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An Examination of the Relevance of the Codification and Application of the American Business Judgment Rule to Nigerian Corporate Law

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Abstract

The business judgment rule is an ancient doctrine that was developed in the US. It seeks to prevent courts from reviewing directors' decisions, on the basis that directors have the capacity and expertise to make business decisions. This article examines the desirability of applying the US business judgment rule in Nigeria. Through a comparative analysis, it argues that the peculiarities of Nigeria's corporate law and environment do not justify the application of the rule. More specifically, it contends that differences in the legal regime for derivative suits, standards of duty of care and skill, corporate law culture, and the distinct epoch in which the business judgment rule and the duty of care and skill were recognized in the US, make its application unnecessary in Nigeria. It concludes that the current statutory duty of care and skill should be retained to hold directors accountable for reckless business decisions.

Keywords

Business judgment rule, codification, application, United States, Nigeria, corporate law

INTRODUCTION

The business judgment rule has gained traction in US corporate law and jurisprudence. The rule recognizes that the directors of a company are the principal decision makers on corporate affairs, and courts are not suited to second-guess those decisions provided the directors exercise proper discretion.[1] Many other jurisdictions have codified and applied the rule in their

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1 J Schnell "A procedural treatment of derivative suit dismissals by minority directors" (1981) 69/3 *California Law Review* 885 at 885. See also F Triem "Judicial schizophrenia in corporate law: Confusing the standard of care with the business judgment rule" (2007) 24 *Alaska Law Review* 23 at 26, noting that "the essence of the business judgment rule is deference to directors' decision making based on judicial unwillingness to

corporate laws. This article examines the relevance of codifying and applying the US business judgment rule in the Nigerian corporate governance regime. The article is divided into six sections. The next section discusses the meaning and history of the business judgment rule. The article then examines why the rule was developed and applied in determining directors' breach of duty of care and skill. The following section discusses the codification of the rule in US corporate law and investigates the various ways in which the rule has been applied by US courts. The article then discusses various reasons that inform the position of this article that codifying the rule in Nigeria and applying it to Nigerian corporate law are not necessary. It concludes with a suggestion that the continuous use of the extant statutory duty of care and skill in Nigerian corporate law is imperative in order to avoid undue diminution of the standard for assessing breach of the duty.

THE BUSINESS JUDGMENT RULE: MEANING AND A BRIEF GENESIS

It is axiomatic in corporate law that the shareholders are the owners of the company while the directors manage the company's affairs.[2] Indeed, from a pragmatic point of view, the actual power to steer the affairs of the company rests with the board of directors. In most cases, the stockholders only endorse the board's decisions.[3] However, the directors' duty to manage the affairs of the company entails that the directors must be careful and skilful in executing their duties. Nevertheless, it is often claimed that directors are human beings and, as such, cannot be the ultimate paragons of circumspection. This view sits snugly on the corporate law doctrine called the "business judgment rule".

The business judgment rule has become a dominant theme in corporate law discourse in both judicial and academic circles.[4] In large part, this is because the doctrine seeks to strike a proper balance between directors' discretion and accountability in the management of the company's affairs.[5] The

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re-examine a business decision and judicial reluctance to discourage directors from risk-taking".

2 M Rich "The business judgment rule: Partial armor for directors and officers" (2014) *New Jersey Lawyer* 55 at 55.

3 M Ubelaker "Director liability under the business judgment rule: Fact or fiction" (1981) 35 *Southwestern Law Journal* 775 at 777.

4 R Pepples "Use and misuse of the business judgment rule in close corporations" (1985) 60/3 *Notre Dame Law Review* 456 at 456, stating "the business judgment rule occupies a venerable position among corporate law principles. The rule is uniformly noted in major law school casebooks and hornbooks and is cited frequently by the court. The business judgment rule invariably appears in any distillation of general corporate law."

5 J Leach "The correct understanding of the business judgment rule in section 76(4) of the Companies Act 71 of 2008: Avoiding the American mistakes" (LLM thesis submitted to the Faculty of Law, University of Cape Town, 2014) at 38, available at: <http://open.uct.ac.za/bitstream/handle/11427/9615/thesis_law_2014_leach_j.pdf;sequence=1> (last accessed

problem of directorial discretion and accountability has evolved in the corporate law debate because of the separation of the ownership and control of firms.[6] This separation hardly allows the interests of the directors and shareholders to converge, and often leads to a situation where directors either exercise their powers for their own interests as opposed to the interests of the shareholders or engage in acts that constitute moral hazards.[7] Put differently, the separation creates what corporate law mainstream scholars have termed "agency problems"[8] and makes it difficult for shareholders to monitor the manner in which the directors manage the company's affairs.

Although the business judgment rule remains a dominant theme in corporate law, a precise definition of the term has eluded scholars.[9] This does not mean that scholars have not made efforts to define the concept. It has been noted that the business judgment rule is "a doctrine holding that directors of corporations should not be liable for what amounts to a good faith exercise of business judgment, even if other boards might have reached a contrary decision".[10] Also, scholars and judicial decisions have defined the rule as a rule of presumption. For instance, Nadelle opined that "under the business judgment rule, a board that has approved a specific action will be presumed

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7 June 2020), stating that "the business judgment rule is the mechanism by which the inherent tension between accountability and authority is resolved".

6 For the literature on this, see A Berle and G Means *The Modern Corporation and Private Property* (1932, The Macmillan Company).

7 See G de la Rosa and J Shopovski "Directors' conflict of interest: Different European legal perspectives" (2013) 4/4 *Beijing Law Review* 174 at 174.

8 "Agency problem" implies that an agent does not always act in the principal's interest. For this definition and the costs associated with agency problems, see M Jensen and W Meckling "Theory of the firm: Managerial behaviour, agency cost and ownership structure" (1976) 3 *Journal of Financial Economics* 305. For other literature, see C Oyarzin "Institutional shareholders and corporate governance: Do institutional shareholders have an active participation in preventive governance in the United Kingdom? And if so, how?" (2011) 38/1 *Revista Chilena De Directio* 9 at 10, stating "this theory perceives the governance relationship as a contract between shareholders (the principal) and directors (the agent), and this agency theory utters a fundamental problem in organizations-self-interested behavior. A corporation's manager could have personal goals that compete with the owner's goal of maximization of shareholder wealth. When shareholders authorize managers to administer the firm's assets, a potential conflict of interests exists between the two groups". See also S Ishak, A Che Omar and A Ahmad "Directors' fiduciary duties to perform in the best interest of the companies: An inter-related relationship between ethics and governance" (2011) 3/1 *International Business & Management* 111 at 113, stating that "agency theory has assumed that management as the opportunist agents [sic] and thus requires monitoring from various types of monitoring tools". For agency costs, see V Brudney "Corporate governance, agency costs, and the rhetoric of contract" (1985) 85 *Columbia Law Review* 1403 at 1406–07.

9 D Branson "The rule that isn't a rule: The business judgment rule" (2002) 36 *Valparaiso University Law Review* 631 at 632, noting that "the business judgment rule is multifaceted".

10 K Davis "Once more, the business judgment rule" (2000) *Wisconsin Law Review* 573 at 573.

to have acted in good faith on a fully informed basis, and in an honest belief that the action taken was in the best interest of the corporation".[11] In *Aronson v Lewis*, the court noted that the rule "is a presumption that in making a business decision, the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action was taken in the best interests of the company".[12] The various perspectives about the meaning of the term have prompted the view that the rule is "one of the least understood concepts in the entire corporate field".[13] Notwithstanding the variegated definitions, one explanation is ingrained in the rule. Under the rule, courts will be unwilling to impose legal liabilities on directors who are sincere in making a business decision for the company that turns out to be injurious to the company. From another perspective, these definitions suggest that the rule enjoins courts to show deference to directors' business decisions, provided that the decisions are not made in bad faith or tainted with fraud. In essence, directors' independence in making business decisions for their corporation foregrounds the rule.

The business judgment rule originated in the US two centuries ago and has been consistently applied since.[14] In 1829, the Supreme Court of Louisiana noted in the famous case of *Percy v Millaudon*[15] that:

> "The test of responsibility (of directors) therefore should be, not the certainty of wisdom in others, but the possession of ordinary knowledge; and by showing that the error of the agent is of so gross a kind that a man of common sense, and ordinary attention would not have fallen into it. The rule which fixes responsibility because men of unerring sagacity are supposed to exist, and would have been found by the principal, appears to us essentially erroneous."[16]

Essentially, the concept arose in the US "from the judicial concern that persons of reason, intellect, and integrity would not serve as directors if the law

11 N Grossman "Director compliance with elusive fiduciary duties in a climate of corporate governance reform" (2007) 12/3 *Fordham Journal of Corporate & Financial Law* 393 at 402.

12 473 A 2d 805 (Del 1984) at 812.

13 H Manne "Our two corporation systems: Law and economics" (1967) 53 *Virginia Law Review* 259 at 270, cited in L Johnson "Corporate officers and the business judgment rule" (2005) 60 *Business Lawyer* 439 at 454.

14 A Brumbaugh "The business judgment rule and the diversified investor: Encouraging risk in financial institutions" (2017) *UC Davis Business Law Journal* 171 at 175.

15 (1829) 8 Mart (NS) 68 (La 1829).

16 Id at 77–78, cited in I Smith "The application of the business judgment rule in fundamental transactions and insolvent trading in South Africa: Foreign precedents and local choices" (LLM mini-thesis submitted to the Faculty of Law, University of Western Cape, 2016) at 1, available at: <https://etd.uwc.ac.za/bitstream/handle/11394/5523/Smit_i_llm_law_2017.pdf?…1…> (last accessed 7 June 2020).

exacted from them a degree of prescience not possessed by people of ordinary knowledge".[17]

Since the Louisianan Supreme Court decision in *Percy*, the doctrine of the business judgment rule has become the fulcrum of protecting directors from liability in US corporate law. Indeed, the rule has become "long standing, deeply entrenched and comprehensively accepted by courts".[18] For instance, the Wisconsin courts[19] and courts in other states have religiously applied the doctrine.[20] Apart from the courts, the rule has been codified in US law through the American Law Institute (ALI) Corporate Governance Project.[21] More fundamentally, many countries have codified the rule[22] or expressed their intention to do so,[23] with the US law and judicial approaches serving as the major templates for such codification. The next section discusses the role of the business judgment rule in corporate law.

THE BUSINESS JUDGMENT RULE: ITS BASIS IN CORPORATE LAW

Most proponents of the business judgment rule claim that the rule is important to corporate law because risks are involved in almost every business transaction.[24] Furthermore, transactions that yield maximum return on investment are those that have high degrees of risk.[25] Consequently, if directors are scared that their business decisions will be subjected to litigation and the attendant judicial scrutiny and personal liability, they will abstain from taking risks. Often, failure to take the risk would not only affect

17 S Arsht "The business judgment rule revisited" (1979) 8/1 *Hofstra Law Review* 93 at 97.

18 Brumbaugh "The business judgment rule", above at note 14 at 182.

19 See *Figge v Bergenthal* 130 Wis 594 (1905) at 615 and 624–25; and *Theis v Durr* 125 Wis 651 (1905) at 659.

20 T McEachin "*Theriot v Bourg*: The demise of the business judgment rule in Louisiana?" (1998) 59 *Louisiana Law Review* 375 at 389, noting that "almost every other jurisdiction in the country recognizes the business judgment rule".

21 See *Principles of Corporate Governance: Analysis and Recommendations* (1994, American Law Institute) (fondly known as the "ALI Corporate Governance Project"), para 4.01(c), available at: <https://www.ali.org/publications/show/corporate-governance-analysis-and-recommendations/> (last accessed 7 June 2020).

22 Australia, Germany, Malaysia and South Africa and have codified the rule. See D Branson "A business judgment rule for incorporating jurisdictions in Asia" (2011) 23 *Singapore Academy of Law Journal* 687 at 688.

23 A Gurrea-Martinez "Re-examining the law and economics of the business judgment rule: Notes for its implementation in non-US jurisdictions" (2018) 18/2 *Journal of Corporate Law Studies* 417 at 417.

24 D Rosenberg "Supplying the adverb: The future of corporate risk-taking and the business judgment rule" (2009) 6/2 *Berkeley Business Law Journal* 216 at 217.

25 McEachin "*Theriot v Bourg*", above at note 20 at 384. See also L McMillan "The business judgment rule as an immunity doctrine" 4/2 *William & Mary Business Law Review* (2013) 521 at 528, stating that "in order to maximize shareholder wealth and grow a corporate enterprise, directors must often make business decisions that entail an assumption of risk; very seldom does return exist without risk, and there is generally presumed to be a positive correlation between the two".

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shareholders' return on investment, it would also impede innovation in the firm that might be beneficial to the shareholders.[26] As one scholar notes, "because the potential profit often corresponds to the potential risk, it is very much in the interest of the shareholders that the law not create incentives for overly cautious corporate decisions".[27] This justification for the business judgment rule is further strengthened with the argument that shareholders could hold many portfolio investments and diversify their risk. Thus, directors should be allowed to take high-risk business decisions because, even if they do so, the shareholders would only suffer a loss in respect of a proportion of their investment.[28]

Apart from the issue that, without the business judgment rule, directors would be risk-averse, it is often argued that "judicial review is naturally ill-suited to analyse the quality of business decisions".[29] Thus, courts lack the expertise to know and make good business decisions for corporations. Therefore, if courts are allowed to interfere or second-guess directors' business decisions, there will a high chance that they will make mistakes in deciding the propriety or otherwise of directors' business decisions.[30] More essentially, the courts might not be properly informed about the events or circumstances that informed the directors' decision and the application of the courts' hindsight could lead to a biased decision[31] or action against directors.[32] In such

26 McEachin, id at 384 and 389.

27 J Deutsch "Part II: The business judgment rule under Connecticut corporation law and commentary in *Joy v North*" (1982) 56 *Connecticut Business Journal* 451 at 461.

28 See *Joy v North* 692 F 2d 880 (1982) at 885–86, where the court noted, "shareholders can reduce the volatility of risk by diversifying their holdings. In the case of diversified shareholder [sic], the seemingly more risky alternatives may well be the best choice since great losses in some stocks will over time be offset by even greater gains in others … A rule which penalizes the choice of seemingly riskier alternatives thus may not be in the interest of shareholders generally."

29 Brumbaugh "The business judgment rule", above at note 14 at 178.

30 Rosenberg "Supplying the adverb", above at note 24 at 223.

31 This is fondly called the "hindsight bias" and "describes the human tendency to conclude from the occurred damage to a breach of duty during the decision procedure or with regard to the concrete decision result. The possibility of averting the occurred damage is over-estimated, because possibilities of averting the occurred damage seem more likely from a retrospective view. Thus, the occurred damage would be seen as a direct consequence of the decision and the breach of duty would lie within the non-preventing of the damage": S Eisele "Codification of the business judgment rule in section 76(4) Companies Act 2008: Comparing the South African with the German approach" (LLM thesis submitted to the University of Cape Town, 2017) at 30, available at: <https://open.uct.ac.za/bitstream/handle/11427/25021/thesis_law_2017_eisele_stefan.pdf?sequence=1> (last accessed 7 June 2020).

32 A Lee "Business judgment rule: Should South African corporate law follow the King's Report's recommendation" (2015) 1 *University of Botswana Law Journal* 50 at 77. It has been noted that "the judiciary is institutionally not in the correct position to judge with the power of hindsight a decision which, at the time of making the decision, was ex ante correct or reasonable; but which ex post facto was not": Leach "The correct understanding", above at note 5 at 31.

circumstances, "courts cannot be punished for making a poor business decision, provided that it is legally sound".[33] As with the justification of non-judicial interference, it has been noted that, even if directors make decisions that turn out be injurious to the corporation, the shareholders (not the courts) have the inherent power to sanction the directors through a vote to remove them at the company's general meeting.[34] Therefore, the courts' intervention might amount to a waste of judicial time and resources[35] in a matter that could be dealt with internally.

Another element of the basis of the business judgment rule is that most company laws empower directors to manage the business of corporations.[36] Intrinsic in this power is the right of directors to exercise their discretion in making decisions for the corporation in certain circumstances.[37] If directors are not allowed to exercise their discretion, or where the exercise of their discretionary power is always subjected to judicial scrutiny, there is a risk that directors may, because of fear of personal liability, be scared to take decisions that would be beneficial to the corporation. More fundamentally, such judicial intervention will scare a critical mass of individuals who wish to take up directorship positions in corporations.[38] This, in turn, would negatively

33 Gurrea-Martinez "Re-examining the law", above at note 23 at 423.

34 K McCarthy "Corporate officer liability and the applicable standard of review under Delaware law and agency law" (paper submitted in partial fulfilment of the requirements of the King Scholar Program, Michigan State University College of Law, 2017) at 17, available at: <https://digitalcommons.law.msu.edu/cgi/viewcontent.cgi?article=1274&context=king> (last accessed 7 June 2020).

35 For justification of the rule on grounds of judicial economy, see *Karasik v Pacific E Corporation* 21 Del Ch 81 at 97 (Ch 1935).

36 In *MMS Cos Liquid Audio Inc* 813 A 2d 1118 (Del 2003), the court noted (at 1127) that "the business judgment rule, as a standard of judicial review, is a common law recognition of the statutory authority to manage a corporation that is vested in the board of directors".

37 L Johnson "Unsettledness Delaware corporate law: Business judgment rule, corporate purpose" (2013) 28 *Delaware Journal of Corporate Law* 405 at 412, noting that "Delaware courts frequently ground the rule in that section of the corporate statute providing that the business affairs of the corporation are to be managed by or under the discretion of the board". See also, C Swanson "Juggling shareholder rights and strike suit in derivative litigation: The ALI drops the ball" (1993) 77 *Minnesota Law Review* 1339 at 1360, stating "the rule also gives directors the broad discretion to formulate company policy without the fear of judicial second-guessing"; and D Curtin "Demand of directors in a shareholder derivative suit when the board has approved the wrong" (1985) 26/2 *Boston College Law Review* 441 at 444, noting that, "the protection of the doctrine rests upon the assumption that the directors must be given wide latitude in making decisions to manage the corporation properly and efficiently. Accordingly, when a director makes a decision in the course of his corporate duties that he believes erroneously but in good faith, to be in the best interests of the corporation, a court will not substitute its judgment for the judgment of the director or hold the director liable for any loss resulting from the honest mistake".

38 P Waller "The directors' business judgment rule: The final act" (1988) 22 *Suffolk University Law Review* 649 at 650, arguing that the business judgment rule is geared towards "encouraging talented individuals to assume the post of corporate director".

affect not only the quality of the individuals who manage the affairs of corporations and but also the quality of corporate decisions.[39] The next section discusses the codification of the rule and the various ways in which US courts have applied it.

CODIFICATION AND APPLICATION OF THE BUSINESS JUDGMENT RULE IN THE US

It has been noted that the business judgment rule is an "exclusively American legal construct that dates back to the early 19th century"[40] and is "almost adopted throughout the United States".[41] It is applied in American corporate law as an exception to directors' duty of care and skill,[42] which duty requires directors "to be diligent and prudent in the management of corporate affairs".[43] In the context of statutory recognition, the business judgment rule has been codified under the ALI Corporate Governance Project.[44] Specifically, the ALI rule provides that:

> "[A] director or officer who makes a business judgment in good faith fulfils the duty under this section if the director or officer: is not interested in the subject matter of the business judgment; 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 circumstances; and rationally believes that the business judgment is in the best interests of the corporation".[45]

Apart from the ALI rule, most US states have codified the rule in their corporate statutes.[46] For instance, in Nevada, "directors and officers, in deciding upon matters of business, are presumed to act in good faith, on an informed basis and with a view to the best interests of the corporation".[47] Also, the Californian Corporation Code exempts directors from liability for any action for which they exercise business judgment, if the action is done in a manner that the directors believe to be in the best interest of the company and its

39 McEachin "*Theriot v Bourg*", above at note 20 at 384.

40 A Ponta and R Catana "The business judgment rule and its reception in European countries" (2015) 4/7 *The Macrotheme Review* 125 at 132.

41 T Aman "Cost-benefit analysis of the business judgment rule: A critique in the light of the financial meltdown" (2010) 74 *Albany Law Review* 1 at 7.

42 Johnson "Unsettledness Delaware corporate law", above at note 37 at 424, arguing that "the business judgment rule is a doctrinal vessel of judicial review into which the fiduciary duties of care and loyalty are fitted and subsumed". See also Eisele "Codification of the business judgment rule", above at note 31 at 1.

43 Ubelaker "Director liability", above at note 3 at 784.

44 Above at note 21.

45 Id, para 4.01(c).

46 A Greenhow "The statutory business judgment rule: Putting the wind into directors' sails" (1999) 11 *Bond Law Review* 33 at 55.

47 Nevada Revised Statutes (2001), sec 78.138(3).

shareholders, and with such care and reasonable investigation as an ordinarily prudent person in the same position would use under the same circumstances.[48]

The business judgment rule has also been applied and developed through judicial decisions in the US.[49] In *Miller v American Telephone & Telegraph Co*, the US Court of Appeals for the Third Circuit noted that the: "rule expresses the unanimous decision of American courts to eschew intervention in corporate decision-making if the judgment of officers is uninfluenced by personal considerations and is exercised in good faith … Underlying the rule is the assumption that reasonable diligence has been used in reaching the decision which the rule is invoked to justify".[50]

Consistency in the recognition and application of the business judgment rule in the US was further echoed by the court in *In Re Caremark International Derivative Litigation*,[51] where the Delaware Court of Chancery opined that: "[w]hether a judge or jury considering the matter after the fact, believes a decision substantively wrong, or degrees of wrong extending through stupid to egregious or irrational provides no grounds for director liability, so long as the court determines that the process employed was either rational or employed in [sic] good faith effort to advance corporate interest".[52]

The statutory and case law recognition of the business judgment rule in the US noted above, show that the rule is embedded in the US corporate law and governance regime. The rule, however, has been applied in different forms in

48 California Corporation Code (2012), sec 309. For other states that have adopted the business judgment rule, see: Alaska Corporation Code (2018), sec 10.06.450(b); Arkansas Code (2015), sec 4-36-302; Connecticut General Statutes (2012), sec 33-356; Florida Statutes (2010), secs 607.0830 and 607.0831; Georgia Code (2017), sec 14-2-830; Indiana Code (1989), sec 23-1-35-1; Louisiana Revised Statutes (2012), sec 12.92(E); Maine Business Corporation Act (2001) 13, sec 831; Maryland Corporations and Associations Code (annotated 2004), sec 2-405.2; Michigan Company Laws (2014), sec 450.1541(a); Minnesota Statutes (2016), sec 317 A.215; Missouri Revised Statutes (2011), sec 351-345; Montana Code (annotated 2017), sec 35-416; Nevada Revised Statute (2019), sec 78.138; New Hampshire Revised Statute (2013), sec 293-A:8.30 (e) and (f); New Jersey Revised Statutes (2013), secs 14A and 6-14(2); New Mexico Statute (2006), sec 53-4-18.1; New York Business Corporation Law (2014), sec 717; North Carolina General Statute (2014), sec 55.8-30; Oklahoma Statutes (2014), sec 18-867; Pennsylvania Consolidated Statute (2014), sec 513; Rhode Island General Laws (2014), sec 7-1.2-811; South Carolina Code of Laws (2013), sec 33-8-30; Tennessee Code (2010), sec 48-18-304; Texas Business Corporation Act (2005), art 2.41; Utah Code (2006), sec 16-10a-840; Vermont Statutes (2012), sec 11A VSA S.8.30; Wisconsin Statutes & Annotations (2015), sec 180.0828; and Wyoming Statutes (2011), sec 17-16-830.

49 For instance, in *Resolution Trust Co v Norris* 830 F Supp 351 (SD Texas, 1993), the court noted (at 356) that "Texas courts to this day will not impose liability upon a non-interested corporate director unless the challenged transaction is ultra vires or tainted by fraud … Such is the business judgment rule in Texas".

50 507 F 2d 759 (3rd Cir 1974) at 762.

51 698 A 2d 959 (Del Ch 1996).

52 Id at 967.

the US. In some jurisdictions, it is applied as a rule of presumption. For instance, in Delaware, the courts apply the rule as "a presumption that in making business decisions, the directors of a corporation acted on an informed basis, in good faith and in the belief that the action taken was in the best interest of the company".[53] Apart from Delaware courts, the US Court of Appeals, Third Circuit noted in *Johnson v Trueblood* that: "[t]he business judgment rule validates certain situations that otherwise would involve conflict of interest for the ordinary fiduciary. The rule achieves this purpose by postulating that if actions are arguably taken for the benefit of the corporation, then the directors are presumed to have been exercising their sound business judgment rather than responding to any personal motivations".[54]

One critique of this "presumption approach" to the application of the business judgment rule is that it places a considerable burden of proof on a plaintiff to show that the directors have not fulfilled the conditions precedent that would entitle them to take the benefit of the rule.[55] Moreover, it creates judicial bias in favour of directors, in that the court presumes that the directors have acted properly and will only call upon the directors to show the entire fairness of the transaction when the plaintiff places some material facts before the court that defeat the presumption.[56]

Under the ALI provision, the business judgment rule is applied under a different rubric: it operates as "a safe harbour",[57] in the sense that the directors bear the onus of proving that the requirements of the rule apply to the transaction and, if they successfully discharge this burden of proof, they transition into an unassailable safe harbour.[58] The problem with this application of the rule is that it could create an opportunity and a fait accompli that would exculpate directors from liability for corporate decisions, irrespective of how awful those decisions turn out to be.[59] Another potential concern about the ALI version of the rule is that, apart from the good faith and non-interested requirements, which could be interpreted objectively, the requirements regarding the information the director had with respect to the subject matter

53 *Aronson v Lewis*, above at note 12 at 812.

54 629 F 2d 287 (3rd Cir 1980) at 292.

55 D Branson "A business judgment rule", above at note 22 at 692. See also M Legg and D Jordan "The Australian business judgment rule after *ASIC v Rich*: Balancing director authority and accountability" (2014) 34 *Adelaide Law Review* 403 at 414, noting that "the party alleging liability may rebut the presumption by showing … : (a) That the directors violated any of their fiduciary duties; or (b) That the business judgment rule is inapplicable because the directors committed an act of fraud, illegality or otherwise. If the party alleging liability rebuts the presumption, the director must prove that the challenged transaction was entirely fair to the corporation and its shareholders."

56 In *Krasner v Moffet* 826 A 2d 777 (Del 2003), the court opined (at 287) that "when the presumption of the business judgment rule has been rebutted, the entire fairness rule is implicated and the defendants bear the burden of proof".

57 Branson "The rule that isn't a rule", above at note 9 at 636.

58 Ibid.

59 See Smith "The application", above at note 16 at 24.

of the decision and the belief that the decision is in the best interest of the company are interpreted subjectively. This is because the ALI provision emphasizes what the "director reasonably believes to be appropriate in the circumstances"[60] and whether he "rationally believes that the business judgment is in the best interests of the corporation".[61] By implication, the shareholders would bear the brunt of bad decisions resulting from a director's personal and subjective judgment.

These approaches in the application of the business judgment rule have created several doctrines regarding the interpretation of the rule. Indeed, the rule is often either interpreted as an abstention doctrine,[62] immunity doctrine[63] or as a standard of review.[64] Under the abstention doctrine, "courts simply refuse to analyze board decisions in certain individual cases".[65] In *Shlensky v Wrigley*, the Appellate Court of Illinois noted: "[t]he response which courts make to such applications is that it is not their function to resolve for corporations questions of policy and business management. The directors are chosen to pass upon such questions and their judgment unless shown to be tainted with fraud is accepted as final".[66]

Similarly, the Supreme Court of New York asserted in *Kamin v American Express Co* that "the directors' room rather than the courtroom is the appropriate forum for thrashing out purely business questions which will have an impact on profits, market prices, competitive situations or tax advantages".[67] The challenge with the abstention doctrine, as noted by some critics, is that it creates "a presumption of non-review".[68] With respect to the immunity doctrine, directors are encouraged to exercise absolute powers whenever they make a business decision and they will be immune from liability arising from the decision if a reasonable person in comparable circumstances would make the same decision.[69] As a standard of review, it requires the courts to minimise their review of directors' business decisions.[70] Thus, under this

60 ALI Corporate Governance Project, above at note 21, para 4.01(c)(ii).

61 Id, para 4.01(c)(iii).

62 For a comprehensive analysis of the abstention doctrine, see SM Bainbridge "The business judgment rule as abstention doctrine" (2004) 57 *Vanderbilt Law Review* 83.

63 For the literature on immunity doctrine, see McMillan "The business judgment rule", above at note 25.

64 B Sharfman "The importance of the business judgment rule" (2014) 14 *New York University Journal of Law & Business* 27 at 28–29, stating that the rule "is the most important standard of judicial review under corporate law".

65 Ponta and Catana "The business judgment rule", above at note 40 at 126.

66 237 NE 2d 776 (111 App Ct 1978) at 779.

67 383 NYS 2 d 807 (Sup Ct 1976) at 810–11.

68 A Scarlett "A better approach for balancing authority and accountability in shareholder derivative litigation" (2008) 57 *University of Kansas Law Review* 39 at 71.

69 J Leach "The correct understanding", above at note 5 at 44, stating that "the business judgment rule is the mechanism by which the inherent tension between accountability and authority is resolved".

70 Branson "A business judgment rule", above at note 22 at 687.

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limb, "the main function of the business judgment rule is to create a less demanding control standard than the ideal standard created by the definition of due diligence and prudence".[71] The implication of the immunity and standard of review doctrines is almost the case of a distinction without any difference. This is because both doctrines require minimal judicial intervention and limited relief for the plaintiff once the directors meet the requirements for the application of the rule.[72]

The business judgment rule has mostly been applied in the US in shareholder litigation against directors. With respect to minority shareholder litigation against directors, the rule has been applied to shield directors from liability both from a case law and statutory perspective. The seminal decision of the court in *Auerbach v Bennett*[73] is important here. The General Telephone and Electronics Corporation made controversial payments of over $11 million for a period of four years. The company set up an audit committee, which examined the company's accounts and wrote a report to the Securities and Exchange Commission.[74] Based on the committee's report, the plaintiff, who was also not satisfied with the management of the company's finances, instituted a derivative suit in which he claimed that current and past directors of the company knew about, and should explain, the dubious payments.[75] In line with the conventional practice in the US, the company established a shareholder litigation committee (SLC), consisting of three non-interested directors, to determine whether it was in the best interest of the company that the derivative suit should continue. The SLC recommended that the derivative suit would not be beneficial to the company.[76] The Court of Appeals of the State of New York accepted the SLC's recommendation and held that the committee's decision was a business judgment that did not warrant interference by the court unless the plaintiff could adduce evidence of fraud.[77] Similarly, in *Abbey v Control Data Corporation*,[78] the plaintiff, through a derivative action, alleged that the directors breached their fiduciary duties and federal securities rules. Subsequently, the company's board of directors set up an SLC, which recommended that the derivative action would not be beneficial to the

71 Ponta and Catana "The business judgment rule", above at note 40 at 127.

72 Id at 126, noting that, under the standard of review, "courts take an objective examination of the merits of the board decisions". The scholars also note (id at 131) that the immunity rule "operates pretty similar to the standard of review approach since the effect is the same: insulation of directors from liability for business-related decisions. The functional analysis, which is to be made prior to granting immunity, is the same, but the procedural analysis focuses though on disqualifiers that can indemnify violations of the duty of loyalty, such as fraud, self-dealing, inappropriate information or lack of any decision".

73 47 NY 2d, 619 (1979).

74 Id at 624.

75 Ibid.

76 Id at 625–26.

77 Id at 631.

78 603 F 2d 724 (8th Cir 1979).

company and also applied for a summary judgment.[79] The US Court of Appeal, Eighth Circuit ruled in favour of the company and noted that the SLC could legally discontinue a derivative action.[80] In the Indiana case of *Cutshall v Barker*,[81] the Indiana Court of Appeals foreclosed the possibility of second-guessing the decision of a law firm that acted for the corporation and the SLC, and upheld the law firm's decision to terminate the plaintiff's derivative suit on the ground that the law firm was disinterested in the transaction.[82] The court seems to have given the decision in accordance with the Indiana corporation law that clearly stipulates that any determination by an SLC as to whether or not it is in the company's interest that a party pursues his right to claim a remedy through a derivative suit shall be deemed to be conclusive.[83]

Notwithstanding these decisions and statutory provisions, US courts have demonstrated a degree of inconsistency in applying the business judgment rule to derivative suits. Therefore, in the Delaware Supreme Court case of *Zapata Corporation v Maldonado*,[84] the court developed a two-prong test for applying the rule. With respect to the first prong, the court would investigate the good faith, independence and rationale for the SLC's conclusion.[85] At this stage, "limited recovery would be permitted on these issues and the corporation would have the burden of proof".[86] Under the second prong, the court would utilize its own business nous to decide the propriety or otherwise of granting the motion to dismiss the suit.[87] The mischief the second prong was intended to cure was to avoid undue foreclosure of a valid derivative action of a member of the company, while at the same time determining the suit in a manner that would advance the company's interest as sought by the SLC.[88] It could be argued that the *Zapata* decision shows how US courts sit on the fence with respect to applying the business judgment rule. Indeed, case law shows how US courts use both the business judgment of directors and courts' own business judgment without stating the metrics that plaintiffs would use to assess courts' business judgment. Qualls captures this conundrum when he posited that the "court has failed to provide any standard for determining when a court's independent judicial business judgment is

79 Id at 727.
80 Id at 730–31.
81 733 NE 2d 973 (Ind Ct App 2000).
82 Id at 981–82.
83 Indiana Code (1989), sec 23-1-32-4.
84 430 A 2d 779 (Del 1981).
85 For this, see also K Qualls "*Zapata Corp v Maldonado*: Delaware's judicial business judgment rule: A ship without a rudder" (1982) 19 *California Western Law Review* 189 at 204, citing *Zapata*, above at note 84 at 788.
86 Ibid.
87 Id, at 205, citing *Zapata*, above at note 84 at 788.
88 Ibid.

warranted. Litigants need to know what factors the court will consider when deciding whether to proceed".[89]

Away from derivative suits, the business judgment rule has been utilized to absolve a company that failed to disclose a highly profitable mineral discovery, contrary to the Federal Securities and Exchange Commission rule.[90] The court has held that "the timing of disclosure is a matter for the business judgment of the corporate officers entrusted with the management of the corporation".[91] In some cases, courts only refuse to apply the rule in favour of directors if the complainant adduces evidence that the directors were "grossly negligent".[92] Thus, in *Aronson v Lewis*, the Delaware Supreme Court succinctly stated that "while the Delaware cases use a variety of terms to describe the applicable standard of care, our analysis satisfies us that under the business judgment rule, director liability is predicated upon concepts of gross negligence".[93] Similarly, in *Washington Bancorporation v Said*,[94] the Federal Deposit Insurance Corporation instituted a suit against the directors of an insolvent bank who had granted a loan of $10 million to a company without investigating the company's financial statement. The directors also approved a compensation scheme for the bank's president upon the termination of his employment because of the bank's takeover. The Federal Deposit Insurance Corporation alleged that the directors were grossly negligent in their conduct because they did not conduct thorough investigations before approving the loan and because they relied on the opinion of the bank's solicitors and committees when they approved the payment of compensation to the president. The US District Court for the District of Columbia held that the transactions that the directors approved were routine in nature and, as a result, they should not be held liable for gross negligence.[95]

In most cases, there is confusion as to whether the court's application of the concept of gross negligence by directors in making business decisions is limited to the substance of the decision or to the process through which they

89 Id at 209.

90 See *SEC v Texas Gulf Sulfur Co* 410 F 2d 833 (2nd Cir 1968).

91 Id at 850, footnote 12.

92 See *Gimbel v Signal Cos* 316 A 2d 599 (Del Ch 1974) at 615, suggesting that the rule would not apply to "actions which are without bounds of reason".

93 Above at note 12 at 812. Also, in the case of *Allaun v Consol Oil Co* 147 A 2d 345 (Del 1929), the court noted (at 360) that the business judgment rule will not apply in cases of "reckless indifference or a deliberate disregard of the interests of the whole body of stockholders". See also *Warshaw v Calhoun* 221 A 2d 487 (Del 1966) at 492–93.

94 812 F Supp 1256 (DDC 1993).

95 Id at 1267–68. For other cases on gross negligence, see *Holland v American Founders Life Insurance Co* 376 P 2d 162 (Colo 1962); *Pool v Pool* 16 So 2d 132 (La App 1943); *Devereux v Berger* 284 A 2d 605 (Md 1971); *Bordelon v Cochrane* 533 So 2d 82 (La App 1988); *Uccello v Gold'N Foods Inc* 90 NE 2d 530 (Mass 1950); *Deal v Johnson* 862 S 2d 214 (Ala 1978); and *Louisiana World Exposition v Federal Insurance Co* 864 F 2d 1147 (5th Cir 1989).

arrived at the decision.[96] In *Smith v Van Gorkom*,[97] the board of directors approved the takeover of the company for $55 per share after two hours' deliberation. The board did not seek the opinion or report of the investment bankers or any other document that would justify the share value of the takeover. Rather, the board relied heavily on a 20-minute oral report by the board's chairman. The Delaware Supreme Court looked at the board's procedure for approving the takeover and held that the business judgment rule would not apply because the directors had been grossly negligent.[98] One obvious challenge with this approach that supports non-judicial interference with the merits of the decision is that it is often difficult to separate the reasonableness of the process and "the substantive reasonableness of directors' decisions".[99] Framed another way, the determination of the reasonableness of the process will often be contingent upon the reasonableness of the decision.

CODIFICATION AND APPLICATION OF THE US BUSINESS JUDGMENT RULE: IS IT FIT FOR PURPOSE FOR NIGERIAN CORPORATE LAW?

As in other jurisdictions, the jurisprudence[100] and company law of Nigeria recognize that the board of directors manages the company's business and that the directors owe a duty to the company to exercise the due care and skill that a reasonably prudent director would exercise in comparable circumstances.[101] A director who breaches this duty would be liable in an action for negligence.[102] It could be gleaned from the Nigerian law that the objective test is the predominant test in determining directors' liability for breach of their duty of care and skill. In essence, if a reasonably cautious director in the same position as a director who is alleged to have breached the duty of care would have exercised his discretion in a different manner, the director's personal belief, even if honest, is immaterial. These provisions mark a radical

96 It has been noted that "the application of the business judgment rule is an examination of the decision-making process, not of the decision itself": McEachin "*Theriot v Bourg*", above at note 20 at 383. See also F Gevurtz "The business judgment rule: Meaningless verbiage or misguided notion?" (1994) 67 *Southern California Law Review* 287 at 302, noting that: "there are a number of variations on this process-versus-substance theme. All have in common, however, the notion that the business judgment rule calls for less judicial scrutiny for the merits of the directors' decision than of the process the directors used in arriving at the determination. One obvious extreme is to conclude that the business judgment rule precludes any review at all of the substance of the decision".

97 488 A 2d 858 (Del Sup Ct 1985).

98 Id at 873.

99 D Rosenberg "Galactic stupidity and the business judgment rule" (2007) *Journal of Corporate Law* 301 at 322.

100 *Olawepo v Securities and Exchange Commission* (2011) 16 NWLR (pt 1272) 122 at 129.

101 Companies and Allied Matters Act cap C20 Laws of the Federation of Nigeria, 2004 (CAMA), sec 282(1).

102 Id, sec 282(2).

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departure from the business judgment rule in the US, where the director's personal assumptions and belief that he is acting in the company's interest are critical in determining his liability. Thus, the statutory rule in Nigeria implies that "if a company appoints a moron, it is well within its rights to still expect him to measure up to the standard of a notional, reasonable director".[103] Suffice it to say that the Nigerian law imposes a strict liability regime on directors once the reasonably prudent director's test is applied. Also, as noted above, a director who fails the reasonably prudent director test would be liable in an action for negligence. The peculiarity of the penal regime under the Nigerian law is that it does not create a multi-layered degree of negligence. Indeed, once a director fails the test, the law would hold him liable for negligence without assessing whether his conduct should be classified as gross negligence or simple negligence. The critical question that follows is: does Nigerian corporate law need the rule to be codified and applied? This section argues that Nigeria does not need it, for the reasons set out below.

Shareholders' derivative litigation

The first reason why the business judgment rule should not be codified and applied in Nigerian corporate law is because of its negative implications for derivative actions. Similar to other jurisdictions, Nigeria's company law recognizes that the company has a corporate personality. Indeed, a company is a person in law distinct and separate from its members. This legal personality of a company not only confers legal rights, but also imposes legal duties on the company. Subsequently, if a party does an act that infringes upon the company's corporate rights, only the company can sue to enforce its legal rights.[104] The law, however, recognizes that there are instances where the directors are the wrongdoers and may wish to frustrate any action that would remedy the wrong against the company. As a result, the law makes provisions that allow a shareholder to bring an action on behalf of the company.[105]

103 H Adamu "An examination of the director's duty of care and skill under company laws of Nigeria and the United Kingdom" at 9, available at: <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2909167> (last accessed 7 June 2020).

104 This is known as the rule in *Foss v Harbottle* (1843) 2 KB 461. This rule is codified under CAMA, sec 299. This section provides that "subject to the provisions of this Act, where irregularity has been committed in the course of a company's affairs or any wrong has been done to the company, only the company can sue to remedy that wrong and only the company can rectify the irregular conduct".

105 The instances are stated in id, sec 300(a)–(f). They are: (a) where the company enters into an illegal or ultra vires transaction; (b) where the company is purporting to do by ordinary resolution an act that under its constitution or CAMA is required to be done by special resolution; (c) where any act or omission affects the shareholder's individual right as a member; (d) where there is fraud committed against the company or the minority shareholders and the directors fail to take appropriate action to redress the wrong; (e) where a company meeting cannot be called in time to be of practical use in redressing a wrong done to the company or to the minority shareholders; and (f) where the

A major plank in the conditions precedent for a shareholder derivative action in Nigeria is that the applicant must have "given reasonable notice to the directors of the company of his intention to apply to the court if the directors do not bring, diligently prosecute or defend or discontinue the action".[106] One unique feature of this provision is that, while it allows the directors the opportunity to do the needful, it does not foreclose the aggrieved shareholder from prosecuting the claim on behalf of the company if the directors fail to do so. More fundamentally, it does not clothe the directors with the broad discretion and power to set up a committee whose possible "subjective" decision will terminate a shareholder derivative suit that may turn out to be beneficial to the corporation.

As noted earlier, US corporate law and jurisprudence recognizes the use of an SLC in determining whether or not a derivative action should proceed. Although it may be argued that US courts, in respecting an SLC's decision and applying the business judgment rule, would consider whether "the directors delegate their decision-making authority to a disinterested committee",[107] it is argued that there is no guarantee that an SLC would consist of disinterested members or be free from "structural bias".[108] In essence, notwithstanding the court's decision in *Zapata*, which seemed to suggest that the court could apply its own business judgment in determining the propriety or otherwise of the committee's motion to dismiss a derivative suit, the court noted that: "[w]e must be mindful that directors are passing judgment on fellow directors in the same corporation, and fellow directors, in this instance who designated them to serve both as directors and committee members. The question naturally arises whether a 'there but for the grace of God go I' empathy might play role".[109]

contd

directors are likely to derive a profit or benefit, or have profited or benefitted from their negligence or breach of duty.

106 Id, sec 303(2)(c).

107 Qualls "*Zapata Corp*", above at note 85 at 196.

108 Gevurtz "The business judgment rule", above at note 96 at 329.

109 Id at 329–30, footnote 203, quoting *Zapata*, above at note 84 at 789. It has been noted that: "the inherent bias [in the SLC approach] can come from many sources. Foremost is the tainted majority's control over the Committee's selection process. The majority is likely to seek individuals who are prominent figures in the business world or board members of their or other corporations. These individuals usually entertain sympathetic views towards the problems of directors and look unfavourably on shareholder intrusion into the province of the management. Entrusting control of a lawsuit to a committee selected, funded and authorized by defendant directors presents an inescapable potential for abuse. The problem is further complicated when the committee is comprised of the corporation's own directors. Not only do structural and financial ties exist between committee members and management, but unavoidable psychological and social attachments affect their neutrality. An individual asked to consider the actions of a colleague cannot be expected to be neutral. The individual may be risking his salary, future benefits, status, and ultimately, his job if he fails to conform to the corporation's wishes": Qualls "*Zapata Corp*", above at note 85 at 203.

Furthermore, the use of an SLC inevitably gives the impression that the SLC has assumed the duty of the courts in resolving shareholders' derivative suits. More fundamentally, the statutory hurdles for shareholders' derivative actions in Nigeria are already burdensome. Thus, apart from the requirement that the shareholder should give notice of his intention to apply to the court if the directors fail to prosecute the action, the law also requires the shareholder to obtain leave of the court[110] and adduce evidence that the wrongdoers are the directors who are in control and that they would not take the necessary action.[111] The shareholder must also establish that he is acting in good faith[112] and that it is in the company's best interest that the action be brought.[113] Discharging this evidential burden is no mean feat. As a result, the application of the US business judgment rule will compound the extant onerous hurdle in proving liability for harm done to the company in shareholders' derivative litigation in a climate with weak minority shareholders and more closely held corporations, which makes it difficult for dissatisfied shareholders to find a market in which to sell their shares.[114]

In addition to this challenge, Nigeria's corporate law, unlike that of the US, does not recognize the demand rule. The core thrust of this rule in the US is that a shareholder will be excused from making a demand that the directors institute a derivative suit if it clear that there is a conflict of interest among the directors and that a greater percentage of the directors are the wrongdoers.[115] In other words, the court would endorse such a demand on the grounds that the directors have interests in the subject matter of the suit and that it would be futile to ask the shareholder to demand that they bring the suit. In the case of Nigeria, a shareholder in a derivative action must make a demand to the directors to sue before he can apply to the court to bring the action on behalf of the company. The implication of this is that a shareholder in the US has better protection than his Nigerian counterpart. To apply the business judgment rule to the Nigerian shareholder in a derivative action would require the shareholder to overcome the double hurdles of the directors' decision to bring the suit on behalf of the company and the court's power to review

110 CAMA, sec 303(1).

111 Id, sec 303(2)(a).

112 Id, sec 303(2)(c).

113 Id, sec 303(2)(d).

114 For instance, it has been observed that the remedies available to shareholders in derivative suits are mere "illusory protection": A Nwafor "Shareholder derivative action: Nigerian statutory innovation: Not yet a victory for the minority shareholder" (2010) 7 *Macquarie Journal of Business Law* 214 at 214. With respect to the US, a scholar noted that "recent applications of the business judgment rule to derivative actions indicate that shareholders face an almost insurmountable barrier to establishing the liability of directors under allegations not only of negligence but also of illegal activities": Ubelaker "Director liability", above at note 3 at 802.

115 Qualls "*Zapata Corp*", above at note 85 at 193 and 196.

the directors' business decision. This would pare down shareholders' ability to obtain relief for wrongs done to the company.

Variegated standards of duty of care and skill and the business judgment rule in both jurisdictions

As noted above, the standard for the duty of care and skill under Nigerian corporate law is that which "a reasonably prudent director would exercise in comparative circumstance".[116] This test, as stated earlier, is clearly objective. It is argued that this test imposes a good standard of care and skill on directors. In fact, the statutory provision in its current state will, to a great extent, encourage honest and reasonable persons to take up directorial positions in companies. By contrast, under the business judgment rule in the US, the test is subjective in the sense that a director will not be liable if he adduces evidence that, at the time of making the business decision, he believed it to be proper in the circumstance and that he had a rational conviction that the decision was in the company's best interests. The problem with the US test is that "the focus is not on what the hypothetical reasonable director would have done but on what some rational director might have done".[117] In addition, the requirement that the director should rationally believe that the decision is in the company's best interests raises a more fundamental problem. This is because, as noted by a scholar, "in truth, this rational basis has little if anything to do with the care that went into the decision. Rather, it serves as an objective confirmation of the critical, but entirely subjective requirement that the directors have a good faith belief that their decision is in the corporation's best interest".[118]

Besides this objective / subjective standard argument between the statutory duty of care and skill in Nigeria and the business judgment rule in the US, it is important to reiterate that, under the statutory duty of care and skill in Nigeria, a director who breaches the duty could be liable in an action for negligence. This provision recognizes the fundamental challenge with which corporate law grapples: to ensure that directors who may not own shares in the company conduct the company's affairs with circumspection.[119] With respect to the US, case law suggests that the standard for the application of the business judgment rule has shifted from "simple errors"[120] to gross negligence.[121] There are two problems with this reformulation of the standard for liability.

116 CAMA, sec 282(1).

117 Davis "Once more", above at note 10 at 575–76.

118 Id at 576.

119 Aman "Cost-benefit analysis", above at note 41 at 6.

120 E Johnson and R Osborne "The role of the business judgment rule in a litigation society" (1980) 15/1 *Valparaiso University Law Review* 49 at 54.

121 See *Brehm v Eisner* 746 A 2d 244 (Del 2000) at 259. See also *Warshaw v Calhoun*, above at note 93 at 492–93 where the court noted that the rule would apply if it were established that the directors grossly abused their discretion.

First, in some instances, what amounts to gross negligence is ambiguous.[122] Also, the "gross negligence standard" contradicts the normative standard of ordinary negligence in the law of tort and the breach of duty of care and skill in an agent-principal relationship.[123] It is therefore argued that, if Nigeria's corporate law adopts this soft and merciful standard, it runs the risk of whittling down the duty of care and skill because it would convey "legislative signals that negligence is acceptable provided the directors and officers thought they were benefitting the company".[124]

"The "gross negligence" standard in the US seems to be informed by the fact that, if the courts applied the ordinary negligence standard, it would expose directors to a litany of litigation. The extension of this argument to Nigeria is quite problematic. In fact, it is argued that there is no guarantee that the application of the US business judgment rule in Nigeria would minimize directors' exposure to the risk of litigation for breach of the duty of care and skill. To the best of the knowledge of this author, there is currently a dearth of cases in Nigeria against directors for breach of duty of care and skill.[125] This suggests that the extant statutory provision is fit for purpose. In other words, the current statutory formulation has enhanced directors' duty of care and skill in Nigeria and limited the flood of potential litigation against directors for breach of the duties. This supports the argument that the implementation of the US business judgment rule could increase litigation against directors for breach of the duties, because the rule is only deployed against directors when their business judgment fails the tests for the application of the rule. It follows that, if the conditions for the application of the rule are not established, shareholders will then have unlimited licence to bring legal actions against directors.[126]

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122 Johnson "Unsettledness Delaware corporate law", above at note 37 at 428, noting that "but the duty of care is not merely a duty to avoid negligence, because such phrasing lacks a reference point: Don't be grossly negligent to what?"

123 Gevurtz "The business judgment rule", above at note 96 at 304.

124 J Harris and A Hargovan "Still a sleepy hollow? Directors' liability and the business judgment rule" (2017) 31 *Australian Journal of Corporate Law* 1 at 9. With respect to a similar claim in South Africa, see J Chrysostome Kanamugire "The directors' duty to exercise care and skill in contemporary South African company law and the business judgment rule" (2014) 5/20 *Mediterranean Journal of Social Sciences* (2014) 70 at 76, noting that "the effect of the United States styled business judgment rule is that it will neutralize the objective standard imposed by the partially codified duty of directors to exercise, care, skill and diligence".

125 Only one case has dealt with the issue of duty of care in recent times. In *Securities Solutions Ltd and Others v Mrs Biodun Idowu Adamu-Oladiran and Others* (2016) LPELR-40068 (CA) at 32, the court held that two directors who did not know about the illegal sale of shares by another director failed to exercise the degree of care required under the law. The court held so, notwithstanding the directors' argument that they were not executive directors of the company who were involved in the day to day management of the company's business.

126 Gurrea-Martinez "Re-examining the law", above at note 23 at 431.

Difference in corporate law culture and the order of recognition of duty of care and the business judgment rule

The corporate law culture and the order of recognition of the business judgment rule and the duty of care in the US raise serious issues about the feasibility of the codification and application of the business judgment rule in Nigeria's corporate governance regime. Essentially, the American corporate governance approach has regard for director primacy.[127] Under this approach, "accountability through judicial intervention should yield to directorial authority".[128] It seems that one reason for the deference of US corporate law and courts to the power of directors ultimately to take decisions for corporations arises from the fact that the US has large corporations and diversified shareholders. As a result, there could be organizational challenges among shareholders with respect to how to operate the companies. Bainbridge supports this view when he persuasively contends that: "[a]uthority-based decision making structures are characterized by a central agency empowered to make decisions binding on the firm as a whole, tend to arise when the firm's constituencies face information asymmetries and have differing interests. Because the corporation demonstrably satisfies those conditions, vesting the power of fiat in a central decision maker is the essential characteristics [sic] of its governance".[129]

Apart from this reason adduced by Bainbridge, it seems that the director primacy model in the US arose because of the political and legal expediency to protect directors who take risky business decisions. In fact, with respect to the business judgment rule, it has been noted that the rule: "[h]as assumed a new role in the twilight of the twentieth century. These are years that have witnessed the spate of foreign payments incidents out of which stemmed not only a series of lawsuits to recover the value of such payments for

127 Leach "The correct understanding", above at note 5 at 53, noting the same problem for South Africa's adoption of the US business judgment rule. It is pertinent to note that it is not argued that US corporate law and culture do not respect the shareholder primacy model. It is the opinion of the writer that corporate law and culture in the US consider the interests of directors in corporate governance. For example, a tradition of executive compensation schemes attests to this fact. For scholarly works on executive compensation in the US, see M Loewenstein "The conundrum of executive compensation" (2000) 35 *Wake Forest Law Review* 1; R Posner "Are American CEOs overpaid, and, if so, what if anything should be done about it?" 58 *Duke Law Journal* (2009) 1013; R Thomas and K Martin "Litigating challenges to executive pay: An exercise in futility" (2001) *Washington University Law Quarterly* (2001) 569; and S Kaplan "CEO pay and corporate governance in the US: Perceptions, facts, and challenges" (2013) 25/2 *Journal of Applied Corporate Finance* 8.

128 Leach "The correct understanding", above at note 5 at 38.

129 S Bainbridge "Director primacy and shareholder disempowerment" (2006) 119 *Harvard Law Review* 1735 at 1745. See also S Bainbridge "Director primacy: The means and ends of corporate governance" (2003) 97 *Northwestern University Law Review* 547 at 569–72.

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corporations, but also stirrings in congress, regulatory bodies such as the Securities and Exchange Commission and elsewhere".[130]

By contrast, Nigerian corporate law culture places more emphasis on the shareholder primacy approach. This model of corporate governance believes that directors are ultimately trustees and agents of the stockholders of the company[131] and that "corporate law's objective is to develop legal structures that will maximize shareholder wealth".[132] This approach finds justification in the fact that a company is "an aggregate of its shareholders"[133] and "shareholders are not only owners but also risk bearers"[134] in the company. Some case law provides a paradigmatic illustration of this point. In the seminal case of *Okeowo v Migloire*, the court noted that the fiduciary duties of directors are for the benefit of the corporation as opposed to any individual director.[135] Also, in *Artra Industries (Nigeria) Ltd v NBC1*, the Supreme Court of Nigeria held that, whenever directors of a corporation are exercising their managerial powers and duties, they must show crass compliance with the law, which requires them to regard the corporation's interest as paramount.[136]

From an axiological perspective, the deference to the shareholder primacy approach in Nigerian statutes and jurisprudence is justified if one considers that the director primacy approach is prone to encourage malfeasance, undue risk-taking and greed in the governance of corporations. The 2008 financial crisis in the US and other parts of the world clearly attests to this fact.[137] Indeed, literature on corporate failures in the US in the past decade is replete with the fact that US corporate law culture encourages excessive risk-

130 R Duesenberg "The business judgment rule and shareholders derivative suit: A view from inside" (1982) 60/2 *Washington University Law Review* 311 at 311.

131 A Meese "The team production theory of corporation law: A critical assessment" (2002) 43 *William & Mary Law Review* 1629 at 1631. See also, J Ho "Economic theories of the firm versus stakeholder theory: Is there a governance dilemma" (2008) 38 *Hong Kong Law Journal* 399 at 399.

132 D Millon "New directions in corporate law: Communitarians, contractarians, and the crisis in corporate law" (1993) 50/4 *Washington and Lee Law Review* 1373 at 1373–74.

133 H Lestari "Director duty to employees: Co-relation between corporate and labour laws" *Mimbar Hukum Edisi Khusus* (November 2011) 59 at 62, available at: <https://www.researchgate.net/publication/265571847_dIrector%27s_duty_to_eMPloyees_co-relatIoN_BetweeN_corPorate_aNd_laBour_laws> (last accessed 7 June 2020). See also E Lacobucci "Corporate fiduciary duties and prudential regulations of financial institutions" (2015) 16/1 *Theoretical Inquiries of Law* 183 at 186, opining that "directors and officers were … understood to owe fiduciary duties to the company, which was understood further to require them to act in the interests of shareholders".

134 J Slawotsky and J Truby "The director duty of care in Qatar" (2016) 26 *Duke Journal of Comparative & International Law* (2016) 337 at 354.

135 (1979) NSCC 211 at 263.

136 (1998) 4 NWLR (pt 546) 357 at 364.

137 See S Schartz "Misalignment: Corporate risk-taking and public duty" (2016) 92 *Notre Dame Law Review* 1 at 3, opining that "there is widespread agreement that excessive corporate risk-taking was one of the primary causes of the systemic economic collapse that became the 2008–2009 global financial crisis".

taking.[138] In particular, the sub-prime mortgage market failures of notable financial institutions such as Fannie Mae, Freddie Mac and Lehman Brothers were largely due to unregulated risk-taking by directors and deference to directorial decision making in US corporate law and culture.[139] Regrettably, as one scholar noted, notwithstanding the conduct of the directors, some were immune from personal liability because of the protection afforded to them by the business judgment doctrine.[140] In Nigeria where directors' accountability and undue corporate risk-taking are potential problems, the application or transplantation of the business judgment rule will make directors lack the gravitas required for the management of corporations and will encourage moral hazards.

Further, unlike in Nigeria, the business judgment rule was well-developed in the US before the duty of care. Consequently, it shaped the substance of the duty of care.[141] As Lyman noted with respect to one US state:

> "The primacy of the business judgment rule over fiduciary duties in Delaware's analysis of director performance is an accident of history. The duty of care, being a doctrinal latecomer, was along with the duty of loyalty, embedded into the pre-existing business judgment rule framework in Cede, in an effort to harmonize those duties with the rule. But the rule has retained analytical preeminence, leading to a diminished emphasis on what is really the most critical to corporate governance, both in and out of court: Did directors fulfil or breached [sic] either of their fiduciary duties?"[142]

Indeed, the earlier arrival and application of the business judgment rule has made the duty of care subservient to the rule and opened the floodgates for situations where courts deploy or misapply the rule whenever breach of

138 W Kaal and R Painter "Initial reflections on an evolving standard: Constraints on risk taking by directors and officers in Germany and the United States" (2010) 40 *Seton Hall Law Review* 1433 at 1452, noting that "the business culture in the United States has traditionally been associated with a more entrepreneurial spirit, which is linked with an increased willingness to take risks in order to attain a higher return". See also, W Bratton "Enron and the dark side of shareholder value" (2002) 76 *Tulane Law Review* (2002) 1275 at 1283.

139 See E Banks *Risk Culture: A Practical Guide to Building and Strengthening the Fabrics of Risk Management* (2012, Palgrave Macmillan) at 162–63. See also, V Acharya et al "Guaranteed to fail: Fannie Mae, Freddie Mac and the debacle of mortgage finance" at 44, available at: <https://files.stlouisfed.org/files/htdocs/conferences/gse/White.pdf> (last accessed 7 June 2020), arguing that these financial institutions were clearly major participants in high risk mortgage lending"; and Rosenberg "Supplying the adverb", above at note 24 at 217.

140 Aman "Cost-benefit analysis", above at note 41 at 1.

141 S Lombard "Importation of a statutory business judgment rule into South African company law: Yes or no?" (2005) 68 *Journal of Contemporary Roman Dutch Law* 614 at 623.

142 Johnson "Unsettledness Delaware corporate law", above at note 37 at 424–25.

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directors' duty of care should be called into question.[143] Applying the rule to Nigeria, with a different history of emergence of the duty of care and the business judgment rule, would create doctrinal tensions, serious problems of interpretation similar to the experience in US case law and attendant uncertainties regarding corporate law. Thus, such a pluralist model of determining directors' breach of duty would create a situation where courts may not only face difficulties in determining which one should be accorded greater importance, but also struggle to strike a proper balance in applying the duty of care and the rule.

CONCLUSION

This article has shown that the business judgment rule serves as a "principle that directors can employ to shield their decisions from judicial scrutiny".[144] Notwithstanding the various rationales and tests for the application of the rule in the US, the rule seems to hold the neoclassical theory opinion that directors may be altruistic in the discharge of their duty to the company and will always act in the interest of the shareholders.[145] This article has also demonstrated that, despite the rule's underlying objectives, its codification and application are not necessary for Nigeria because of the enormous differences in corporate law and business environment between the two jurisdictions. The difference in shareholders' derivative litigation, standards of duty of care and skill, corporate law culture, and the distinct historical period in which the business judgment rule and the duty of care and skill were recognized in the US make the codification and application of the rule undesirable for Nigeria. It is, therefore, argued that the current statutory provisions regarding duty of care in Nigeria should be retained because they serve their purpose and suit the peculiarities of the Nigerian business environment. Thus, the objective standard in the law helps to deter directors from reckless conduct or unnecessary risk taking. It also provides a definite and just standard through which to assess directors and hold them personally liable for their reckless or delictual conduct. Therefore, the transplantation of the business judgment rule to Nigeria would not only diminish the importance of the statutory duty of care and skill, but would also not generally augur well for corporate governance in Nigeria.[146] Little wonder that a mainstream scholar of corporate law noted that the business judgment rule "is a phrase of limited

143 Lombard "Importation", above at note 141 at 623–24.

144 C Wen "Assessing the applicability of the business judgment rule and the defensive business judgment rule in the Chinese judiciary: A perspective on takeover dispute adjudication" (2010) 34/1 *Fordham International Law Journal* 124 at 128.

145 See O Hart "An economist's view of fiduciary duty" (1993) *University of Toronto Law Journal* 299 at 299–300.

146 For the literature on the risks of transplantation, see P Brietzke "The politics of legal reform" (2004) 3 *Washington University Global Studies Law Review* 1 at 31 and 32. See also D Rodrik "Institutions for high quality growth: What they are and how to acquire them" (2000) 35 *Studies in Comparative International Development* 3 at 3.

utility and much potential mischief. Accordingly, the business judgment rule is a rule which corporate law would well do without".[147]

CONFLICTS OF INTEREST

None

147 Gevurtz "The business judgment rule", above at note 96 at 336–37.

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