

Similar Rhetoric, Different Elements, Converging Outcomes

– A Comparative Review of Business Judgment
Rule under the US and Korean Law –

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Seoul National University, School of Law

Kyung-Hoon Chun

Research Questions

- Business Judgment Rule (“BJR”)
 - Considered a hallmark of US corporate law
 - Openly adopted by Korean Supreme Court (similar wording)
 - One example of “convergence of corporate law” under US influence

- Comparison of the US and Korean versions of BJR
 - They apparently look similar, but are they really similar in substance?
 - If the elements/scopes are different, are the actual outcomes really different?
 - Implications for comparative legal study?

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1. *Background of Discussion*
 2. BJR under US Law
 3. BJR under Korean Law
 4. Comparison
 5. Overall Outcomes
 6. Conclusions


Background

- Convergence of corporate law and corporate governance
 - Despite persistence of unique local laws/governances, at least partial convergence is undeniable.
 - Through various mechanisms: harmonizing national laws, dual listings, international soft law, transplant or reception of foreign law
 - Strong influence of US corporate law (Hansmann/Kraakman,2004)

- Korean corporate law in a comparative context
 - Generally civil law jurisdiction, under strong influence of German law
 - Korean corporate law carries notable influence from US law (both statutes and case law), in particular since 1998 Asian Financial Crisis
 - BJR is a notable example

Background

- Legal transplant or reception
 - Legal transplant: “the moving of a rule or a system of law from one country to another, or from one people to another” (Watson, 1993)
 - Reception: “the adoption in whole or in part of the law of one jurisdiction by another jurisdiction” (Black’s Law Dictionary) ⇒ Suitable to capture gradual diffusion of law or the continuous nature of the process
- Regardless of which terms we use,
 - Should be understood as dynamic processes of interaction, often leading to semantic or functional transformation, rather than a mere imposition of law from one jurisdiction onto another
 - The story of the BJR substantiates this observation

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BJR under US Law

■ Meaning

- A legal doctrine that offers protection to directors by granting them deference for their business decisions
- “BJR has a number of different, and sometimes conflicting possible meanings”

■ Key aspects mentioned by courts and scholars

- Presumption of no liability: burden of proof on the plaintiffs
- Focus on the procedures: “informed decision“ is crucial (*Smith v. Van Gorkom*)
- Minimal review of the substance: no hindsight review, but requires “rational business purpose”
- Requires gross negligence of the defendants

BJR under US Law

- ALI Principles

4.01 Duty of Care of Directors and Officers; the Business Judgment Rule

[omitted]

(c) A director or officer who makes a business judgment in good faith fulfills the duty under this Section if the director or officer:

(1) is not interested in the subject of the 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 circumstances; and

(3) rationally believes that the business judgment is in the best interests of the corporation.

BJR under US Law

Formulation as Requirements & Effects

- Requirements
 - Business decisions made by directors in good faith
 - No conflict of interest
 - Informed decision based on adequate review of pertinent information
 - A rational business purpose
- If these requirements are met, the BJR is successfully invoked.
 - Courts accord deference to the decision.
 - Once BJR is applied, directors are rarely held liable (*Van Gorkom* is exceptional case).
- If there is conflict-of-interest, the entire fairness rule is applied.
 - Defendants have a burden of proving the fairness of the decision (both substantively and procedurally).
 - Once the EFR is applied, the directors are likely to be held liable.

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Directors' Duties/Liability under Korean Law

■ Duties

- Duty of care: “a duty of care as a faithful manager” to the company (Art. 382(2) of Korean Commercial Code [KCC] → Art. 681 of the Civil Code)
- Duty of loyalty to the company (KCC Art. 382-3)

■ Liability

- Directors' liability to the company (KCC Art. 399)
 - Requires (i) breach of duty or violation of law or AOI, (ii) loss to the company, (iii) intent or negligence, and (iv) causation
 - May be pursued either (i) directly by the company or (ii) derivatively by shareholders (KCC Art. 403)
- Directors' liability to a third party (KCC Art. 401)
 - Requires (i) breach of duty or violation of law or AOI, (ii) loss to the third party, (iii) intent or gross negligence, and (iv) causation

BJR under Korean Law

- A Community Credit Cooperative Case (2002)
 - Involved the coop's non-recovered loan (and a director's liability therefor)
 - Relevant portion of the ruling: “if the [defendant] conducted loan evaluations in accordance with appropriate procedures, based on adequate information available in the circumstances, and in good faith, for the company's best interest, then his business judgment would fall within a permissible range of discretion, and he would have fulfilled the duty of care or duty of loyalty towards the cooperative.”
 - Under this standard, the defendant were held liable because of his personal interest with the borrower.

BJR under Korean Law


- Samsung Electronics Case (2005): shareholder derivative suit
 - Claim 1: “The BJR does not apply to an act violating law or regulation.”
 - Claim 2&3: “If the directors had diligently collected necessary information and thoroughly reviewed it to make a reasoned business judgment regarding the [acquisition], ensuring it was in the best interest of the company, then they would have fulfilled their duty of care as prudent managers”
 - Under this standard,
 - Directors were not held liable for a failed investment in a heavy-electrics manufacturing company
 - Directors were held liable for an underpriced sale of shares in affiliate company to another affiliate company (for details see footnote 51)

BJR under Korean Law

- Daewoo Case (2007): the most detailed version
 - if the director, without violating law,
 - (a) (x) went through the process of collecting and reviewing necessary information, to the extent reasonably available,
 - (y) based on such information, made a business judgment in good faith, reasonably believing that the judgment is in the company's best interest, and
 - (z) if the substance of the judgment is not egregiously unreasonable and falls within the range of reasonable choice,
 - (b) then the director cannot be held liable for damages to the company, even if the company incurs losses.
 - (c) However, if the director did not go through the aforementioned process, and decided based on merely general or abstract expectations, then such director's actions cannot be considered within the permissible range of business judgment.

BJR under Korean Law

- BJR in a criminal context
 - Directors' breach of fiduciary duty may constitute 'criminal breach of trust' under Korean law (subject to criminal fine or imprisonment of up to lifetime).
 - Criminal breach of trust requires “intent”, and negligence is not sufficient.
 - The BJR is not a necessary condition for excluding criminal intent, but the defendants often assert that they satisfied the requirements of the BJR to deny the criminal intent.

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Comparison: similarities

■ Purposes

- Encouraging forward-looking and risk-taking approach, with acknowledging inherent risks in business decisions
- Granting discretion in business judgment

■ Excluding illegal acts

- The BJR does not shield illegal acts or fraud.

■ Requirements

- Both versions commonly emphasize informed decision based on adequate review of the reasonably available information.
- “Rational belief that the judgment is in the best interests of the corporation”

Comparison: similarities

Delaware case law	ALI Principles	Korean court cases
<ul style="list-style-type: none"> ▪ business decision made in good faith ▪ informed decision with reasonable diligence and care ▪ rational business purpose ▪ absence of fraud or illegality ▪ absence of waste ▪ no conflict of interest 	<ul style="list-style-type: none"> ▪ business decision made in good faith ▪ being reasonably informed ▪ rational belief that the judgment is in the best interests of the corporation ▪ no personal interest in the subject of the judgment 	<ul style="list-style-type: none"> ▪ business decision made in good faith ▪ based on review of necessary information ▪ rational belief that the judgment is in the best interests of the corporation ▪ absence of illegality ▪ substance of the judgment being not egregiously irrational

Comparison: differences

- Gross negligence vs. Ordinary negligence
 - Under the BJR, US law requires gross negligence to recognize a breach of directors' duty of care.
 - Korean law considers mere ordinary negligence sufficient.

- Procedural vs. Substantive Review
 - The Korean version of the BJR requires that the substance of judgments should not be egregiously unreasonable.
 - The US version of the BJR focuses on procedural aspects, with courts refraining from evaluating the substance of business decisions. (But “rational business purpose“ is required.)

Comparison: differences


■ Conflict of interest

- US version of BJR requires no conflict of interest. If there exists conflict of interest, an enhanced standard of review (entire fairness rule) is applied.
- The Korean version of BJR does not explicitly mandate “no conflict of interest.”
 - While elements such as “rational belief in the company’s best interest” and “good faith” may imply the absence of conflicts of interest, they are not expressly required as in US law.
 - There is no clear legal doctrine akin to the entire fairness rule that imposes a stricter standard of review in cases of conflict of interest.
 - Burden of proof still rests on the plaintiff.

Comparison: differences

	US BJR	Korean BJR	Remarks
1	Defendant's gross negligence is required	Defendant's ordinary negligence is sufficient	Korea favors plaintiff.
2	Courts refrain from substantive review.	Courts review the substance to see whether the business decision is egregiously unreasonable.	Korea favors plaintiff.
3	In case of conflict-of-interest,		US favors plaintiff.
	Instead of the BJR, entire fairness rule is applied and the burden of proof shifts to defendant.	No enhanced standard of review. The burden of proof still rests on plaintiff.	

What is the overall impact of these differences?

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The Real Difference Between Two BJR

- In US,
 - So long as the BJR is applied, directors are almost safe.
 - *Van Gorkom*, which held directors liable under the BJR, stands as a rare and controversial exception.
 - Therefore, in litigation against directors, the crucial issue is which standard of review is applied (the BJR or a stricter one).

- In Korea,
 - No diverging standard of review, but even under the BJR (or under the rhetoric of BJR), directors are held liable quite often.
 - How often?

The Real Difference Between Two BJRs

- In Korea, out of 32 Supreme Court cases (civil cases only) that mentioned the BJR as the applicable standard,
 - defendants' liability was denied in 9 instances
 - defendants' liability was acknowledged in 19 cases
 - defendants' liability was partially acknowledged in 4 cases
- Review of these cases shows that directors were held liable in case of
 - violation of law
 - defendant's conflict of interest
 - transactions with affiliated companies (which may implicate conflict of interest)

Converging Outcomes

- Under US law,
 - conflict-of-interest ⇒ application of stricter standards of review ⇒ the burden of proof shifts onto the defendant ⇒ directors are likely to be held liable
- Under Korean law,
 - conflict-of-interest ⇒ no stricter standards of review ⇒ no shift of burden of proof ⇒ but more flexibility in reviewing the substance and the lower hurdle for establishing directors' breach of duty (not gross negligence) ⇒ courts often recognize defendants' breach of duty and liability.

Converging Outcomes

For instance, in cases involving conflicts of interest, such as (i) providing questionable loans to a company in which the current director holds significant shares or (ii) selling assets to such a company at unreasonably low prices, courts may recognize procedural negligence or even substantive unreasonableness on the part of the implicated directors, leading to their liability.

As a result, even under the BJR, liability was recognized in a substantial portion of the 32 Supreme Court cases, totaling 23 instances.

Converging Outcomes

Despite the differences between the BJR in two countries, an observation of the overall outcomes suggests a degree of convergence.


The interplay of certain variances, which amplify directors' liability (i.e., ordinary negligence as opposed to gross negligence and review of substantive rationality) and others that mitigate it (i.e., application of BJR in conflict-of-interest situations), yields a comparable conclusion: directors of Korean companies also face significant exposure to accountability in conflict-of-interest situations.

Converging Outcomes

Hastily concluding that the BJR in Korea and the US are similar based on rhetorical resemblances would be inaccurate.

Equally inaccurate is to assert that the BJR in Korea is entirely different from the US counterpart, especially portraying it as highly advantageous to directors.

Whether intended or not, the Korean adaptation of the BJR bears subtle modifications from the US, resulting in a largely similar overall outcome.

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Conclusion

- Result of comparison
 - Similar rhetoric
 - Different elements/scope/effect
 - Converging overall outcomes

Conclusion

■ Explaining such a result

- US corporate law distinguishes ‘standard of conduct (duty of care)’ and ‘standard of review (BJR)’ ↔ No such a clear distinction under Korean law
- US courts often resort to different standards of review (e.g., BJR vs ETR; strict scrutiny vs rule of reason) ↔ Korean courts are not familiar with such an approach
- Therefore, even if the US/Korean courts reach same conclusion (intuitively) for a given case, the reasoning structures are different.
 - US: whether to apply BJR or entire fairness?
 - Korea: whether to recognize breach of duty of care? The Korean version of the BJR provides a list of points/elements that the court should take into consideration.

Conclusion

- Implications for a comparative study
 - Similarity in appearance of a legal doctrine does not mean similarity in its substance.
 - Difference in substance of a legal doctrine does not always mean different outcomes.
 - The process of legal transplant or reception is intricate and multi-layered.

Thank you ขอบคุณ

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謝謝 धन्यवाद

감사합니다