A STUDY OF LINK BETWEEN CORPORATE SOCIAL RESPONSIBILITY AND BUSINESS JUDGEMENT RULE IN COMPANIES

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I. Introduction

It has now become well-settled that Mr. FitzGerald has rightly pointed out about the importance of Corporate Social Responsibility (CSR). It bears seminal importance not only for the company and the stakeholders but for the society as a whole. CSR decision has been taken by the company for the development of the society and it acts as a medium to connect the company with its customers or clients very easily. This enhanced connectivity of the company with its customers may increase the sale and profit of the company. CSR builds a positive image of company in the market. It changes the public perception towards the company which in turn enhances client confidence . CSR activity increases the connectivity of the company with the community and it in turn widens the opportunity of the employees of the companies to interact with potential customers and helps in marketing the product of the company . Employees of the company, generally, perform better when they engage themselves in socially responsible activities. When employees engage in social welfare activities, it is seen that they become more innovative and creative for the company and hence CSR enhances the skill of the employees . Again, the Business Judgment Rule (BJR) protects a decision of a corporate board of directors from a fairness review unless a strong complaint provides sufficient evidence that the board has breached its fiduciary duties or the decision-making process is tainted with evil intention . The rule protects officers and directors from liability where they have made decisions in good faith and using appropriate procedures, even if those decisions turn out to be poor or unwise. Directors eligible for protection under the BJR are not liable for breaching duties of care merely because they have made mistakes . In order to avail the protection of BJR, the directors must fulfil certain conditions. However, the decisions to invest in CSR activities are taken by the directors. Again, Business Judgment Rule also talks about the mechanism to protect the Directors and Officers of the company from the liability of wrong decision making. There is a close connection and relation between CSR and Business Judgement Rule.

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The paper intends to establish the relationship between CSR and BJR in corporate governance. The authors have discussed the definition, origin and development of the concept 'Business Judgment Rule'. The paper also highlights judicial developments relating to the concept 'BJR' and finally the paper also gives some suggestions along with conclusion.

II. Definition, Origin and Development of the Concept of 'Business Judgment Rule'-

Business Judgment Rule (BJR) protects the interests for Directors and Officers of the company. It helps to protect the Board of Directors from frivolous legal allegations against their activities and decisions. Directors have fiduciary relationship with the company. Fiduciary relationship includes duty of care and duty of loyalty. Directors discharge their responsibilities in the best interest of the company. They carry on their functions as agent of the Company. But, in spite of taking outmost care and discharging responsibilities in good faith, company may suffer loss. In this situation, directors and officers may be implicated and accused for the failure of the company. This may deter the directors and officers to take decisions freely in the interests of the company. Fear of punishment may prevent officers and directors to discharge their duties freely and in the best interest of the company. Business Judgment Rule (BJR) has been introduced to rescue the directors and officers from this fearful situation at the time of discharging their duties.

Business judgment Rule says that business decisions are outside the review of the court or tribunal where the board of directors acts in good faith and in the best interest of the company and in a manner that a reasonable person would act under similar circumstances. This rule makes officers, directors, managers and other agents of corporation immune from liability to the corporations which are within their authority and power to make when sufficient evidences prove that the transactions are made in good faith and in the best interest of the company. Directors are considered as the brain of the company and they are responsible to manage and direct the affairs of the corporation. They very often have to take the difficult decisions regarding whether to acquire other business or sell assets or purchase land, building and other assets or expand the existing business or issue shares and dividends or file suits against third parties or not etc. They may also face potential hostile take overs by other competitors in the market. To help the directors and officers face these challenges without fear of liability, courts have given protections and defenses to the decisions of directors and officers.

The concept of BJR was originated in Otis Case in 1945. In this case, shareholders alleged that corporate directors failed to obtain the best price available in the sale of securities by dealing with only one investment house and by generally neglecting to "shop around" for the best possible price, resulting in a loss of nearly half a million dollars. The federal District Court in USA held that although the directors chose the wrong course of action, they acted in good faith and therefore were not liable to the shareholders. The court also added that "mistakes or error in the exercise of honest business judgment do not subject the officers and directors to liability for negligence in the discharge of their appointed duties".

Business decisions are very important for the companies, most of the time it involves uncertainty and huge risks. All the decisions of the directors may not always result in benefit to the corporation. Some of these may result in losses to the corporation. As a result of the loss, directors may be liable to compensate the corporation. The concept of Business Judgement Rule (BJR) has been introduced to save the directors, officers and agents of the company from liability when they discharge their duties with absolute care and in good faith. It helps the directors to protect and promote the full and free exercise of the managerial powers of the directors. In BJR, it is presumed that during 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 interest of the company. The burden is on the party challenging the decision to establish facts rebutting the presumption. The justification behind BJR is to provide a safe harbor to the directors and officers from their personal liability for breaches of the duty of care and diligence in relation to honest and rational business judgement. However, following conditions must be satisfied:

a) There must be 'business judgment'-

The word 'business judgment' indicates any decision to take or not to take action in respect of a matter relevant to the business operation of the corporation. The term 'judgment' means the decision whether to do or not to do something or to vote for or against a proposal. There must be a judgment in the decision-making process. The judgment must have a connection to the business operations of a company.

b) Business Judgment must be made by Directors or Officers of the company-

Company is an artificially created legal person. Directors are the brain of the company. Success and failure of the company depends upon the efficiencies of the directors. They take the decisions of the company in the best interest of the company. In order to make a judgment as business judgment, the judgment must be made by the directors or officers of the company.

c) The directors or officers must have a duty of care and diligence-

Directors have fiduciary duties towards the corporation. Fiduciary duty includes duty of care and duty of loyalty. Directors or officers must have a duty of care and diligence towards the company. The duty of care necessitates that a director must exercise his powers in good faith and in the best calculated manner, taking into account both the short- and long-term consequences of his acts, to promote the success of the company for value addition of the company.

d) Decision must be made in Good Faith-

The directors must make the decision in good faith. A decision is taken in good faith if it is not backed by evil intention. Directors must take the decision in the best interest of the company. During the decision-making process, they should not fulfill their own interests at the cost of the interests of the company.

e) Business decision must be taken on informed basis-

Directors must take the decision on an informed basis. Duty of care can only be successful if the decisions are taken on an informed basis. They must verify all the aspects of the issue before taking any final decision. The quantum of decision will depend upon the nature of the decision, subject matter and complexities of the of the matter. A director should be informed about the business reasons for the transaction, impact of the transaction on the shareholders, employees, customers and other constituencies and fairness of the transaction.

So, a director can be protected by the BJR only when the above prerequisites are satisfied and fulfilled.

III. Judicial Approach about Business Judgement Rule-

In **Peoples Department Stores Inc. (Trustee of) vs. Wise** Hon'ble Supreme Court of Canada held that "Directors and officers will not be held to be in breach of the duty of care u/s 122(1)(b) of the Canada Business Corporation Act, if they act prudently and on a reasonably informed basis…"

In Itak International Corp. vs. CPI Plastics Group Ltd , it was held that to take advantage of the business judgment rule, there must first have been a genuine exercise of judgment.

In Aronson vs. Lewis , Hon'ble Delaware Supreme Court held that BJR creates a rebuttable 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 company. This policy puts the onus on plaintiffs to produce evidence of fraud, bad faith or self-dealing on the part of the directors. Without such evidence, court will refrain from second guessing the directors."

In Grobow vs. Perot , Hon'ble Supreme Court of Delaware has given a guideline for satisfaction of Business Judgment Rule (BJR). Hon'ble court held that in order to apply

Business Judgement Rule, directors in a business should:

i. act in good faith,

ii. act in the best interest of the corporation;

iii. act on an informed basis;

iv. not be wasteful;

v. not involve in self-dealing transactions.

In Smith vs. Van Gorkom Hon'ble court held that directors will be liable when evidence was presented that they reached a decision to sell a company at a particular price after hearing only a 20 minutes oral presentation regarding the sale. The court also noted that the directors had received no documentation indicating that the sale price was adequate and had not requested a study to help them determine whether the price was fair or not. Hence the directors were held liable to the shareholders for negligence because they failed to adequately inform themselves and had not engaged in a sound judgment process.

IV. Dynamics between Corporate Social Responsibility and Business Judgement Rule-

Corporate Social Responsibility (CSR) is a self-regulating business model that helps a company to be socially responsible and accountable to it . It is a business model by which companies make a concentrated effort to protect and preserve the environment . Business and society are inter connected and inter dependent to each other. One cannot survive without other. But, very often business houses think that profit maximization is the only aim of the business ignoring its responsibility towards the society. Milton Friedman said that" the only one responsibility of business towards society is the maximization of profits to the shareholders within the legal framework and the ethical custom of the country". CSR is a commitment to improve community well-being through discretionary business practices and corporate resources . CSR helps in improving public image of the company, increasing brand awareness and recognition, decreasing cost of the product, advantaging the company over competitors and increasing customer and employee engagement. It can help the company in improving its goodwill in various ways.

However, board has an important role in the CSR activities of the company. Board of Directors is responsible for managing the governance, culture and management of CSR. It is the responsibility of the directors to ensure that an effective corporate governance structure is prevailed in the company. Board approves the CSR strategy, its budget, plans and corporate strategies. It ensures that the company follows an efficient corporate governance structure ensuring that CSR activities are carried on maintain highest ethical standards . Boards do also evaluate the social, ethical, and environmental impact of CSR activities and monitors it. Board plays the role of direction setting of the company through which CSR activities are carried on, measured and implemented .

The principles of Business Judgment Rule have a direct connection with the CSR initiatives of the companies. Business Judgment Rule protects the directors from their liability which arises out of intentional wrong decision making. During the implementation of CSR activities, Directors have to take various important decisions. They have to bear the risk of their erroneous decision which results financial loss of the company and that may make them liable finally. BJR may give them freedom to take sensitive and risky decision if the decision is taken in the best interest of the company and in good faith. They enjoy greater business autonomy in taking important decisions. BJR gives them a 'safe harbor' from personal liability in relation to honest, informed and rational business judgments . BJR contains few criteria which may influence CSR- motivated decision making . Principles of BJR may help to implement CSR more accurately and effectively. If the directors implement CSR principles keeping in mind the basic elements of BJR it will be more fruitful and effective. BJR helps the corporation and Board to adopt and implement what is the best interest of the corporation. Generally, CSR-motivated behavior often involves non-commercial considerations. There is no personal profit-making intention of the directors behind CSR activities. BJR also based on the same philosophy that the absence of conflict of interest in the decision-making process of the directors.

V. Conclusion and suggestions-

From the above discussion, it becomes evident that Corporate Social Responsibility is 'sine qua non' for the corporate houses today. It does not benefit the company and its stakeholders only but to the society at large. The decision about the Corporate Social Responsibility is generally taken by the Directors of the company. In fact, company is an artificially created legal person. It needs human agency to discharge its functions throughout the year. Directors are those human agencies. They are called as the brain of the company. They play various roles at different points of time. Sometimes they are called as agents, sometimes they are called as officers of the company, they are also called as trustees and managing partner of the company. In fact, they have fiduciary relationship with the company. They play very important role in all most all decision making of the company. They are expected to discharge their duties with full care and loyalty. But, in spite of taking all reasonable care, their decision may be erroneous and as a result of which company may suffer financial loss. But business judgment rule says that if they take the wrong decision without any evil intention and in outmost good faith and also in the honest belief then they may be excused from their liability. This BJR gives freedom to Directors to take various decisions without fear of liability. BJR also protects the directors from taking wrong decision about the investment in CSR of the company. During the decision-making process about the CSR, BJR helps the directors and encourages them to take risky decision as well. Hence, there is a positive relationship between CSR and BJR of the company. BJR helps directors to take final decision about the CSR of the company. However, directors must take the decision about CSR keeping in mind the elements of BJR. Thus, the authors endorse the view that all the conditions of BJR must be satisfied in order to avail the benefit of it. Board takes all the decision including the provision of fund for CSR and management of CSR etc. These decisions must be taken prudently and with outmost care and diligence. If the principles of BJR are followed properly then the decisions about CSR will also be accurate and effective and which in turn will make the company profitable and it will increase the goodwill of the company at the same time.

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