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UNDERSTANDING DEFENSIVE PRACTICES IN BUSINESS AND LAW: *A DUTCH CASE STUDY*

Thy Pham

ABSTRACT

Companies and judges have continually mitigated director liability risks to relieve defensive behaviour in business. Yet, a definition of defensive behaviour is absent in legal academia. Moreover, the defensive behaviour argument has not been put to the test. This research paper seeks to apply the concept of defensive behaviour in medicine to defensive behaviour in business. A case study was undertaken in the Netherlands in 2013 to explore defensive behaviour in business. For the purpose of the study, 54 interviews were conducted with top managers of Dutch group companies. The results reveal that rather than undertaking an accurate risk assessment, the company directors tend to dread liability risks. Nevertheless, director liability risks are generally considered not to be directly responsible for defensive behaviour. Situations involving significant public exposure and the perceived certainty of litigation were, however, shown to be good predictors of defensive behaviour. Individual experience was also found to be a source of defensive behaviour. Yet, this research did not definitively conclude that these conditions lead to defensive behaviour that could qualify as being undesirable. It seemed that this was mediated by a strong belief that liability risks can be mitigated and top managers' risk concerns reduced. The research results provide an indication that protective shields have an important value in addressing the problem of defensive behaviour effectively.

THE CO-EXISTENCE OF DIRECTOR LIABILITY AND DIRECTOR LIABILITY SHIELDS

Director liability law is believed to be an important corporate governance instrument that provides incentives for or imposes constraints on the behaviour of company directors. In director liability law, an important assumption is that the threat of liability induces company directors to take due care and to avoid risky decisions that may threaten the company's continuity. Accordingly, deterrence is widely accepted as one of the fundamental purposes of director liability litigation within and outside of legal academia. The abundance of empirical research on deterrence revealed that the perceived probability and severity of punishment is most effective in shaping behaviour.[1]

Yet, it has been a long-standing tradition in business and law that director liability risks are mitigated. Companies make efforts to insure, reduce or exclude director liability risks. Director liability shields are part of firm governance and are commonly regarded as good corporate governance practice. Not only are these shields seen as important instruments to recruit men and women for responsible positions on the company's board of directors, their presence signals the company's good risk and insurance management. Among the interviewees, there was not a single participant who did not have D&O insurance. In fact, many of them demanded both D&O insurance and indemnification (75.0 percent).

Moreover, courts make sure that company directors' room for error is protected by raising the liability bar to the standard of 'serious reproach' not merely 'improper

[1] For example, G Pogarsky, 'Modeling change in perceptions about sanction threats: The neglected linkage in deterrence theory' (2004) 20(4) Journal of Quantitative Criminology 343; R Paternoster and S Simpson, 'Sanction threats and appeals to morality: Testing a rational choice model of corporate crime' (1996) 30(3) Law & Society Review 557; S Klepper and D Nagin, 'Tax compliance and perceptions of the risks of detection and criminal prosecution' (1989) 23(2) Law & Society 214; M R Geerken and W R Gove, 'Deterrence: Some theoretical considerations' (1975) 9(3) Law & Society Review 498.

performance'.[2] The first standard being the standard of judicial review distinguished from the latter, the standard of conduct. The Dutch Supreme Court justified the liability bar of serious reproach by sermonising that 'it is in the best interest of the company that company directors are prevented from undesirable defensive considerations [out of fear of director liability, TP] when they discharge their obligations'.[3] The judge-made 'higher' director liability standard of 'serious reproach' has now been codified in Section 2:9(2) of the Dutch Civil Code, which came into effect on 1 January 2013. Furthermore, the Supreme Court has applied the standard of serious reproach to tort-based claims made by the corporation, the company's shareholders and creditors.[4]

Although companies and judges employ different instruments to mitigate director liability risks, both apply the same argument to justify director liability shields. If director liability risks are not mitigated, there is a risk that company directors will start exhibiting defensive behaviour. Yet, there is no definition of defensive behaviour in legal academia. Moreover, the defensive behaviour argument has not been put to the test and there is no general consensus as to when defensive behaviour becomes undesirable.

DEFENSIVE PRACTICES

Defensive Medicine

There is a rich body of empirical research in defensive medicine that focuses on the correlation between liability and defensive behaviour. Several studies specifically delve into the correlation between liability threat perception and defensive behaviour. These studies argue that it is the *perceived* rather than the actual liability risk that determines physicians' behaviour, causing physicians to overestimate liability risks.[5] Carrier et al. have termed physicians' overestimating liability risks as 'dread risks' to explain defensive behaviour.[6] This could lead to such behaviour on the part of physicians that does not culminate in better care but in fact the opposite. Indeed, the defensive behaviour rationale holds that physicians' fear of malpractice lawsuits may induce physicians to resort to defensive medical practices, ranging from increasing the use of tests and procedures, increasing paperwork, avoiding treating high risk-patients or providing treatments, limiting practice scope, or even leaving medical practice.[7] The tendency to overestimate liability risks triggers the problem of alignment of physicians' attitudes with actual risk. Tort reforms have in the meantime been adopted in several U.S. states. Furthermore, a number of studies are now calling for the institution of *safe harbours.* These can only be introduced if an applicable, widely-accepted and evidence-based practice guideline is followed.[8] It was argued that safe harbours may improve communication

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[2] Dutch Supreme Court, 10 January 1997, Nederlandse Jurisprudentie 1997, 360 (Staleman/Van de Ven), 3.3.1.

[3] Dutch Supreme Court, 20 June 2008, Nederlandse Jurisprudentie 2009, 21 (Willemsen Beheer/NOM), 5.3.

[4] ibid; Dutch Supreme Court, 8 December 2006, Nederlandse Jurisprudentie 2006, 659 (Ontvanger/Roelofsen), 3.5.; Dutch Supreme Court, 11 September 2009, Nederlandse Jurisprudentie 2009, 565 (ComSystems/Van den End q.q.), 5.3.2.-5.3.3.

[5] See, eg., E R Carrier (et al), 'High physician concern about malpractice risk predicts more aggressive diagnostic testing in office-based practice' (2013) 32(8) Health Affairs 1383; E R Carriers (et al), 'Physicians' fears of malpractice lawsuits are not assuaged by tort reforms' (2010) 29(9) Health Affairs 1585; D Dranove and Y Watanabe, 'Influence and deterrence: How obstetricians respond to litigation against themselves and their colleagues' (2010) 12(1) American Law and Economics Review 69; L R Burns (et al), 'Impact of physicians' perceptions of malpractice and adaptive changes on intention to cease obstetrical practice' (1999) 15(2) The Journal of Rural Health Research 134; D P Kessler and M McClellan, 'The effects of malpractice pressures and liability reforms on physicians' perceptions of medical care' (1998) NBER Working Paper 6346; Lawthers (et al), 'Physicians' perceptions of the risk of being sued' (1992) 17(3) Journal of Health Politics, Policy and Law 468, 474.

[6] E R Carrier (et al), 'High physician concern about malpractice risk predicts more aggressive diagnostic testing in office-based practice' (2013) 32 (8) Health Affairs 1383, 1389; E R Carriers (et al), ''Physicians' fears of malpractice lawsuits are not assuaged by tort reforms' (2010) 29 (9) Health Affairs 1585, 1591.

[7] See also L R Tancredi and J A Barondess, 'The problem of defensive medicine' (1978) 200(4344) Science 879 (discussing the underlying problem of defensive behavior in medical practice).

[8] E R Carriers (et al), 'Physicians' fears of malpractice lawsuits are not assuaged by tort reforms' (2010) 29 (9) Health Affairs (Exhibit 4); E R Carrier (et al), 'High physician concern about malpractice risk predicts more aggressive diagnostic testing in office-based practice' (2013) 32 (8) Health Affairs 1383,1390. See also D Kessler and M McClellan, 'Do doctors practice

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concerning the consequences of a tort claim, and may narrow the gap between perceived and actual liability risks.

Defensive behaviour in business?

Blankenburg showed in his comparative study that the litigation rate in the Netherlands is considerably low for every type of lawsuit.[9] In the present study, 18.5 percent of the participants reported having been subjected to a closed lawsuit, including those that were dropped, settled, and/or paid out. For those cases that had been brought to court, none of the participants was judged liable in their capacity as company director. All the participants reported that their employing companies had taken out D&O insurance, making the risk of out-of pocket-payments negligible. In only one case, a participant reported having to bear out-of-pocket attorney's fees, which eventually was partly reimbursed by the company. However, it was the impression among the interviewees that the trend towards litigation is growing. The majority (59.3 percent) of them voiced concern that director liability risks have increased. In a survey conducted among Dutch supervisory directors, 88.0 percent of the respondents reported experiencing increased exposure to director liability.[10]

Defensive behaviour argument in business

Is there a problematic gap between perceived and actual liability risks in business that triggers defensive behaviour? If so, what underlies defensive behaviour? And how can the gap between the actual liability risks and the attitudes towards litigation risks be understood? To answer these questions, this paper draws on insights from the literature on defensive medicine regarding the relation between liability threat perception and defensive behaviour.
Based on the definition applied by Sclar and Housman in the context of defensive medicine, the following definition of defensive behaviour in business has been applied in this paper[11]:

> *Defensive behaviour occurs when company directors (1) take unnecessary precautions, and/or (2) neglect their duty of care, primarily, but not solely, to reduce personal liability risk.*

The first behavioural pattern can be referred to as assurance behaviour, which may include implementing elaborate internal controls, keeping more extensive records of board meetings and board decisions, ordering more information, and administrating extensive risks analyses prior to business decisions in order to appear to meet the legal responsibilities placed on company directors. The second behavioural pattern may be referred to as avoidance behaviour by isolating oneself from sources of director liability, including not attending board meetings and taking part in board discussions, eluding emergency and crisis situations, adhering only to low-risk activities, refusing to take high-risk decisions, or even refusing board service.

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defensive medicine?' (1996) 111(2) The Quarterly Journal of Economics 353 (arguing that tort reforms reduce defensive medical practices); D N Dewees (et al), 'The medical malpractice crisis: A comparative empirical perspective' (1991) 54(1) Law and Contemporary Problems 218 (argued that defensive medicine was used to trigger tort reforms).

[9] E Blankenburg, 'The infrastructure for avoiding civil litigation: Comparing cultures of legal behaviour in the Netherlands and West Germany' (1994) 28(4) Law & Society Review 793. See also E Blankenburg, 'Patterns of Legal Culture: The Netherlands compared to neighbouring Germany' (1998) 46(1) The American Journal of Comparative Law 1.

[10] M Lückerath-Rovers and A de Bos, 'Nationaal Commissarissen Onderzoek 2012' (2012) Nyenrode Business Universiteit, Erasmus Universiteit Rotterdam 59-60 (Lückerath-Rover and Bos' survey among Dutch supervisory directors showed a substantial higher rate of liability risk perception than the present research. There are various reasons for this. This research is not a survey. The target group for this research consisted of top managers, including executive and non-executive directors, who serve larger group companies with highly professionalised legal, risk and insurance departments. In addition, top managers interviewed for the purpose of this research were highly confident that they were adequately protected by their corporations and their D&O insurance).

[11] D Sclar and M Housman, 'Medical malpractice and physician liability: Examining alternatives to defensive medicine' (2003) 4(1) Harvard Health Policy Review 76. See also D M Studdert (et al), 'Defensive medicine among high-risk specialist physicians in a volatile malpractice environment' (2005) 293(21) American Medical Association 2609, 2612-2613 (distinguishing assurance behaviour and avoidance behaviour).

As the existing presumption is that the perceptions of director liability threats may evoke undesirable risk aversion to the detriment of the company's interest, the defensive behaviour argument therefore is based on three consecutive assumptions:

- director liability threats influence the behaviour of company directors;
- this influence consequently transforms behaviour into undesirable defensive behaviour; and
- such undesirable defensive behaviour has negative effects.

Underlying the problem of defensive behaviour is the recognition that human beings may overestimate liability risks and resort to defensive practices. The ‘affect heuristic’ has often been used to explain reliance on feelings in risk assessment and decision making.[12] It has been argued that feelings, experienced such as dread or worry, may inform people and guide their judgment and decision making and may be a propeller for defensive behaviour.

The experience of being sued was repeatedly described by participants as one of the most stressful experiences a director may face with significant psychological effects. Litigation was perceived as unpredictable, uncontrollable and disastrous, both financially and psychologically. Participants therefore associate litigation with distress.[13] It was explained that when directors are accused of director liability, their professional abilities are challenged publicly, their reputation tainted, and their identity impaired. It seemed from the interviews that risk concerns reflected a tendency to overestimate the likelihood of dread risks – director liability was perceived as rare but as having devastating outcomes – rather than of an accurate assessment of the actual director liability risks. The consequences of director liability were associated with strong affective meaning.[14] This has also been identified in literature as ‘probability neglect’, when people are focused on the negative outcome rather than on the fact that it is unlikely to occur.[15] As such, it can be argued that company directors perceive director liability not only by how they think about the risk but more so by how they feel about the risk exposure. The next paragraph explores whether feelings of dread influence top managers’ decision making.

DIRECTORS' ATTITUDE TOWARDS DIRECTOR LIABILITY RISKS

Although most of the participants in this study associated director liability with dread and believed that director liability risks have increased, none of the participants believed that director liability risks have changed or would directly change their behaviour or influence their decision making. It seems that under normal circumstances, director liability risks do not directly occupy directors' patterns of risk perception. Smallman and Smith also supported this argument in their survey. The results of their survey showed that managers tend to respond primarily to a narrow range of organisational risks, with a clear emphasis on those associated

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[12] P Slovic (et al), ‘The affect heuristic’ in T Gilovich, D Griffin and D Kahneman (eds.), *Heuristics and biases: The psychology of intuitive judgment* (CUP 2000) 397. See also G F Loewenstein (et al), ‘Risk as feelings’ (2001) 127 Psychological Bulletin 267; P Slovic and E Peters, ‘Risk perception and affect’ (2006) 15(6) Current Directions in Psychological Science 322 (these two studies distinguished risk as feelings and risk as analysis. Risk as analysis refers to a deliberative mode of thinking for making risk assessments and decisions. Risk as feeling refers to instinctive and intuitive responses to hazards).

[13] Same results were also observed by E R Carrier (et al), ‘High physician concern about malpractice risk predicts more aggressive diagnostic testing in office-based practice’ (2013) 32(8) Health Affairs 1383; E R Carriers (et al), ‘Physicians’ fears of malpractice lawsuits are not assuaged by tort reforms’ (2010) 29(9) Health Affairs 1585; S C Charles (et al), ‘Sued and non-sued physicians: Satisfactions, dissatisfactions, and sources of stress’ (1985) 28(9) Psychosomatics 462; Martin (et al), ‘Physicians’ psychologic reactions to malpractice litigation’ (1991) 84 (11) Southern Medical Journal 1300; S C Charles, ‘The psychological trauma of a medical malpractice suit: a practical guide’ (1991) 76(11) Bulletin of the American College of Surgeons 22; McAninch (et al), ‘Psychological effects of poor outcome and professional liability actions on physicians’ (2008) 101(10) Southern Medical Journal 1032.

[14] Loewenstein (et al 2001) (the study found that people are very sensitive to strong positive or negative consequences, regardless of their probability).

[15] C R Sunstein, ‘Terrorism and probability neglect’ (2003) 26 (2) The Journal of Risk and Uncertainty 121.

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with the corporation's performance, competition (17.1 percent), and company failure (13.7 percent).[16] The research thus suggested that personal liability risks are generally not part of managers' patterns of risk perception, and therefore do not influence managers' decision making. This present study shows, however, that certain circumstances lead company directors to perceive director liability as high-value risk, and a source of defensive behaviour. Furthermore, individual experience with director liability may be a source for future defensive behaviour.

Director liability as high risk

Director liability may be perceived as a high risk when extensive public exposure is involved, or when directors believe it is very likely that litigation will arise, which in turn generates undesirable publicity. Participants considered two circumstances to be seriously threatening and a possible source of defensive behaviour. The first relates to alleged irregularities, involving fraud, and the second relates to bankruptcy. In both of these cases, there is a great deal of public exposure, and the likelihood of being confronted with the personal threat of a claim is considered to be high.

Allegations relating to fraud were perceived to be threatening because of the high level of unknown risks in terms of the scope and severity of damage to the corporation and to its integrity and reputation. Fraud exposure was also often associated with a failure of managerial control and a failure of internal controls of subsidiaries. Thus, when fraud is suspected, there is an immediate concern that a company director may not have been as 'in control' as he should have been, and may be vulnerable as regards director liability.

Several developments may have amplified the directors' sense of personal liability for corporate irregularities. Among others, participants indicated first − as part of the internal controls framework − the obligation to provide for a whistle-blower scheme, and the corresponding duty to act upon indications of irregularities.[17] Moreover, company directors are more aware of controls at subsidiaries, because they are compelled to account for the corporations' falling short of the internal controls in the annual report.[18] The second change is that non-executives and supervisory directors are keener to initiate internal and/or forensic investigations with or without the co-operation of the management board. Many of the supervisory directors who were interviewed felt it was one of their core duties to act upon signs of irregularities, whether of general, operational, or financial nature, but particularly when these irregularities involved members of the management board. The third was the liability exposure to international anti-bribery legislation and the books-and-records provisions under the framework of the U.S. Foreign Corrupt Practices Act 1998 (FCPA). The FCPA enforces anti-bribery legislation applicable to all companies and their natural persons (both U.S. and non-U.S. companies), issuers and privately held corporations, as well as accounting provisions applicable to issuers.[19] Accordingly, the scope of the FCPA brings about an international public monitor over companies' business integrity and books and records worldwide. Indeed, a small sample of impactful cases involving Dutch companies have made company directors more

[16] C Smallman and D Smith, 'Patterns of managerial risk perceptions: Exploring the dimensions of managers' accepted risks' (2003) 5(1) Risk Management 15.

[17] Best practice II.1.7 DCGC 2008.

[18] Best practice II.1.4 DCGC 2008.

[19] See 15 U.S.C §§ 78m(b)(2)(A), 78m(b)(2)(B) (imposes liability for corrupt practices); see 15 U.S.C §§ 78m(b)(2)(A), 78m(b)(2)(B) (imposes strict corporate liability on issuers for books-and-records violations and failures of adequate systems of internal control at subsidiaries).

aware of the impact of anti-bribery and books-and-records provisions in terms of potential personal liability exposure.[20]

Bankruptcy was also perceived to be threatening. The participants strongly believed that in all of the cases, bankruptcy trustees would likely bring a claim or will threaten to do so. Further, the directors in this study believed that they were moving targets for bankruptcy trustees, and, as such, subject to 'selective liability' practices, irrespective of whether they were to blame. According to the Guidelines for Bankruptcy Trustees, prior to instituting a claim, trustees in bankruptcy are obliged to examine whether there are grounds that give rise to challenging former directors for personal liability in connection with the emergence of bankruptcy.[21] Bankruptcy trustees have been criticised for deviating from their own professional standards and/or being incentivised by their own or their firms' financial interests rather than the interest of the bankruptcy estate.[22] It has been argued that bankruptcy trustees are motivated to generate their firms' sales by enabling colleagues to conduct the investigation and/or by enabling colleagues to actually litigate the case.[23] Moreover, deviation may be reinforced by the availability of D&O insurance and the prospect that recovery or settlements are secured.

There was a general feeling that the availability of D&O insurance increased company directors' vulnerability regarding threats of litigation, as they are perceived by others as having 'deep pockets'. Therefore, it was argued that the higher the D&O limit, the more likely it would prompt bankruptcy trustees or others to pressure for settlement or litigation. Paradoxically, D&O coverage was strongly demanded precisely in these two high-risk circumstances. Several of the interviewees indeed reported that these circumstances often gave rise to a demand to secure oneself with an adequate level of personal protection. Moreover, in these circumstances in particular, it seemed that the public and personal consequences that participants thought they would suffer if they were charged with director liability could be significant. Further, these consequences exert a more powerful influence on their risk judgments than the financial consequences, since all of the participants believed they were adequately protected from liability costs by their D&O insurance.[24] This raises the question as to whether the threat of being sued is a compelling reason for company directors to exhibit defensive behaviour, regardless of the financial stakes.

The influence of individual experience

Whether or not defensive behaviour will arise may depend on individual experience with director liability, as it could amplify or reduce risk perception, and trigger defensive behaviour. Company directors who were previously exposed to director liability were clearly

[20] *In the Matter of Royal Dutch Petroleum Company and The 'Shell' Transport Trading Co., p.l.c.* (SEC Exchange Act of 1934 Release No. 50233, Accounting and Auditing Enforcement Release No. 2085, and Administrative Proceeding File No. 3-11595, all dated August 24, 2004); *Securities and Exchange Commission v. Koninklijke Ahold N.V.* (Royal Ahold), Civil Action No. 04-1742 (RMU) (D.D.C.) (October 13, 2004); *Securities and Exchange Commission v. A. Michiel Meurs and Cees van der Hoeven*, Civil Action No. 04-1743 (RMU) (D.D.C.) (October 13, 2004); *Securities and Exchange Commission v. Johannes Gerhardus Andreae*, Civil Action No. 04-1741 (RMU) (D.D.C.) (October 13, 2004); *In the Matter of Koninklijke Philips Electronics N.V.* (SEC Exchange Act of 1934 Release No. 69327, Accounting and Auditing Enforcement Release No. 3452, and Administrative Proceeding File No. 3-15265, all dated April 5, 2013).

[21] Paragraph 5.1 Praktijkregels voor curatoren, September 2011.

[22] ibid 21 (bankruptcy trustees are obliged to first examine whether there are grounds that give rise to challenging former directors for personal liability in connection with the emergence of bankruptcy).

[23] M Kalff, 'De procederende kantoorgenoot van de curator: een blik vanuit de D&O verzekeringspraktijk' in M Kalff, R Mulder and S H de Ranitz (eds), *Insolad. De integere curator* (Kluwer 2007) 35-37.

[24] Sclar and Housman (2003) 76-77 (the study found the same results based on their interviews with physicians regarding medical malpractice and physician liability).

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more concerned about their personal liability exposure than were their lay peers.[25] It has, however, been suggested that individual experience with a hazard may also increase habituation and may result in minimising risk concerns.[26] This present study demonstrated that previous individual experience did serve to provide feedback on the controllability and avoidance of director liability risks, but did not reduce risk perception in all instances. Direct experience was demonstrated to trigger demands for institutional responses and protective actions, and accordingly it amplified risk perception. Unlike some company directors who had no previous liability experience, none of the company directors who had this experience was prepared to serve on boards that could not provide protective shields. Moreover, previous liability experience led participants to demand both D&O insurance and indemnification, as they wanted both 'belt and braces' to feel comfortable in their position on the board.

Based on directors' self-reporting, repeated risk experience could result in habituation only under specific conditions involving high frequency with low impact and a neutral - or positive - outcome; for instance, when suits are dropped because the claims are ill-founded, the impact is low and the outcome is neutral.[27] Yet, this research also showed that a process of habituation may be invoked under conditions involving high frequency and high impact but a positive outcome. For instance, when a claim is filed followed by public exposure but the director is judged not to be personally liable. For many of the participants, 'acquittal' from personal liability was associated with the recognition of their personal and professional integrity, and was evidently an important step in the rehabilitation process. Moreover, acquittal was believed to provide an important foundation to restore ones reputation and to overcome the psychological trauma. The study by Martin et al. demonstrated that those who have won a lawsuit reported less psychological trauma, shame and doubt.[28] This may explain why company directors attach such great importance to legal defence and to the coverage of legal expenses. The interviews showed that those directors who were repeatedly exposed to director liability and were acquitted were clearly less concerned about the impact of the suit on their career and their reputation than were those who settled the case, or whose case was pending. Furthermore, those participants displayed considerable knowledge of director liability law and less concern for future director liability exposure. Moreover, they expressed confidence that director liability risks could be controlled, managed and overcome.

Undesirable defensive behaviour and the value of protective shields

It has been demonstrated that exceptional circumstances involving intense public exposure is a good predictor for a change in risk perception. Whether risks concerns are a source of defensive behaviour may also depend on top managers' individual experience with director liability. It was commonly recognised that defensive behaviour can increase wasteful overhead expenses and in the worst case, it can threaten the company's competitiveness as risks are either being avoided or excluded, thus putting the company into a state of recession. Considering that it can be a problem to determine where caution ends and defensive behaviour begins, it can be argued that defensive behaviour may become undesirable and have a negative effect when company directors are inclined to exclude all risks due to avoidance demand, but in fact by

[25] J Barnett and G M Breakwell, 'Risk perception and experience: Hazard personality profiles and individual differences' (2001) 21(1) Risk Analysis 175 (the researchers also found that a negative outcome of previous risk experiences and a higher frequency of being adjudged were predictors for greater future risk concerns).

[26] B Richardson, J Sorensen and E J Soderstrom, 'Explaining the social and psychological impacts of a nuclear power plant accident' (1987) 17(1) Journal of Applied Social Psychology 16 (the authors suggested that people with greater experience of constant and extreme risks may be less concerned. It was explained that processes of habituation were invoked to cope with risk).

[27] This finding is consistent with the findings of Barnett and Breakwell (2001) 176 .

[28] Martin (et al) (1991) 1303.

isolating themselves they are disregarding their duty of care, or when they refuse to take any risks due to a demand for assurance although there was a duty to act. Both types of defensive behaviour may lead to the company's decline and compromise its continuity.

However, company directors do continually accept board service, and thus expose themselves continually to personal liability risks. Why? Generally, it is because they are interested in and feel positive about the important public position. The interviews showed that company directors continue to feel positive about carrying out activities that expose them to personal risk.[29] Dangers were surpassed by the confidence that risks can and need to be mitigated. Thus, there was substantial interest in, and careful attendance to, director liability risks and instruments to reduce these risks.[30]

CONCLUSION

In legal academia, it is believed that director liability law functions as an important corporate governance instrument that provides incentives or imposes constraints on the behaviour of company directors. Business practice and legal reality revealed however that when perceived liability threat deviates from actual liability threat, it may give rise to defensive behaviour that in turn generates a corporate governance problem. This paper argued that company directors continue to dread liability risks rather than subject them to accurate assessment, and as a result may overestimate (or underestimate) these risks. It was demonstrated in this research that directors are prone to act defensively in situations involving significant reputational risks and perceived certainty of litigation. Further, the research gives indications that liability shields may function to relieve the negative effects of defensive behaviour. However, when considering these shields, it must be taken into account that defensive behaviour can also serve responsible business conduct. Thus, the research results provide indications that the corporate governance challenge is to balance the co-existence of director liability threat perception and the perception of director protective shields. This leads to new thinking that good corporate governance, from a director liability law perspective, must encompass instruments that reduce undesirable defensive practices while preserving significant deterrence against breaches of director duty; and that the purpose, rationale and potential of director liability shields should be examined within the framework of corporate governance.

[29] L Sjöberg, 'Emotions and Risk Perception' (2007) 9(4) Risk Management 232 (in Sjöberg's research a positive correlation between interest and risky activities was found).
[30] ibid 29.

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