Review Committee in 1990, and the Companies and Securities Advisory Committee in 1991.[94] The Explanatory Memorandum to the CLERP Bill in supporting the statutory enactment expressed the view that "a failure to expressly acknowledge that directors should not be liable for decisions made in good faith and with due care, may lead to failure by the company and its directors to take advantage of opportunities that involve responsible risk taking".[95] The current Australian provision is found in s 180(2) of the Corporations Act 2001.[96]

D. Section 132(1B) of the Companies Act 1965 of Malaysia

In 1999, Malaysia's High Level Finance Committee Report on Corporate Governance recommended the enactment of a statutory business judgment rule.[97] The Committee felt that such a statutory business judgment rule was necessary when considered together with the extensive codification of fiduciary duties and the duties of skill and care and the introduction of a statutory derivative action as recommended in its Report.

In addition, in August 2006 the Corporate Law Reform Committee of Malaysia in its Consultation Paper 5 suggested the adoption of a business judgment rule based on s 180(2) of the Australian Corporations Act 2001.[98] In recommending the need for a statutory formulation of the business judgment rule, the Committee agreed with the Australian view that the absence of a statutory rule may cause a company to suffer loss as a result of the company and its directors failing to take advantage of business opportunities that involve responsible risk-taking.[99]

The Committee's proposal received the support of about 70% of the individuals and institutions who submitted responses to it on this matter.[100] Resulting from this the Companies (Amendment) Act 2007 inserted a new provision, s 132(1B), into the *Companies Act 1965*. The provision reads as follows:

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94 See Explanatory Memorandum to the CLERP Bill para 6.2

95 *Ibid* para 6. 3

96 Section 180(2) reads:

A director or other officer of a corporation who makes a business judgment is taken to meet the requirements of subsection (1), and their equivalent duties at common law and in equity, in respect of the judgment if they:

(a) make the judgment in good faith for a proper purpose; and

(b) do not have a material personal interest in the subject matter of the judgment; and

(c) inform themselves about the subject matter of the judgment to the extent they reasonably believe to be appropriate; and

(d) rationally believe that the judgment is in the best interests of the corporation.

The director's or officer's belief that the judgment is in the best interests of the corporation is a rational one unless the belief is one that no reasonable person in their position would hold.

97 See Ch 6 para 3.2 of the Report.

98 See para 3.17 at pp 54-5.

99 See Consultative Document 5, CLRC, paras 3.18 at p 54

100 CLRC, *Responses and Comments Received on Consultative Document 'Clarifying and Reformulating the Directors Role and Duties'*.

> A director who makes a business judgment[101] is deemed to meet the requirements of the duty under subsection (1A)[102] and the equivalent duties under the common law and in equity if the director-
> A. makes the business judgment in good faith for a proper purpose;
> B. does not have a material personal interest in the subject matter of the business judgment;
> C. is informed about the subject matter of the business judgment to the extent the
> D. director reasonably believes to be appropriate under the circumstances; and
> *reasonably*[103] believes that the business judgment is in the best interest of the company.

A comparison between the Malaysian and Australian provisions will reveal a number of differences. Whilst the former applies to "a director", the latter concerns "a director or other officer".[104] The definition of the term "director" in s 4 of the Malaysian Act includes a shadow director, an alternate or substitute director.[105] Section 4also defines the term "officer" as including a secretary or employee of a company, a receiver and manager of any part of the undertaking of a company appointed under any instrument and a liquidator appointed in a voluntary winding up. The statutory business judgment rule would have applied to the officers mentioned in s 4, if Malaysia had adopted s 180(2) of the Australian provision in its original form.

It can be seen that the s 132(1B) gives extensive protection from liability for negligence if the four requirements as set out in the section are satisfied. Significantly, a director who satisfies the requirements of these four items is also presumed to meet the requirements of the new dual objective/subjective standard under s 132(1A) in respect of his duty of care, skill and diligence. A pertinent question is whether s 132(1B) will protect honest directors if they have made a serious and extremely unwise error of judgment that causes a substantial loss to their company? In Australia one of the requirements for the business judgment rule to apply (as stated in paragraph (d) of s 180(2)) is that the affected directors must "rationally" believe that the business judgment is in the best interest of the company. The Australian section makes an attempt to amplify this requirement by stating that "*a director's or officer's belief that the judgment is in the best interests of the company is a rational one unless the belief is one that no reasonable person in their position would hold*".[106] Two changes were made when the Malaysian legislature adopted s 180(2). First the phrase "rationally believes" in the Australian section was replaced

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101 Section 132(6) defines 'business judgment' as 'any decision on whether or not to take action in respect of a matter relevant to the business of the company'.

102 That is s 132(1A) which deals with a director's duties of care, skill and diligence. See part 6 above for a discussion of the duties.

103 Writer's emphasis.

104 For a definition of the term "officer" under the Corporations Act 2001 of Australia, see s 9 of that Act.

105 Further, the effect of s 132(6) is that for the purposes of the new provision in s 132(1B) the term "director" includes the "chief executive officer, the chief operating officer, the chief financial controller or any other person primarily responsible for the operations or financial management of a company, by whatever name called".

106 Writer's emphasis.

with the phrase "reasonably believes" in paragraph (d) of the Malaysian provision in s 132(1B). Secondly the Malaysian legislature chose not to include the passage quoted above in italics as part of its section 132(1B) probably because of this change in wording.

When can a director's belief that his business judgement is in the best interest of the company be deemed reasonable? At this stage it is difficult to anticipate how the Malaysian courts will interpret the requirement of reasonable belief mentioned in paragraph (d) and how far they will go in using the rule to protect directors. Needless to say, it is the facts of each case which will decide the issue of reasonableness. *Pioneer Haven Sdn Bhd* v *Ho Hup Construction Co Bhd & Anor and other appeals*[107] was a recent case in which the facts did not present any difficulty to the court regarding the application of the business judgment rule. In this case five of the ten defendants were non-executive directors of the plaintiff company. It was alleged that they had breached their duty of care in committing the company to a Joint Development Agreement ("JDA") entered into by the company's subsidiary. There was evidence that they had made inquiries from the management about the JDA and had independently assessed the information and advice given to them before they had made their judgment. They were also informed by the managing director of the company that a reputable firm of solicitors were appointed to advise the company on the JDA. It was held by the Court of Appeal that the directors had made a business judgment and they could rely on the business judgment rule in s 132(1B). The Court said:[108]

> In view of it being a business judgment within the deeming provision of s 132(1B) of the Act which they made at [the plaintiff's] board meeting…. the court should be slow to interfere with it. This deeming provision is a statutory recognition of the common law principle that courts are reluctant to pass judgment on the merits of a business decision taken in good faith or to substitute such decisions with their own. It must also not be lost sight of that none of the said directors…had any personal interest in the JDA. There was neither any allegation nor proof whatsoever that they had acted in the collusion with the other defendants to act to the detriment of [the plaintiff].

E. Does Malaysia need a business judgment rule?

As discussed above, one of the reasons why the Law Commissions in the United Kingdom did not recommend the adoption of a statutory business judgment rule was because of the existence of judicial precedent that indicated that the courts would not interfere with honest and responsible business judgments made by directors. If a statutory business judgment rule in the form of s 132(1B) had not been enacted in Malaysia, the courts would have followed English case law relevant to the subject. This fact may be used by critics to express the view that s 132(1B) is an unnecessary addition to the Malaysian Companies Act.[109] The authors of this article do not agree with this view. It is submitted

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[107] [2012] 3 MLJ 616.

[108] *Ibid* at p 661.

[109] In Australia there has been much debate on the need for enacting a business judgment rule in statutory form. See Ford's Principles of Corporation Law, note 38 at p 396 and 398. See also Farrar, Directors' Duties of Care, (2011) SAcLJ 745 at 759 to 760.

that the enactment of section 132(1B) has its merits and that it is a welcome development. The existence of a clear statutory provision on the subject will certainly benefit company directors, their legal advisers as well as the courts. Although it cannot be denied that codification may bring with it its own problems, this article submits that it is easier to extract the law, the requirements and the limits of the business judgment rule from a statutory provision like s 132(1B) than from English case law on the same subject. With the exception of the possible difficulty that may encountered in construing requirements of paragraph (d) of s 132(1B), the enactment of the section has helped to make the law more understandable to directors and certain to their legal advisers. Those involved in training and advising directors about responsible business decisions and risk-taking and the law associated with these matters may now find that they have an easier task to perform.

There is another important reason why this article supports the codification of the business judgment rule in s 132(1B). Case law of the closing years of the twentieth century and the recent inclusion of the objective/subjective standard as a statutory provision in the Malaysian Companies Act 1965 are indications that the courts and the legislature take a serious view of the subject of directors' negligence. A possible dampening effect of these new developments in Malaysia is that it may encourage directors to be overly cautious or unadventurous in their business decisions and to be unenthusiastic about venturing into businesses which involve risk-taking. The stricter standard of care that has arisen as a result of the adoption of the objective/subjective standard may also be a matter of concern for prospective directors of companies, particularly prospective independent directors. The business judgment rule as embodied in s 132(1B) may allay doubts amongst honest directors as to whether they would be made liable for their company's losses if a bona fide and informed business judgment that they had made in the interests of the company had gone wrong.

IX. CONCLUSION

Malaysia has always demonstrated a commitment to reform and update its company law so that it may meet the challenges of changing times.[110] The enactment of the new statutory provisions dealing with directors' duties of care, skill and diligence and the business judgment rule illustrates Malaysia's commitment to modernise its company laws. Regardless of the statistical percentage of family-owned companies in Malaysia or the influence of values and culture on business practices, the promotion of good corporate governance is certain. Although family companies have different characteristics than non-family companies, the end result remains the same: to ensure that decisions made meet a standard of diligence expected of a director. As a result, the introduction of the objective/

[110] Some critics may disagree but this article will support its view by pointing out that the Companies Act 1965 has been amended no less than seventeen times since its inception to incorporate various measures of reform. In addition a significant step for reform was demonstrated when the Corporate Law Reform Committee was established in 2003 by the Malaysian Government to review Malaysia's corporate laws. The Committee's Final Report bearing the title "Review of the Companies Act 1965-Final Report" contains an impressive number of proposals for the reform of Malaysia's corporate laws, some which have been already implemented by the Companies (Amendment) Act 2007.

subjective standard in the new s 132(1A) regarding directors' duties of care, skill and diligence creates a standard which is necessary for modern times. Persons accepting the office of director should realise that the days of passive part-time director are now over and the courts will no longer take an indulgent attitude if directors neglect their duties. Further the enactment of s 132(1A) lays to rest the uncertainty that had governed this area of the law in Malaysia.

Despite the common heritage between the United Kingdom and Malaysia, the fact that the United Kingdom had rejected the enactment of a statutory business judgment rule should not be used to argue that Malaysia should have done likewise. The statutory business judgment rule created by s 132(1B) may ensure the new and stricter standard of care imposed by s 132(1A) does not dampen the spirit of enterprise of directors. The limited liability regime and the separate legal identity doctrine have made the registered company a popular vehicle for the undertaking of one or more business activities. It is commonplace that commercial activity cannot be divorced from its accompanying risks and risk-taking in business ventures may sometimes prove disastrous for a company. But extreme caution, conservatism and defensive management may hinder the progress of commercial companies and serve to defeat the purpose for which such companies are formed. The new business judgment rule embodied in s 132(1B) is not to shield directors from liability if they breach their duty of care but to assure them that they will be protected from liability if they make honest and informed business judgments regarding matters which they reasonably believe to be in the company's interest and the matter is one in which they have no personal interest.