



## Shielding Directors, Spurring Innovation? The Impact of the Court of Appeal's Ruling

The Company is the world's first inventor of the electronic passport and multi-application electronic identification system ("**Company**"), brought an action against its nine former directors including the chairman, seeking to recover losses amounting to GBP2.05 million (approximately RM11.72 million) arising from the failure of its investment in a United Kingdom border control project ("**BCS Investment**").

The Company alleged that the directors had breached their fiduciary duties, duties to act in good faith, duties of care and skill and various statutory duties under the Companies Act 2016. Among the specific allegations were that the directors wrongfully approved the BCS Investment, caused or procured payments to be made, and failed to recover the losses incurred.

### **Business Judgment Rule without Hindsight Bias**

In a recent Court of Appeal decision, it affirmed that directors who act honestly, with reasonable care and in good faith are entitled to protection from liability, even when their business decisions ultimately prove unsuccessful. The test focuses on the directors' reasonable belief at the time the decision was made and not whether subsequent events vindicated their decisions.

The Court of Appeal stated that the requirement does not demand that directors ensure successful outcomes or exercise perfect judgment. Rather, it requires that directors form a reasonable belief, based on the circumstances and information available at the material time, that their decision was in the company's best interest. The subsequent

failure of the BCS Investment does not retrospectively invalidate the reasonableness of the directors' belief back in 2016.

### **Ruling Encourages Risk-Taking, Protecting Directors from Bad Outcomes**

The Court of Appeal also emphasised the importance of the business judgment rule, noting its policy objectives. The rule encourages competent individuals to serve as directors and supports legitimate business risk-taking. If directors were exposed to personal liability for every unsuccessful business decision, many qualified individuals would be deterred from accepting directorships. Those who did serve would be inclined to adopt overly conservative strategies, which could stifle business growth and innovation.

The Court of Appeal's decision offers valuable clarity on the scope of directors' duties and reinforces the recognition of bona fide business judgments. Companies can now expect directors to be more open to strategic or innovative ventures, knowing that the courts will not second-guess such decisions provided they are made honestly, diligently, within the directors' powers and without any breach of fiduciary duties.

This may foster a more entrepreneurial culture within Malaysian corporations. For businesses, it provides reassurance that directors acting properly will be shielded from personal liability.

### **A Double-Edged Sword: Balancing Director Protection with Corporate Accountability**

That said, the decision raises broader considerations for corporate governance in Malaysia. By emphasising that directors who act honestly, with reasonable care and in good faith should not be liable even when business decisions ultimately fail, the courts have confirmed an important protection for directors.

However, if this protection is applied too widely in future cases, there is a risk of eroding accountability and responsibility. Directors could become less vigilant in scrutinising business proposals or in exercising their duty of care, knowing that the courts are unlikely to intervene unless there is clear evidence of bad faith. This could lead to a culture of complacency at the board level.

Directors of public-listed companies carry significant responsibilities. It is therefore essential that the business judgment rule does not overshadow the directors' duties to exercise reasonable care, skill and diligence. The burden of failed decisions would fall disproportionately on shareholders, creditors, employees, and the investing public,

stakeholders with limited influence over boardroom deliberations. Losses from risky or ill-considered strategies would be absorbed by these parties, potentially eroding investor confidence in Corporate Malaysia.

The real challenge lies in protecting directors from second-guessing past decisions while preserving accountability. Courts must remain vigilant to ensure that while bona fide commercial risks are respected, the business judgment rule does not become a blanket shield for imprudent or reckless conduct.

In other words, the principle affirmed in this case should be understood as protecting directors who act reasonably on the information available at the time, not as a blanket permission to take undue risks at the expense of shareholders and the public. Robust governance processes, due diligence and documentation will therefore remain vital in ensuring that directors' decisions fall within the protection of the business judgment rule.

It remains to be seen whether the case will be taken further to the Federal Court. Until then, this Court of Appeal case stands as an important affirmation of the business judgment rule in Malaysia, reflecting the courts' willingness to respect bona fide commercial decisions made in good faith and with reasonable care.

*This article is authored by our Partner, Mr Leonard Yeoh, Senior Associate, Ms Pua Jun Wen, and Associate, Ms Sharon Teo. The information in this article is intended only to provide general information and does not constitute any legal opinion or professional advice.*

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