The directors’ duty of care, skill and diligence:

Rethinking the dual test

BY

Leung Yee Ching
11017341
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The subjective test

The theoretical aspect

The natures of the test

The morality of aspiration

Suppose there is a perfect director who acts thoroughly according to what the section 465 (2) (a) and (b) requires. Let us name him Mars. Mars is a director who has several professional qualifications and a man with brilliant business sense. He also possesses a fruitful experience in the industry that his company belongs to. Seen he is a perfect director, during his directorship, firstly, he never makes a mistake. Secondly, he not only knows about all the knowledge and skills but he is always able to use it and apply it. Thirdly, he always makes decision and thinks in the way that a person having his excellent business sense would do. Fourthly, he never forgets about what he has learned in the past, especially those learned in the professional fields that he holds the qualifications and those learned in his previous occupations.

According to the subjective test laid down in the s465 (2) (b), which is a test that would be raised according to the competence of the director, whether he has exercised his duty of care, skill and diligence would be determined in the light of all the knowledge, skill and experience he has of which, I suppose, would be quite a tough criterion to be met. Now suppose he really did a good job in his directorship (since he is perfect) and has exercised all that are required just as what we have seen above.

At this point, all that he has done is just a threshold to discharge his liability under
s465 (2) (b). Given the fact that Mars is such a competent director, any missing of the performances we have mentioned above would be contradicting the s465 (2) (b) which in turn causes a breach of duty. Since it would be absurd to suppose that Mars could do more than the general knowledge, skill and experience that he has, what he has done is actually already his best that could be done. There is nothing more we could demand on him. Therefore, the statute is indeed asking the directors to do their best\(^1\) at all time.

According to Professor Lon L. Fuller, there are two kinds of morality, namely, the morality of aspiration and the morality of duty.\(^2\) The morality of aspiration sets up the excellence of human beings that is worth to be pursued while the morality of duty lays down the minimum requirements that we would have to conform to. What the law should do is to promote the morality of duty, not the morality of aspiration. “There is no way by which the law can compel a man to live up to the excellence of which he is capable” (in Fuller’s words)\(^3\). In a democratic society, individuals should be free to choose their style of living they want as long as their actions are not going to harm the others\(^4\). For what is at stake is about the right to liberty\(^5\), the government can only limit their freedom with justifications, either in principle or in policy.\(^6\) The problem lies in the nature of the law itself. The law should be used in a protective manner

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1. Some scholars share the view that the subjective is asking the directors to do their best: “A subjective standard would require the company director to do his best and that could be considered the strongest practical incentive either duty could impose.” See Zwinge, “As Analysis of the Duty of Care in the United Kingdom in Comparison with the German Duty of Care”, International Company and Commercial Law Review, Vol. 22 No. 2 p. 37 and Riley, “The Company Director’s Duty of Care and Skill: The Case for an Onerous but Subjective Standard”, The Modern Law Review, Vol. 62 No. 5 p. 700
3. Ibid p. 9
rather than an aggressive one. The nature of the law should be in a protective nature which states that what should not be done rather than in an aggressive nature which commands what and how an individual should do. It is not the job of the law to push anyone to do their best which deviates from the protective function it is supposed to have.

The problem lies in the subjective test is now clear. The test is trying to push the directors to an extent that they have no say in what and how they should do but to do as good as they can at all time in order to discharge their liability. To do so is itself not a false but an extra justification is needed to justify this kind of coercive power which is used now to oblige individuals to do their best. In such a case, the directors are likely to be obliged rather than having an obligation⁷ to do what the statute is asking for.

But of course the partisan of the subjective test may say that although it is legally not justified in imposing such an aggressive duty on directors, it is morally right to do so since the potential of individuals has been utilized to benefit the society as a whole. My reply would be that, putting aside whether it is morally right or not, it is one thing that a prima facie duty being imposed is right and it is quite another that such a duty such be legislated. We all know that not wasting food is morally right but it is hard to justify the legislation of forcing individuals not to waste food. Therefore, the promotion of the morality of aspiration of the subjective test needs a justification

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⁷ Hart explains it in a case where A is pointing a gun to B. In such a case, it is sufficient to say that B is obliged to hand over his money. However, it is not the case that B is having an obligation to do so. The belief that any disobedience would trigger the gunshot is not sufficient to justify the existence of an obligation. The constitution of the obligation is quite independent from the facts and does not relevant to the belief that the disobedience causes the gunshot. See Hart, The Concept of Law, Oxford University Press 2012 p. 82-83
which is now still missing.

The normativity of the law of companies

The second problem lies in the nature of the subjective test is that it is lacking for a normative explanation which justify the use of the coercive power.

Of course the positivists (especially those exclusive positivists) may object me in saying that even a subjective test is not having a normative explanation, it is still justified just because of the authority of law. And the subjective test is valid in virtue of the fact that the statute itself is a conventionally recognized source of law. They may claim that at the very beginning they are not looking at the normative aspect at all but the descriptive aspect. Therefore, whether pushing the directors to their limit is supported by some moral reasons or not is never their concern. The legitimacy of the subjective test is merely from the consequence that it is going to generate desirable outcomes, namely, from the prosperity of most of the companies to the prosperity of the society. To put it plain, it is the desirable end which serves as a justification that justifying the mean which is now the subjective test.

To reply to their claim precisely, I would have to seek arguments from the natural law school to assert that morality is the domain of the legitimacy of law just as how

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9 Ibid p. 105
10 Quite a number of scholars support this kind of reasoning of which using the consequence to justify the mean. See Riley, “The Law Commission’s Questionable Approach to the Duty of Care and Skill” Company Lawyer, Vol. 20 No. 6 p. 199 about the discussion on the Consultation Paper in UK.
Dworkin had done in his famous essay “Hard Cases”\(^\text{11}\). But in doing so, we will fall into a deadlock like conducting another Hart-Fuller debate which I shall not pursue further here. Therefore, to get rid from the unresolved debate, I would like to use another approach which focuses on the coherence of the new Companies Ordinance.

An assumption here is that the Cap 622 being a set of rules should possess certain degree of internal coherence among its rules\(^\text{12}\). In other words there should be a principle that governing all of the rules. So if it is right for the positivists to claim that it is the desirable outcome that justifying the use of a subjective test, they would have to show that the pursuit of that desirable outcome is governed by a principle which not only supporting that test but also at the same time penetrating the whole system of the Cap 622. Otherwise, they would have to give another reason to explain the departure of the subjective test from the whole set of rules of Cap 622.

Let us assume that the principle of promoting the public welfare (as this is the result of pushing the directors) is the governing principle of Cap 622. But then the Cap 622 would have been different from what it is like now. For instance, the duty of the directors to act *bona fide* is merely a subjective test that “there will not be a breach of the duty even though their belief might have been unreasonable”\(^\text{13}\). The public welfare would have been better served had the directors been further tested by an objective

\(^{11}\) Dworkin, *Taking Rights Seriously*, Harvard University Press 1978 Chapter 4. However, some positivists disagree with it. For example Joseph Raz argues that the legal rules are norms that not necessarily need to have moral reasons to be its justifications. See Raz, *Practical Reason and Norms*, Oxford University Press 1999 p. 154-155 of which Raz has clearly stated the claim. But it would be out of our scope in joining the debate so I just leave it aside for the moment.


\(^{13}\) Directly quoted from Lo & Qu, Law of Companies in Hong Kong, Sweet & Maxwell 2013 p. 281. Similar claim has been made among scholars, for example, see Lynch, “Section 172: A Ground-Breaking Reform of Director’s Duties, or the Emperor’s New Clothes?” Company Lawyer, Vol 33 No. 7 p. 201
test which sets the minimum requirement of forbidding unreasonable judgments.

Furthermore, if not only directors are asked to exercise the knowledge and skills they have, but also the senior managements or even the auditors are asked to bear the same burden of responsibility, then the public would be served even better. However, these all are not taking place in Cap 622. Yet, on the other hand, it is hard to rationalize the departure of the subjective test from the bulk of the remaining rules. So I reject the view that a merely descriptive justification is sufficient for being a principle that justifies the imposition of the subjective test.

If we switch the interpretation to the normative aspect we may see that it actually serves better in interpreting the Cap 622 in a better light. The normative aspect is concise: it is the normative elements that supporting and penetrating the new Companies Ordinance of which the value such as respecting individuals’ chooses and promoting cooperation prevail. It explains the respect shown by the courts on the business judgments made by directors in demanding them to act bona fide regardless the fact that the judgments made may sometimes be unreasonable. It also explains

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14 I believe Dworkin is right in saying that “statutes should be read to promote the aims of a community of principle, that is, that they should be read to express a coherent scheme of conviction dominant within the legislature that enacted them”. Dworkin, Law’s Empire, Hart Publishing 2012 p. 330. If we want to read the Cap622 in its “best light” (in Dworkin’s words), the normative aspect provides us a more coherent reading.

15 It has been commonly known among scholars. For examples: “The lack of criteria by which to measure success has been criticized but may reflect judicial unwillingness to become embroiled in assessing business strategy.” Fisher, “The Enlightened Shareholder – Leaving Stakeholders in the Dark: Will Section 172(1) of the Companies Act 2006 Make Directors Consider the Impact of Their Decisions on Third Parties?” International Company and Commercial Law Review, Vol 20 No. 1 p. 15 and “[T]he law should be a facilitator [...] without interfering with contractual arrangements or proper commercial judgements.” Worthington, “Reforming Directors’ Duties”, The Modern Law Review, Vol. 64 No. 3 p. 442 and “[T]he decision as to what will promote success [of the company], and what constitutes such success, is one for directors’ good faith judgment. This ensures that business decisions on, for example, strategy and tactics are for the directors, and not subject to decision by the courts, subject to good faith.” Keay, “Section 172(1) of the Companies Act 2006: an interpretation and assessment” Company Lawyer, Vol 28 No. 4 p. 108. Moreover, there are several cases that have held this view: “[The subjective test] required the directors to act in a manner which they, not the court, considered to be in the best interest of the company.” Lynch, “Section 172: A Ground-Breaking Reform of Director’s Duties, or the Emperor’s New Clothes?” Company Lawyer, Vol 33 No. 7 p. 201 and “Lord
the limit of the imposition of liability on auditors and senior managements.

Another reason of supporting a normative interpretation is that although the statutes do not state very clearly, there must be, at most of the time, some values behind the rationale of having or not having a certain rule in a system of law. Values are important things that we have to consider. It would be absurd to suppose that the law serve and only serve a particular purpose. For we all know that if we send anyone who crosses the road during a red light to a capital punishment would absolutely result in a disappearance of such an undesirable behavior. But we would not do it because it infringes the right of individuals and it is in anyway unjustifiable. The same applies to the subjective test. If anyone wants to impose such a test on directors, the burden of proof would be put on their side and it would be their turn to provide a reason for the imposition to overcome the challenge raised by others, especially those libertarians. That is why the descriptive aspect fails, at least as far as we have considered.

If it is sound and valid to claim that a normative point of view should be used, the subjective test without the support of a normative explanation is unjustified.

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Wilberforce opined: ‘It would be wrong for the Court to substitute its opinion for that of the management, or indeed to question the correctness of the management’s decision […] if bona fide arrived at.’ Spink & Chan, “The Hong Kong Company Director’s Duty of Skill and Care: A Standard for the 21st Century?” Hong Kong Law Journal, Vol. 33 p. 158 and “[Scrutton LJ:] ‘I should be sorry to see the court take upon itself the management of concerns which others may understand far better.’” Ipp, “The Diligent director” Company Lawyer, Vol. 18 No. 6 p. 163

Nozick argues that no state which does more than a minimal state is legitimate or justifiable. Nozick, Anarchy, State, and Utopia, Basic Books 1974 p. 53. It has been further stated as “From each as they choose, to each as they are chosen.” See Nozick, Anarchy, State, and Utopia, Basic Books 1974 p. 160
The principles in govern

Relationship of responsibility and competence

So far we have considered the nature of a subjective test and we now turn to the principles supporting it.

The principle behind the test is that the responsibility should be linked to the competence. The higher competency a director possesses, the more responsibility he should take. Concerning this principle, there are three defects about it.

The first defect of this principle is about fairness. Putting aside the subjective test, it is hard to argue that a law enacted should treat individuals differently in according with their competence, at least in general. Think about the traffic rules. For any accident, it is weird to think that an expert driver, say, a racer, would be held more liable than an ordinary driver. What is at stake is about the equality before law. “The law of the land should apply equally to all, save to the extent that objective differences justify differentiation” (in Bingham’s words). 17 To impose a higher liability on the competent directors than the incompetent directors is no less unjustifiable than to impose a higher liability on the rich than the poor. Unless the partisans of the subjective test could provide a principle, which I have not yet learned, as a reason to explain why there is a necessity to distinguish directors according to their competency, it would be inappropriate to apply such a test. Without such a reason, the subjective test just seems to be discriminating the competent directors. Their competence is now a burden to them rather than an advantage that they are supposed to enjoy. Prejudicing

certain group of people is not always unacceptable, but without a reason to support the prejudice would cause an unfair result\textsuperscript{18}.

The second defect is about the spirit of law. The directors’ duty of care is mainly derived from the tort\textsuperscript{19} which aims at compensating the plaintiff by paying damages that rectifying the situation as if the tortious action has not taken place\textsuperscript{20}. The focus should be on the \textit{action} rather than on the \textit{actor}. If the action itself is proved to have breached the duty of care that the defendant owes to the plaintiff, then the case would be decided in favor of the plaintiff regardless whoever the defendant may be. A remark should be added is that I am not saying that the actor can never be relevant to the case, but it is obviously wrong in saying that the actor is \textit{always} in the consideration which is what the subjective test is claiming.

The third defect lies on the fact that the subjective test causes a lost of a single standard which in turn injects an uncertainty. I do not intend to seek for an absolute certainty that lays down an exhaustible list of duties that any director would have to conform to\textsuperscript{21}. But since the subjective test focus on the competence a particular director has, if we admit that the competence of any director is not exactly the same,

\begin{footnotes}
\item[18] Example like the affirmative action is nevertheless justifiable. See Dworkin, \textit{A Matter of Principle}, Oxford University Press 2001 p. 293-315 about the reasoning in the case \textit{The Regents of the University of California v Allan Bakke}.
\item[19] “The duty of care owed by a corporate director is merely a subset of the duty of care imposed on individuals in society by tort law.” See Rowland, “Earnings Management, the SEC, and Corporate Governance: Director Liability Arising from the Audit Committee Report” Columbia Law Review, Vol. 102, No. 1 p. 194.
\item[20] Williams & Hepple suggest that the term “duty of care” in the law of tort is about reliance which constitutes a special relationship between two parties. (Williams & Hepple, Foundations of the Law of Tort, Butterworths 1984 p. 100-101) They state that the law of tort has six purposes. (Ibid p. 27-30) But for simplicity I just take out the second and the third purposes, namely, to compensate the plaintiff and to restore the situation, as examples.
\item[21] Since I suppose that the test of directors’ duty is in the nature of principle rather than in the nature of rule, there is by no mean that we could generate such a “list of duties”. See the elaboration in p. 28-29 about the distinction between rules and principles.
\end{footnotes}
then the criterion of the subjective test used in different cases would also be different.
To put it plain, every time when the court conducts the subjective test, the criterion
used would be in an *ad hoc* manner.

Let us recall Mars as an example. Suppose he has two other colleagues, Jupiter and
Mercury, and suppose they all hold the same type of directorship in the company. The
only difference between them is that they possess different competency respectively.
Now there is a case comes to the court which sues all the directors of the company.
Since all three directors have different experience, skills and knowledge, the court
would consider the situation of each of them *separately*, at that moment. After the
scrutiny, only Jupiter is held liable in breach of a subjective duty in virtue of some
competence that he possesses. Suppose Jupiter has been removed from the broad and
there are two other directors, Venus and Saturn who are similar to Jupiter in respect of
their competence, have been nominated into the board to replace Jupiter. Later, there
is another case, one that very similar to the precious one, comes to the court. Of
course Mars and Mercury would not be held liable since they have been *tested* before.
But for Venus and Saturn, since their skills, knowledge and experience are not exactly
the same to Jupiter, they would have to be tested *at the moment* when the case comes
to the court. Thus, Venus and Saturn may or may not be held liable, depends on how
the court reasons and decides. It means that there is no way for Venus and Saturn to
know what attributes a breach of subjective duty in their cases *in advance*. And the
ironic thing is that if there is another different case comes to the court, even Mars and
Mercury will be *tested again*. Therefore, there will be infinite standards in infinite
situations for every single individual, logically speaking. So to speak, the third defect
contradicts the *nulla poena sine lege* principle as people have only been told to
observe a rule of which the content they have not yet been told before they come to the court.

**Facilitating cooperation**

The partisan of the subjective test may argue in another way round. They may claim that they are not only pursuing the flourishing of the companies and society as a goal through this subjective test. They are actually treating the test itself as a good thing to facilitate cooperation of which has its intrinsic value. So they are actually constructing their argument in a normative manner. What they see is that facilitating cooperation in a human society is itself one kind of morality. However, this strategy would success or not remains to be seen.

In the sections above, we have already examined the effects that the test brings. Assuming the test can facilitate cooperation, it, at the same time, gives a burden to all directors and asks them to do their best. It also treats each director individually according to their capacity which in turn leaves no room for the director to choose but to utilize all competencies they have got. By these natures, the directors’ freedom has been impaired\(^{22}\) and their right to liberty has been infringed in some sense. In fact, it is a trade-off between individual’s freedom and the flourishing of the cooperation. To facilitate the cooperation, the subjective test is actually imposing an extra burden on those directors in exchange for the benefit of the others.

\(^{22}\) I suppose it is of little doubt that any law that has been imposed would impair individuals’ freedom. As Hayek has put it: “[E]very law restricts individual freedom to some extent by altering the means which people may use in the pursuit of their aims.” See Hayek, *The Road To Serfdom*, The University of Chicago Press 1972 p. 73
I admit that facilitating the cooperation maybe itself a good. But at the same time freedom and right also have its intrinsic value. If the subjective test has to be proposed in this way, the partisan either have to prove that what it brings is a Pareto improvement\textsuperscript{23}, or the flourishing of cooperation is supreme to freedom or the right to liberty or any other value that would be affected by the test. Otherwise, it is not yet justified to adopt such a test.

The duty of the law is to provide a framework for the fosterage of any value in order to leave room for the citizens to choose among those values by themselves\textsuperscript{24}. It is far away for the government to legitimate a certain value by devaluing the others. Doing in that way would be a start of legal paternalism or, to the worst when it goes to an extreme, totalitarianism.

\textsuperscript{23} In a Pareto improvement, there is at least one person be better-off while no one is worse-off. See Lieberman & Hall, Principles & Applications of Economics, South-Western 2010 p. 435

\textsuperscript{24} I join the contractarianism about the view that "individuals should be at liberty to live how they choose and make whatever agreements they see fit, and should be permitted to opt out of the application of legal rules." See Keay, "Directors’ Duties to Creditors: Contractarian Concerns Relating to Efficiency and Over-Protection of Creditors" The Modern Law Review, Vol. 66 No. 5 p. 674
The practical aspect

Epistemological problems

We now turn to the practical aspect and we will see another problem lies in the heart of the subjective test is that it is in fact unpractical. Consider the wordings used by the statute. It is talking about “the general knowledge, skill and experience that the director has”. However, what does it mean by “the director has” can hardly be determined. What can be the indicators to determine what knowledge does the director has? Should it be his educational background? Or the professional qualification(s) that he has? Or his working experience?

Let us have a trial. Suppose Mars was an accounting major student. He worked in an audit firm for three years after graduation. He has got a CPA qualification and after that he immediately left the firm and studied law. After his postgraduate study, he entered a law firm and has worked there for twenty five years. He no longer conducted any accounting related work after he left the audit firm but still holding the CPA qualification. And suppose that another director, Jupiter, has worked in an audit firm for thirty years while he has no accounting educational background. In his day a CPA qualification is not a must so he has never got the license and just let his colleagues to sign the audit report for the audit firm. Now suppose the company they work for has gone wrong. The shareholders bring a case to the court and sue the directors for a breach of duty laid down by the subjective test. Should the court treat Mars as an accountant or a lawyer? Or both? Should the court see Jupiter as a professional accountant? Assuming the case is about a mistake made in the financial account of the company that only a professional accountant should have discovered.
In a *de jure* sense, Mars is, for sure, a certified accountant but Jupiter is not. In a *de facto* sense, Mars is an idle accountant who has not toughed accounting for more than twenty years but Jupiter is undoubtedly an experienced accountant. If the court reasons according to qualification, then Mars is liable but Jupiter will be free to go; if the reasoning is on experience, Mars should be set free but Jupiter is liable; or if the court reasons by educational background, the liability goes back to Mars but not to Jupiter. In any way does the court decide, it will nevertheless be a conflict between educational background, professional qualification and working experience. Therefore, it is nearly impossible to tell what can be the indicator that could *ultimately* and *conclusively* determine what kind of knowledge one has. But if we confess that all are the indicators, then we have to assign a weight for each of them respectively and it just makes the situation be even more complicated.

If we look at the subjective test more closely in this way, putting aside the incommensurable nature of the measurements we have discussed, what we are doing is to assess a director’s competence by *objective* elements. Therefore, lifting up the subjective appearance of the subjective test, it is actually an *objectively subjective* test. So what is the point of conducting a test, which is in appearance subjective but in its nature objective, on the top of another, already existed, objective test? It is just a tantamount.

Moreover, we have to be clear about that knowing certain skills or knowledge is one thing but exercising that skills and knowledge is quite another. For instance, a person knowing the audit standards does not entitle that he is able to perform the audit procedure; a person knowing the law in certain area does not entitle that he is able to
conduc a trial in the court by himself. So if we assess one’s ability by some *soi-disant* objective facts, it is quite possible that we are focusing on the side of knowing rather than exercising.

Furthermore, for the general meaning of the terminology “knowledge”, I take it as an entity that must involve a *true* condition. It would be quite often a case that it is not the knowledge itself has been changed but it is the reality that has changed so makes the knowledge becomes no longer valid. Since the facts, such as ordinances and accounting standards, often change, whether the director has continuously catching up with the changes in reality would be a first-person assessable question that we are not in the position to know or, even whose, that the director himself does not know that he does not know. If there is a change in the facts that makes the knowledge possessed by a director becomes no longer (true) knowledge, given the statute aims at what subjectively does the director has, convicting him for a breach of subjective duty either by exercising the expired knowledge or not exercising the updated knowledge would be a wrong decision. Suppose all the objective evidences have suggested that the director should have known the related knowledge that he actually does not know. Then convicting the director would be unfair. But if the court could find out that the director is innocent and then to free the director (which is the desirable decision) in such a case, it must be the case that we have got some extra information which reveals

25 Professor Williamson gives an excellent example for this: “One is surely not always in a position to know whether one knows \( p \) (for almost any proposition \( p \)), however alert and conceptually sophisticated one is. The point is most vivid when the subject believes \( p \) falsely. Consider, for example, a situation of a well-informed citizens N.N. who has not yet heard the news from the theatre where Lincoln has just been assassinated. Since Lincoln is dead, he is no longer President, so N.N. no longer knows that Lincoln is President (knowing is factive). However, N.N. is in no position to know that anything is amiss. He continues reasonably to believe that Lincoln is President; moreover, this seems to him to be just another item of general knowledge. N.N. continues reasonably believe that Lincoln is President. Although N.N. does not know that Lincoln is President, he is in no position to know that he does not know that Lincoln is President.” See Williamson, *Knowledge and its limits*, Oxford University Press 2009 p. 23
the fact that the director is not in the position to know the change of the knowledge (or reality). That information must be something more than the objective evidence and lies within the director hence must be subjective in nature. So to speak, to assess the subjective ability of the director, we consider the objective facts. For the assessment of objective facts, it misses the subjective elements within the director so we go back to assess the director himself. It is logically begging the question. Therefore, adopting a single objective test would be a better way that I would like to defend in the last section to come.

The last thing I want to add in this section is about the vagueness of the concept competency. Let us briefly take the Olympic game as an example. Suppose there is a player that has generally been acknowledged to be the best player that the rest of all the players are not comparable to him. Now suppose the result turns out to be that the player has got a first runner-up rather than the champion. Then should I say that he has not utilized the competency he has?

The point I want to make here is that at usual when we say whether someone should have behaved in certain way given that person possesses certain talents, we are just making use of the objective facts to guess that we think that how he should have done. But when we want to know how much competency he has got is a question, ontologically speaking, about what actually turns out to be rather than what it is supposed to be. For the player in the Olympic game, if it is no reason for us to

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26 To say it more precisely, we are looking at the actual world rather than the possible worlds in a philosophical sense. To judge whether one has done his best or not, the answer may lie in the actual world of which the result has already been turned out. In certain situation, it would be nonsense, as in the Olympic game example, if we ask how that person would have been. See Kripke, Naming and Necessity, Basil Blackwell 1980 p. 15-20 for the elaboration of the concept of possible worlds which is shown in an example of dice thrown.
suspect that the player has cheated, then the result has honestly reflected how competent the player is. Since in reality there are infinite constraints, including physical constraint, mental constraint, time constraint, etc., it would be absurd to suppose that the player should have done better because what has turned out is already his best performance, if there is no cheating. The same applies to our directors. For directors face the same set of constraints as all we do, it is unfair to judge their performance only by the soi-disant competency that we think they should have and to conclude that they should have done better. What should be at stake is their intention, not the result. Given they have done all that they could without any fraudulent intention, the outcome should have been reached by them in doing their best. If what the subjective test aims at is, which I suppose that it should be, to prohibit wrongful act, then it should point to the fraudulent elements rather than referring to a conjecture. But it would be another problem that should not be dealt with in the section of directors’ duties.

Till this moment, I hope I have made myself clear that I stand by the side of laisser-faire that citizens should have a right to be free from any unjustified interference taken by the government. However, other scholars have raised different kinds of justifications for the imposition of the subjective test. In the following part I would like to examine those one by one and see if those are able to justify the imposition.
Justifications for the subjective test

The Economic aspect

Many scholars insist for a subjective test because of economics reasons. They believe that imposing duties on directors would increase the efficiency (or decrease the deadweight loss), lower the transaction cost and maximize the aggregated welfare.

Their argument flows in this way: The subjective test is going to dig out all the competence a director has and further push them to be conscious all the time on what they are doing in their position as a director, the excellent corporate governance would well be guaranteed. Given all the directors are doing their best, the efficiency is supposed to be higher than the otherwise, i.e. not having the subject test. And since the test is the law, there will be no other cost incurred on any other parties so that ideally the cost on selecting the director would be minimized for both the companies.

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27 English and Scottish Law Commissions once stated that the reforming of the directors’ duties should be guided by some principles including ideas that “the law should be a facilitator, working efficiently and cost-effectively”. See Worthington, “Reforming Directors’ Duties”, The Modern Law Review, Vol. 64 No. 3 p. 442. Some argue for not imposing, but their reasoning is also focusing on the economic aspect, see Keay, “Directors’ Duties to Creditors: Contractarian Concerns Relating to Efficiency and Over-Protection of Creditors” The Modern Law Review, Vol. 66 No. 5 p. 675. Some link the efficiency to the maximization of aggregate wealth or welfare, see Riley, “The Law Commission’s Questionable Approach to the Duty of Care and Skill” Company Lawyer, Vol. 20 No. 6 p. 198.

28 “From an economic point of view a codified statement of the law could help reduce legal costs. Without the law, parties would probably have to incur considerable transaction costs if they had to draft the terms of such a duty privately and the parties would have to fix all requisite conduct in advance” See Zwinge, “As Analysis of the Duty of Care in the United Kingdom in Comparison with the German Duty of Care”, International Company and Commercial Law Review, Vol. 22 No. 2 p. 37.

29 Some go to a more extreme economic-orientated mind and believe that even the objective should serve the economic aspect: “[T]he question has to be asked what the law’s purpose should be in promulgation a duty of care and skill. Arguably the answer should be to maximize the parties’ aggregate welfare, that is, the joint welfare of the parties but not necessarily the welfare of each individual party.” Zwinge, “As Analysis of the Duty of Care in the United Kingdom in Comparison with the German Duty of Care”, International Company and Commercial Law Review, Vol. 22 No. 2 p. 37, italics mine. Some argue in favor of not imposing but they also lay their argument on the ground of “maximizing aggregate social welfare”, see Keay, “Directors’ Duties to Creditors: Contractarian Concerns Relating to Efficiency and Over-Protection of Creditors” The Modern Law Review, Vol. 66 No. 5 p. 676-677.
and directors. Hence the test leads to the prosperity of the companies and further to the society as a whole.

For the moment, I leave aside the problem about whether it is really the case that would happen in the reality. Let us suppose, arguendo, the subjective test is going to bring some economic benefits, say, greater aggregated welfare or higher level of efficiency.

To argue for the imposition, the partisans have three strategies. They may claim that the economics outcome is of itself a desirable one and worth to be pursued just for its own sake. Or they may claim that that is one of the desirable outcomes, among many, that our legislation should pursue and on top of that the subjective test helps in achieving that without harming the other social values. The last strategy is to claim that although the economics benefit is not itself a desirable end, it has its instrumental value in bringing us to a desirable end.

It is not hard to show that the first strategy is vulnerable. Suppose our society has certain level of wealth, certain pattern of wealth distribution and the directors enjoy certain degree of freedom (if it is measurable). Now suppose there is a new law being enacted and the effect it brings is that the total aggregated welfare would be increased but the distribution of the wealth would be concentrated in a small group of people. Also, the freedom enjoyed by the directors would diminish greatly. Givens this result, I believe it would be questionable about whether the new law should be enacted. But for the partisan of the first strategy, they would have to confess that the new society is pro tanto better and the new law is tout court good, since it increases the aggregated
wealth, regardless what the other changes that follow. It is obviously contradicting own sense of justice\textsuperscript{30}.

The partisans may have a better claim under the second strategy. Under this strategy, they would admit that apart from wealth there are some other values like freedom and justice. Although the subjective test is going to give a greater burden to directors and to infringe their right to liberty, it is nevertheless good to be imposed since it brings economic benefit. At this point, I would have to ask the partisans for a clarification. Do they mean that, given all the desirable components, there is an ideal status that could be reached of which combined those components which serve as ingredients of the ideal status that respectively have certain weight? Or do they mean that there is nothing to be considered about the pattern of the combination of those components but the only consideration is to seek for the greatest amount of each component as possible because of the fact that each of them should be valued for its own sake? For simplicity, I would like to adopt Dworkin’s categorization and to name the former as recipe theory and the latter compromise theory\textsuperscript{31}.

To better illustrate the recipe theory, let us suppose that, ontologically speaking, there is an ideal statue of which there is a certain degree of liberty that should be enjoyed by the directors, certain amount of economics benefit that should be generated by them and certain burden that should be borne by them. With the combination of these three components, the status reached would be ideal. Assume that the subjective test is going to a right direction that changes the three components and makes the reality

\textsuperscript{30} This kind of utilitarian rationale as presented ignores the distribution of wealth so has long been criticized. See Smart & Williams, Utilitarianism For and Against, Cambridge University Press 1973 p. 134-135 and Rawls, A Theory of Justice, Harvard University Press 1971 p. 25-27

\textsuperscript{31} Dworkin, A Matter of Principle, Oxford University Press 2001 p. 268
more like the ideal case. Then, it should not be regretted by anyone about the change of any of the components. Just like when we are making a cake we are only aiming at the production of the cake and it is no point in regretting for not putting more eggs or flour in the beginning, given the cake has been made perfectly. However, it is plainly not the case here since liberty, justice and wealth stand on its own. I suppose, ceteris paribus, the more of anyone of these would be pro tanto a better result. I doubt about whether the soi-disant ideal status ever ontologically exists, putting aside whether that is practically discoverable. So the recipe theory is deemed to regress to a compromise theory.

But the compromise theory faces severe challenges also. As it is now the case that all the components have its own value, any sacrifice of one in exchange for another would be an arguable case. The problem lies in the fact that there is neither objective criterion nor subjective criterion to judge whether the change is desirable or not.

For the objective criterion, I mean that those components are in fact incommensurable. As John Finnis has stated:

“...In short, no determinate meaning can be found for the term ‘good’ that would allow any commensurating and calculus of good to be made in order to settle those basic questions of practical reason which we call ‘moral’ questions. […] To maximize net good is senseless, in the way that it is senseless to try to sum up the quantity of the size of this page, the quantity of the number six, and the

32 For simplicity, in saying that these values stand on its own I assume, arguendo, that these are values that are not dependent on the social practices notwithstanding the fact that wealth may not fall in this category. See Raz et al., The Practice of Value, Oxford University Press 2005 p. 19, 34
quantity of the mass of the book. […] Similarly, each of the basic aspects of human good is a good and thus has in common with the others the feature that, of it, one can sensibly ask ‘Is this something I should rather be getting / doing / being?’ but the different forms of goods, like the different kinds of quantities, are objectively incommensurable.”

For what is at stake is about wealth, liberty and justice which are independent from each other. But can the partisans get rid of it by reversing all these into one criterion just as what Jeremy Bentham had done in raising utility to be such a criterion? I believe the answer is no since picking up any one of them would seem to be arbitrary and vulnerable to any attack. Even if we transform it into something like the “primary good” as John Rawls has stated in his famous book, we would be going too far away and lost its meaning in our discussion. And I doubt any economics-minded scholar would take it to be his position. Even Richard Posner confesses that freedom should be valued for its own sake apart from economic consideration and wealth should be departed from utility.

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33 Finnis, Natural Law and Natural Rights, Oxford University Press 2011 p. 115, italics mine.
35 “The primary social goods, to give them in broad categories, are rights and liberties, powers and opportunities, income and wealth.” Rawls, A Theory of Justice, Harvard University Press 1971 p. 92
36 “Freedom appears to be valued for itself rather than just for its contribution to prosperity – or at least to be valued for reasons that escape the economic calculus.” Posner, The Problems of Jurisprudence, Harvard University Press 1990 p. 379
37 Posner, “Utilitarianism, Economics, and Legal Theory” Journal of Legal Studies, Vol. 8 No. 1 p. 110. But it is confusing that he sometimes seems not intended to distinguish between these two concepts. In his book Economic Analysis of Law he states that “[c]entral to this book is the further assumption that man is a rational utility maximizer in all areas of life, not just in his ‘economic’ affairs.” (Posner, Economic Analysis of Law, Aspen 2003 p. 4, italics mine) However, obviously the concept utility must be broader than the concept wealth (which is the unit that Posner has used in his calculation throughout the whole book). Therefore, it logically follows that his calculation has missed out something in between utility and wealth. I suspect whether it is the rationale behind that forces him to confess that there are values other than wealth, as I have quoted in footnote 37 above. To put it plain, but not less accurately, the economic analysis of the statute fails no matter utility is independent from wealth or not.
For the subjective side, I mean that in considering individuals’ preference, there is simply no right answer for the question. If I ask anyone to decide whether a more just society of which everyone enjoys higher level of liberty or a wealthier society of which the wealth has been maximized is more preferable, the answer would simply fluctuate among different persons. If the partisans of the subjective test want to argue for the test in virtue of the economic benefit, they are actually ignoring the individual difference.

For the last strategy, the problem is more conspicuous. In saying that the wealth maximization has its instrumental value, an ultimate value (that being served by the wealth maximization) has to be stated. Assume the ultimate value is justice. To support the subjective test, the partisans are claiming that not only the subjective test is maximizing wealth but the wealth that being maximized is also leading us to justice. But then the focus would have been shifted. Why do not we just focus on justice but on wealth in such a case? When claiming that the test should be imposed, the partisans are making use of the economic benefit to serve as a justification. So the imposition is just just because it maximizes wealth. There is simply no independent value that can be used to judge whether the test is suitable or not. The legitimacy of the test is derived from, and only derived from, the economic outcome. Whenever there is a legislation that maximizes wealth, it should be imposed according to this theory. Then the ultimate value, justice, is simply out of place. The partisan can claim that the imposition is right but what they cannot do is to claim that it is right because of a reason other than the economic consideration. And if they want to disclaim my choice and to say that justice is not the ultimate end, they would have to give their

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38 Dworkin, A Matter of Principle, Oxford University Press 2001 p. 252
own answer and in addition of it to prove that the enlargement of wealth must go with the same direction with the enlargement of the ultimate end they have just chosen. In any case, the focus will be lapped to wealth rather than the ultimate end. Therefore, wealth maximization is a disguised instrumental value – it is de facto the ultimate value. So we go back into the trap that we have met in the first two strategies. The problem is actually not yet been solved.

To this point, I hope it is clear that the economic aspect is more complicated and unpersuasive than we have seen it at first sight. Before moving to the next point, I would like to make one thing clear. I am not saying that an economic consideration can never be a justification, but we should not begin our search of a justification in an economic aspect. If the counter arguments I have raised in the first part are sound and valid, it is enough to disclaim the claim that the economic benefit brought by the subjective test is enough to justify the imposition.

Legal aspect

In this part I would like to examine the arguments raised in the legal area.

Some scholar suggests that the subjective test is a test that has been used by the courts for a long time. Thus, the subjective test should be kept since the courts are now having the expertise to use the subjective test. I doubt whether it is an argument that

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39 The economic analysis in fact attracts quite a lot of criticisms, example like: “Professor Goodhart quite correctly goes on to point out that the law and economics approach seems, at times, to elevate the achievement of economic efficiency above concepts of justice and equity.” Miller, “The Role of the court in Balancing Contractual Freedom with the Need for Mandatory” University of Pennsylvania Law Review, Vol. 152 No. 5 p. 1650
ever has any power. Does it mean that if there is any better test it would be
nevertheless inappropriate to substitute the inferior one with a better one? For what is
in the discussion is about fairness and justice which are thoroughly out of the scope of
the discussion about the ability of the courts in applying the test. If there is a better
test that could be developed, the courts have to overcome its inability in using it. It is
not the test to compromise the courts, but the other way round.

Another argument argues that the subjective test is just a subset\(^{40}\) of the existing tort
law or restatement\(^{41}\) of the existing law. This is an argument that possesses certain
strength. For illustrative purpose, we focus on the existing tort law.

To claim that the subjective test is relevant to the existing tort, I believe that the
partisans are pointing to negligence. I admit that directors owe several duties to the
company. But the duty under negligence is not necessarily equivalent to the duty
directors owe to the company. The nature of the two duties is not the same indeed. For
the reasonable person test in tort is conducted in an objective manner. In *Blyth v
Birmingham Waterworks Co*, Judge Alderson B. has said\(^{42}\):

> “Negligence is the omission to do something which a reasonable man, guided
> upon those considerations which ordinarily regulate the conduct of human affairs,

\(^{40}\) The duty of care owed by a corporate director is merely a subset of the duty of care imposed on
individuals in society by tort law.” See Rowland, “Earnings Management, the SEC, and Corporate
102, No. 1, p. 194

\(^{41}\) Some Scholars claim that the codification of the Companies Act 2006 s. 170-181 in UK which
includes the dual test is not just limited to the tortious duty of care but nevertheless generally “seeks
only to restate the principles as they exist at common law and in equity at the time of codification”.
Vol. 66 No. 2 p. 362

would do, or doing something which a prudent and reasonable man would not do."

In conducting the test, there is nothing to do with the ability one possesses. So it is actually an argument supporting an objective test rather than a subjective one. Let me further illustrate it with the foreseeability test as an example. Now suppose we subject to a subjective test just like directors are supposed to be under the s465 (2) (b). For the foreseeability test, the courts would have to make adjustment in their decision between different people since it is obvious that some people foresee further but some do not. But it is never an approach to be taken to define the foreseeability according to the competence of the defendant. The courts actually conduct the test by constructing a hypothetical reasonable person. So it is clearly not the case that we subject to a subjective test.

But the proposer of the subjective test may argue for the professional standard of care rather than an ordinary duty of care. However, when we look into the Bolam test\textsuperscript{43}, we would not find any subjective elements either. The Bolam test is in fact focusing on the hypothetical reasonable skilled person and to ask what would that person do in the case at stake. It is never the courts’ consideration in what skill the defendant has and how he would do. So, once again, it is an objective test\textsuperscript{44}.

Partisans of the subjective test may ground another argument on the certainty of the

\textsuperscript{43} Ibid p. 151

\textsuperscript{44} I think it is quite clear that this kind of test is generally conducted using objective elements: “The common law has long recognized that if an employee [...] holds himself out to possess a particular skill he will be held to an objective standard of reasonableness in its exercise.” See Zwinge, “As Analysis of the Duty of Care in the United Kingdom in Comparison with the German Duty of Care”, International Company and Commercial Law Review, Vol. 22 No. 2 p. 38
law. They may argue that the codification of the subjective test has increased the cleanness of the directors’ duties since before the codification the courts mainly rely on the common law principles. But if I am right in presenting the example of Mars, Mercury and Jupiter in part one, whether codifying the subjective test or not does not matter. It is tout court the test itself that creates a large degree of vagueness.

Or let me reply to their argument precisely. What they are claiming is that the change of a subjective test from a common law principle to a statute would make the subjective test becomes clearer. However, I am reserved about this claim and wonder if they have mixed up a rule and a principle.

Let us return to the case of Mars and Mercury. After their case (let us name it case A) has been decided by the court, the court has in fact derived a new rule from the statute of subjective test. The new rule (let us name it rule A) is that anyone has the competence as Mars and Mercury do would not be held liable under the circumstance of case A. However, before the case has been decided, this rule has not yet existed. The court is actually citing the statute as a justification to justify the creation of the new rule. Suppose there is another case B, with the circumstance slightly different from case A, comes to the court. Although the difference is small but it is crucial to the extent that turns the head of the court and makes Mars and Mercury liable this time. So there is another new rule B, namely, anyone has the competence as Mars and Mercury do would be held liable under the circumstance of case B. But the justification of this rule, which is the statute of the subjective test, is actually the same

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45 Ahern, “Directors’ Duties, Dry Ink and the Accessibility Agenda” Law Quarterly Review, Vol. 128 p. 120
as rule A. So here comes the question: What makes the difference? How can the same rule simultaneously justify two new rules that go to opposite directions? There must be another domain other than only the statute that can justify the change. That domain is the principles. In applying the statute, the judge in fact makes use of some kinds of *inexhaustible* principles to justify the usage of the statute of which he used to justify the creation of the new rules. Those principles are always precedent to any new rule and only because of this could those principles be able to have the legitimacy to justify the change of the application of the statute. Since the principles have weight (unlike the rules which are applied in an all-or-nothing manner), only principles could explain why certain facts matter in case B but not in case A (or vice versa) and why the similar facts in both cases have different degrees of importance hence lead to different results. So given the vagueness of the statute of the subjective test, the test is deemed to be applied with principles rather than just itself as a rule. Then it would be strange to change the subjective test, which should be applied as a principle in nature, from a common law principle to a statutory rule. Therefore, it is quite misleading in saying that the codification of the test creates higher degree of certainty.

The last claim I would like to consider is that the subjective test serves the spirit of the companies ordinance better since the CO is used to facilitate cooperation and benefit all in the society. I have mentioned the relevant points before in part one. I admit that some of the objectives of the CO are to facilitate cooperation and benefit citizens.

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48 Ibid p. 37
49 Ibid p. 26
50 Ibid p. 24
51 “Company Law, we are told, “is a functional area of law: it must facilitate commercial activity and enable, or at least not prevent, the delivery of benefits to all the company’s stakeholders.” Riley, “The Law Commission’s Questionable Approach to the Duty of Care and Skill” Company Lawyer, Vol. 20 No. 6 p. 199
But it is far from saying that the imposition of the subjective test can serve the two objectives.

The subjective test has raised the burden borne by the directors. It has tightened its standard of regulation. I have not yet seen any reason why a stricter regulation must entitle a better cooperation or any benefit. If that is really the case, I wonder why not the proposers spread the subjective test out to other occupations. Giving an appropriate degree of flexibility to the directors would flourish cooperation and bring benefit also. What the government should do is to provide a framework that protects everyone but to let the people to cooperate by themselves. It is not its job to do more than that.

**Teleological aspect**

The proposers of the subjective test have another ground to build their arguments. Quite a number of them tend to say that the test is actually serving some purposes. The test, as they said, creates common good, helps Hong Kong to build a better image\(^52\), enforces modern business practice, satisfies public expectation\(^53\) and prevents financial crisis\(^54\). Let me try to make sense of these claims one by one.

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\(^{52}\) “Good governance is crucial to maintaining Hong Kong as a leading international finance centre of quality.” Spink & Chan, “The Hong Kong Company Director’s Duty of Skill and Care: A Standard for the 21St Century?” Hong Kong Law Journal, Vol. 33 p. 146


\(^{54}\) “The 2008 financial crisis has revealed an unprecedented level of distrust in business management teams [...] As a result, regulators provide regulatory support towards vigorous markets benefiting from
I think to this point it is quite clear that the subjective test has asked the directors for too much. It has put an unreasonable burden on them. So the only way to say that the subjective test could create common good is to rely on the utilitarian doctrine. The logic is that it is better to let a small group of people (the directors) suffer than to let the aggregated utility of the whole society diminishes. The directors are taking up the responsibility that they would not have been taken had the subjective test been not imposed for the society as a whole. The improvement of the corporate governance and the flourishing of the companies are the so-called common goods, in their reasoning.

The first question arises from the concept of common good. I doubt whether there is the common good that no one would disagree about. Even if I admire the flourishing of the companies is good, it is only a common good. Is not the right to free from governmental intervention also a common good? So if the partisans of the subjective test want to insist that the test promotes common good, they should either prove that their common good is superior to the common good infringed by the test or provide another justification that could justify the infringement. However, the former, as I said before, faces the problem of incommensurability and the latter has not yet given by them. This point also answers the claim that the test helps Hong Kong to build a better image. For a city assigning a reasonable responsibility to directors is no less desirable than a city imposing unreasonable burden on directors in exchange for the flourishing more efficient corporate control, imposing new regulations or reconstructing corporate governance mechanisms that limit managerial discretions and/or enhance directors; accountability.” Zhao, “Promoting More Socially Responsible Corporations Through UK Company Law After the 2008 Financial Crisis: the Turning of the Crisis Compass” International Company and Commercial Law Review, Vol. 22 No. 9 p. 280

55 I suppose they may argue in claiming that the total situation of having the subjective test is better than the total situation without it. See this kind of reasoning in Smart & Williams, Utilitarianism For and Against, Cambridge University Press 1973 p. 32-33
of companies.

The second question arises in the reasoning. I think it is quite clear that the problem lies in the test is about the test itself. It is also a reply to the claim about enforcing modern business practice. The arguments we should be looking at is about whether the test is right or not rather than what follows from the test. If the benefit of the majority follows is enough to justify the infringement of directors’ right, does it mean that any policy that would benefit the majority will nevertheless be justified even a minority suffers? Then that will be a tyranny of the majority that leaves us no place to talk about rights. That is a way of reasoning that I think we should unreservedly contempt. And if the so-called business practice is not respecting individuals’ right, then why should we follow? On top of that I even doubt whether it is really the modern business practice.

For the point about public expectation, I wonder if the public has a right to ask the directors to conform to their expectation. It would be strange to ground the argument on that. For instance, if the public expects the Chief Executive to do better (which I think the public does), does it mean that we should impose a subjective test on the CE to ask him to do better? If we transform their argument to a Hohfeldian right model, their mistake would be conspicuous:

(1) A has a claim-right that B should φ, if and only if B has a duty to A to φ

(2) B has a liberty (relative to A) to φ, if and only if A has no-claim-right (‘a no-right’) that B should not φ

(3) B has a liberty (relative to A) not to φ, if and only if A has no-claim-right (‘a
Now it is clear that if the public wants to ask the directors to conform to their expectation, they should prove that the directors have a duty to them and they have a claim-right to the directors. However it would be absurd to say that the *tout court* expectation could form any right in favor of the public to make any claim on directors. Therefore, it is obvious that any argument builds on expectation must fail.

For the last point about preventing financial crisis, my reply is that the proposers have gone to a wrong direction. I agree that the financial crisis is a problem that we should not overlook. But should the burden be put on directors is another matter that we have to consider carefully.

Let me take an example plainly to show the problem. Now suppose the crime rate in Hong Kong has increased. Then what the government should do, I suppose, is to put more resources into the police force and all related departments to tackle the problem. It can do everything but putting the burden on citizens and to try to tighten the law in order to prevent crimes. The same applies to the market. If the government thinks that there is a tendency that the risk of having financial crisis has increased, what it should do is to strengthen the regulating department, like the Securities & Futures Commission, rather than putting the burden on directors. Therefore, I think they are just going to an opposite direction to look onto the directors.

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Individual aspect

The last aspect I would like to consider is on the individual level. Partisans of the subjective test raise arguments on the ground that the test actually promotes activism among directors. In addition, it is fair to ask for the performance of some expertise or skills or knowledge since directors are hired on that ground. Moreover, the test protects other stakeholders.

According to what the partisans say, the subjective test in fact serves as an incentive that encourages the directors to be more active in the board. But as I have said before, they are seemed to be whipped rather than encouraged to take an active role. And I am quite confused about the rationale behind why the activism should be linkage with the legislation. If now the government thinks that the voting rate is not meeting its expectation, does it mean that the government has to pass an ordinance to “encourage” the activism among citizens? It goes back to what we have examined before. It is one thing that the directors have a moral duty to do more but it is quite another in saying that they have a legal duty to be active. It must not be confused between what the directors ought to do and what they are required to do.

The next point is about fairness. Partisans say that the directors are hired because of

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57 “A subjective standard could entail a real movement away from the law’s toleration of passivity if the standard was combined with an onerous account of the role of the director and its constitutive functions” Zwinge, “As Analysis of the Duty of Care in the United Kingdom in Comparison with the German Duty of Care”, International Company and Commercial Law Review, Vol. 22 No. 2 p. 37

58 Example like the Joint Consultation Paper of the Law Commission of England and Scotland: “[W]e consider it fair that if he has some special expertise he should exercise it”. Paton, “Codification of Corporate Law in the United Kingdom and European Union: The Need for the Australian Approach” International Company and Commercial Law Review, Vol. 11 No. 9 p. 315

59 Clark, “The Director’s duty of skill and care: subjective, objective or both?” Scots Law Times, Vol. 27 p. 242

60 See footnote 1
the fact that they possess some special skills. Then it follows that it is fair to ask for
the performance of all those skills. For what the partisans are claiming is that it is the
company’s intention to hire directors on the ground that they are experts in certain
area.

What I would disagree about is their reasoning. I admit that companies hire directors
in virtue of their competence. But that competence must not necessarily overlap with
the competence that the subjective test is demanding. In a fair circumstance, what
kind of performance that the company is demanding the director should be clearly
stated or mutually understood between both parties. That reflects the degree of
competence that the company is expecting. But for the subjective test, what it is
demanding is beyond what is previously agreed between both parties. I am not saying
that what the company has demanded on the director cannot be what the subjective
test is demanding. But what the company has demanded must be logically narrower
than what the subjective test is demanding.

I think the partisans have mixed up the concept between what should have intended
and what did have intended\textsuperscript{61}. To make this point clear, let us assume a director has
signed a completed\textsuperscript{62} contract with the company of which has stated his duty
precisely. Now suppose there is a case comes to the court that the director is being
sued for his breach of duty under the subjective test. The plaintiff, that is the company,
may argue that the director is under a statutory obligation to fulfill his subjective duty
notwithstanding the fact that the contract has not stated that in detail since that

\textsuperscript{61} Dworkin, A Matter of Principle, Oxford University Press 2001 p. 20
\textsuperscript{62} It is to eliminate the vagueness raised from the view that the corporate law fills the gaps within any
uncompleted contract. See Keay, “Directors’ Duties to Creditors: Contractarian Concerns Relating to
Efficiency and Over-Protection of Creditors” The Modern Law Review, Vol. 66 No. 5 p. 672-673
subjective duty attribute to the company’s intention in hiring that director. I wonder if it is really fair and just for the plaintiff to make this kind of claim. That duty has not been stated on the contract is not an argument that supporting their claim, but it is quite an argument that against that. For both parties did not state clearly what duty is required in words in the contract in order to put the intention into effect is not a fact that reflecting they were having the intention to ask for that duty, but it is the fact that they did not. There could be quite a lot of reasonable reasons that no less persuasive than the plaintiff’s claim that support why the duty has not been put into the contract. Maybe just because that has never come to their mind and that would be excluded and not being stated in the contract had that come to their mind. It is now clear that the fairness lies in what both parties did have intended rather than what we assume both parties should have intended. Now the subjective test is actually assuming that there is more than what did have intended and hence prejudicing the directors and putting them into a disadvantage. If companies want to make a claim base on their intention of recruitment, they should state that on the contract or agreement rather than rely on the statute to create and assign that intention retrospectively at the time in the court. And it is not the job of the CO to help companies to take advantage over directors.

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63 Dworkin, A Matter of Principle, Oxford University Press 2001 p. 20
64 Endicott argues in a similar approach for incomplete agreements and stated that “It seems that the role of a court is (not to impose on the parties those obligations they intended to undertake but) to hold the parties to just those obligations that they agreed to undertake.” See Horder et al., Oxford Essays in Jurisprudence, Oxford University Press 2000 p. 163, italics from the Author.
The objective test

I hope to this point I have made myself clear that I oppose the subjective test. But I nevertheless support an objective test and in the following I would try to reply to the critics against the objective test. But first of all I would like to establish the legitimacy of the objective test.

Theoretical aspect

Unlike the subjective test, the objective test does not aim at pushing the directors. Its objective is to serve as a safeguard to prevent any unreasonable misconduct. It has long been a tradition that anyone whose action is very likely to cause influence to his neighbors, that person is very much likely to owe a duty of care to others. But of course, in the language of CO, it is the company itself owes a duty of care to others, strictly speaking. However, it does not mean that there should be no one taking the responsibility of the company. For the company is just an agent acting according to what has been decided by “its brain”, i.e. the board of directors. In the usage of language we personalize the company but, still, the directors should be responsible for the action of the company:

“We suppose that the corporation must itself be treated as a moral agent, and then we proceed by applying facsimiles of our principles about individual fault and

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65 In Lord Atkin’s own words, he stated that “Who, then, in law is my neighbour? The answers seems to be - persons who are so closely and directly affected by my act that I ought reasonably to have them in contemplation as being so affected when I am directing my mind to the acts or omissions which are called in question.” See Hutchinson, Laughing at the Gods :Great Judges and How They Made the Common Law, Cambridge University Press 2012 p. 123
responsibility to it. We might say that anyone who has had full control over the manufacture of a defective product has a responsibility to compensate those injured by it.” 66

Given the fact that it is the directors who are controlling the company and the company’s action is very likely to influence others, the director should have the responsibility to act with reasonable care. Therefore, it is legitimate to impose an objective test on directors in the way like the reasonable test imposing on us, as a normal citizen, under the law of tort.

But those opposing the objective test may say that since I oppose the subjective test on the ground that the test infringes directors’ freedom, I would be inconsistent to myself if I nevertheless support an objective test given it does the same as what the subjective test did. So I would like to clarify the difference between the abstract rights and the concrete rights. 67

As I have said, I suppose, any person should have the right to liberty of which the government should not intervene that person without proper justification. However, that does not entitle that the government should never put restriction on one’s freedom. For any individual in the society also enjoy a right to be freed from the interference of other individuals. In such a case, what are at stakes are the competing rights of individuals. The government must, of course, take into account the right of liberty, which is a very abstract right, into account. But it should nonetheless strive a

66 Dworkin, Law’s Empire, Hart Publishing 2012 p. 170, italics mine
balance between the interests of those to be protected and the right of liberty of those to be guaranteed by which to define the concrete rights of individuals, i.e. the right to liberty of which the reasonable care is inbuilt. To achieve the balance, the objective test can rely on the tort law doctrine but the subjective test cannot. That is why the objective test is more theoretically grounded and hence more preferable than the subjective test.

**Practical aspect**

The objective test is not aiming at finding out what is the *best* a director could do. It is quite the opposite. It only aims at the *threshold* which should be met by a reasonable hypothetical director in that position. What is in our consideration is only the single objective standard. The individual difference between different directors would not been taken into account. Therefore, the objective test actually could get rid of the challenges toward the subjective test.

**Reply to critics**

The first critic is that the objective test punishes those directors who have done their best. The proposers think that the standard established by the objective test may be

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68 Some scholars stand by this view. Example like: “[T]he judicial and statutory legal environment must strive for a balanced approach that considers the interests of the majority as well as the interests of the minority.” Miller, “The Role of the court in Balancing Contractual Freedom with the Need for Mandatory” University of Pennsylvania Law Review, Vol. 152 No. 5 p. 1648

so high that the director just could not meet. I wonder if it is possible that the standard would turn out to be that high since what is at stake is about *reasonableness*. But dwelling on that would be meaningless so I would like to turn to the reasoning behind.

To take a more radical approach, I admit the view that punishing those who have done their best maybe *a priori* true but it is nonetheless *a posteriori* false. I suppose that any position would have been supposed to perform certain functions. At most of the time when we judge anyone who is holding any position about whether that person is blamable or not, we are looking at the objective function that that person is supposed to perform. We blame the person regardless whether his has done his best or not. For one has choices prior to taking up the position, at the time when one has chosen to take up that post, one is subjected to a set of objective standard. When someone has taken up a position, it is not an excuse to discharge his responsibility *in that position* by saying that he has done his best. So those who raise this claim have actually missed out the context that the directors have taken up the directorship by themselves. I suppose they would reply to my reply in saying that my reply has discriminated those directors who have not met the minimum standard. But is not the criteria used by the Transport Department in picking up the qualified drivers also “discriminates”, using their terminology, those incompetent candidates? Can I say that the Transport Department “discriminates” those who suffer from narcolepsy by not letting them to apply for a driver license? As I have said before, the objective test serves in a protective manner, then it is obvious that it should pre-suppose some criteria in taking up the directorship in order to prevent any misconduct, leaving aside deliberately conducted or not, *in advance*. 
The second critic is raised on the ground that there is no definition about concepts like reasonableness and directors’ duties. Since there are no such definitions, any attempt in trying to make judgment base on these concepts is deemed to fail.

Before replying to this claim, I would like to make it clear on what does it mean by “no definitions”. Does it mean that there is ontologically no such definitions? Or does it mean that those are concepts that vary among different people hence cannot be exactly defined since there are too many definitions? To reply to these respectively, it is better to look at an example.

Suppose I have made a definition on the concept of reasonableness. The proposers of the second critic, if they stand by the first form of no definition thesis, would object

Quite some scholars take this kind of skeptical approach about different concepts. Example like fairness: “[F]airness is ‘one of the great unexplained mysteries of corporate law.’ Undoubtedly, one reason for this is the fact that ‘fairness’ is intuitive.” See Keay, “Directors’ Duties to Creditors: Contractarian Concerns Relating to Efficiency and Over-Protection of Creditors” The Modern Law Review, Vol. 66 No. 5 p. 678

“’[T]he reasonable man’ standard is inapplicable. […] [T]he notion of a ‘reasonable director per se appears chimerical.’” Finch, “Company Directors: Who Cares about Skill and Care”, The Modern Law Review, Vol. 55 No. 2 p. 205 and “Jurors are enjoined to find the accused guilty of a negligence-based offence only if his conduct has fallen below the standard to be expected of a reasonable man: that standard is left to them with no further definition.” See Horder et al., Oxford Essays in Jurisprudence, Oxford University Press 2000 p. 85 italics mine.

Some scholars think that the duties of the directors are hard to be construed with consistence or there is no single standard that could be found. Examples like: “[H]aving in mind the age of most of the cases and their different commercial environment, it is not possible to construe any consistent statement of the law from them. As Romer J. himself said, the practical duties of a director in one company will differentiate significantly from those of a director in a different company. The tasks of individual directors within the same company also may fluctuate greatly.” Zwinge, “As Analysis of the Duty of Care in the United Kingdom in Comparison with the German Duty of Care”, International Company and Commercial Law Review, Vol. 22 No. 2 p. 33 and “Indeed, no single objective test appears feasible. Directors do not form a homogeneous category […] Few would demand the same level of skill from the director.’” Finch, “Company Directors: Who Cares about Skill and Care?” The Modern Law Review, Vol. 55 No. 2 p. 203 and “The adoption of an objective standard has not received express consideration in Ireland. The point if often made that the failure to adopt an objective stand reflects the fact that directors are a non-homogenous grouping because, unlike in the case of the professions, there is no common entry in terms of qualifications and training.” Ahern, “Legislation for Directors’ Duty to Exercise Care, Skill and Diligence in Ireland: A Comparative Perspective” International Company and Commercial Law Review, Vol 21 No. 8 p. 269 and see also Riley, “The Company Director’s Duty of Care and Skill: The Case for an Onerous but Subjective Standard”, The Modern Law Review, Vol. 62 No. 5 p.714-715
me in saying that my definition is wrong because there is no definition about that. But to make a sound and valid objection, they have to tell me and explain to me which part of my definition is wrong or how my definition goes wrong. However, for them to answer my question, they actually must have presupposed an answer otherwise. Even if they cannot tell what the answer is, they cannot deny that the answer exists and if and only if that exists could they say that I am wrong. Therefore, they are indeed participating in my task of defining the concept of reasonableness to give a judgment by which gives me one more option of definition. Then the situation is that they are giving me one more definition for me to choose rather than proposing that there is no definition. Of course they can say that I am wrong, but what they cannot do is to say that I am wrong yet simultaneously to insist that there is no definition.73

For those proposers stand by the second form of no definition thesis, they may agree to me that definitions exist yet having their own version of definition. They disagree with me about the content of it. It is an objective more powerful than the previous one. But having definitions does not entitle that we could not find out a definition that most of us would agree to. Among those definitions there must be an overlapping area in between. Using the language of Rawls, we can find out the overlapping area by the mechanism of reflective equilibrium:

“In searching for the most favored description of this situation we work from both ends. We begin by describing it so that it represents generally shared and preferably weak conditions. We then see if these conditions are strong enough to

73 Dworkin categorizes the two kinds of skepticism as internal skepticism and external skepticism. Furthermore, he argues that both forms of skepticism fail. In his eyes, this kind of skepticism would be an external one while the following is the internal skepticism. See Dworkin, Law’s Empire, Hart Publishing 2012 p. 78-86
yield a significant set of principles. If not, we look for further premises equally reasonable. But if so, and these principles match our considered convictions of justice, the so far well and good. But presumably there will be discrepancies. In this case we have a choice. We can either modify judgment, for even the judgments we take provisionally as fixed points are liable to revision. By going back and forth, sometimes altering the conditions of the contractual circumstances, at others withdrawing our judgments and conforming them to principle, I assume that eventually we shall find a description of the initial situation that both expresses reasonable conditions and yields principles which match our considered judgments duly pruned and adjusted. This state of affairs I refer to as *reflective equilibrium*.”

If anyone disagrees with my definition, he must have another one and by comparing between the definitions of mine and his we could nevertheless find out the *core* conceptions of the concept. Again, in Rawls’ words, he stated that:

“*[T]he best account of a person’s sense of justice is not the one which fits his judgments prior to his examining any conception of justice, but rather the one which matches his judgments in reflective equilibrium.*”

Of course no one can make an exact definition to define justice. But it does not mean that we cannot distinguish between just and unjust. The same applies to the concept of reasonableness. Although we may not be able to define the concept in an exact manner, we can nevertheless distinguish between reasonable and unreasonable after

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75 Ibid p. 48
we have considered conceptions of reasonableness. Hence we must be able to work out an operable definition\(^76\). In virtue of this, the attack of the no definition thesis lost its aim and hence it fails.

The third critic is that the objective test provokes cautious behaviors\(^77\). Let me briefly reply to this.

I think this is a strange objection because it is an objection that can be used exactly to object the “neighbors rule”\(^78\). What they say is that imposing an objective test on directors would make them feel unsafe about breaching the objective duty so they would act more cautiously. Then can I say that, using their logic, the “neighbors rule” actually is provoking cautious behaviors among all citizens because the rule is binding to all? I do not think it is quite the situation. For we all know that anyone, including directors, should act reasonably and that requirement\(^79\) is not that strong to an extent that would provoke any cautious behaviors divorcing the directors’ usual conducts\(^80\).

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\(^76\) I believe that the core of the concept is quite clear to some extent. As Ripstein has said, which I suppose few would disagree with, the reasonable person in the common law tradition is about “the idea of a fair balance between liberty and security”. See Ripstein, *Equality, Responsibility, and the Law*, Cambridge University Press 1999 p. 7. Even there is no exact definition, there are some core conceptions (like what Ripstein has stated) which serve as “ingredients” to form a definition which is operable in courts and make the objective test possible.

\(^77\) “It is a concern that a stricter duty might cause directors to become excessively cautious in their management of the company, thereby failing to take the sorts of business risks essential for thriving, successful companies.” Riley, “The Law Commission’s Questionable Approach to the Duty of Care and Skill” Company Lawyer, Vol. 20 No. 6 p. 201 and Riley, “The Company Director’s Duty of Care and Skill: The Case for an Onerous but Subjective Standard”, The Modern Law Review, Vol. 62 No. 5 p. 709

\(^78\) See footnote 65

\(^79\) Similar opinion has been made by Andrew Hicks: “Whereas one cannot expect all directors to possess a comprehensive portfolio of skills, one can expect them all to be reasonably careful.” Zwinge, “As Analysis of the Duty of Care in the United Kingdom in Comparison with the German Duty of Care”, International Company and Commercial Law Review, Vol. 22 No. 2 p. 33

\(^80\) Since directors sometimes are expected to take risk in exchange for profit, some criticize the test on the ground that the test may “inhibit legitimate risk taking”. See Riley, “The Company Director’s Duty of Care and Skill: The Case for an Onerous but Subjective Standard”, The Modern Law Review, Vol. 62 No. 5 p. 710-711
The forth critic is that the objective test infringes the right of those being a director. This is an argument that to some extent overlaps with the second critic in the sense that the test deters those “incompetent” individuals from being directors. They blame the objective test on the ground that the test is trying to screen out those incompetent individuals who could pick up the directorship had the test not been imposed. But to make these claims, they have missed my point. As I have said, I embrace the laisser-faire of which individuals are free to choose. The reason I support the objective test in screening out the incompetent individuals lay in the argument in competing rights. It is nothing to do with the intention, tout court, to screen those incompetents out. For sure it is better to have competent directors than to have incompetent directors to govern the company, ceteris paribus. But it is not what the objective test is for. Is not the freedom to choose its directors itself desirable and beneficial? It is just like our voting system. It is the voting system itself that realizes the value of the freedom to choose. If we are aiming at finding out a most talent leader, then to nominate a philosopher king, as Plato once suggested, will be more appropriate than to vote. It is the same to the market. If the desire to pick up those competent directors is in a strong sense to an extent that could overrule the freedom to choose, why do not we, at the very beginning, inject some kinds of mechanism, like

81 “[W]hat right has the law to say that he should not be a director of this enterprise if he cannot bring to the task the skills of the “reasonable” director?” Zwinge, “As Analysis of the Duty of Care in the United Kingdom in Comparison with the German Duty of Care”, International Company and Commercial Law Review, Vol. 22 No. 2 p. 38. A reply to this claim is in the reply to the second critic about the discussion of the abstract rights and concrete rights.
83 Some attribute the result of having screened out the incompetent directors itself as a benefit of which only competent directors are chosen. Riley names it the “self-selection argument” and criticizes it under an epistemological perspective. See Riley, “The Company Director’s Duty of Care and Skill: The Case for an Onerous but Subjective Standard”, The Modern Law Review, Vol. 62 No. 5 p.712-716
84 Plato, The Republic, Cambridge University Press 2012 p. 175
launching a “director license”, to assure directors’ competence? The values hidden behind the free-market supported by the \textit{laizzer-faire} doctrine is about the freedom of the companies to choose and the freedom of the directors to be chosen\textsuperscript{85}. I do not think it is an \textit{exclusive} concern to pick up the most competent directors in the market apart from the respect to freedom and the right or liberty. As I have argued before, all other stakeholders who are going to be influenced by the directors’ conducts also own a concrete right that free from the negligence of the directors. Therefore, the objective test is a “necessary evil” (to express in words in favor of those objecting the test) to strike a balance between all parties. So the outcome that those incompetent individuals have been screened out is nothing to do with infringing their rights, but is exactly the opposite – the test is respecting the rights of all parties.

The fifth critic is that it is just not needed at all\textsuperscript{86}. But as I have said, all of us are subjected to an objective test under tort law. It is not bizarre to have such a test to protect all the related parties in the new CO. Free market does not entitle that there should be no regulation at all, but it is quite the opposite. Given the subjective test is not well grounded, the objective test is the appropriate candidate in maintaining the smooth operation of the free-market\textsuperscript{87}.

\textsuperscript{85} See footnote 16
\textsuperscript{86} “Some people have argued that market forces were the most efficient method of controlling directors. If a company performed poorly because of the incompetence of its directors shareholders could sell their shares and the company most likely releases its directors. Nevertheless, the way for shareholders to sell their shares and thereby ‘punish’ the directors is closed in cases of corporate collapse.” Zwinge, ”As Analysis of the Duty of Care in the United Kingdom in Comparison with the German Duty of Care”, International Company and Commercial Law Review, Vol. 22 No. 2 p. 37
\textsuperscript{87} However, it should be noted that the application should not be too strict, as Lowry has pointed out: “If the courts are too severe here in their interpretation of what reasonableness requires they will make it difficult for boards to find directors.” See Lowry, ”The Irreducible Core of the Duty of Care, Skill and Diligence of Company Directors: Australian Securities and Investments Commission v Healey”, The Modern Law Review, Vol. 62 No. 5 p. 259. It is a practical necessity to strike a balance.
The sixth critic is that the test serves both parties badly. Putting aside the complicated economic analysis, I suppose what is at stake is about the concept of duty and justice. If what they mean of “badly” and is base on economic aspect (which I suppose they are), I believe it is not the argument we should be looking. Case like *Tennessee Valley Authority v Hill* in which the dam construction that had been invested for over one hundred million dollars has been stopped would be a case that should have been decided the other way, if we conduct our reasoning in the economic sense of which exclusively consider efficiency and wealth maximizing. Therefore, I believe, if they want to object the objective test, it is their turn to raise arguments base on *duty* and *fairness*. Given the test prevents irresponsible behaviors among directors and serves as a safeguard to protect stakeholder, when we putting aside the economic considerations, what is the point of claiming that it “serves both parties badly”?

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88 See Riley, “The Company Director’s Duty of Care and Skill: The Case for an Onerous but Subjective Standard”, The Modern Law Review, Vol. 62 No. 5 p. 712. The argument is about the compensation that the company has to pay to the director for the risk encountered under the objective test. I suppose it is the kind of argument that made in economic aspect. Also see footnote 80

89 Example like the famous Chicago School of Economics: “In arguing for less government regulation, the contractarian scholars of the Chicago School of Economics have noted the importance of reducing transaction costs, emphasizing that the fiduciary paradigm for corporate governance interferes with the market for corporate control and impedes profit maximization…[T]he parties will have an increased cost which will be passed on to consumers, resulting in an inefficient use of resources that will ultimately cause society to suffer.” Miller, “The Role of the court in Balancing Contractual Freedom with the Need for Mandatory” University of Pennsylvania Law Review, Vol. 152 No. 5 p. 1622

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