

# *The Research on Introducing the Business Judgment Rule to China*

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**Abstract:** The business judgment rule originates from American as an efficient law tool to maintain the stability of the operation of corporation. The business judgment rule as an efficient tool of corporate governance, which plays a significant role in balancing the liability and the duty of directors. It serves as a safe harbor for director management from risk of liabilities brought from necessary decision makings. In detail, a “good faith” director could be cleared of all suspicion of dishonest if they meet the requirements of the business judgment rule. Although the current Chinese company law regulates the fiduciary duties of directors, but it still leave some Abstractroom for managers and directors to conduct their behaviors and perform their duties. But the introduction and implementation of this rule could reduce the existed deficiency in current Chinese company legislation as well as promote the efficiency of the decision making systems and procedures.

## **1. Introduction**

The business judgment rule plays a role as a theory of supporting corporate managers' actions and provides a safe harbor for directors when they act to meet the requirements[1] Although there is not a clear definition of the business judgment rules, the model business corporation act indirectly provides provisions for business judgment rules. It regulates that directors should act in good faith and the best interests of companies.[2] Regarding director's duties in China, the current Chinese company Law makes great progress as regulating the directors' duties. However, it just generally describes the directors' duty of fiduciary, which includes the loyalty duty and the diligence duty, and some deficiency still exist. For example, the gap of the business judgment rule leads to the dilemma of adjudication predicament. The business judgment rule has been tested and developed in other jurisdictions may not only tackles the judiciary difficulties but also decreases contradictory judgment. This essay will examine the business judgment rule, from its historical origin to development, and analyses its interpretation, application and necessity. Last but not the least, this essay will discuss the need for transplanting the business judgment rule in China.

## **2. The Background of the Business Judgment Rule**

With the development of economic globalization, business activities and market opportunities are changing rapidly. The practical decision of directors can play an essential role in gaining

competitive advantages and benefiting companies and shareholders' interests. Thus, it is significant to prevent directors from abusing their authorities and encouraging directors to perform to maximum corporations' interests positively. The key to improving the accountability mechanism of business managers and inspire directors' enthusiasm at the same time is to establish common and operational rules for determining whether behavior meets the requirements of diligence. The biggest significance of the business judgment rule is that it raises the criteria for determining the diligence obligation from the respect of decisions of the company's management. But how to utilize the business judgment rule let it shines rather than becomes a weapon of protecting directors' misbehaviours, it is primarily related to the definition and scope of the business judgment rule as well as its applicability. The primary objective of this research is to introduce the business judgment rule in the light of its origin and development, to compare regulations among different jurisdictions and then evaluate them to figure out the available and applicable experience with the connection of Chinese realism.

In recent years, many types of research have been aimed to study and enhance the business judgment rule around the world. Neri-Castracane, G (2015) reviews that the business judgment rule can least play an essential role in promoting corporate social responsibilities, depending on the situation at hand. [3] Matthew, P. (2016) argues that China may benefit from modifying the business judgment rule affirmed in Canada as a means to circumvent low standards, a lack of independence concerning judicial appointments, and given the courts' limited expertise to evaluate or second-guess certain business decisions.[4] Nonetheless, the importance of business judgment rule has been widely discussed in Chinese academia, and a lot of scholars has pointed out their own opinion about how to transplant the business judgment rule in China. Some argue that the business judgment rule is unrealistic in the current legal environment, lacking the well-trained judgments and enough transparent economic surrounding. The ultimate point is that the fiduciary duty of directors isn't regulated clearly to comply with the business judgment rule, which will impedes the implementation of this rule.

### **3. The Application of the Business Judgment Rule in the Usa**

The business judgment rule originated from the USA and was codified in the Companies Act 2008 under section 76(4). The rule was founded with the objective to limit judicial intervention in decision made within the private business sector. [5] This rule provides protection to a director who faces allegations of a breach of directors' duties if the directors has satisfied the requirements set out in section 76(4). In USA, the court will consider carefully the fallowing factors when they apply the business judgment rule. In detail ,they are (1) is not interested in the subject of his business judgment; (2) is informed with respect to the subject of the business judgment to the extent the director or officer reasonably believes to be appropriate under the circumstance; (3) and rationally believes that the decision would be in the best interest of the company.[6] Firstly, in the view of business decision, there is no denying that the decision of doing something is parallel to a decision of considering not to act(ibid). Secondly, Due care, this factor inquires directors to consider all the relevant information prior to make decisions. The informed prerequisite focuses on the preparedness of a director or officer in making a business decisions ,as opposed to the quality of the decision itself. The third factor---good faith and the best interest of the company demand the decision made by directors should have rational business purpose.[7] In other words, the director will not be allowed to make business decision in their own interests, which will influence extremely their independence on protecting company's best interest.

#### 4. The Possibility and Necessity of Introducing the Business Judgement Rule

In modern times, China has introduced many Western legal principles and theories to foster Chinese legal progress and meet the need of reality. For example, Chinese company law transplanted shareholder-derived litigation from the US corporate law but neglected the business judgment rule, which plays a vital role against the misuse of shareholder-derived litigation. In parallel, although the fiduciary duties have been influenced positively in company activities, some deficiency still exist, driving the practical legal issues, such as the ambiguousness in the application scope. In comparison, the business judgment rule as an essential criterion for reviewing the duty of care of directors in America. On the other hand, in the perspective of human fallibility, it may be unreasonable and unrealistic for directors to make sound judgments, with the lack of sufficient information. This rule is rooted in human nature and inspire directors to realize their ambitions without hesitation. As is known, directors must take necessary risk to lead company successfully and sometimes it is necessary for directors to take some risky actions to occupy a favorable position of advantages in the fierce commercial competition. Thus, the application of the business judgment rule can avoid to constrain the innovation and venturesome business activity. Additionally, the business judgment rule can provide an efficient decision-making mechanism to directors to display their commercial talent. Furthermore, the business judgment rule can reduce the unnecessary trouble of court judging directors' decisions, and especially directors are more qualified with the financial market and business. Thus, this rule can reduce the waste of judicial resources and the confusion of judgment. Lastly, it is widespread for some shareholders may disagree board resolutions and are willing to challenge it in the court. If the court reviews each decision on the merits, it will impede the process of decision-making. More importantly, the rule just require decisions made by directors will be retrospectively analyzed in a manner that does not result in a court second guessing the decisions of the board and creating hindsight bias. In other words, the application of the business judgment rule can prevent the judicial interference from impairing business and economic growth as well as maintain the judicial independence.

#### 5. Conclusion

In general, the business judgment rule can be sheltered directors when their conduct under the good faith, the maximum interests of companies, and the reasonable diligence. To sum up, it is worthwhile to introducing the business judgment rule to tackle current problems in Chinese juridical practice and accelerate the development of Chinese corporate governance.

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