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The Director's Fiduciary Duty In A Close Corporation

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by

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I. INTRODUCTION

This thesis will describe the different approaches the United States and Thailand employ with regard to the director's fiduciary duty in a close corporation. These approaches embody legal standards for director's conduct and protective measures and devices established by law and judicial rules to protect a director who performs his duty with honesty and in the best interest of the corporation. These different approaches reflect underlying economic and public policy issues.

A close corporation is generally a small business entity, but it is favored because it provides limited liability. In the US a close corporation is organized and incorporated under the provisions of state corporation law. Each state has its own corporation statute. In effect, a close corporation in the US may vary from state to state. Although the basic characteristics of this type of business entity are the same, states have diverse, special provisions for close corporations, and these different approaches are followed to optimize special close corporation needs.

In order to avoid preoccupation with the differences in details of a close corporation in the US, this thesis focuses on the Revised Model Business Corporation Act, the model corporation law for many states as well as Delaware General Corporation

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1A close corporation in the US is a close corporation or a closely-held corporation according to the MODEL BUSINESS CORPORATION ACT (hereinafter the “MODEL ACT”) or corporate statute of each state. In Thailand, a close corporation is a limited company under THE CIVIL AND COMMERCIAL CODE, BOOK III, TITLE XXII (hereinafter the “COMMERCIAL CODE”).
21F. O'NEAL, CLOSE CORPORATIONS, § 1.10 (2d ed. 1971); For discussion about tax advantage, see H. HENN and J. ALEXANDER, LAWS OF CORPORATION, § 262, at 713 (3d ed. 1983). This thesis does not discuss tax advantage of the close corporations.
31F. O'NEAL, supra note 2, § 3.60.
4WILLIAM S. HOCHSTETLER AND MARK D. SVEJDA, STATUTORY NEEDS OF CLOSE CORPORATIONS--AN EMPIRICAL STUDY; CLOSE CORPORATION LEGISLATION OR FLEXIBLE GENERAL CORPORATION LAW?, 10 J.CORP. L. 849, 859 (1985).
Law and Delaware courts’ rules.5 Furthermore, the American Law Institute's Principles of Corporate Governance Project and the Corporate Director’s Guidebook are good sources for studying and understanding the corporation law in the US. Therefore, this thesis also focus on these materials also.

The comparative analysis of Thai close corporation law will be based primarily on the Civil and Commercial Code, Book III. Specific Types of Contracts, Title XXII. Partnerships and Companies6 which is the Thai law relevant to a limited company. A limited company under Thai law has similar characteristics as those of a close corporation in the US, but there are differences. These differences in approaches of the corporation law in the US and those in Thailand will be addressed.

The second chapter of this thesis introduces the principles of a close corporation in the US and a limited company in Thailand as well as describes the basic characteristics of this type of business entity in broad terms.

The third chapter of the thesis describes a director’s fiduciary duty in a close corporation by introducing the reader in part A to the role of a director in managing the corporation affairs. Parts B and C describe the scope of the director’s fiduciary duty in a close corporation in the US and a limited company in Thailand, respectively.

The fourth chapter describes the business judgment rule, the courts’ rule regarding the presumption of the director’s duty in making a business decision, in the US. This is the approach that US courts under the common law system have created to protect a director in a close corporation.

The fifth chapter describes three protective measures and devices available under US law for a director to use for protecting himself in serving as a director in a close corporation.

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5 Generally known, Delaware corporation law, both judicial and statute rules play dominant role in changing corporation law and developing a large body of judicial rules and precedent in the US.
6 THE CIVIL AND COMMERCIAL CODE, BOOK III, TITLE XXII was promulgated on January 1, 1924. Many provisions have been revised from time to time, following the revision of THE SECURITIES AND EXCHANGE ACT and THE PUBLIC LIMITED COMPANY ACT, but the provisions relevant to director’s fiduciary duty.
corporation as well as an approach a director in limited company in Thailand uses to protect himself from performing his duty for the company.

Finally, the thesis addresses whether a director’s fiduciary duty in a close corporation and protective measures and devices for a director in a close corporation are appropriate for application in the US and in Thailand. Because of differences in economic environment and public policy, the legal literature is conflicting on whether a director’s fiduciary duty in a close corporation should be based on contractual freedom of all parties so that the duty will reflect the evolution of business practice and public policy at that time. This concept is applied in some states, but not all, but is quite controversial.
II. PRINCIPLES OF A CLOSE CORPORATION

A. What is a Close Corporation?

As close corporations, ranging from a small business (family-held corporation) to a big business enterprise,\(^7\) comprise the vast majority of corporations in the United States,\(^8\) undoubtedly, they influence economic and public ordering.\(^9\) The state-provided legal rules governing close corporations play a significant role in arranging economic and private ordering as well as public policy of the state.\(^10\) This is true for limited companies in Thailand as well as in the US. Before discussing the principles of a close corporation and a limited company in Part B and C, respectively, of this chapter, the initial question is that "What is a close corporation?"\(^11\)

A close corporation is a corporation whose shares, or at least voting shares, are held by a single shareholder or closely-knit group of shareholders.\(^12\) Generally there are no public investors and its shareholders are active in the conduct of the business.\(^13\)

\(^7\)HOCHSTETLER & SVEJA, supra note 4, at 859. Although most corporations have relatively few assets and low volume of sales, size alone is not determined of whether a corporation is 'close'. Ford Motor Company was closely held until it went public in 1995. Other large close corporations include S.C. Johnson & Son Inc., manufacturer of Johnson's Wax, and Mars, Inc., producer of candies and food, see 1 F. O'NEAL, supra note 2, § 1.03.

\(^8\)H. HENN & ALEXANDER, supra note 2, § 257, at 695 (3d ed. 1983).


\(^10\)Id.

\(^11\)In this part, the thesis treats a close corporation and limited company synonymous.


\(^13\)Id.
Although, this definition also describes special characteristics of a close corporation, it is not universally accepted.\textsuperscript{14} The definition of a close corporation has been defined in different ways, for example:

Generally, statutory definitions limit the number of shareholders, require share transfer restrictions, and prohibit public trading of corporation’s shares.\textsuperscript{15} For example, the Massachusetts Supreme Judicial Court, concluded that a close corporation is typified by: (1) a small number of shareholders;\textsuperscript{16} (2) no ready market for the corporate shares;\textsuperscript{17} and (3) substantial majority shareholder participation in the management, direction, and operations of the corporation.\textsuperscript{18}

The American Law Institute defines a closely held corporation as a corporation whose equity securities are owned by a small number of persons, and such securities have no active trading market.\textsuperscript{19}

Commentators, however, have typically distinguished a close corporation from a publicly held corporation by emphasizing the following characteristics:\textsuperscript{20}

(a) A close corporation has a small number of shareholders;\textsuperscript{21}

(b) All shareholders of a close corporation are active in the management of the corporation;\textsuperscript{22}

(c) There are restrictions on a close corporation’s shares transfer;\textsuperscript{23} and

\textsuperscript{14}Israels, The Close Corporation and The Law, 33 Cornell L.Q. 488, 491 (1948). (No satisfactory all-purpose definition of a close corporation appears ever to have been worked out.)
\textsuperscript{15}The Model Statutory Close Corporation Supplement § 10; Del. Code Ann. § 352.
\textsuperscript{17}Id.
\textsuperscript{18}Id.
\textsuperscript{19}ALI’s Principles of Corporate Governance: Analysis and Recommendation, ALI-CORPGOV § 1.06 (1994).
\textsuperscript{20}Hochstetler & Sveida, supra note, 4 at 852.
\textsuperscript{21}W. CARRY & M. EISENBERGE, CORPORATIONS at 366 (5th ed. 1980) (a close corporation is a corporation whose shares are held by a relatively small number of persons).
\textsuperscript{22}Legislation Note, Corporations--Definition of the Close Corporation, 16 Vand. L. Rev. 1267, 1272 (1963) (a close corporation is a corporation in which the shareholders are engaged in the management of the corporation).
\textsuperscript{23}F. O’Neal, supra note 2, § 1.07.
(d) There is no market available for a close corporation’s shares.\(^{24}\)

The definitions of a close corporation described above focus on the specific characteristics of a close corporation which differ significantly from characteristics of a publicly held corporation.\(^{25}\) It can be drawn from these definitions that a close corporation is one type of corporations with special characteristics. These definitions will raise the questions: (1) what is a corporation; and (2) what is its status in the community.

A corporation has been defined as an artificial person or legal entity enacted by or under the authority of the laws of a state.\(^{26}\) Such entity subsist as a body politic under a special denomination which is regarded in law as having a personality and existence distinct from that of several members, and which is, by the same authority, vested with the capacity of continuous succession, irrespective of changes in its membership, either in perpetuity or for a limited term of years, and of acting as a unit or single individuals in matters relating to the common purpose of the association, within the scope of the power and authorities conferred upon such bodies by law.\(^{27}\)

The Model Act defines a corporation as a corporation for profit, incorporated under or subject to the provision of this Act.\(^{28}\)

Although the definitions of a close corporation are varied, the basic characteristics of a corporation are common. Thus, a close corporation shall be summarily defined as a legal entity\(^{29}\) created by few shareholders\(^{30}\) for profit\(^{31}\) under authority of state with special characteristics of no separation of functions between

\(^{24}\)Id. § 1.02 (a close corporation is a corporation whose shares are not generally traded in the securities markets.)

\(^{25}\)HOCHSTETLER & SVEJDA, supra note 4, at 853.


\(^{27}\)Id.

\(^{28}\)MODEL. BUS. CORP. ACT § 1.40.


\(^{30}\)CARRY & EISENBERGE, supra note 21, at 366

\(^{31}\)MODEL BUS. CORP. ACT § 1.40.
shareholders and management,\textsuperscript{32} share transfer restrictions,\textsuperscript{33} and no established market available for its shares.\textsuperscript{34}

B. A Close Corporation in the US

In the US a close corporation is subject to a state corporation statute which provides a set of standard form governance rules for persons wishing to own and operate a close corporation in its jurisdiction.\textsuperscript{35} As described in Part A of this thesis, a close corporation has been classified as a legal entity for profit. One shareholder can create a close corporation simply by delivering articles of incorporation containing a statement that corporation is a statutory close corporation to the secretary of the state for filing.\textsuperscript{36}

1. Historical Background

For a number of years, all corporations, close corporations and publicly held corporations, traditionally, had been organized and governed by the same corporate statute.\textsuperscript{37} Prior to World War II, legislatures and courts seldom recognized the distinctions between a close corporation and a publicly held corporation.\textsuperscript{38} During the past fifty years, however, many commentators have directed attention to the unique needs of close corporation.\textsuperscript{39}

\textsuperscript{32}Legislation Note, supra note 22, at 1272.
\textsuperscript{33}1F. O'Neal, supra note 2, § 1.07.
\textsuperscript{34}Id. § 1.02.
\textsuperscript{35}O'Kelley & Thompson, supra note 9, at 175.
\textsuperscript{36}Model Bus. Corp. Act § 2.01; Del. Code Ann. § 101(a) provides that “...any person, partnership, association or corporation, singly or jointly with others,..., may incorporate or organize a corporation...”
\textsuperscript{37}Henn & Alexander, supra note 2, § 257, at 696.
\textsuperscript{38}Id. at 852.
\textsuperscript{39}Id.
Legislatures and courts have realized that close corporation needs are distinct from publicly held corporation needs in the following ways:

a) a close corporation does not have the division between the ownership and management. Typically, the shareholders of a close corporation are also the officers, thus, the shareholders expect to manage the corporation through direct participant, rather than through board of directors;

b) the shareholders in a close corporation are in frequent contact with each other. Management rights and privileges may have been determined through contractual agreement and therefore, the formalities of holding annual meeting of shareholders and directors appear unnecessary;

c) the shareholders in a close corporation are in better position than shareholders in a publicly held corporation to protect their investment in the corporation through the use of shareholders’ agreements; and

d) deadlock is more likely to occur in a close corporation than in a publicly held corporation. Unanimous vote requirements increase the likelihood that the shareholders will not be able to reach agreement on issues that affect the corporation.

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40Id.
41HOCHSTETLER & SVEJDA, supra note 4, at 853. In publicly held corporations the board of directors performs the management function, but may assign his duty to director committee or officer.
431F. O’NEAL, supra note 2, § 1.07.
45MILLER, supra note 42, at 593.
46HOCHSTETLER & SVEJDA, supra note 4, at 854.
47HOCHSTETLER & SVEJDA, supra note 4, at 854. Deadlock occurs when shareholders are consistently unable to muster sufficient support for action requiring shareholder approval, see 2F. O’NEAL, supra note 2, § 9.02.
48HENN & ALEXANDER, supra note 2, § 257, at 696.
491F. O’NEAL, supra note 2, § 9.02.
Disagreement still exists as to how close corporation needs are best met.\textsuperscript{50} The courts, however, have developed judicial exceptions to general corporation laws designed primarily for publicly held corporation needs.\textsuperscript{51} Some legislatures have revised general corporate statutes by creating flexible laws that better serve both publicly held corporations and close corporations.\textsuperscript{52} Other legislatures have enacted special close corporation legislation that is designed specifically for close corporations.\textsuperscript{53}

2. Basic Principles

The law governing the relative rights of shareholders, directors, and officers of a close corporation historically has been state corporation law. That remains so today,\textsuperscript{54} although there have been changed to meet close corporation needs. As a result, the basic principles of a close corporation in the US, nowadays, shall be summarized as follows:

a) A Legal Entity. A close corporation has traditionally been recognized as a legal entity separate and distinct from its shareholders.\textsuperscript{55}

b) Shareholder. A close corporation is created by a shareholder\textsuperscript{56} Generally, a maximum number of shareholders is a requirement for a close corporation.\textsuperscript{57}

\textsuperscript{51}Hochstetler & Svejda, \textit{supra} note 4, at 855.
\textsuperscript{52}Id.
\textsuperscript{53}Id.
\textsuperscript{54}O’Kelley & Thompson, \textit{supra} note 9, at 57.
\textsuperscript{55}Barbar, Piercing the Corporate Veil, 17 Williamette L. Rev. 371 (1981).
\textsuperscript{56}Model Bus. Corp. Act § 2.01; Del. Code Ann. § 101 (a). Shareholders may be an individual, partnership, corporation, or association.
\textsuperscript{57}Del. Code Ann. § 342 (1).
c) Capital. Shareholder must invest the capital, money, properties, workforce or others, to corporation in order to use for undertaking corporation affairs. The capital contributed to the corporation shall be divided into portions represented by shares.\textsuperscript{58} The stock ownership is ordinarily allocated among the participants in the corporation in direct proportion to the capital invested.\textsuperscript{59}

d) Shareholders’ Agreement. Shareholders’ agreements are one of the most flexible planning tools available to a close corporation.\textsuperscript{60} Specifically, these agreements allow close corporation's shareholders to depart from traditional corporate management structure and to agree among themselves to manage the business.\textsuperscript{61}

e) Share Transfer Restrictions. In some states the close corporation statute provides share transfer restrictions as a condition for incorporation of a close corporation.\textsuperscript{62} Other states permit reasonable restrictions on share transfer to designated persons, class of person, and requirement for election status.\textsuperscript{63}

f) Limited Liability. Shareholders are liable only to the extent of the capital invested in a close corporation.\textsuperscript{64} Any obligations that are assumed by a close corporation belong solely to the corporation, not to shareholders.\textsuperscript{65}

\textsuperscript{58}HARY J. HAYNSWORTH, WHAT EVERY LAWYER NEEDS TO KNOW ABOUT DRAFTING DOCUMENTS FOR CLOSELY-HELD CORPORATIONS, SPECIAL PROBLEMS OF CLOSELY HELD CORPORATIONS, Q171 ALI-ABA 5, 60 (1988); MODEL BUS. CORP. ACT § 6.20, Official Comment. No par value required for a corporation, and shares subscribed before in corporation must be paid in full.

\textsuperscript{59}Id.

\textsuperscript{60}GHINGER, SHAREHOLDERS’ AGREEMENT FOR CLOSELY HELD CORPORATIONS: SPECIAL TOOLS FOR SPECIAL CIRCUMSTANCES, 4 U. BALT L. REV. 221, 212 (1975). For details discussed about shareholder’s agreement, see HOCHSTETLER & SVEJDA, supra note 4, at 501-49.

\textsuperscript{61}HOCHSTETLER & SVEJDA, supra note 4, at 525; See also, e.g., MODEL BUS. CORP. ACT § 7.32, Official Comment; DEL. CODE ANN. § 350.

\textsuperscript{62}HOCHSTETLER & SVEJDA, supra note 4, at 963; For details discussed about restrictions of share transfer, see id. at 958-967.

\textsuperscript{63}Id.; See also MODEL BUS. CORP. ACT § 6.27.

\textsuperscript{64}HOCHSTETLER & SVEJDA, supra note 4, at 919; MODEL BUS. CORP. ACT § 6.22; Del. Code Ann. § 162. Shareholder may become personal liable by reason of his own acts or conducts through piercing corporate veil.

\textsuperscript{65}MODEL BUS. CORP. ACT § 6.22(b).
g) Management. Alternatively, a close corporation may be managed by directors or shareholders.\textsuperscript{66} Although in the event a director manages the corporation, the functions of shareholder, director and officer are not usually obviously identified.\textsuperscript{67}

h) Filing Requirement. Under state corporation law, a close corporation is required to file the articles of incorporation to the Secretary of State in order to be a legal entity.\textsuperscript{68}

C. A Limited Company in Thailand

In Thailand a limited company, like a close corporation in the US, is also defined as an entity for profit,\textsuperscript{69} having a small number of shareholders,\textsuperscript{70} no market for its shares,\textsuperscript{71} and restrictions on transfer of shares.\textsuperscript{72}

1. Historical Background

A limited company is subject to the Civil and Commercial Code\textsuperscript{73} of Thailand. The Commercial Code is comprised six books.\textsuperscript{74} The provisions relevant to a limited

\textsuperscript{66}\textsc{Model Bus. Corp. Act} § 7.32 (a)(1); \textsc{Del. Code Ann.} § 351.
\textsuperscript{67}See generally, \textsc{Hochstetler & Svejda, supra} note 4, at 849-56.
\textsuperscript{68}\textsc{Model Bus. Corp. Act} § 2.03; \textsc{Del. Code Ann.} § 106.
\textsuperscript{69}\textsc{The Commercial Code} § 1012.
\textsuperscript{70}The provision which limited the number of shareholder has been revoked by \textsc{The Civil and Commercial Code Amendment B.E. 2535 (1992)}. Therefore, a limited company in has been no longer limited a number of shareholders. Generally, a limited company, however, has a small number of shareholders. On the other hand \textsc{The Public Limited Company Act B.E. 2535 (1992)} requires at least 15 shareholders to be incorporated as a public limited company.
\textsuperscript{71}\textsc{The Commercial Code} § 1102.
\textsuperscript{72}id. § 1129 and § 1130.
\textsuperscript{73}\textsc{The Civil and Commercial Code, Book III, Title XXII} was promulgated on January 1, B.E. 2467 (1924).
\textsuperscript{74}\textsc{Book I General Principles}, \textsc{Book II Obligations, Book III, Specific Types of Contracts, Book IV Properties, Book V Family, and Book VI Successions}. 
company have been provided in Book III Specific types of Contracts, which are based upon three basic concepts,\(^7\) that include:

a) Concept of Legal Personality. A limited company is a legal entity separate from its shareholders;\(^6\)

b) Concept of Share Capital. A capital of a limited company is divided into a small unit with the same value called share;\(^7\)

c) Concept of Limited Liability. A shareholders of a limited company have a limited liability only for the capital invested by each of them into the company.\(^8\)

Although a limited company is a legal entity for profit, it has been classified as one type of contract among investors as well.\(^9\) This special characteristic of a limited company is distinct from a close corporation in the US. The pre-incorporated shareholders’ agreement is a prerequisite for creation of a limited company.\(^10\) Besides, the Commercial Code requires at least seven individual shareholders\(^11\) who agree to create limited company before filing.\(^12\)

At first the Commercial Code was promulgated without classification of a private limited company and a public limited company, all limited companies are subject to the Commercial Code. In 1974 the Securities Exchange of Thailand, known as the Stock Exchange of Thailand, was established by the Securities Exchange of

\(^7\)General overview of a limited company reveals strong influence from United Kingdom corporation law.
\(^7\)Id.
\(^6\)Id.
\(^10\)The Commercial Code § 1097.
\(^7\)The Commercial Code § 1012. Provisions relevant to a limited company have been provided in the Civil and Commercial Code, Book III, Specific Types of Contracts, Title XXII Partnerships and Companies.
\(^11\)Shareholder may be a individual, partnership, corporation, association, but all seven promoters of limited company required for registration of the memorandum of association must be individuals. (Ruling by The Regulation of the Commercial Registration Division, The Registration of Partnerships and Companies B.E 2530 (1987), Art. 61).
\(^12\)The Commercial Code § 1097.
Thailand Act B.E. 2517(1974). Three years later, the Public Limited Companies Act B.E. 2521 (1987) was enacted. Accordingly, the Civil and Commercial Code Amendment B.E. 2521 (1987) was promulgated by revising and repealing many provisions relevant to a limited company in the Commercial Code which were inconsistent with the Public Limited Companies Act. Then, a limited company has been classified as a private limited company with a small number of shareholders and restriction on share transfers.

2. Basic Principles

The basic principles of a limited company in Thailand are as follows:

a) A Legal Entity. A limited company is a legal entity for profit separate and distinct from its shareholders.84

b) Shareholder. Shareholders of limited company, unlike a close corporation in the US, must have at least seven shareholders during the life time of a limited company.85

c) Capital. A limited company is required to have capital, money, properties, or workforce, for undertaking the business and meeting the requirement of law. The capital contributed to the company must be divided into portion represented by shares of the company. The company’s shares need to have a par value.86

d) Share Transfer Restrictions. No established market available for shares of a limited company. The Commercial Code permits a limited company to restrict transfer

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83 *The Civil and Commercial Code, Book III, Title XXII* was revised again when *The Revised Public Limited Companies Act B.E. 2535* (1992) was promulgated in 1992.

84 *The Commercial Code* § 65 and § 1096.

85 *Id.* § 1960.

86 *Id.* § 1960.
of it shares in the articles of incorporation,\textsuperscript{87} and also allow a limited company to deny transferring of its shares for reasonable reasons.\textsuperscript{88} Further, a limited company is prohibited to own its share or take its shares in pledge for whatever reasons.\textsuperscript{89} A limited company also is prohibited to offer its shares to public by the Securities and Exchange Act 1992.

e) Limited Liability. Like a close corporation in the US, each shareholder of a limited company has no liability exceeding the capital invested.\textsuperscript{90}

d) Management. Even though a limited company is a small business, a director is required by law for managing the company.\textsuperscript{91} As a result, the Commercial Code allows a director of a limited company to voluntarily elect for full liability in his office.\textsuperscript{92}

e) Filing Requirement. Under the Commercial Code requires two subsequent filings, first the memorandum of association filing,\textsuperscript{93} and second the incorporation filing\textsuperscript{94} in order to be a legal entity.

\textsuperscript{87}Id. § 1129.\textsuperscript{88}Id. § 1330.\textsuperscript{89}Id. § 1143.\textsuperscript{90}Id. § 1196. Unlike, piercing corporate veil in the Corporation law in the US, there is no provision imposed shareholders to be personally liable for their acts or conducts.\textsuperscript{91}Id. § 1144.\textsuperscript{92}Id. § 1101. Because a director manages the company business, not shareholders, he represents the company in all aspect, as if he is the company himself.\textsuperscript{93}Id. § 1097.\textsuperscript{94}Id. § 1111.
III. THE DIRECTOR’S FIDUCIARY DUTY IN A CLOSE CORPORATION

A. Introduction to the Role of a Director in Managing Corporation Affairs

As described in Chapter II, supra, a corporation is a legal entity or an artificial entity.\(^5\) Undoubtedly, a corporation cannot express its intention, acts, and conduct business itself. The question to ask would be: How can a corporation express its intention? How can it act and conduct its business?

Obviously, some form of governance is necessary for a corporation. Who should provide a corporate governance? Shareholders? Although shareholders are the corporation’s owners, the fundamental principle of corporation law is that a corporation is a legal entity, separate and distinct from its shareholders.\(^6\) As a result, shareholders should not automatically provide a corporate governance.\(^7\)

In the US, as to form of a corporate governance the Model Act § 8.01 provides the following principle as to the corporate governance in a corporation.\(^8\)

Chapter 8, Subchapter A, Section 8.01: Requirement for and Duties of Board of Directors.
(a) Except as provided in section 7.32, each corporation must have a board of directors.
(b) All corporate powers shall be exercised by or under the authority of, and the business and affairs of the corporation managed under the direction of, its board of directors, subject to any limitation set forth in the articles of incorporation or in an agreement authorized under section 7.32.

\(^5\)See supra, text accompanying note 26-28.
\(^6\)See supra, text accompanying note 5 and 84.
\(^7\)In a close corporation the state corporation law allows shareholders manage the corporation affairs, in this event, however, shareholders must bear responsibility of directors. See MODEL BUS. CORP. ACT SUPP. § 21; DEL. CODE ANN. § 352.
\(^8\)See also DEL. CODE ANN. § 141.
This provision expresses that the board of directors is the traditional form of corporate governance.99 The board controls the corporation's business activities, although it is not an owner of the corporation. Generally, director's management power must be exercised by the board of directors collectively, and individual directors are not given general agency power to deal with outsiders.100 Nevertheless, neither the Model Act § 8.01 nor state corporation statutes101 clearly defines the board of directors' role although establishing the breadth of this role is clearly a precondition to legal liability for failure to meet director's fiduciary duty.102

The American Law Institute's103 Principles of Corporate Governance,104 describes the functions and powers of the board of directors in managing the corporation's business as follows:

Section 3.02. Functions and Power of the Board of Directors
Except as otherwise provided by statute:
(a) The board of directors of a publicly held corporation should perform the following functions:
   (1) Select, regularly evaluate, fix the compensation of, and, where appropriate, replace the principal senior executive;
   (2) Oversee the conduct of the corporation's business to evaluate whether the business is being properly managed;
   (3) Review and, where appropriate, approve corporation's financial objectives and major corporate plans and actions;

99MODEL BUS. CORP. ACT § 8.01, Official Comment. If a corporation does not have a shareholder agreement that satisfied the requirement of section 7.32 or market exist for its shares as specified in section 7.32, it must adopt the traditional board of directors as it sole form of governance. Id.
100O' KELLEY & THOMPSON, supra note 9, at 181.
101DELA. CODE ANN. § 141.
102O' KELLEY & THOMPSON, supra note 9, at 319.
103Since 1979 The American Law Institute has funded a study of corporate governance project named "Corporate Governance Project", the Principles set by this project are increasingly addressed by the state and federal jurisdiction, as well as, the state or federal legislation, see GUIDELINE TO THE CORPORATE GOVERNANCE PROJECT (1994).
104ALI's PRINCIPLES OF CORPORATE GOVERNANCE § 3.02. (1994). Although this section is set basic functions and powers of the board of directors of a publicly held corporation, it can be used as basic functions and power of the board of any corporation including a close corporation; See also, THE CORPORATE DIRECTOR'S GUIDEBOOK—1994 EDITION, 49 BUS. LAW. 1247, 1249 (1994), describing the board's oversight responsibilities, rather than management.
(4) Review and, where appropriate, approve major changes in, and determinations of other major questions of choice respecting, the appropriate auditing and accounting principles and practices to be used in the preparation of the corporation’s financial statements;

(5) Perform such other functions as are prescribed by law, or assigned to the board under a standard of the corporation.

(b) A board of directors also has power to:

(1) Initiate and adopt corporate plans, commitments, and actions;
(2) Initiate and adopt changes in accounting principles and practices;
(3) Provide advice and counsel to the principal senior executives;
(4) Instruct any committee, principal senior executive, or other officer, and review the action of any committee, principal senior executive, or other officer;
(5) Make recommendations to shareholder;
(6) Manage the business of the corporation;
(7) Act as to all other corporate matters not requiring shareholder approval.

Typically, the board of directors makes the basic decisions with respect to the activities of the corporation and directs the officers to execute the decisions of the board. Thus, a director is not expected to be involved in day-to-day operation of the business or to have a specialized skill and knowledge possessed by corporate employees. As a result, the liability of directors for involvement in decisions regarding corporate management and affairs will likely be determined by application of the business judgment rule, to be described in Chapter IV, infra.

In Thailand as to a corporate governance, similarly, the Commercial Code, § 1144 provides the issue relevant to corporate governance in limited company in the following principle:

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105 JAMES E. SPIOTTO, DIRECTOR AND OFFICER LIABILITY: WHO WATCHES THE WATCHMEN?, 931 PLI/CORP 361, 367 (1996); See also MODEL BUS. CORP. ACT § 8.25; DEL. CODE ANN. § 141(c) and § 142. The board of directors may delegate its power to committee or officer.
106 Id. In addition to these functions, in a close corporation a director usually involves in day-to-day work because traditionally, the functions of director and officer in close corporation are not absolutely separated.
107 Id.
The Commercial Code, Book III, Title XXII, Chapter IV, Part III, Section 1144: Every limited company shall be managed by the director or directors under the control of the general meeting of the shareholders and according to the regulations of the company.

This provision uses the terms "a director or directors" rather than "the board of directors", because under Thai law a director may be liable individually. Generally, in a limited company, if there is more than one director appointed by general meeting of shareholders, it constitutes the board of directors. The board of directors manages the corporation collectively through the resolution or meeting of the board of directors. In managing the corporation the board of directors exercises its power independently, although this provision provides that "...under control of the general meeting of shareholders...", it merely means that the board of directors has a duty to report all corporate activities done by the board of directors to the meeting of shareholders for acknowledgment, approval or ratification as the case may be.

In sum, a director or the board of directors is the locus of all powers and authorities exercised by the corporation. Under due responsibility, the board of directors is entitled to delegate its power to committee or officer. A director is entitled to compensation for his services, but is not entitled to share in the corporation's residual profits like shareholders. Because a director plays a significant role in managing the corporation affairs, it needs to balance the power in which the corporation delegates to director and the possibility that directors will favor personal interests over the corporate interest and the possibility of excessively negligent behavior of a director in managing

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109 *Id.* § 1159-1160.
110 *Id.* § 1159-1164.
111 O'KELLEY & THOMPSON, *supra* note 9, at 181.
113 *Model Bus. Corp. Act* § 8.11; *Del. Code Ann.* § 141 (h). Under Thai law there is no provision relevant to director's compensation right, but practically, it needs to have contract between the corporation and director which must be approved by the meeting of shareholders.
corporation business,\textsuperscript{114} thus, the fiduciary duty has been created as a standard for a director in performing their duties in the corporation, to be described in Part B and C below.

Under his role, a director enjoys his rights, for example, the right to receive compensation. On the other hand, he must perform his duty in compliance with the standards, and be liable for the breach of his duty and some damage occurred during his office. There are numerous duties a director must be concerned with. In general, the sources of duties of director may be (a) prescribed by the corporation law; (b) inherent in an office; (c) imposed by special legislative provisions; or (d) imposed by the corporation itself.\textsuperscript{115} Whatever the duty to be performed by a director, it is required that a director bear a fiduciary duty to the corporation and its shareholders.

**B. The Director’s Fiduciary Duty in a Close Corporation in the US**

In the US, the fiduciary duty of a corporate director has its origins in English common law of both trusts and agency from over 200 years ago.\textsuperscript{116} This fiduciary duty is based upon the fundamental principle that the business and affairs of a corporation are managed by or under its board of directors.\textsuperscript{117} In carrying out their managerial roles, however, directors are charged with fiduciary duty to protect the interests of the corporation and to act in the best interests of its shareholders.\textsuperscript{118} In so doing, the director should have basic understandings of corporation business and an numerous relevant

\textsuperscript{114}O’KELLEY & THOMPSON, supra note 9, at 181.
\textsuperscript{115}ALI’S PRINCIPLE OF CORPORATE GOVERNANCE, Comment to § 4.01 (1994).
\textsuperscript{118}Loft, Inc. v. Guth, 2 A.2d 225 (Del. Ch.1938), aff’d., 5 A.2d 503 (Del. Sup.1939).
factors which vary from one corporation to another. Thus, as one commentator pointed out, a director's fiduciary duty exists because the decisions that face directors of a corporation are sufficiently complex and difficult to predict that it would not be feasible to specify in advance how to respond to a wide range of future contingencies. Because the relationship between the corporation and a director is based upon an agreement, fiduciary duty is also the mechanism invented by legal system for filling the unspecified term of shareholder's contingent contract.

With regard to the principle of the standards of fiduciary duty of a director in performing his managerial role, the Model Act § 8.30 provides:

The Model Business Corporation Act, Chapter 8, Subchapter C, § 8.30: General Standards for Directors
   (a) A director shall discharge his duties as a director, including his duties as a member of a committee;
       (1) in good faith;
       (2) with the care an ordinarily prudent person in a like position would exercise under similar circumstances; and
       (3) in a manner he reasonably believes to be in the best interest of the corporation.
   (b) In discharging his duties a director is entitled to rely on information, opinions, reports, or statements, including financial statements and other financial data, if prepared or presented by:
       (1) one or more officers or employees of the corporation whom the directors reasonably believes to be reliable and competent in the matters presented;
       (2) legal counsel, public accountants, or other persons as to matters the director reasonably believes are within the person's professional or expert competence; or
       (3) a committee of the board of directors of which he is not a member if the director reasonably believes the committee merits confidence.

121 Id.
(c) A director is not acting in good faith if he has knowledge concerning the matter in question that makes reliance otherwise permitted by subsection (b) unwarranted.

(d) A director is not liable for action taken as a director, or any failure to take any action, if he performed the duties of his office in compliance with this section.

The Model Act sets forth the standards of fiduciary duty by focusing on the manner in which a director performs his duties, not the correctness of his decision.\textsuperscript{123}

Analyzing this Section is helpful in understanding director’s duties:

The phrase “in good faith” is used in a wide variety of legal contexts, but the courts usually assume it means referred as having no fraud, bad faith or self-dealing.\textsuperscript{124}

The word “care” expresses the need to pay attention and to act diligently and reasonably.\textsuperscript{125}

The phrase “ordinarily prudent person” embodies long traditions of the common law like “ordinarily prudent businessman” which recognizes the need for innovation, essential to profit orientation, and focuses on the basic director attributes of common sense, practical wisdom, and informed judgment.\textsuperscript{126}

The phrase “...in a like position would exercise under similar circumstances” is used to recognize that: a) the nature and extent of responsibility will vary, depending upon such factors as the complexity, size, urgency, and location of the activities carry on by particular corporation;\textsuperscript{127}(b) decision must be made on the basis of the information known to the director without the benefit of hindsight;\textsuperscript{128} and (c) the special background,\textsuperscript{129}

\textsuperscript{123}\textit{Model Bus. Corp. Act} § 8.30, Official Comment.
\textsuperscript{124}See, e.g., Smith, 448 A.2d at 873.
\textsuperscript{125}\textit{Corporate Director’s Guidebook—1994 Edition}, supra note 104, at 1252.
\textsuperscript{126}\textit{Model Bus Corp. Act} § 8.30, Official Comment.
\textsuperscript{127}\textit{Id.} This means that the statute does not consider the responsibility of director by comparing with other corporation which engages in the like business.
\textsuperscript{128}\textit{Id.}
\textsuperscript{129}\textit{Id.}
qualifications, and management responsibilities of a particular director may be relevant in evaluating his compliance with the standard of care.\textsuperscript{129}

In complying with the standard expressed in this Section a director is entitled to rely upon information, opinions, reports or statements described in (b) of this Section, but a director still has a responsibility to keep informed of the efforts from the person assigned. The standards of fiduciary duty of director provided by this Section is self-executing.\textsuperscript{130} That is, if a director performs his duties which meets requirements of the standards of conduct set forth in this Section, a director is automatically released from any liability with no need to consider possible applicability of the business judgment rule\textsuperscript{131} by court.

Although, this Section does not define exact types of director fiduciary duty, it has been long recognized that director’s fiduciary duty is composed of two legal distinct obligations; the duty of care and the duty of loyalty.\textsuperscript{132} These two obligations have also been recognized by courts that a director, as quasi-trustee, should be judged by fiduciary duty standard of not simply good faith but prudent conduct.\textsuperscript{133} For example, the Court in \textit{Litwin v. Allen}\textsuperscript{134} addressed that:

"It is clear that a director owes loyalty and allegiance to the company—a loyalty that is undivided and an allegiance that is influenced in action by no consideration other than the welfare of the corporation. Any adverse interest of a director will be subjected to a scrutiny rigid and uncompromising. He may not profit at the expense of his corporation and in conflict with its rights; he may not for personal gain divert unto himself the opportunities which in equity and fairness belong to his corporation. He is required to use his independent judgment. In the discharge of his duties a director must, of course, act honestly and in good faith, but that is

\textsuperscript{129}Id.
\textsuperscript{130}Id.
\textsuperscript{131}Id. For business judgment rule, see infra, Chapter IV.
\textsuperscript{133}Horsey, supra note 116, at 974.
\textsuperscript{134}25 N.Y.S. 2d 667 (N.Y. Sup. 1940).
not enough. He must also exercise some degree of skill and prudence and
diligence.\textsuperscript{135}

1. Duty of Care

By the nineteenth century, the concept that corporate directors owed a common
law fiduciary duty of care to their institutions was recognized but was generally confined
to the directors of banks and financial institutions.\textsuperscript{136} By the latter part of the nineteenth
century and the beginning of the twentieth century, the concept that a corporate director
owes a fiduciary duty of care to his corporation and its shareholders had extended to a
director of industrial corporation.\textsuperscript{137} Initially the Supreme Court in *Briggs v. Spaulding*\textsuperscript{138}
went that directors should be held to the action of “ordinarily prudent and diligent
men”.\textsuperscript{139} Thereafter, the courts commonly defined the standard of duty of care of director
in terms of the conduct of “a reasonable and prudent person”,\textsuperscript{140} and also refer to “duty of
care”.\textsuperscript{141} However, the Model Act § 8.31 does not use the exact phrase of “duty of care”
in providing the standard of conduct of director.

In addition to the requirements provided by law with regarding to duty of care, the
courts have ruled additional principles in determining director’s responsibility for duty of
care:

a) The director need to be informed one.\textsuperscript{142} For example, the Court in *Smith v. Van Gorkom*\textsuperscript{143} addressed that:

\textsuperscript{135} Id. At 677-78.
\textsuperscript{136} Horsey, *supra* note 116, at 973-74.
\textsuperscript{137} Id.
\textsuperscript{138} 141 U.S. 132 (1891).
\textsuperscript{139} Id. at 152.
\textsuperscript{140} Horsey, *supra* note 116, at 974.
\textsuperscript{141} See also Smith, 448 A.2d at 873; In re Caremark International, Inc., 698 A. 2d at 967.
\textsuperscript{142} See also Kalplan v. Centex Corp., 284 A.2d 119, 124 (Del. Ch. 1971); Aronson, 473 A. 2d at 812; In re
Caremark International Inc., 698 A.2d at 970.
\textsuperscript{143} 448 A. 2d at 858.
"[S]ince a director is vested with the responsibility for the management of the affairs of the corporation, he must execute that duty with the recognition that he acts on behalf of others. Such obligation does not tolerate faithlessness or self-dealing. But fulfillment of the fiduciary function requires more than the mere absence of bad faith or fraud. Representation of the financial interests of others imposes on a director an affirmative duty to protect those interests and to proceed with a critical eye in assessing information of the type and under the circumstances....

Thus, a director's duty to exercise an informed business judgment is in the nature of a duty of care, as distinguished from a duty of loyalty.''''

b) The director liability is predicated upon a concept of gross negligence. For example, the court in Aronson v. Lewis stated that:

"[T]o invoke the rule's protection directors have a duty to inform themselves, prior to making a business decision, of all material information reasonably available to them. Having become so informed, the must then act with requisite care in the discharge of their duties. 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 concept of gross negligence."''''

In addition to the principles ruled by the court heretofore, in determining whether to impose liability to a director, the courts traditionally presume 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 taken was the best interests of corporation. Compliance with a director's duty of care can never appropriately be judicially determined by reference to the content of the board's decision that leads to a corporate loss, apart from

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144Id. at 872-73. (emphasis added).
145See also Litwin, 25 N.Y.S. 2d at 677-78; Aronson, 473 A. 2d at 812; Smith, 488 A. 2d at 858; Cede & Co. v. Technicolor, 634 A.2d at 345, 636 A. 2d at 956.
146473 A. 2d at 805.
147Id. at 812 & n. 6. (emphasis added).
148Aronson, 473 A. 2d at 812.
consideration of the good faith or rationality of the process employed. That is, whether a court considering the matter after the facts believes a decision substantively wrong, or degrees of wrong extending through "stupid" to "egregious" or "irrational" provides no ground for director liability, so long as the court determines that the process employed was either rational or employed in good faith effort to advance corporate interests. To employ a different rule--one that permitted an "objective" evaluation of the decision--would expose a director to substantive second guessing by ill-equipped judges or juries, which would, in the long-run, be injurious to investor interests. This court rule is called business judgment rule, to be described in Chapter IV, infra.

As to duty of care the American Law Institute's Principles of Corporate Governance also set the standards of duty of care for a director, by considering applicable laws and the courts' rules relevant to duty of care:

Section 4.01. Duty of Care of [Directors]; The Business Judgment Rule
(a) A [director] has a duty to the corporation to perform the director's or officer's functions in good faith, in a manner that he or she reasonably believes to be in the best interests of the corporation, and with the care that an ordinarily prudent person would reasonably be expected to exercise in a like position and under similar circumstances. This Subsection (a) is subject to the provision of Subsection (c) (the business judgment rule) where applicable.

(1) The duty in Subsection (a) includes the obligation to make, or cause to be made, an inquiry when, but only when, the

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149 In re Caremark International Inc., 698 A.2d at 967.
150 Id.
151 Id. & n. 6. (The vocabulary of negligence while often employed, e.g. Aronson v. Lewis, Del. Supr., 473 A.2d 805 (1984) is not well-suited to judicial review of board attentiveness, see, e.g., Joy v. North, 692 F.2d 880, 885-6 (2d Cir. 1982), especially if one attempts to look to the substance of decisions any evidence of possible "negligence." Where review of board functioning is involved, courts leave behind as a relevant point of reference the decisions of the hypothetical "reasonable person", who typically supplies the test for negligence liability. It is doubtful that we want business men and women to be encouraged to make decisions a hypothetical persons of ordinary judgment and prudence might. The corporate form get it utility in large part from its ability to allow diversified investors to accept greater investment risk. If those in charge of the corporation are to be adjudged personally liable for losses on the basis of a substantive judgment based upon what a person of ordinary or average judgment and average risk assessment talent regard as "prudent" "sensible" or even "rational" such persons will have a strong incentive at the margin to authorize less risky investment projects.)
circumstances would alert a reasonable [director] to the need therefor. The extent of such inquiry shall be such as the [director] reasonably believes to be necessary.

(2) In performing any of his or her functions (including oversight function), a [director] is entitled to rely on materials and persons in accordance with ss 4.02 and 4.03 (reliance on directors, officers, employees, experts, other persons, and committees of the board).

(b) Except as otherwise provided by statute or by a standard of the corporation and subject to the board’s ultimate responsibility for oversight, in performing its functions (including oversight functions), the board may delegate, formally or informally by course of conduct, any function (including function of identifying matters requiring the attention of the board) to committees of the board or to directors, officers, experts, or other persons; a director may rely on such committees and persons in fulfilling the duty under this Section with respect to any delegated function if the reliance is in accordance with ss 4.02 and 4.03.

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

(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] reasonably believes to be appropriate under the circumstances; and;

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

(d) A person challenging the conduct of a [director] under this Section has burden of proving a breach of duty of care, including the inapplicability of the previsions as to the fulfillment of duty under Subsection (b) or (c), and in a damage action, the burden of proving that the breach was the legal cause of damage suffered by the corporation....

The standards of duty of care set by the American Law Institute are articulated in the most jurisdictions today.\(^{152}\) This is because such standards are boarder than theose set forth by the Model Act or state corporation statutes, by using the different wordings, for example, “director’s functions” instead of “director’s duty”, and “rationally believes” instead of “reasonably believes”.

\(^{152}\)In re Caremark International Inc., 698 A.2d at 967& n. 15.
2. Duty of Loyalty

The second legal component of director’s fiduciary duty is a duty of loyalty. Historically, the scope of duty of loyalty of director to a corporation has been defined by judicial decision rather than by statute. The classic expression of duty of loyalty is found in *Guth v. Loft, Inc.*, in which the Supreme Court of Delaware stated that:

“Corporate [directors] are not permitted to use their position of trust and confidence to further their private interests. While technically not trustee, [directors] stand in a fiduciary relation to the corporation and its stockholders. A public policy, existing through the years, and derived from a profound knowledge of human characteristics and motives, has established a rule that demands of a corporate officer or directors, peremptorily and inexorably, the most scrupulous observance of his duty, not only affirmatively to protect the interests of the corporation committed to his charge, but also to refrain from doing anything that would work injury to the corporation, or to deprive it of profit or advantage which his skill and ability might properly bring to it, or to enable it to make in the reasonable and lawful exercise of its power. The rule that requires an undivided and unselfish loyalty to the corporation demands that there shall be no conflict between duty and self-interest. The occasions for the determination of honesty, good faith and loyal conduct are many and varied, and no hard and fast rule can be formulated. The standard of loyalty is measured by no fixed scale.”

In order to understand the duty of care and duty of loyalty, it is helpful to distinguish among their characteristics. The Corporate Director’s Guidebook describes the distinction of the characteristics of these two legal duties of director as follows:

“Duty of Loyalty. By assuming his office, the corporate director commits allegiance to the enterprise and acknowledges that the best interests of the corporation and its shareholders must prevail over any individual interest of his own. The basic principle to be observed is that the director should not use his corporate position to make a personal profit or gain other personal advantage....

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152 A. 2d 503 (Del. Sup. 1939).
154 *Id.* at 510.
Duty of Care. In addition to owing a duty of loyalty to the corporation, the corporate director also assumes a duty to act carefully in fulfilling the important tasks of monitoring and directing the activities of corporate management.\(^\text{155}\)

Considering the difference between these two duties, it can be concluded that negligence, mismanagement, and decisions to do wrongful acts are dealt with in the duty of care, but fraud, self-dealing, misappropriation of corporate opportunities, improper diversions of corporate assets, and similar matters involving potential conflict of interests between a director and the corporation are considered in the duty of loyalty.\(^\text{156}\)

The conduct requirement under the duty of loyalty, which is the second component of the traditional fiduciary duty, parallels that which is required under the duty of care.\(^\text{157}\) The duty of loyalty obligates the director to act at all times in the best interests of the corporation and its shareholders and not engage in self-dealing.\(^\text{158}\) The common law application of duty of loyalty are in two classic settings: (a) conflicts of interest transactions; and (b) the corporate opportunities.\(^\text{159}\)

### a. A Conflict of Interest Transaction

The common law courts focused on the director’s fiduciary duty owed to the corporation, so substantive agreements between a corporation and its director were void

\(^{155}\) The Corporate Director’s Guidebook, 33 Bus. Law. 1591, 1599-1600 (1979).


\(^{158}\) Id.; See also Norlin Corp. v. Rooney, Pace, Inc., 744 F. 2d 255, 264 (2d. Cir. 1984).

\(^{159}\) O’Kelley & Thompson, supra note 9, at 401. The duty of loyalty issues may arise in the context of a variety of transaction; for example, conflict of interests transactions; usurpation of corporate opportunities; competition with the corporation by director and improper use of corporate position, property, or information, see ALI’S PRINCIPLES OF CORPORATE GOVERNANCE, PART V. In this thesis merely focus on conflict of interest transactions and corporate opportunities.
or voidable simply because of a conflict of interest existed.\(^{160}\) In itself, a conflict of interest is not inherently improper,\(^{161}\) and as the complexity and interconnection of American business increased,\(^{162}\) conflicting interest transactions have been no longer viewed by courts as void or voidable because the courts themselves will look at the contract and decide its fairness without shareholders’ approval.\(^{163}\)

Today the duty of loyalty relevant to a conflict of interest transaction between a director and the corporation is generally treated by state corporation statutes.\(^{164}\) This “safe harbor” statute was enacted to ameliorate the common law rule which made such transactions voidable whether or not it was fair or approved by other directors who were disinterested.\(^{165}\) The Model Act provides the validity of director’s conflict of interest transaction as follows:

The Revised Model Business Corporation Act, Chapter 8, Subchapter C, § 8.31: Director Conflict of Interest
(a) A conflict of interest transaction is a transaction with the corporation in which a director of the corporation has a direct or indirect interest. A conflict of interest transaction is not voidable by the corporation solely because of the director’s interest in the transaction if any one of the following is true;

1. the material facts of the transaction and the director’s interest were disclosed or known to the board of directors or committee of the board of directors and the board of directors or committee authorized, approved, ratified the transaction;
2. the material facts of the transaction and the director’s interest were disclosed or known to the shareholders entitles to vote and they authorized, approved, or ratified the transaction; or
3. the transaction was fair to the corporation.

(b) For purposes of this section, a director of the corporation has an indirect interest in a transaction if (1) another entity in which he has a

\(^{161}\)THE CORPORATE DIRECTOR’S GUIDEBOOK, supra note 104, at 1255.
\(^{162}\)O’KELLEY & THOMPSON, supra note 9, at 402.
\(^{164}\)DEL. CODE ANN. § 144 (a) (3).
material financial interest or in which he is a general partner is a party to the transaction or (2) another entity of which he is a director, officer, or trustee is a party to the transaction and the transaction is or should be considered by the board of directors of the corporation....

This Section defines the terms “a conflict of interest transaction” as one which does not include transaction in which the director participates in the transaction only as a shareholder or receives only a proportionate share of the advantage or benefit of the transaction.\textsuperscript{166} This Section, however, does not define “interested” director,\textsuperscript{167} but normally, a director should be viewed as interested in a transaction if he or immediate members of his family have a financial interest in the transaction or a relationship with the other parties to the transaction such that the relationship might reasonably be expected to affect his judgment in the particular matter in a manner adverse to the corporation.\textsuperscript{168}

The Model Act defines a method to eliminate the automatic rule of voidability of conflict of interest transaction, that is, if such transaction is fair or has been approved by directors or shareholders in the manner provided by this Section, this transaction is automatically valid.\textsuperscript{169} The transaction in question is subject to special requirements for approval of conflict of interest transaction. That is it is to be approved by disinterested directors or disinterested shareholders according to the process provided by this Section.\textsuperscript{170}

If these requirements for approval, authorization, or ratification are not met, a transaction is tested by the court under the fairness test. The fairness of a transaction

\textsuperscript{166}MODEL BUS. CORP. ACT § 8.31 (b), Official Comment.
\textsuperscript{167}Aronson, 473 A. 2d at 812. A director is not considered to be “interested” under Delaware corporation law if he neither “appears on both sides of a transaction nor expect to derive any personal financial benefit from it in the sense of self-dealing, as opposed to a benefit which devolves upon the corporation or all stockholders generally. \textit{Id.}
\textsuperscript{168}\textit{Id.}
\textsuperscript{169}\textit{Id.}
\textsuperscript{170}It should be noted that the vote requires for authorization, approval, or ratification of a conflict of interest transaction is more onerous than the standard applicable to normal voting requirement for approval of corporate actions, see MODEL BUS. CORP. ACT § 8.31 (b), Official Comment.
traditionally is evaluated on the basis of facts and circumstances. Normally, a transaction is deemed fair if the disinterested persons might have entered into the arm’s length.

With regard to conflict of interest transactions the American Law Institute’s Principles of Corporate Governance, also have applicable the standards:

Section 5.02. Transaction with the Corporation
(a) General rule. A [Director] who enters into a transaction with the corporation (other than a transaction involving the payment of compensation) fulfills the duty of fair dealing with respect to the transaction if:

(1) Disclosure concerning the conflict of interest and the transaction is made to the corporate decision-maker who authorizes in advance or ratifies the transaction; and

(2) Either:

(A) The transaction is fair to the corporation when entered into;

(B) The transaction is authorized in advance, following disclosure concerning the conflict of interest and the transaction by disinterested directors who could reasonably have concluded that the transaction was fair to the corporation at the time of such authorization;

(C) The transactions ratified, following such disclosure, by disinterested directors who could reasonably have concluded that the transaction was fair to the corporation at the time it was entered into, provided (i) a corporation decision-maker who is not interested in the transaction acted for the corporation in the transaction and could reasonably have concluded that the transaction was fair to the corporation; (ii) the interested [director] made disclosure to the such decision-maker pursuant to Subsection (a)(1) to the extent he or she then knew of the material facts; (iii) the interested [director] did not act unreasonably in failing to seek advance authorization of the transaction by disinterested [directors]; and (iv) the failure to obtain advance authorization of the transaction by

172Sincare Oil Corporation, 261 A. 2d at 923; Weinberger, 457 A. 2d 701, 710 (Del. Sup. 1983).
disinterested [directors] did not adversely affect the interested of the corporation in a significant way; or (D) The transaction is authorized in advance or ratified, following such disclosure, by disinterested shareholders, and does not constitute a waste of corporate asset at the time of shareholder action.

b. The Corporate Opportunities

Duty of loyalty instructs a director to be absolutely fair and candid in pursuing personal interests.\textsuperscript{173} Hence, the duty of loyalty makes it wrongful for a director to unfairly compete with his corporation or to unfairly divert corporate resources or opportunities to his personal use.\textsuperscript{174}

1. The Corporate Opportunity Doctrine.

The courts have developed the scope of director’s duty of loyalty based on increasing sophistication and experience with the corporate form, and the need to encourage honest decisions by a director and discourage direct or indirect devices by which the director may benefit personally at the expense of the corporation.\textsuperscript{175} The Court in \textit{Burg v. Horn}\textsuperscript{176} stated that the corporate opportunity doctrine should not be used to bar the corporate directors from purchasing any property which might be useful to the corporation, but only to prevent their acquisition of property which the corporation needs or is seeking, or which they are otherwise under a duty to the corporation to acquire for

\textsuperscript{173}O’Kelley & Thompson, \textit{supra} note 9, at 317.
\textsuperscript{174}Id.
\textsuperscript{175}Id.
\textsuperscript{176}380 F. 2d 897 (2d. Cir. 1967).
In recent case, Cellular Information System, Inc. v. Broz, the Supreme Court of Delaware stated that:

"[A] corporate [director] may not take a business opportunity for his own if: (1) the corporation is financially able to exploit the opportunity; (2) the opportunity is within the corporation's line of business; (3) the corporation has an interest or expectancy in the opportunity; and (4) by taking the opportunity for his own, the corporate fiduciary will thereby be placed in a position inimicable to his duties to the corporation.

....a [director] may take a corporate opportunity is presented if: (1) the opportunity is presented to the [director] in his individual and not his corporate capacity; (2) the opportunity is not essential to the corporation; (3) the corporation holds no interest or expectancy in the opportunity; and (4) the [director] has not wrongfully employed the resources of the corporation in pursuing or exploiting the opportunity....

Thus, the contours of this doctrine are well established. It is important to note, however, that the tests...provide guidelines to be considered by a reviewing the court in balancing the equities of an individual case. No one factor is dispositive and all factors must be taken into account insofar as they are applicable."

In considering the director's duty of loyalty under the corporate opportunity doctrine, the courts normally apply the line of business test or interest or expectancy test, or corporate financial capability, or combination of these tests. As regards corporate opportunities, the American Law Institute's Principles of Corporate Governance sets the formulation for taking of corporate opportunities by analyzing the court judgment relevant to this proposition in the following content:

Section 5.05. Taking of Corporate Opportunities by [Directors]

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177 Id. at 899.
179 Id. at 155 (citation omitted); see also Guth, 23 Del. Ch. at 267, 5 A. 2d at 509.
(a) General Rule. A [director] may not take advantage of a corporate opportunity unless:

1. The [director] first offers the corporate opportunity to the corporation and make disclosure concerning the conflict of interest and the corporate opportunity;
2. The corporate opportunity is rejected by the corporation; and
3. Either:
   A. The rejection of the opportunity is fair to the corporation;
   B. The opportunity is rejected in advance, following such disclosure, by [disinterested directors], in a manner that satisfies the standards of the business judgment rule; or
   C. The rejection is authorized in advance or ratified, following such disclosure, by disinterested shareholders, and the rejection is not equivalent to a waste of corporate assets;

(b) Definition of the Corporate Opportunity. For purposes of this Section, a corporate opportunity means:

1. Any opportunity engage in a business activity of which a [director] become aware, either:
   A. In connection with the performance of functions as a [director], or under circumstances that should reasonably lead the [director] to believe that the person offering the opportunity expects it to be offered to the corporation; or
   B. Through the use of corporate information or property, if the resulting opportunity is one that the [director] should reasonably be expected to believe would be of interest to the corporation; or
2. Any opportunity to engage in a business activity of which a senior executive becomes aware and knows is closely related to the business in which the corporation is engaged or expects to engage.....

2. The Corporate Competition Doctrine

As regards a director that competes with the corporation, there is no statutory standards, but in common law there is such an obligation assumed by every man and
woman who agrees to serve as a corporate director. The duty, for example, prevents a
director from personally engaging in material business competition with his corporation
without the approval of the corporation. Broad statements are made in the treatises and
some court decisions to the effect that a director may compete with his corporation as
long as he acts in good faith, for example, the Court in Burg V Horn stated that:

"[A] director may be barred from competing with his corporation
even though he does not by doing so appropriate a corporate opportunity. But [his] duty not to compete, like the duty to offer opportunities to the
corporation, is measured by the circumstances of each case, so that the
consideration which led us to hold that the properties acquired by the
[director] was not corporate opportunities strongly suggest a finding that
[director] was free to compete by acquiring them."

Regarding competition with the corporation, the American Law Institute’s
Principles of Corporate Governance, describes the standards for competition with the
corporation by a director.

Section 5.06. Competition with the Corporation
(a) General Rule. [Directors] may not advance their pecuniary interests by
engaging in competition with the corporation unless either:

(1) Any reasonably foreseeable harm to the corporation from such
competition is outweighed by the benefit that the corporation
may reasonably be expected to derive from allowing the
competition to take place, or there is no reasonably foreseeable
harm to the corporation from such competition;

(2) The competition is authorized in advance or ratified, following
disclosure concerning the conflict of interest and the
competition, by disinterested director, ..., in a manner that
satisfies the standards of the business judgment rule; or

(3) The competition is authorized in advance or ratified, following
such disclosure, by the disinterested shareholders, and
shareholders’ action is not equivalent to a waste of corporate
assets.....

183Id.; See also Morton v. Rank America, Inc., 812 F. Sup. 1062, 1070 (C.D. Cal. 1993).
184380 F. 2d 897 (1967).
185Id. at 901.
In conclusion, certainly, in the US a director in a close corporation owes a fiduciary duty to his corporation and its shareholders. The basic legal fiduciary duty is divided into two settings; duty of care and duty of loyalty. These two duties are typically inherent in the director’s office which are recognized by the legislature and judiciary even though the state legislature does not provide for these duties explicitly. Thus, anyone who wants to serve as a director in a close corporation must consider this fiduciary duty by looking at state corporation statutes and court decisions as to these propositions.

More conveniently, one can easily understand the director’s fiduciary duty as well as his rights and responsibilities by studying the principles set forth by the American Law Institute’s Principles of Corporate Governance and the Corporate Director’s Guidebook in which both of these materials have established the principles, underlying reasons, and explanation of each principle by analyzing the applicable law and court decisions. Furthermore, the principles set forth by the American Law Institute’s Principles of Corporate Governance have been revised from time to time in order to cover new issues arising from revising statutes and courts’ decisions. These are practical resources for individuals who want to consider serving as a corporate director in any corporation including a close corporation.

C. The Director’s Fiduciary Duty in a Limited Company in Thailand

In Thailand the Commercial Code recognizes that a director is not an employee of the company, rather he is a representative who is appointed by the meeting of

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186Smith, 488 A. 2d at 872.
187The current American Law Institute’s Principles of Corporate Governance was promulgated in 1994.
188THE CORPORATE DIRECTOR’S GUIDEBOOK--1994 EDITION provided by the American Bar Association.
shareholders to be delegated power and authority of the company.\(^\text{190}\) As a result, a
director, typically, must manage corporation compliance with the company objectives
provided in the memorandum of association, the articles of incorporation and by-laws.\(^\text{191}\)
In carrying out his managerial role, a director performs his duty independently, but under
supervision of the meeting of shareholders.\(^\text{192}\)

The director’s fiduciary duty in Thailand also has its origins in English common
law,\(^\text{193}\) but Thai limited company law forms a unique approach for a limited company
which differs from those of a limited company in England and a close corporation in the
US. The Commercial Code § 1168 provides the standards of a director for performing
his duty.

The Commercial and Civil Code § 1168: The directors must in his conduct
of the business apply the diligence of a careful businessman.
In particular they are jointly responsible;
(1) for the payment of shares by the shareholders being actually
made;
(2) for the existence and regular keeping of books and documents
prescribed by law;
(3) for the proper distribution of the dividend or interest as
prescribed by law;
(4) for the proper enforcement of the resolutions of the general
meeting.

A director must not, without the consent of the general meeting of
shareholders, undertake commercial transactions of the same nature as and
competing with that of the company, either on his own account or that of a
third person, nor may be a partner with unlimited liability in another
commercial concern carrying on a business of the same nature as and
competing with that of the company.

\(^{190}\)The Supreme Court Decision No. 4477/1530 (1987).
\(^{191}\)VAJASITH, supra note 76, at 151.
\(^{192}\)THE COMMERCIAL CODE § 1144.
This Section does not provide for the fiduciary duty of a director explicitly. It sets forth the standards of director’s conduct in fulfilling his managerial role in a limited company. Nevertheless, this Section is interpreted to cover the common law fiduciary of (a) duty of care; and (b) duty of loyalty of a director in managing the company affairs.

1. Duty of Care

The standard for duty of care set forth in the Commercial Code, Section 1168 ¶ I, is that of “the diligence of a careful businessman”. This standard of duty of care of a director under Thai law is higher than that of the “ordinarily prudent person” and even higher than that an ordinary person applies to his own business. Since a director assumes the position of protecting the interest of others, the shareholders, he must perform his duty as a professional. Although, a director is required to exercise the due care of a businessman, there is no bright line to apply for this standard. Thus, courts generally consider the facts and the circumstances of traditional practice in each type of business.

Notwithstanding the fact that the Commercial Code § 1167 provides that the relation between the directors and company is governed by the agency law, the standard of duty of care of a director is higher than that of agent because, unlike an agent

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194 Id.
195 Id. at 420.
196 CHAROENPITAK, supra note 192, at 420.
198 Id.
199 THE COMMERCIAL CODE § 1167.
who must perform his duty under control of the principal, a director is entitled to manage
the company freely by himself, not subject or under control of shareholders.\textsuperscript{200}

Generally, if the company has more than one director, directors jointly carry on
their duty through the resolution of the meeting of board of directors.\textsuperscript{201} The board is
entitled to delegate their power or authority to committees or officers.\textsuperscript{202} In the case
where the board delegates its power or authority to committees or officers, the board has
ongoing responsibility for monitoring and overseeing the committees and officers in
performing the matters assigned. Thus, naturally, the scope of the director’s liability is
varied dependent upon the type and size of the company and internal regulations of the
company as well as circumstances. However, to discharge his duty, a director must
perform his duty with due care which meets the standard provided by corporation law,
otherwise, he shall be liable for his negligence.\textsuperscript{203}

By the nature of doing business, the company and shareholders bare the risk of
their interests. A director, as a company representative responsible for managing and
making business decisions for others, may be confronted with the unsatisfactory result of
his decisions which may cause damages to the company. In this event, a director who
discharges his duty according to the standards provided by law is not liable for the
resulting damages.\textsuperscript{204}

In addition to a general duty of care, under Section 1168 members of a board of
directors as a whole must be jointly liable for duties expressly imposed by the law. These

\textsuperscript{200}According to Thai law shareholders merely have a right to supervise management in order to protect
their interests. Shareholders cannot control or direct directors to perform any activities which directors
consider not be reasonable in his business decision.

\textsuperscript{201}The Commercial Code § 1169 ¶ II. It should be noted that the standard of duty of care under the
Commercial Code is applied to directors individually, as well as jointly as a board of directors.

\textsuperscript{202}The Commercial Code § 1164.

\textsuperscript{203}The Supreme Court Decision No. 1141/2502 (1959). The Supreme Court of Thailand decided that a
director is liable for his negligence.

\textsuperscript{204}The Supreme Court Decision No. 1980/2519 (1976). The Supreme Court of Thailand decided that a
director who performed his duty with a due care was not liable for misconduct of other directors that
caused damages to the company.
four imposed duties are mandatory. A director is not entitled to be exonerated from these duties by any means.

2. Duty of Loyalty

The corporate director’s duty of loyalty is derived from the law of agency applied to an agent and a principal. As a result, a director is liable to his company, like an agent is liable to his principal. The general duties of an agent which are applied to duty of loyalty of director are, for example:

1. A director must not enter into any transaction if the conflict of interest between himself and the company occurred;

2. Any pecuniary, property, or benefits derived from the performance of his duties as a director must be delivered to the company;

3. Any damages to the company occurred from director’s negligence because of malpractice, misconduct or ultra vires, a director must be liable for such damages.

Apart from the general duties derived from agency law, a director is charged by Commercial law as to a limited company with the duty of loyalty in Section 1168, ¶ III, which focuses on when a director unfairly competes with his company either directly or indirectly. This Section prohibits a director from unfairly competing with the corporation because of when a director manages and controls the company business, he sets and implements company policy as well as knows about substantial confidential information

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205 This four duties are prescribed by the Commercial Code and other laws in which a limited company itself must perform, thus the board of directors, a representative of the company, needs to be performed these duties on behalf of the company. If the board does not perform these duties which cause any damages to the company, the board must be liable for the breach of its duty.

206 RATTANAKORN, supra note 196, at 187.

207 VAJASITH, supra note 76, at 172.

208 THE COMMERCIAL CODE § 805.

209 Id. § 810.

210 Id. § 812.
in connection with management and company business,\textsuperscript{211} e.g. customers, markets, line of products and financial data. If, therefore, a director is permitted to compete with the company, the company and shareholders will have their interests diluted.\textsuperscript{212} Permitting the director to compete with the company is unfair for the company and shareholders.\textsuperscript{213}

The duty of loyalty under the Commercial Code is considered in two contexts: competition with the company and conflict of interest transactions.

\textbf{a. Competition with the Company}

The director’s competition with the company is divided into two settings:

\textbf{(i) Directly Competing with the Company}

As provided in Section 1168, the requirements of competition with the company are (a) commercial transactions of the same nature as the company, and (b) competing with the company. If the commercial transaction is not the same in nature as those undertaken by the company, or if it is the same in nature, but the director is undertaking the business in a different area, his/her actions are not deemed to be competition with the company.\textsuperscript{214} There is no fixed or strict rule for determining when there is the competition with the company.\textsuperscript{215} Traditionally, the courts consider the facts regarding the company business and the commercial transactions alleged to be competing with the company.

\textsuperscript{211} CHAREONPITAK, supra note 192, at 423-24.
\textsuperscript{212} \textit{Id.} at 424.
\textsuperscript{213} \textit{Id.}
\textsuperscript{214} RATTANAKORN, supra note 196, at 378.
\textsuperscript{215} \textit{Id.}
including company’s objectives and the line of business, the market, location of business, and size of business.\textsuperscript{216}

(ii) Being an Unlimited Partner in Other Competing Commercial Concern

The second prohibited activity is that of a director being an unlimited partner in other commercial concern carrying on business that is the same as and competing with that of the company. The underlying reason for this prohibition is that the unlimited partner is entitled to manage the partnership and has an interest in managing that partnership as if he is a sole proprietor.\textsuperscript{217} Therefore, by this approach, the result is tantamount to a director competing with the company by himself as described in (i), \textit{supra}.

However, this provision is not mandatory. A director may compete with his company or be unlimited partner in other competing commercial concern if the meeting of shareholders permits him to do so by authorization, approval or ratification, as the case may be. This shareholders’ authority is derived from the principle that the company incorporated by agreement between shareholders, and shareholders are the residential claimants. Hence, shareholders may agree on any matters as log as they do not violate the law, public policy or harm any other persons or public norms.

b. Conflict of Interest Transaction

As to the conflict of interest transaction there is no provision that explicitly

\textsuperscript{216}Id.
\textsuperscript{217}The Commercial Code § 1025.
prescribes the duty of a director with regard to conflict of interest transaction. By applying the law of agency a director owes the duty not to enter into any transaction in which a conflict of interest between the director and company exists.\textsuperscript{218} Furthermore, the Commercial Code, Book I General Principles, Section 74 constraints representative conduct in the event there is a conflict of interest with his juristic person.\textsuperscript{219} Applying this Section with a director in limited company, a director cannot represent his corporation when there is a conflict of interest between a director and his company. Section 74 is mandatory and thus a director will never appear on both sides of a conflict of interest transaction.

It is noteworthy that this Section prohibits a director from representing the company in conflict of interest transaction, but it does not deal with the validity of a conflict of interest transaction. Therefore, by interpreting this Section a director may enter into a conflict of interest transaction with the company and this conflict of interest transaction is not void or voidable in so far as the director does not represent the company in that transaction.

In case of a conflict of interest transaction where there is no disinterested director or the remaining disinterested directors are inadequate to constitute the quorum or undertake this transaction compliance with the law, the Commercial Code\textsuperscript{220} provides that the interested person or the Public Prosecutor may request the court to appoint an ad hoc representative. Alternatively, in practice, the meeting of shareholders will appoint an ad hoc director or directors to represent the company in case of a conflict of interest transaction.

In summary, like the director’s fiduciary duty in the US, the director’s fiduciary duty in Thailand is divided into two basic duties: the duty of care and the duty of loyalty.

\textsuperscript{218}The Commercial Code § 805.
\textsuperscript{219}The Commercial Code § 74.
\textsuperscript{220}The Commercial Code § 73 and § 75.
The director's fiduciary duty under Thai law may vary from those under the US law slightly in detail due to adjustments in the practicalities in each country resulting from different evolution in business practice and public policy.
IV. THE BUSINESS JUDGMENT RULE IN THE US

The corporation law in the US, courts and legislators limit, or sanction contractual limitations on the scope and impact of fiduciary duty, particularly, when used to discipline directors in the performance of their official duties.\textsuperscript{221}

The legislative limit, supplemented sometimes by judicial rules, includes (1) exculpation provision making fiduciary duty, at least in part, a default rule that can be contracted around; (2) rules limiting a corporation’s power to indemnify its officers and directors for wrongdoing in their official capacity; (3) rules reducing the roles of fiduciary duty as a regulator of conflict of interest transactions; and (4) regulation derivative suits, including rules allowing directors under certain circumstances to take control of derivative litigation.\textsuperscript{222}

The major court-made limit is the business judgment rule, which restricts judicial review of directors’ official conduct.\textsuperscript{223}

A. Historical Background

Concurrent with the development of the concept of a director’s duty of care and duty of loyalty, courts have recognized the need for judicial restraint against imposing liability on corporate fiduciaries for more errors of judgment.\textsuperscript{224} Here, too, the concept of

\begin{footnotesize}
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\item \textsuperscript{221} O’KELLEY & THOMPSON, supra note 9, at 318.
\item \textsuperscript{222} Id. at 318-19.
\item \textsuperscript{223} Id. at 318.
\item \textsuperscript{224} HORSEY, supra note 116, at 975.
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limiting the liability of directors by exonerating them for judgmental error has its origins in English common law as old as common law duty of care and duty of loyalty.

In the US, the rule of judicial deference for judgmental error of a director finds expression as early as 1829 by state court in Louisiana. In 1850, a Rhode Island state court expressed similar judicial concern for exculpating directors for judgmental error in Hodges v. New England Screw Co.

The most understanding and balanced articulations of corporate directors fiduciary duty of care and duty of loyalty, in the context of the operation of the business judgment rule, however, has been found in a decision of Litwin v. Allen, the New York Supreme Court stated that:

"... [D]irectors are liable for negligence in the performance of their duties. Not being insurers, directors are not liable for errors of judgment or for mistakes while acting with reasonable skill and prudence. It has been said that a director is required to conduct the business of the corporation with the same degree of fidelity and care as an ordinarily prudent man would exercise in the management of his own affairs of like magnitude and importance. General rules, however, are not altogether helpful. In the last analysis, whether or not a director has discharged his duty, whether or not he has been negligent [i.e. violated the duty of care], depends upon the facts and circumstances of particular case, the kind of corporation involved, its size and financial resources, the magnitude of the transaction, and the immediacy of the problem presented. A director is called upon 'to bestow the care and skill' which the situation demands.

...But clairvoyance is not required even of a bank director. The law recognizes that the most conservative director is not infallible, and that he will make mistakes, but if he use that degree of care ordinarily exercised by prudent bankers he will be absolved from liability although his opinion may turn out to have been mistaken and his judgment faulty."
A business judgment presumption has evolved over the years in favor of directors. This presumption protects decisions from being questioned in hindsight when informed director make reasonable business judgment in discharging of his fiduciary duty to the corporation.\textsuperscript{232} The courts have ruled the business judgment rule in determining whether to impose liability of director.\textsuperscript{233}

B. Principle of the Business Judgment Rule

There are no statutory formulation of the business judgment rule.\textsuperscript{234} The business judgment rule has been developed by court and well established in the case laws, but courts have ruled and explained the business judgment rule diversely,\textsuperscript{235} for example:

The Court in \textit{Gries Sport Enterprises, Inc. v. Cleveland Browns Football Co., Inc.}\textsuperscript{236} explained that:

"The business judgment rule is principle of corporate governance that has been part of the common law for at least one hundred fifty years. It has traditionally operated as a shield to protect directors from liability for their decisions. If the directors are entitled to protect of the rule, then the courts should not interfere with or second-guess their decisions. If directors are not entitled to protection of the rule, then the court scrutinize the decision as to its intrinsic fairness to the corporation and corporation’s minority shareholders. The rule is a rebuttal presumption that directors are better equipped than the court to make business judgments and that the directors acted without self-dealing or personal interest and exercised reasonable diligence and acted with good faith. A party challenging a board of directors’ decision bears the burden of rebutting the presumption

\textsuperscript{232} See generally HORSEY, \textit{supra} note 116.
\textsuperscript{233} Id.
\textsuperscript{234} The Supreme Court of Delaware has recognized that under Delaware law, the business judgment rule is the offspring of the fundamental principle, codified in 8 Del. C. § 141 (a); See Smith, 488 A. 2d. at 872.
\textsuperscript{236} 496 N.E. 2d 959 (Ohio 1986).
that the decision was a proper exercise of the business judgment of the board."\(^{237}\)

The Court in *Wheeler v. Pullman Iron and Steel Company*\(^{238}\) stated that:

"It is, however, fundamental in the laws of corporations, that the majority of its stockholders shall control the policy of the corporation, and regulate and govern the lawful exercise of its franchise and business. Everyone purchasing or subscribing for stock in a corporation impliedly agrees that he will be bound by the acts and proceedings done or sanctioned by a majority of the shareholders, or by the agents of the corporation duly chosen by such majority, with the scope of the power conferred by the charter, and court of equity will not undertake to control the policy and business methods of a corporation, although it may be seen that wiser policy might be adopted and the business more successful if other methods were pursued. The majority of shares of its stock, or the agents by the holders thereof lawfully chosen, must be permitted to control the business of the corporation in their discretion, when not in violation of its charter or some public law, or corruptly and fraudulently subversive of the rights and interests of the corporation or of a shareholder."\(^{239}\)

The Delaware Court in *Davis v. Louisville gas & Electric Co.*\(^{240}\) ruled that:

"We have then a conflict in view between the responsible managers of a corporation and the overwhelming majority of its stockholders on the one hand and the dissenting majority on the other—a conflict touching matter of business policy, such as has occasioned innumerable applications to courts to intervene and determine which of the two conflicting views should prevail. The response which court make to such applications is that it is not their function to resolve for corporations’ questions of the policy and business management. The directors are chosen to pass upon such question and their judgment unless shown to be tainted with fraud is accepted as final. The judgment of the directors of corporations enjoys benefit of a presumption that it was formed in good faith and was designed to promote the best interest of the corporation they serve."\(^{241}\)

\(^{237}\) *Id.* at 963-964.

\(^{238}\) 143 IId. 197, 32 N.E. 420, 423 (1892).

\(^{239}\) *Id.* at 207.

\(^{240}\) 16 Del. Ch. 157, 142 A 654 (1928).

\(^{241}\) *Id.* at 159, 142 A 654 at 659.
Traditionally, the business judgment rule has offered safe harbor for a disinterested director who made honest, informed business decisions reasonably believed to be in the best interests of his corporations. In effect, as one commentator said the reasoning behind the business judgment rule is four-fold:

"First, by recognizing human fallibility, the rule encourages competent individuals to assume directorships. Second, the rule recognizes the business decisions frequently entail risk, and thus provides directors the board discretion they need in formulating dynamic and effective company policy without fear of judicial second guessing. The rule ‘recognizes that shareholders to a very real degree voluntarily undertake the risk of bad business judgment; investors need not buy stock, for investment markets offer an array of opportunities less vulnerable to mistakes in judgment by corporate officers.’ Third, the rule keeps court from becoming enmeshed in complex corporate decision-making, a task which they are admittedly ill-equipped to handle.... Finally, the rule ensures that directors rather than shareholders manage corporations."

Notwithstanding confusion with respect to the business judgment rule has been created by the numerous varying formulations of rules and facts. Courts have often stated the rule incompletely or with an elliptical shorthand reference. The American Law Institute’s Principles of Corporate Governance sets forth the standard of the business judgment rule by analyzing the court relevant decisions:

§ 4.01 (c) A director...who makes a business judgment in good faith fulfills the duty under this Section if the director...:
(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...reasonably believes to be appropriate under the circumstances; and
(3) rationally believes that the business judgment is in the best interests of the corporation."

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244 ALI’S PRINCIPLES OF CORPORATE GOVERNANCE, COMMENT TO § 4.01, ALI-CORPGOV (1994).
245 ALI’S PRINCIPLES OF CORPORATE GOVERNANCE, PART IV. DUTY OF CARE AND THE BUSINESS JUDGMENT RULE, ANALYSIS AND RECOMMENDATION, ALI-CORPGOV § 4.01 (c) (1994).
Besides, another source for the basic standards of business judgment rule in the US is the Corporate Director’s Guidebook[^246] which explains the business judgment rule as follows:

"....This rule,..., protects a disinterested director from personal liability to the corporation and its shareholders, even though a corporate decision the director has proved turns out to be unwise or unsuccessful. In reviewing a disinterested director’s conduct, a court will not substitute its judgment (particularly in hindsight) for that of the director, provided that the director:
- acted in good faith;
- was reasonable informed; and
- rationally believed the action taken was in the best interests of the corporation.

Accordingly, the business judgment rule, unlike the standard of conduct encompassed in the duties of care and loyalty, is not a description of a duty or standard used to determine whether a breach of duty has occurred; rather it is an element of judicial review use in analyzing director conduct to determine whether a director should be held personally liable. If the rules applies, directors are presumed to have exercised their judgment in good faith and in the rational belief that the actions were taken in the best interests of the corporation. In such circumstance, a court will not examine the merits of the decision of directors or substitute it judgment regarding the wisdom of a decision within the business judgment of directors."[^247]

Although the business judgment rule exists in the US corporation law, there has been no a universal standard of the business judgment rule that can apply to all states.[^248] As the court said "the business judgment rule is a tool of judicial review, not a standard of conduct."[^249] The applicability of business judgment rule depends on the facts on a

[^246]: CORPORATE DIRECTOR’S GUIDEBOOK--1994 EDITION, supra note 104.
[^247]: Id. at 1254.
[^248]: For discussion on the differences of three major positions on the business judgment rule and their passion for universal agreement on its true meaning, see BOLOTTI & HANKS, JR., supra note 241.
[^249]: Gris Sports Enterprises, 496 N.E. 2d. 959, 964 (Ohio 1986).
case-by-case basis and has been developing in the US courts, especially the Court of Delaware.250

C. Relationship between the Business Judgment Rule and the Director’s Fiduciary Duty

1. The Business Judgment Rule and Duty of Care

Courts often describe the line between liability and non-liability by reference to business judgment rule.251 Under this rule, courts refuse to second-guess director’s judgments unless his conduct is sufficiently egregious.252 However, if a director is found to have acted in a grossly negligent manner, then he will not be protected by the business judgment rule.253

The business judgment rule is related with the duty of care in two primary aspects: a) non-decision making context or substantive due care; and b) a decision making context or procedural due care.254

a. A Non-decision Making Context or Substantive Due Care

A director is found liable in the non-decision making context only upon an express abdication of responsibility or upon obvious and prolonged failure to exercise

251O’Kelley & Thompson, supra note 9, at 346.
252Id.
253Id.
254Hansen, supra note 234, at 1356.
oversight or supervision. The classic case for this standard ruled by court is *Litwin v. Allen*. The court explained liability of director for duty of care based on gross negligence as follows:

"[I]t would seem that if it is against public policy for a bank, anxious to dispose of some of it securities, to agree to buy them back at the same price, it is even more so where a bank purchases securities and gives the seller the option to buy them back at the same price, thereby incurring the entire risk of loss with no possibility of gain other than the interest derived from the securities during the period that the bank hold them. Here, if the market price of the securities should rise, the holder of the repurchase option would exercise it in order to recover his securities from the bank at the lower price at which he sold them to the bank. If the market price should fall, the seller holding the option will not exercise it and the bank will sustain the loss. Thus any benefit of a sharp rise in the price of the securities is assured the seller and any risk of heavy loss is inevitably assumed by the bank. If such an option agreement as is here involved were sustained, it would force the bank to set aside for six months whatever securities it had purchased....

Director are not in the position of trustees of an express trust who, regardless of good faith, are personally liable for losses arising from and infraction of their trust deed. I find liability in this transaction because the entire arrangement was so improvident, so risky, so unusual and unnecessary as to be contrary to fundamental conceptions of prudent banking practice....

What sound reason is there for a bank, desiring to make an investment, short term or otherwise, to buy securities under a arrangement whereby any appreciation will inure to the benefit of the seller and any loss will be borne by the bank? The five and one-half point differential is no answer. It does not meet the fundamental objection that whatever loss there is would have to be borne by the Bank and whatever gain would go to the customer. There is no more here than a question of business judgment as to which men might well differ. The directors plainly failed in this instance to bestow the care which the situation demanded."

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255 O'KELLEY & THOMPSON, supra note 9, at 346.
256 25 N.Y.S. 2d 667.
257 Id. at 697-699.
It is well established that when a director is not exercising business judgment, the business judgment rule and the necessary limitations it imposes on the duty of care do not apply.\textsuperscript{258}

b. A Decision Making Context or Procedural Due Care

Director’s conduct is assessed by looking at how they reached a particular decision rather than by looking at the substance of the decision itself.\textsuperscript{259} The director will not be found liable although the decision itself was not one that would have been made by the ordinary prudent person.\textsuperscript{260} To satisfy their procedural due care obligations, directors must carry out a decision-making process calculated to provide them with information sufficient to reach a rational judgment.\textsuperscript{261} A director can make a decision that would not have been made by the ordinary prudent person or escape liability if appropriate processes provided by law are followed.\textsuperscript{262} Whether the appropriate process was followed will be measured by court against concept of gross negligence.\textsuperscript{263}

The Delaware Supreme Court in Smith v. Van Gorkom\textsuperscript{264} firmly established that the business judgment rule applies to the in duty of care standard regarding the decision making context.\textsuperscript{265} In that case the Supreme Court of Delaware explained the relationship between the business judgment rule and the duty of care as follows:

"Under Delaware law, the business judgment rule is the offspring of the fundamental principle, codified in 8 Del. C. § 141 (a), that the business and affairs of a Delaware corporation are managed by or under its board of directors.\textsuperscript{...}

\textsuperscript{258}Hansen, supra note 234, at 1359.
\textsuperscript{259}O’Kelley & Thompson, supra note 9, at 348
\textsuperscript{260}Hansen, supra note 234, at 1356.
\textsuperscript{261}O’Kelley & Thompson, supra note 9, at 348
\textsuperscript{262}Hansen, supra note 234, at 1357 & n. 13.
\textsuperscript{263}Id. at 1358.
\textsuperscript{264}448 A.2d 858 (Del. 1985).
\textsuperscript{265}Hansen, supra note 234, at 1357.
In carrying out their managerial roles, directors are charged with an unyielding fiduciary duty to the corporation and its shareholders. The business judgment rule exists to protect and promote the full and free exercise of the managerial power granted to Delaware directors. The rule itself "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 taken was in the best interests of the corporation."...

The determination of whether a business judgment is an informed one turns on whether the directors have informed themselves "prior to making a business decision, of all material information reasonably available to them...."

Under the business judgment rules there is no protection for directors who made an unintelligent or unadvised judgment....

A director's duty to inform himself in preparation for a decision derives from the fiduciary capacity in which he serves the corporation and its stockholders....

Since a director is vested with the responsibility for the management of the affairs of the corporation, he must execute that duty with the recognition that he acts on behalf of others. Such obligation does not tolerate faithlessness or self-dealing. But fulfillment of the fiduciary function requires more than the mere absence of the bad faith or fraud. Representation of the financial interests of others impress on a director an affirmative duty to protect those interests and to proceed with a critical eye in assessing information of the type and under the circumstances present here. Thus, a director's duty to exercise an informed business judgment is in the nature of a duty of care, as distinguished from a duty of loyalty. Here, there were no allegations of fraud, bad faith, or self-dealing, or proof thereof. Hence, it presumed that the directors reached their business judgment in good faith, and considerations of motive and irrelevant to the issue before us. The standard of care applicable to a director's duty of care has also been recently restated by this court. In Aronson, supra, we stated:

'While the Delaware case 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 predicted upon concept of gross negligence.'

We think that the concept of gross negligence is also the proper standard for determining whether a business judgment reached by a board of directors was a informed one."266

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266 Id. at 872-73.
As to the relationship between duty of care and the business judgment rule, the American Law Institute’s Principles of Corporate Governance has explained this relationship by analyzing the applicable statute relevant to duty of care and the court decisions as well as the business in real world. In the Introductory Note, Part IV. Duty of Care and Business Judgment Rule, Principles of Corporate Governance,267 the "Principles" guide states:

"Historically, courts rather than legislatures have play the central role in shaping the law regarding the duty of care of corporate directors and officers. In the past 25 five years, however, over two-third of the states have enacted statutory provisions concerning the duty of care....

....It should be emphasized at the out set, however, that these are general legal standards and their application, in most instances, will involve subtle evaluations of specific facts and circumstances. The complexity and the scale of many modern corporations—and unavoidable uncertainties and complexities related to the roles of directors and officers—caution against unrealistic, harsh application of part IV’s general standards....

Directors obviously should not be required to insure that every potential corporate problem is anticipated or that every instance of wrongdoing (e.g. looting by the employee) is prevented. Indeed, the complexity and scale of many modern corporations compel directors and officers to rely heavily on other directors or officers, employees, experts, other persons, and committees of the board.... In general, courts applying duty of care standards should recognize that reliance is essential in many corporate contexts and that there are inherent dangers in judging a failure by directors or officers to act or foresee in the stark light of hindsight.

.... The business judgment rule provides a special protection to informed business decisions as distinguished, for example, from continued inattention to doctoral obligations. The basic policy underpinning of the business judgment rule is that corporate law should encourage, and afford broad protection to, informed business judgments (whether subsequent event prove the judgments right or wrong) in order to stimulate risk taking, innovation, and other creative entrepreneurial activities. Shareholder accept the risk that an informed business decision—honestly undertaken and rationally believed to be the best interest of the corporation—may not be vindicated by subsequent success. The special protection afforded

267INTRODUCTORY NOTE, PART IV. DUTY OF CARE AND BUSINESS JUDGMENT RULE, PRINCIPLES OF CORPORATE GOVERNANCE (1994), ALI-CORPGOVPT. IV INTRO, available in WESTLAW.
business judgments is also based on a desire to limit litigation and judicial intrusiveness with respect to private-sector business decision-making.

The facts that directors [] act as a group has important practical and legal implications. In becoming informed with respect to the subject of the business judgment, for example, directors, in addition to drawing on their own backgrounds, any learn form, or rely on, the discussions of their fellow directors as well as management presentations. The different backgrounds of individual directors, the distinct role each plays in the corporation, the value of maintaining board cohesiveness, the magnitude of the matter under consideration, the time frame in which a decision must be made, and similar factors are all relevant when determining whether a director "is informed with respect to the subject of the business judgment to the extent the director...reasonably believes to be the appropriate under the circumstance....

Since, the business judgment of the board of directors [] are not decisions of individuals, and since oversight obligations rest on the board as a whole..., difficult causation issues will often arise.... That question depend on whether the acts or omissions were the legal causation of any damage to the corporation.... A director who fails to perform an oversight obligation, for example, may have caused no damage to the corporation because the failure was rendered harmless by the care of other directors.

Finally, it should be remembered that in large measure director properly carry out their function because of motives unrelated to their legal obligations, including a personal sense of responsibility, economic and career incentives, pride, professionalism, peer pressures, and the discipline instilled by competitive markets and tender offers. For well over one hundred years, however, courts and legislatures have considered legal standards with respect to duty of care to be a necessary protection for corporations and their shareholders. As is true of professionals and almost all other in our society, the accountability of directors is a legitimate public policy concern. [Standard set by ALI's Principles of corporate governance in] Part IV reflects this concern as well as a recognition of the need to encourage individuals with vision, ability and expertise to serve corporation. Fairness to those who are willing to serve as directors is clearly an essential value."268

268 Id. at 1-2.
2. The Business Judgment Rule and Duty of Loyalty

As described in Chapter III, Part B, public policy has established a rule that demands a corporate director not only affirmatively protect the interests of the corporation committed to his charge, but also to refrain from doing anything that would work injury to the corporation or to deprive the corporation of profit or advantage which his skill and ability might properly bring to it, or to enable corporation to make in the reasonable and lawful exercise its power.\(^{269}\) Unlike duty of care, duty of loyalty is not a very clearly understood concept.\(^{270}\) Duty of loyalty issues may arise in the context of a variety of transactions, including: sales to, or purchases by the corporation from directors or entities in which the directors have an interest; dealing between the parent corporation and its subsidiary; unfair treatment of minority shareholders by a majority shareholder in corporate acquisitions and reorganization transactions; use of corporate funds to perpetuate control; sale of control; demands of stockholders to commence derivative suits; excessive compensation; insider trading; usurpation of corporate opportunities; competition with the corporation by officers or directors; and improper use of corporate position, property, or information.\(^{271}\)

Basically, the duty of loyalty demands that there shall be no conflict between duty and self-interest. Therefore, the presumption of the business judgment rule will be overcome when it can be shown that a director stood on both sides of a transaction or is otherwise interested in the transaction and was in position to control its outcome.\(^{272}\)

\(^{269}\)Guth, S. A. 2d 503 at 510.


In *In re RJR Nabisco* shareholder litigation, the court described the business judgment in connection with the duty of loyalty form of review as encompassing three elements: (i) a threshold review of the objective financial interests of the board whose decision is under attack, (ii) a review of the board’s subjective motivation, and (iii) an objective review of the process by which it reached the decision under review. A court may review the substance of a business decision made by an apparently well-motivated board for the purpose of assessing whether the decision is so egregious, so far beyond the bounds of reasonable judgment that it seems inexplicable on any ground other than bad faith.

The issues relevant to the relationship between business judgment rule and duty of loyalty appear where there is a conflict of interest transaction, especially, derivative litigation, which is tainted by inadequate process provided by the corporation statute. Because the general concept underlying the duty of loyalty is that a director refrain from the self-dealing application of the loyalty principle can be difficult and highly fact-intensive. When the duty of loyalty line is crossed, the directors must demonstrate the entire fairness of transaction. As the Delaware Supreme Court of Delaware states in *Weinberger V. UOP, Inc.:

There is no ‘safe harbor for...divided loyalties in Delaware. When directors of a Delaware corporation are on both sides of the transaction, they are required to demonstrate their utmost good faith and the most scrupulous inherent fairness of the bargain. The requirement of fairness is unflinching in its demand where one stands on both sides of a transaction, he has the burden of establishing its entire fairness, sufficient to pass the test of careful scrutiny by the court.

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274Id.

275Id.

276MODEL BUS. CORP. ACT § 8.31; DEL. CODE ANN. §144.

277VEASEY, supra note 270, at 2065.

278Id.

279457 A.2d 701, at 710 (citation omitted).
As the Courts have ruled, the key threshold inquiries in duty of loyalty issues are: whether the director has an interest in the transaction and whether the director is independent.\(^{280}\)

A director is considered to be "interested" if he either appears on the both sides of a transaction or expects to derive personal financial benefit from the transaction in the sense of self-dealing, as opposed to a benefit which devolves upon the corporation or all shareholders generally.\(^{281}\) However, the fact that the director may be a director of combined entities is not of itself generally viewed as tainting his independence.\(^{282}\) Furthermore, the fact that a director in a close corporation owns shares of the corporation has not been deemed as a financial interest inconsistent with the exercise of his fiduciary duty on behalf of the corporation and his fellow shareholders.\(^{283}\)

Even if a director is not interested, the further inquiry in certain contexts is whether he is "independent". That is, he is capable of rendering independent judgment.\(^{284}\) A director is deemed to be independent when he is in a position to base his decision on the merits of the issue at hand rather than being governed by extraneous considerations or influence.\(^{285}\) A director will have lost his independence if the facts show that through personal or other relationships the director is beholden to the controlling person.\(^{286}\) As to the independent director, one commentator noted that most cases dealing with a director's independence suggest that a director must be a direct and substantial beneficiary of the

\(^{280}\) Veasey, supra note 270, at 2067-68.

\(^{281}\) Aronson, 473 A.2d at 812.


\(^{283}\) Unocal Corp. v. Mesa Petroleum Co., 493 A. 2d 946, 957-58 (Del. 1985)

\(^{284}\) Id. at 812-816.

\(^{285}\) Kaplan, 499 A.2d at 1189.

\(^{286}\) Aronson, 473 A. 2d at 815.
challenged transaction in order for a court to conclude that the director lacks disinterestedness and independence.\(^{287}\)

If such decision-making is infected with a lack of independence or self-interest, or if proper intra-corporate decision-making mechanisms are not used, the business judgment rule does not apply to protect the director and the burden of proof will be on the director to demonstrate the entire fairness of the transaction.\(^{288}\)

The general decision principle is that, in a case where the business judgment rule applies to protect a director for making business decision, there will be no judicial inquiry into the fairness of the transaction.\(^{289}\) Nevertheless, even disinterested director approval or less than unanimous shareholder’s approval cannot overcome a showing of waste, illegality, *ultra vires*, or fraud.\(^{290}\)

It is crucial to note that if the business judgment rule does not apply in a case the Supreme Court of Delaware in *Cinerama v. Technicolor*\(^{291}\) explicitly stated that inapplicability of the business judgment rule will not be a *per se* indicator of director liability. It simply shifts the burden to the defendants, who will have to make an affirmative showing that the challenged transaction was entirely fair.\(^{292}\) If the deal was the result of an arm’s-length negotiation, the transaction meets the fairness test.\(^{293}\)

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\(^{288}\)Id. at 815-16.

\(^{289}\)See, e.g., AC Acquisition Corp. v. Anderson Clayton & Co., 519 A. 2d 103, 111 (Del. Ch. 1986).


\(^{291}\)No. 8358 (Del. July 17, 1995).

\(^{292}\)Id.

\(^{293}\)Id.
V. PROTECTIVE MEASURES AND DEVICES OF A DIRECTOR

A. Introduction

Assuming a director in a close corporation continuously makes decisions that involve the balancing of rules and benefits for the corporation, in effect, the director bears the liability of his performance for the corporation. In the face of this risk, the director may fear that his duty would jeopardize his personal business. Numerous directors would choose to resign or refuse reelection rather than continue to act for corporations that could not provide any protection or adequate protection. Indeed, even those directors who chose to serve as director or remain in board are discouraged from making the kinds of decisions necessary to stimulate corporate growth or prosperity. The protective measures and devices provided for the director in a close corporation, thus become necessary to ensure that a director would zealously perform his duty, assured that, instead, his corporation would bear the reasonable expenses necessary to defend the director’s honest and integrity.

As to the purposes of protective measures and devices designed for the director to use to protect himself in performing his duty for the corporation, the Court in Cramer v. Generak Tel. & Elec. Corp. summarized them as follows: (a) encourage initiative in

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294O’KELLEY & THOMPSON, supra note 9, at 370.
296Id.
299582 F.2d 259, 274 (3d Cir. 1978).
enterprise decision; (b) encourage qualified persons to serve as director; (c) encourage decision-making by independent directors; and (d) give the director wide latitude in their handling of corporate affairs.

The protective measures and devices provided by corporation law in the US are distinguished from those of Thai limited company law. Because of the lack of the explicit provisions in Thai law as to this proposition, the freedom to contract approach must be used by directors in limited companies in Thailand to protect themselves from personal liability occurred in discharging these duties for the companies.

B. Protective Measures and Devices under US Corporation Law

US corporation law provides three approaches for permitting a corporation to protect its directors. Conversely, a director can use these three approaches to protect himself for liability incurred from his performance in discharging his duty for the corporation. These three basic approaches are: (1) statutory indemnification; (2) statutory limitation on liability; and (3) liability insurance.

1. Statutory Indemnification

State indemnification statutes vary greatly, but the generally specify that indemnification in excess of that authorized by the statute is valid as long as it satisfies public policy. While most indemnification is a matter of contract, in certain

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300 Because the statutory provisions pertaining the indemnification, limitation liability, insurance in every states are varied, this Part is going to cite the Model Bus. Corp. Act and General Corporation Law of Delaware which are deemed to be a model for other states in these matters.


circumstances a director may have a common law statutory right to indemnification.\textsuperscript{303} The indemnification permitted by the statute comes in four versions: (a) mandatory indemnification; (b) permissive indemnification; (c) statutory non-exclusivity; and (d) advance expenses.\textsuperscript{304}

\begin{itemize}
\item[a.] \textbf{Mandatory Indemnification}
\end{itemize}

The first type of indemnification, mandatory indemnification, is provided in Model Act § 8.52.

corporation shall indemnify a director who was wholly successful, on the merits or otherwise, in the defense of any proceeding to which he was a party because he was a director of the corporation against reasonable expense incurred by him in connection with the proceeding.

This Section creates a statutory right of indemnification in favor of a director subject to the basic standard that the director has been "wholly\textsuperscript{305} successful, on the merits or otherwise" in the defense of the proceeding.\textsuperscript{306} A defendant director is "wholly successful" only if the entire proceeding is disposed of on a basis which does not involve a finding of liability.\textsuperscript{307} If a defendant director has been successful on "a merits or otherwise", in such a case, the defendant director is not required to establish any of the

\textsuperscript{303}O’KELLEY & THOMPSON, supra note 9, at 373.
\textsuperscript{305}THE COMMITTEE ON CORPORATE LAWS, REPORT, CHANGE IN THE MODEL BUSINESS CORPORATION ACT--AMENDMENTS PERTAINING TO INDEMNIFICATION AND ADVANCE FOR EXPENSES, 49 BUS. LAW. 741, 763 (1994). (The word "wholly" is added into revised provision in 1994 to avoid the argument accepted in Merritt Chapman & Scott Corp. v. Wolfson, 321 A. 2d 138 (Del. 1974), that a defendant may be entitled to partial mandatory indemnification if, by plea bargaining or otherwise, he was able to obtain the dismissal of some but not all courts of indictment.) \textit{Id}.
\textsuperscript{306}\textit{Id}.
\textsuperscript{307}\textit{Id}.
necessary elements for permissive indemnification, which include acting in good faith and in a manner reasonably believed to be in the best interests of the corporation.  

A director who is precluded from mandatory indemnification by this requirement may still be entitled to permissible indemnification under section 8.51(a) or court ordered indemnification under section 8.54 (a) (3). The word “otherwise” has been used because it would be unreasonable to require a defendant with a valid procedural defense to undergo a possibly prolonged and expensive trial on the merits in order to establish eligibility for mandatory indemnification.

The Delaware law also provides mandatory indemnification in section 145 (c).

To the extent that a director, officer, employee or agent of a corporation has been successful on the merits or otherwise in defense of any action, suit or proceeding referred to in subsections (a) and (b), or in defense of any claim, issue or matter therein, he shall be indemnified against expenses (including attorneys’ fees) actually and reasonably incurred by him in connection therewith.

The Delaware law relating to the mandatory indemnification is distinct from the Model Act in that the Delaware statute permits partial mandatory indemnification for a director who is partially successful.

b. Permissive Indemnification

In addition to mandatory indemnification, the corporation statute authorizes the permissive indemnification at the option of a corporation.  

[^1]: BLOCK ET AL., supra note 293, at 564.
[^2]: See, infra (b).
[^3]: THE COMMITTEE ON CORPORATE LAWS, supra note 303, at 763.
[^5]: VEASEY, supra note 299, at 406.
must be authorized on a per-case, and such authorization requires a finding that a director
has met the standards of conduct.\textsuperscript{313}

The permissive indemnification is provided in the Model Act § 8.51:

(a) Except as otherwise provided in this section, a corporation may
indemnify an individual who is a party to the proceeding because
he is a director against liability incurred in the proceeding if:
(1)(i) he conducted himself in good faith; and
(ii) he reasonably believed:
   (A) in the case of conduct in his official capacity, that
       his conduct was in the best interests of the
       corporation; and
   (B) in all other cases, that his conduct was at least not
       opposed to the best interests of the corporation; and
(iii) in the case of any criminal proceeding, he had no
    reasonable cause to believe his conduct was unlawful; or
(2) he engage in conduct for which broader indemnification has
    been made permissible or obligatory under a provision of
    the articles of incorporation (as authorized by section
    2.02(b)(5)).

(b) A director’s conduct with respect to an employee benefit plan for a
    purpose he reasonably believed to be in the interests of the
    participants in, and the beneficiaries of, the plan is conduct that
    satisfies the requirement of subsection (a)(1)(ii)(B).

(c) The termination of a proceeding by judgment, order, settlement or
    conviction, or upon a plea of \textit{nolo contendere} or it equivalent, is
    not of itself, determinative that the director did not meet the
    relevant standard of conduct described in this section.

(d) Unless ordered by a court under section 8.54 (a)(3), a corporation
    may not indemnify a director:
(1) in connection with a proceeding by or in the right of the
    corporation, except for reasonable expenses incurred in
    connection with the proceeding if it is determined that the
    director has met the relevant standard of conduct under
    subsection (a); or
(2) in connection with any proceeding with respect to conduct
    for which he was adjudged liable on the basis that received
    a financial benefit to which he was not entitled, whether or
    not involving action in his official capacity.

\textsuperscript{313} COMMITTEE ON CORPORATE LAWS, \textit{supra} note 303, at 758.
The standards of conduct provided for in this section are closely related, but not identical, to standards of conduct imposed on directors by section 8.30. Conduct which does not meet one these standards set forth in this Section is not eligible for permissible indemnification under the Model Act, although court-ordered indemnification may be available under section 8.54(a)(3). Conduct that fall within the outer limits does not automatically entitle the director to indemnification, although the corporation may obligate itself to indemnify the director to the maximum extent permitted by applicable law. No such obligation, however, may exceed those outer limits. According to the Model Act, in derivative suit, indemnification is not permitted for judgment or settlement in derivative proceedings because of the underlying reason of circularity.

The Delaware statute provides the permissive indemnification in third party suit and derivative suit separately. That is, section 145 (a) provides for third-party claims; and section 145 (b) provides for derivative suite. The actions permitted the corporation to indemnify a director, however, are as same as in the Model Act.

§ 145(a) A corporation shall have power to indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action, suit and proceeding, whether civil, criminal, administrative or investigative (other than an action by or in the right of the corporation) by reason of the fact that he is or was a director, officer, employee or agent of the corporation, or is or was serving at the request of the corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise, against expenses (including attorneys’ fees), judgments, fines and amounts paid in settlement actually and reasonably incurred by him in connection with such action, suit or proceeding if he acted in good faith and in a manner he reasonably

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314 Id. (A director who meets all three standards of conduct set forth in § 8.30 would have no liability under terms of § 8.30 (d)). Id.
315 Id. at 757.
316 This section has been expanded to include the broader limits of charter provision adopted pursuant to § 2.02 (b) (5), which permits a corporation to authorize or require indemnification for directors so long as their conduct does not fall within one of four exceptions based on the same exceptions for liability-limiting charter provision under section 2.02 (b) (4). Id. at 743.
317 MODEL BUS. CORP. ACT § 8.58(a); DEL. CODE ANN. § 2.02 (b) (4).
318 Id.
believed to be in or not opposed to the best interests of the corporation, and, with respect to any criminal action or proceeding, had no reasonable cause to believe his conduct was unlawful. The termination of any action, suit or proceeding by judgment, order, settlement, conviction, or upon a plea of nolo contendere or its equivalent, shall not, of itself, create a presumption that the person did not act in good faith and in a manner which he reasonably believed to be in or not opposed to the best interests of the corporation, and, with respect to any criminal action or proceeding, had reasonable cause to believe that his conduct was unlawful.

(b) A corporation may indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending or complete action or suit by or in the right of the corporation to procure a judgment in its favor by reason of the fact that he is or was a director, officer, employee, or agent of the corporation, or is or was serving at the request of the corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise against expenses (including attorneys’ fee) actually and reasonably incurred by him in connection with the defense or settlement of such action or suit if he acted in good faith and in manner he believed to be in or not opposed to the best interests of the corporation and except that no indemnification shall be made in respect of any claim, issue or matter as to which such person shall have been adjudged to be liable to the corporation unless and only to the extent that the Court of Chancery or the court in which such action or suit was brought shall determine upon application that, despite the adjudication of liability but in view of all the circumstances of the case, such person is fairly and reasonably entitled to indemnify for such expenses which the Court of Chancery or such other court shall deem proper.

Unlike the Model Act, the Delaware statute authorizes indemnification in a derivative suit, but only for the expenses (including attorney’s fee) incurred in such derivative suit.\(^{319}\)

\(^{319}\) BLOCK ET AL., supra note 293, at 571 & n.40 (In 1986, a proposal to revise § 145 (b) to permit indemnification in derivative suits of judgment and amounts paid in settlement was denied by the General Corporation Law Section of the Delaware Bar Association. However, some states permits indemnification in derivative suit, for example, New York, New Jersey, Pennsylvania.) Id.
c. Statutory Non-Exclusivity

Statutory non-exclusivity is a provision that permits a corporation to formulate its own programs for indemnification beyond the limitation of the statute. The Model Act provides statute non-exclusivity in § 8.58.

A Variation by Corporate Action; Application of Subchapter

(a) A corporation may, by a provision in its articles of incorporation or bylaws or in resolution adopted or a contract approved by its board of directors or shareholders, obligate itself in advance of the act or omission giving rise to a proceeding to provide indemnification in accordance with section 8.51 or advance funds to pay for or reimburse expenses in accordance with section 8.53. Any such obligatory provision shall be deemed to satisfy the requirements for authorization referred to in section 8.53 (c) and in section 8.55 (c). Any such provision that obligates the corporation to provide indemnification to the fullest extent permitted by law shall be deemed to obligate the corporation to advance funds to pay for or reimburse expenses in accordance with section 8.53 to the fullest extent permitted by law, unless the provision specifically provides otherwise.

(b) Any provision pursuant to subsection (a) shall not obligate the corporation to indemnify or advance expenses to a director of a predecessor of the corporation, pertaining to conduct with respect to the predecessor, unless otherwise specifically provided. Any provision for indemnification or advance for expenses in the articles of incorporation, bylaws, or a resolution of the board of directors of shareholders of a predecessor of the corporation in a merger or in a contract to which the predecessor is a party, existing at the time the merger takes effect, shall be governed by section 11.06 (a)(3).

(c) A corporation may, by a provision in its articles of incorporation, limit any of the rights to indemnification or advance for expenses created by or pursuant to this subchapter.

(d) This subchapter does not limit a corporation’s power to pay or reimburse expenses incurred by a director or an officer in connection with his appearance as a witness in a proceeding at a time when he is not a party.

320 KNEPPER & BAILEY, supra note 296, § 20.12, at 669.
321 This Section is a new section which has been revised in the Revised Model Business Corporation Act 1994.
(c) This subchapter does not limit a corporation’s power to indemnify, advance expenses to or provide or maintain insurance on behalf of an employee or agent.

This new section authorizes obligation indemnification and expense advancement provisions in the articles of incorporation or by-laws and elsewhere so long as these provisions are approved by the shareholders or board of directors. However, the corporation’s rights to provide indemnification have been restricted to the extent that permitted by subsection F.

The statutory non-exclusivity provided in the Delaware law is one of the first non-exclusivity provisions which has been used as a model for many state statutes. The distinction of statutory non-exclusivity under Delaware statute is that the Delaware statute provides for non-exclusivity indemnification without any restrictions. The non-exclusivity is provided in § 145 (f).

The indemnification and advancement of expenses provided by, or granted pursuant to, the other subsections of this section shall not be deemed exclusive of any other rights to which those seeking indemnification or advancement, vote of stockholders or disinterested directors or otherwise, both as to action in his official capacity and as to action in another capacity while holding such office.

**d. Advance Expenses**

Indemnification statutes generally provide for advance payment for fees and expense before the final adjudication of the litigation as well. The Model Act revised in 1994 provides advance expenses in § 8.53.

(a) A corporation may, before final disposition of a proceeding; advance funds to pay for or reimburse the reasonable expenses incurred by a

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322 THE COMMITTEE OF CORPORATE LAWS, supra note 303, at 747.
323 MODEL BUS. CORP. ACT § 8.59.
324 BLOCK ET AL., supra note 293, at 617.
325 KNEPPER & BAILEY, supra note 296, § 20.12, at 667.
directors who is a party to a proceeding because he is a director if he delivers to the corporation:

(1) a written affirmation of his good faith belief that he has met the relevant standard of conduct described in section 8.51 or that the proceeding involves conduct for which liability has been eliminated by a provision of the articles of incorporation as authorized by section 2.02(b)(4); and

(2) his written undertaking to repay any funds advanced if he is not entitled to mandatory indemnification under section 8.52 and it is ultimately determined under section 8.54 or section 8.55 that he has not met the relevant standard of conduct described in section 8.51.

(b) The undertaking required by subsection (a)(2) must be an unlimited general obligation of the director but need not be secured and may be accepted without reference to the financial ability of the director to make repayment.

(c) Authorizations under this section shall be made:

(1) by the board of directors:

(i) if there are two or more disinterested directors, by a majority vote of all the disinterested directors (a majority of whom shall for such purpose constitute a quorum) or by a majority of the members of a committee of two or more disinterested directors appointed by such a vote; or

(ii) if there are fewer that two disinterested directors, by the vote necessary for action by the board in accordance with section 8.24(c), in which authorization directors who do not qualify as disinterested directors any participate; or

(2) by the shareholders, but shares owned by or voted under the control of a director who at the time does not qualify as a disinterested director may not be voted on the authorization.

In addition to a written affirmation required in former statute, this new section requires a “Written Undertaking” to repay an advance for expenses which must be made by the director involved.\(^ \text{326} \)
On the other hand, the advance expenses provision of the Delaware statute permits the corporation to allow advance payment without any conditions provided by law. The Delaware law § 145 (e) provides:

Expenses (including attorneys’ fees) incurred by an officer or director in defending civil, criminal, administrative or investigative action, suit or proceeding may be paid by the corporation in advance of final disposition of such action, suit or proceeding upon receipt of an undertaking by or on behalf of such director or officer to repay such amount if it shall ultimately be determined that he is not entitled to be indemnified by the corporation as authorized in this section. Such expenses incurred (including attorneys’ fees) by other employees and agents may be so paid upon such terms and conditions, if any, as the board of directors deems appropriate.

As provided in this subsection the Delaware statute does not require advance payment upon shareholder approval. Therefore, if a director meets the appropriate standard of conduct and if the decision to provide advance payment follows the procedures specified for permissive indemnification, the director is entitled to advance payment. Moreover, the Delaware statute permits advancement of expenses on a non-exclusive basis.

2. Statutory Limitation on Liability

The second approach that US corporation law employs to provide a director in a close corporation with protection from liability is a statutory limitation on liability. Traditionally, corporations protected directors by indemnifying them against liability and purchasing the liability insurance. Around the time Smith v. Van Gorkum case was

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327Maskowitz, supra note 302, at 911.
329O’Kelley & Thompson, supra note 9, at 370
330488 A. 2d, 858 (Del. Sup. 1985).
argued and decided, the cost of liability insurance has increased dramatically and has
became unavailable to a number of previously covered corporations.\(^3\)

Legislatures in Delaware and many other states quickly responded to this
perceived crisis by authorizing a new mechanism for protecting a director from liability.
A limitation or elimination of directors’ liability for negligent acts can be effected by
inserting an appropriate provision in the articles of incorporation.\(^4\)

As to the statutory limitation on liability the Model Act § 2.02 (b)(4) provides:

The articles of incorporation may set forth:

(4) a provision eliminating or limiting the liability of a director to
the corporation or its shareholders for money damages for any action
taken, or any failure to take any action, as a director, except liability for
(A) the amount of a financial benefit received by a director to which he is
not entitled; (B) an intentional infliction of harm on the corporation or the
shareholders; (C) a violation of section 8.33; or (D) an intentional
violation of criminal law.

This Section authorizes a corporation to include a provision in the articles of
incorporation eliminating or limiting the liability of a director to the corporation or its
shareholders for money damages. This is called the charter option statute.\(^5\)
Nevertheless, this option contains four exceptions where a corporation may not include
such a provision in its articles of incorporation.

The Delaware limitation on liability provision has served as a model for more
than thirty states.\(^6\) Section 102 (b) (7) of Delaware law contains the following content.

(b) In addition to the matters required to be set forth in the certificate of
incorporation by subsection (a) of this section, the certificate of
incorporation may also contain any or all of the following matters:

\(^{31}\)O’KELLEY & THOMPSON, *supra* note 9, at 370.

\(^{32}\)Id.

\(^{33}\)THE COMMITTEE ON CORPORATE LAWS, CHANGES IN THE REVISED MODEL BUSINESS CORPORATION

\(^{34}\)KNEPPER & BAILEY, *supra* note 296, § 7.04 at 215.
(7) A provision eliminating or limiting the personal liability of a director to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a director, provided that such provision shall not eliminate or limit the liability of a director: (i) For any breach of the director's duty of loyalty to the corporation or its stockholders; (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law; (iii) under § 174 of this title; or (iv) for any transaction from which the director derived an improper personal benefit. No such provision shall eliminate or limit the liability of director for any act or omission occurring prior to the date when such provision becomes effective. All references in this paragraph to a director shall also be deemed to refer (x) to a member of the governing body of a corporation which is not authorized to issue capital stock, and (y) to such other person or persons, if any, who pursuant to a provision of the certificate of incorporation in accordance with § 141 (a) of this title, exercise or perform any of the powers or duties otherwise conferred or imposed upon the board of directors by this title.

Like the Model Act, the Delaware statute only covers damage liability of directors. Neither equitable remedies nor damage suits against directors are limited by the applicable statute. Moreover, the charter option of the Delaware statute is unclear because one subsection provides one exception by using the phrase “duty of loyalty” which does not appear in any other provisions in Delaware General Corporation Act, or so far as is know, in the business corporation act of other states.

3. Liability Insurance

The last approach provided by the corporation law in the US is liability insurance. Corporations including a close corporation may purchase and maintain on behalf of an

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335 O'KELLEY & THOMPSON, supra note 9, at 398.
336 THE COMMITTEE ON CORPORATE LAWS, supra note 331, at 696.
individual who is a director insurance against liability asserted against or incurred by him in that capacity or arising from his status as a director whether or not the corporations would have power to indemnify or advance expenses to him against the same liability under the Model Act. This right of the corporations is recognized by the Model Act § 8.57.

A corporation may purchase and maintain insurance on behalf of an individual who is a director or officer of the corporation, or who, while a director or officer of the corporation, serves at the corporation’s request as a director, officer, partner, trustee, employee, or agent of another domestic or foreign corporation, partnership, joint venture, trust, employee benefit plan, or other entity, against liability asserted against or incurred by him in that capacity or arising from his status as a director or officer, whether or not the corporation would have power to indemnify or advance expenses to him against the same liability under this subchapter.

The liability insurance is usually referred to as “D&O liability insurance” The Delaware Statute also provides a provision authorizing a corporation to purchase the liability insurance for its directors in § 145 (g).

\[ \text{g) A corporation shall have power to purchase and maintain insurance on behalf of any person who is or was a director, officer, employee or agent of the corporation, or is or was serving at the request of the corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise against any liability asserted against him and incurred by him in any such capacity, or arising out of his status as such, whether or not the corporation would have the power to indemnify him against such liability under the provisions of this section.} \]

\[ ^{337} \text{Id. at 779.} \]
\[ ^{338} \text{O’Kelley & Thompson, supra note 9, at 400. Currently available insurance have been developed a variety of different forms differ from the original insurance. The first insurance policies having two parts designed to protect directors and officers from unwarranted apprehension of liability. Part one was called “Corporate Reimbursement Liability”. Part two was termed “Directors and Officer Liability” and named officers and directors against insurable acts. Id. at 383.} \]
This approach, however, is hardly applicable for a close corporation because a close corporation has always had difficulty obtaining "D&O insurance". As the American Law Institute has analyzed that:

"In the case of small companies, it is often difficult to obtain coverage. The more closely controlled the harder it is. Underwriters are afraid of closely held corporations, because a few people can effectively dominate the company. They anticipate someone saying, "we will do it because I say we will do it". Then after a few of these occasions, a minority stockholder sues in a derivative action for the benefit of the company. All the underwriter can see are problems. The more centralized the control in the company, the more difficult it is to get coverage."

Furthermore, although many state statutes utilize the statutory limitation on liability because the cost of liability insurance has increased dramatically, liability insurance continues to be unavailable to numerous corporations.

C. Protective Measures and Devices under Thai Limited Company Law

Unlike the corporation statutes in the US, the Commercial Code in Thailand does not explicitly provide for indemnification, limitation on liability, and even liability insurance provisions to authorize a limited company to protect its directors. This means

339 O'Kelley & Thompson, supra note 9, at 400.
341 Romano, Corporate Governance in the Aftermath of the Crisis, 39 Emory L.J. 1155, 1161 (1990). (D&O insurers did not respond to the enactment of limited liability statutes by lowering premiums, although the vast majority of corporations that have the opportunity to opt for these new regimes did so. There are at least two plausible explanations for the stickiness in rates. First, the statutes in most states do not exempt from liability claim for breach of the duty of loyalty, violation of federal securities laws, and breach of the duty of care by directors who are also officers. Since class actions alleging federal securities violations tend to generate larger recoveries than derivative suits, the case the statutes eliminated from liability tend to cost insurers less. Of course, some of the claims not eliminated by the statutes, including certain duty of loyalty claims, are not covered by the typical insurance policy either. Second, and perhaps more important, the statutes' effectiveness will be careful to bring their complaints within the included liability categories and will allege recklessness or willful misconduct rather than negligence.) Id.
that a director in the limited company in Thailand does not have protective devices provided by law like a director in a close corporation in the US. What protective measures and devices can a director protect himself from liability arising out of his duty?

As described in Chapter II, a limited company is created by an agreement between shareholders.\textsuperscript{342} Similarly, the relationship between a director and a limited company is created by contract as well. It is clear that under Thai law almost all of the intra-company disputes and propositions may be constrained by contract.\textsuperscript{343} This is also true in event of the liability of the director in a limited company as provided in the Commercial Code § 1170.

When the acts of a director have been approved by a general meeting, such director is no longer liable for the said acts to the shareholders who have approved them, or to the company.

Shareholders who did not approve of such acts cannot enter their action later than six months after the date of the general meeting in which such acts were approved.

This Section is the only one provision dealing with the exculpation of director liability under the Commercial Code. Unlike, the corporation law in the US, the director in a limited company in Thailand shall be liable to the company, shareholders, and creditors.\textsuperscript{344} Notwithstanding, the Commercial Code authorizes a company to discharge its directors by the resolution of the meeting of shareholders.\textsuperscript{345} By this approach a director can be discharged only for liability to the company and shareholders who voted approval acts done by the director. Therefore, the director remains liable to shareholders who did not vote for approval as well as to creditors.\textsuperscript{346} This Section is similar to

\textsuperscript{342}See supra text accompanying note 79-82.
\textsuperscript{343}Traditionally, as long as the dispute or proposition arising out of the intra-company may finally be resolved through the resolution of meeting of shareholders.
\textsuperscript{344}The Commercial Code § 1169.
\textsuperscript{345}The general resolution of meeting of shareholders requires majority vote of shareholders.
\textsuperscript{346}The Commercial Code § 1169 ¶ II and 1170.
statutory indemnification under the US corporation law, but the impact of this Section cannot really be compared to the statutory indemnification in the US.

Another approach that a director can use to protect himself for liability arising out of his duty is to have a limited company eliminate or limit director liability in its articles of incorporation or by contract. Although there is no provision authorizing a limited company to do so, under freedom to contract concepts, the director, a limited company and shareholders may agree to indemnify or limit the liability of its director who represents the company in any acts. The freedom to contract concept has been recognized by contract law in Thailand as long as the contract is not contrary to the public policy, e.g. violation of criminal law, or harm other persons or being contrary to public norms.

In Thailand, like in the US, D&O liability insurance is not available for a limited company, so it is hard for a director to use a liability insurance approach to protect himself like that of the director in a close corporation in the US.

In conclusion, according to Thai limited company laws it appears that there are less protective measures and devices available for a director in a limited company than those of a director in a close corporation in the US. On the other hand, the Commercial Code seems to protect the minority shareholders and creditors of the limited company rather than directors.

347 Id. § 1170.
VI. CONCLUSION

Under traditional corporation law doctrine, undoubtedly a director of a close corporation or a limited company, owes a fiduciary duty of care as well as a duty of loyalty to the corporation and its shareholders. As a result, a director is legally required to manage the corporation for the exclusive benefit of his corporation and its shareholders.

In the US the legislatures and courts recognize the special characteristics of a close corporation which are distinct from a publicly held corporation. Even though a number of states have passed special statutes regarding close corporations or have enacted special sections in their general corporation laws that deal with the common law problems of a close corporation. The provisions with regard to the director’s fiduciary duty, statutory indemnification, statute limitation on liability, and liability insurance are applied to both close corporations and publicly held corporations.

Obviously, the corporation laws in the US have been designed and developed to regulate the publicly held corporations, including the director’s fiduciary duty, statutory

349 MERCEY, EXTERNALITIES, FIRM-SPECIFIC CAPITAL INVESTMENT, AND THE LEGAL TREATMENT OF FUNDAMENTAL CORPORATE CHANGES, 1989 DUKE L.J. 173, 175 (1989). (The fiduciary duty should be owed exclusively to shareholders is derived for the modern financial theory that shareholders retain the ultimate authority to control the corporation because they have the greatest stake in the outcome of the corporate decision-making.).
352 See MODEL BUS. CORP. ACT; DEL. CODE ANN.
353 ELFIN, supra note 349, at 441.
indemnification, statutory limitation on liability, and liability insurance. However, some of these provisions are not practically applied to a close corporation for the following reasons:

1. The provisions regarding the fiduciary duty of loyalty. For example, in conflict of interest transactions a number of processes are available to validate a public corporation transaction regarding a public corporation, however, these validation processes are not practical in a close corporation because, traditionally, a close corporation is permitted to opt-out of the usual corporate formalities, or operate under the direction of shareholders instead of directors. These special characteristics of a close corporation cause the fiduciary duty of a director in a close corporation to seem meaningless, except for being imposed to directly protect the minority shareholders in a close corporation. Therefore, some propositions relevant to the fiduciary duty of a director are better addressed by contract.

2. The protective measures and devices, i.e. statutory indemnification, statute limitation on liability, and liability insurance, appear to be inapplicable to a close corporation. The major purpose of statutory indemnification is to encourage outside directors to serve as directors of a corporation. This rarely occurs in a close corporation because in a close corporation a majority shareholder traditionally serves as director and the management in the corporation. Therefore, indemnification has mainly been designed to authorize the corporation to indemnify the outside director in a publicly held corporation, but not a close corporation.

357See supra text accompanying note 292-339.
358See supra text accompanying note 299-326.
359See supra text accompanying note 41-42.
360See supra text accompanying note 292-297.
Liability limitations for the close corporation context are best achieved by contract because the limitation on liability of director will never affect the rights of persons other than the shareholder and the director.\textsuperscript{361} Thus, the provision to permit a close corporation to provide for limitation on liability in the articles of corporation seems to be appropriate.

Furthermore, the availability of liability insurance prevents resort to corporate assets that may be needed in the business. Hence, the liability insurance seems appropriate for all corporations, but the liability insurance provision seems inapplicable to close corporations\textsuperscript{362} because liability insurance is not generally available to close corporations.

In contrast, a limited company in Thailand has been designed and developed to operate with the family-owned company or (private) limited company.\textsuperscript{363} All provisions in the Commercial Code has been designed and developed for a limited company or family-owned company based upon freedom to contract. The provisions in regard to the fiduciary duty of director as well as protective measures and devices provided for a director in a limited company are merely a set of standard-form provisions to facilitate the process of private ordering,\textsuperscript{364} thus the intra-company parties are free to shape their own contractual arrangement as long as it does not affect third-party rights or is not contrary to public policy or norms in Thailand.\textsuperscript{365}

\textsuperscript{361}Model Bus. Corp. Act § 2.02 (b) (4); Del. Code Ann. § 102 (b)(7).
\textsuperscript{362}See supra text accompanying note 327-334.
\textsuperscript{363}Not until 1974, the Commercial Code imposes to all types of companies, a limited (private) company and a public limited company. After the first Public Limited Company Act was promulgated in 1974, the Commercial Code has been revised to afford the new type of company by restricting the rights of limited company, for example, public offering, issue debenture bond. However, the dominance of limited companies has continued to influence to business investment environment in Thailand which it frustrates the development in public limited company.
\textsuperscript{364}The Commercial Code § 1170.
\textsuperscript{365}This propositions are left for the court to decide what contractual arrangement affects third-party rights or is contrary to public policy.
However, the provisions in the Commercial Code are obviously designed to protect minority shareholders,\textsuperscript{366} rather than directors because, as described above, directors and majority shareholders traditionally are the same persons which manage and control the company. Conversely, the minority shareholders in a limited company, need to be protected by the laws.\textsuperscript{367} Courts in the US also have recognized that in a close corporation the minority shareholder should be protected by laws. As one commentator has pointed out, “in fact, in light of the pervasive conflicts of interest that exists between shareholders and [director], it seems clear that if any group within the [corporation] is in need of additional legal protection it is the shareholders.”\textsuperscript{368} This is especially true for the close corporation. Therefore, the provisions related to fiduciary duty of directors and protective measures and devices provided for limited company in Thailand better serve the small business entities, like a close corporation in the US.

\textsuperscript{366}The Commercial Code § 1170.

\textsuperscript{367}See supra text accompanying note 340-345.

\textsuperscript{368}Macey, supra note 347, at 44.
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