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Evaluating Introduction of the Business Judgment Rule in Sweden

A Comparative Study of Accountability of the Board of Directors
in Sweden and Delaware

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Abstract

The Swedish corporate law scholars have long debated whether there is something similar to the American business judgment rule (BJR) in the Swedish Companies Act (SCA). Recently, the discourse shifted to claim that the BJR exists in Swedish case law and should be introduced in the SCA in the form of a statute. However, the Swedish corporate law scholars have not investigated in much detail whether the BJR should be introduced in the SCA. An eagerness to introduce the BJR might seem bewildering due to the corporate scandals at the beginning of this century and the global financial crisis of 2008–2009. These events left corporate law scholars and those in the business community with the pressing question of whether the board of directors is sufficiently accountable, and the BJR appears to do the very opposite.

In view of the foregoing, this thesis examines whether the BJR should be introduced in the SCA. This examination enables a comparative analysis of the liability rules of the board of directors in Sweden and Delaware, which is the dominant source of state corporate law in the United States. This thesis also steps outside traditional legal sources and considers other disciplines such as moral and political philosophy, sociology, and the methodology of law and economics.

This thesis finds that the BJR does not balance the values of the authority of the board of directors and the need to hold it accountable for its decisions and actions in an appropriate manner because it allows the value of authority to completely dominate. An appropriate balance between these values of authority and accountability requires that none of the values be so preeminent that any of them completely dominate.

The BJR is made more critical because the Delaware courts apply it generously in favor of the board of directors and adopt an inveterate attitude in cases raising duty of care, thus, weakening the duty of care as a viable and meaningful accountability mechanism. Given these findings, this thesis concludes that the Swedish legislator should only consider introducing the BJR in the SCA if it is articulated in a different way. Alternatively, if it is given a dual function to protect both the authority of the board of directors and the need to hold it accountable for its decisions and actions.

The justifications behind the BJR do not change the conclusion because they do not fully defend the existence of the BJR and the dominance of the value of authority. This

thesis also considers the benefits of introducing the BJR in the SCA, but they also do not change the overall conclusion.

Instead, the conclusion is strengthened by the fact that a no liability rule can emerge when the BJR is combined with other protective devices in the SCA in the same way as it does in Delaware if the BJR is not modified or given a dual function. The no liability rule appears to deter the threat of legal liability as an effective accountability mechanism, which cannot be defended by either social norms or market forces.

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Abbreviations

BJR	Business judgment rule
DGCL	Delaware General Corporation Law (As of April 2, 2020)
JT	Legal Journal (<i>Swedish</i> : Juridisk Tidskrift)
MBCA	Model Business Corporation Act (As of December 9, 2017)
NJA	Swedish Law Reports from the Supreme Court of Sweden (<i>Swedish</i> : Nytt Juridiskt Arkiv)
Prop.	Swedish Government Bill (<i>Swedish</i> : proposition)
SCA	Swedish Companies Act (<i>Swedish</i> : Aktiebolagslagen (2005:551))
SOU	Swedish Government Official reports (<i>Swedish</i> : Statens offentliga utredningar)
SvJT	Swedish Law Journal (<i>Swedish</i> : Svensk Juristtidning)

1 Introduction

1.1 Background

Swedish corporate law scholars have long debated whether there is something similar to the American business judgment rule (BJR) under Swedish law.¹ In 2019, the prominent corporate law scholar, Svernlöv, went so far as to claim that the BJR exists in Swedish case law and should be introduced in the Swedish Companies Act (SCA) in the form of a statute.² The BJR shields most decisions made by the board of directors from review by limiting judicial inquiry into the adequacy of the process by which the board of directors reached its decision,³ making it appropriate in contexts that require risks.⁴ When the BJR is applicable, courts are prohibited from scrutinizing the wisdom or appropriateness of the decision itself.⁵

It might appear desirable to introduce the BJR in the SCA because it is still very unclear under what circumstances the board of directors in Sweden can be held liable for business decisions that turn out to be unsound.⁶ The board of directors must be given sufficient authority to manage the corporation,⁷ and without fear of becoming liable, take reasonable risks to innovate and create value in the increasingly competitive and complex global economy.⁸ Further, the concept of the BJR – focusing on the adequacy of the process – may be more sensible than post hoc, substantive review of business decisions which the Swedish liability rule for the board of directors and the managing director in Ch. 29 § 1 of the SCA takes as its starting point.⁹ Finally, an introduction of the BJR in the SCA could harmonize the liability rules for the board of directors between Sweden

¹ Dotevall (1989) at 169; Dotevall (2015) at 375; Dotevall (2017) at 89; Johansson SvJT 1991 at 604; Stattin at 370; Svernlöv (2012) at 58; Östberg at 449; Andersson Advokaten 2017.

² Andersson Advokaten 2019.

³ Jones Iowa Law Review 2006 at 114.

⁴ Schwarcz Emory Law Journal 2015 at 567.

⁵ Jones Iowa Law Review 2006 at 114; Dooley The Business Lawyer 1992 at 471.

⁶ Andersson Advokaten 2019.

⁷ Keay at 259.

⁸ Schwarcz Emory Law Journal 2015 at 533.

⁹ Hereinafter referred to as “the Swedish liability rule for the board of directors.”

and countries that have implemented it. Harmonization of the liability rules of the board of directors can make foreign corporations more willing to do business in Sweden, which in turn can have a positive impact on the Swedish economy.

Swedish corporate scholars, however, have not investigated whether the BJR balances the need to preserve the board of directors' decision-making authority and the need to hold it accountable for its decisions and actions in an appropriate manner. The values of authority and accountability need to be balanced in an appropriate manner if one is to have an effective and efficient corporate governance.¹⁰ If the board of directors is never held accountable, one might see it making decisions and taking actions that are questionable at best and improper at worst.¹¹ This might have been shown after the corporate scandals at the beginning of this century and the global financial crisis of 2008–2009, which left both corporate law scholars and those in the business community with the pressing question of whether the board of directors is sufficiently accountable for its decisions and actions.¹²

The corporate scandals, such as WorldCom in the United States and Parmalat in Europe, revealed that the board of directors in those companies had failed to exercise effective oversight and detect the massive financial fraud that had been perpetrated by the managing directors.¹³ The financial crisis was allegedly caused by the managing directors' excessive risk-taking and the board of directors' inability to monitor and prevent such risks.¹⁴ The board of directors' short-term risk-taking is also claimed to have contributed to this financial crisis.¹⁵ Effects of these events were significant: corporations suffered financial collapse, which resulted in harm to numerous shareholders and a significant spillover effect in the economy.¹⁶ They were so severe that they caused

¹⁰ Keay at 32.

¹¹ *Id.* at 275.

¹² *Id.* at 31. Hereafter the corporate scandals at the beginning of this century will be referred to as “The corporate scandals” and the global financial crisis of 2008-2009 as “the financial crisis.”

¹³ Jones Iowa Law Review 2006 at 136-139.

¹⁴ Schwarcz Emory Law Journal 2015 at 534; Hurt Journal of Corporation Law 2014 at 253, 256-258; Conyon, Judge & Useem Corporate Governance: An International Review 2011 at 399-400.

¹⁵ Conyon, Judge & Useem Corporate Governance: An international Review 2011 at 399-400; Wilmarth Connecticut Law Review 2009 at 971.

¹⁶ Steger & Amann at 91; Miller Cornell Law Review 2004 at 423; Hurt Journal of Corporate Law 2014 at 257, 248; Schwarcz Emory Law Journal 2015 at 536-537.

Delaware courts, which are known to show great deference to the board of directors,¹⁷ to be more willing to hold boards of directors liable.¹⁸ It was even queried whether the BJR should be modified to impose liability for excessive risk-taking.¹⁹

Given the negative effects of the corporate scandals and the financial crisis, it might seem surprising but also more vital that the BJR is investigated thoroughly before it is introduced in the SCA. Therefore, the Swedish legislator and corporate scholars must not only ask the question whether the BJR balances the values of authority and accountability in an appropriate manner, but also assess what results the BJR has when combined with other protective devices generally embodied in corporate law. If these protective devices combined deter the threat of legal liability as an effective accountability mechanism, it must be examined whether other accountability mechanisms, such as market forces and social norms can defend such a result and replace legal accountability to discipline the board of directors.

1.2 Purpose and Research Questions

In light of the above, the purpose of this thesis is to examine whether the BJR should be introduced in the SCA.

To fulfill the purpose of this thesis, it is central to address the following questions:

- What constitutes an appropriate balance between the values of authority and accountability?
- Does the BJR balance the values of authority and accountability in an appropriate manner?
- If the BJR does not balance the values of authority and accountability in an appropriate manner, can justifications commonly given for the BJR explain its existence and its choice of value?
- What are the results when the BJR is combined with other protective devices embodied in the Delaware General Corporation Law (DGCL)?

¹⁷ Cary The Yale Law Journal 1974 at 690-692.

¹⁸ Ferrara, Abikoff & Gansler at 5.01(4).

¹⁹ Schwarcz Emory Law Journal 2015 at 562.

- Will the BJR have the same results in Sweden as it does in Delaware when combined with the protective devices embodied in the SCA?
- If the BJR, when combined with other protective devices, deters the threat of legal liability as an effective accountability mechanism, can market forces and social norms defend such a result and replace the need to have a legal accountability mechanism?

1.3 Method

This thesis utilizes a comparative method and a legal dogmatic method to investigate whether the BJR should be introduced in the SCA. The essence of a comparative method is to compare two legal systems to understand the similarities and differences between them.²⁰ The comparative method is generally employed for several reasons. First, it promotes insight and in-depth knowledge of a foreign legal system as well as one's own. Second, it shows that legal systems tend to imitate each other. Third, it helps to identify solutions to legal issues outside one's legal system, harmonize legal rules, and enable communication between lawyers from different legal systems. All of these reasons justify the use of the comparative method in this thesis, especially the interest in seeking other solutions to legal issues and harmonization.²¹ Harmonization of legal rules in corporate law can be claimed to be particularly important in corporate law because corporations are engaged in business on a global scale and impact the economy and humankind worldwide.

The basic methodical principle of the comparative analysis in this thesis is functionality. The purpose of functionality is to avoid the comparative analysis being misled by conceptual differences between legal systems. Therefore, functionality teaches that what is compared should not have a basis in its own jurisdiction but in the function of the law.²²

²⁰ Valguarnera at 143.

²¹ *Id.* at 143-145.

²² *Id.* at 155-156.

Where appropriate, this thesis employs the legal dogmatic method. This method seeks to find solutions to a legal problem through traditional sources.²³ The traditional legal sources in Sweden include legislation, case law, preparatory work, and legal literature.²⁴

The hierarchy of legal sources differs in the United States from the one in Sweden because the United States has a federal government and is a common law country, unlike Sweden.²⁵ Federal government is a system where the power is divided into two levels, federal and state. The United States is a country of 51 different governments, 50 states and the federal government, wherein each has its own legal system.²⁶ Because the United States follows a common law system, court decisions of individual cases are a source of law.²⁷ However, calling the United States a common law country is somewhat misleading because there has been an “orgy of statute-making” in both corporate law and other fields of law.²⁸ The laws from both the federal and state legal system stem from the constitution, statutes and administrative regulations, and common law.²⁹ State law governs much of the liability rules of the board of directors and their fiduciary duties, which is why this thesis primarily focuses on the DGCL and not federal law.³⁰

Law is not an autonomous body of knowledge and should not be separated from other disciplines because they can yield essential information about how the law should be shaped. Therefore, chapters 3 and 8 step outside traditional legal sources and consider, at least implicitly, other disciplines such as moral and political philosophy, and sociology. These chapters also adopt, to some degree, the methodology of law and economics, which is defined as analyzing the law from a national economic perspective.³¹ The methodology of law and economics can be used to evaluate current law, ascertain whether or not, and how legislation should be changed to achieve economic efficiency, and whether the

²³ Kleineman at 21.

²⁴ *Id.* at 28.

²⁵ Burnham at 1, 41.

²⁶ *Id.* at 1

²⁷ *Id.* at 41.

²⁸ *Id.* at 52.

²⁹ *Id.* at 43.

³⁰ Bebchuk Harvard Law Review 1992 at 1438.

³¹ Bastidas Venegas at 177.

legislation achieves other non-economic objectives. It can also be used to analyze whether a certain type of regulation is cost-effective compared to alternative regulation.³²

Considering other disciplines in this thesis enables an understanding of the importance of the values of authority and accountability and what constitutes an appropriate balance between these values. Nevertheless, it also shows whether market rules and social norms can replace the threat of legal accountability as an effective accountability mechanism. These disciplines do not have formal doctrine of legal sources. Still, this thesis uses literature and legal articles of high value.

1.4 Delimitations

Due to practical constraints, several delimitations have been made to ensure a focused yet comprehensive investigation of the purpose and main research questions. Therefore, this thesis focuses very much on public corporations and not private corporations.³³ It is likely that the nature of accountability for the board of directors will be different in public respective private corporations because their board composition and dynamics vary.³⁴ Furthermore, this thesis only deals with liability for damages to corporations and not third parties, such as the shareholders and creditors. In addition, even though many of the liability rules presented in this thesis also concern the managing directors, the main focus will be on the board of directors.

Each state in the United States has its own corporate law system.³⁵ Corporations are relatively free to select their states of incorporation. This thesis focuses on the state of Delaware because a major fraction of corporations in the United States are incorporated in Delaware and thus governed by the DGCL.³⁶ Delaware is the leader in the state charter competition because it provides flexible laws that benefit the board of directors and the managing directors,³⁷ and has a considerable body of case law interpreting the DGCL.³⁸ Conversely, relevant case law from other states which may have a persuasive effect are

³² *Id.* at 180.

³³ Hereinafter referred to as “corporations.”

³⁴ Keay at 31.

³⁵ Bainbridge (2009) at 8.

³⁶ Bebchuk Harvard Law Review 1992 at 1438.

³⁷ *Id.* at 1438.

³⁸ Bainbridge (2009) at 9.

also used in this thesis. Additionally, references are made to the most important alternative to the DGCL, namely, the American Bar Association's Model Business Corporations Act (MBCA).³⁹

The BJR has been embraced in other countries. Two examples used as an illustration are Australia and Germany.⁴⁰ Even though the implementation of the BJR in Australia and other countries is briefly mentioned, it is beyond the scope of this thesis to examine the BJR in Australia and every other country that has implemented it. The history of the BJR and its relation to mergers and acquisitions also fall outside the scope of this thesis.

The way people think about corporations inevitably affects what constitutes an appropriate balance between the values of authority and accountability and a desirable liability rule for the board of directors. This thesis touches upon the debate on whether the shareholder primacy norm and agency theory should be prevalent theories in corporate law or replaced with stakeholder theory and nexus of contract theory. However, this thesis is unable to unfold the full debate and take a stand in these matters. Moreover, references are made to one-tier and two-tier board systems, but the differences that exist between them, and the merits and demerits of each will not be examined. Beyond that, this thesis will not discuss whether the so-called directors and officer liability insurance should be allowed and how the insurers can influence corporate conduct through the insurance relationship.⁴¹

Lastly, several kinds of measures can be used to ensure accountability of the board of directors.⁴² This thesis focuses on legal accountability and accountability through market forces and social norms. Nevertheless, the justification and drawbacks of accountability that are discussed in this thesis are relevant to all forms of accountability mechanisms.⁴³

1.5 Outline

This thesis is divided into nine distinct chapters. Chapter two begins by presenting two of the core characteristics of modern public corporations, namely, the separation of

³⁹ *Id.* at 9.

⁴⁰ Keay at 207-208.

⁴¹ See Baker & Griffith at 2.

⁴² Keay at 192-241.

⁴³ *Id.* at 71-72, 242.

ownership and control, and authority-based decision-making structures. It then goes on to illustrate the problems created by the separation of ownership and control. Chapter three provides information about the corporate structure in the United States and the roles and general duties of the three constituents in charge of the management of a corporation. Finally, it explores the fiduciary duties of the board of directors. Chapter four includes similar information as in chapter three but instead concerning Swedish corporations.

The fifth chapter describes the meaning of accountability and the rationales and drawbacks of having an accountability mechanism for the board of directors. Subsequently, it endeavors to examine what constitutes an appropriate balance between the values of authority and accountability. Chapter six presents the BJR and analyzes whether it balances the values of authority and accountability in an appropriate manner. If the BJR does not balance the values in an appropriate manner, chapter six will first present the justifications commonly given for the BJR. Thereafter, it will analyze whether the justifications can explain the existence of the rule and its choice of value. It will also acknowledge the rule's underlying assumptions. Lastly, chapter six describes the results of the BJR when combined with other protective devices embodied in the DGCL.

Chapter seven introduces the Swedish liability rule for board of directors. Furthermore, chapter seven assesses whether there is something similar to the BJR in Swedish law and reflects on the current Swedish situation and on a possible introduction of the BJR in the SCA. It then goes on to investigate whether the BJR will have similar results as in Delaware when combined with protective devices in the SCA. Chapter eight analyzes whether market forces and social norms can defend the results of the BJR when combined with other protective devices. It also analyzes whether market forces and social norms can replace the threat of legal liability as an effective accountability mechanism. The final chapter draws together these various findings and answers the question of whether the BJR should be introduced in the SCA.

2 The two characteristics of modern corporations

2.1 Introduction

This chapter presents two of the core characteristics of modern corporations, namely, the separation of ownership and control, and authority-based decision-making structures.⁴⁴ Thereafter, it focuses on problems created by separation of ownership and control. This chapter illustrates the fundamental tension between the need to protect the board of directors' decision-making authority from being trumped by either the shareholders and the courts, and the need to hold the board of directors accountable for its decisions and actions. Resolving the tension between the values of authority and accountability is the chief problem of corporate governance.⁴⁵ Even though there is no single accepted definition of corporate governance,⁴⁶ it can, in its driest form, be conceived of as the study of legal and nonlegal forces that regulate the powers and duties of the board of directors, the managing directors, and the shareholders.⁴⁷

2.2 Separation of Ownership and Control and Decision-making Structures

The majority of corporations worldwide are characterized by the separation of ownership and control, and authority-based decision-making structures.⁴⁸ Although the shareholders nominally “own” the corporation, they have no decision-making powers within the corporation. Rather, management of the corporation is vested in the hands of the board of directors, who in turn delegates the day-to-day running of the corporation to the managing directors, which will be discussed in more detail in chapter 3.⁴⁹ Because the board of directors is given the authority for the decision-making within the corporation, the so-

⁴⁴ Bainbridge (2009) at 3; Bainbridge (2008) at 37-38.

⁴⁵ Bainbridge (2008) at 75.

⁴⁶ Keay at 15.

⁴⁷ Smith & Williams at 173.

⁴⁸ Bainbridge (2009) at 3; Bainbridge Harvard Law Review 2006 at 1745.

⁴⁹ *Id.* at 3.

called authority-based decision-making structure can be said to dominate within the corporations.⁵⁰ Authority-based decision-making structures are characterized by a central agency to which all information in an organization is transmitted and empowered to make decisions that bind the corporation as a whole.⁵¹ It tends to arise when the organization's constituents face information asymmetries, differing interests, and collective action concerns.⁵² Organizations can also be structured according to a consensus-based decision-making structure, which uses "any reasonable and acceptable means of aggregating individual interests" of the organization's constituents.⁵³ In contrast to the authority-based decision-making structure, it works best when each member of the organization has identical information and interests so that preferences can be aggregated at a low cost.⁵⁴

With these criteria being specified, it should be self-evident that effective corporate governance requires ownership of the corporation to be separated from its control and an authority-based decision-making structure.⁵⁵ The shareholders are not able to make decisions through a consensus as they have differing degrees of access to information. Additionally, they lack incentives to gather the information necessary to participate actively in the decision-making as the benefits of becoming informed do not outweigh the costs. Gathering information is a costly and burdensome process because it requires the shareholders to review lengthy and complex corporate disclosure documents to make informed decisions. In contrast, the expected benefits of becoming informed are low for the shareholders because their holdings are generally too small to have a remarkable effect on the voting outcome.

Even if one were to overcome the information asymmetry, the shareholders' widely divergent interests would still preclude active shareholder participation in corporate decision-making through a consensus. Neoclassical economics assumes that the shareholders come to the corporation with wealth maximization as their goal, but the shareholders' opinions about how the share value should be maximized differ.⁵⁶

⁵⁰ Bainbridge (2008) at 37-38.

⁵¹ Gordon & Ringe at 293.

⁵² Bainbridge Harvard Law Review 2006 at 1746.

⁵³ Arrow at 69.

⁵⁴ *Id.* at 69; Bainbridge (2008) at 37.

⁵⁵ Bainbridge (2008) at 37-44; Gordon & Ringe at 293.

⁵⁶ Bainbridge Harvard Law Review 2006 at 1745; Bainbridge (2008) at 41-43.

Nevertheless, the shareholders are not the homogeneous wealth maximizers they once were thought to be, as their interests diverge along a number of dimensions.⁵⁷

Another reason as to why the shareholders cannot make decisions through a consensus is because of the limitations of human cognition. Limited memories, computational skills, and other mental tools would make it impossible for the shareholders to gather and process a vast amount of information that flow within the corporation.⁵⁸ When information within the corporation is directed to one centralized authority, in this context the board of directors, informed decisions can be made and transmitted to the corporation's constituents in an appropriate manner.⁵⁹

A consensus-based decision-making structure is also not ideal because the shareholders would encounter collective decision problems, such as free riding and holding out, and the difficulties with conducting meetings with thousands of shareholders for every decision made within the corporation.⁶⁰ Moreover, consensus-based decision-making does not allow specialization and division of labor because it requires the shareholders to take on several roles within the corporation. Specialization is desirable because it places individuals where they perform the best and saves them from losing time if they were to shift jobs. Authority-based decision-making structure, on the other hand, creates a potential for division and specialization of labor as it centralizes power in the board of directors. It allows the shareholders to focus on their risk-bearing activities, the board of directors on managing and coordinating with the managing director, and so on. This natural division of labor, which is in the best interests of the shareholders, entails that the board of directors is given adequate authority to make binding decisions.⁶¹

2.3 The problems created by Separation of Ownership and Control

While separation of ownership and control makes corporations feasible, separation creates the potential for the shareholders' interests diverging from the interests of the

⁵⁷ Greenwood Southern California Law 1996 at 1026; Hayden & Bodie William and Mary Law Review 2010 at 2095-2096.

⁵⁸ Bainbridge (2008) at 41.

⁵⁹ Arrow at 68; Bainbridge Harvard Law Review 2006 at 1746.

⁶⁰ Bainbridge (2008) at 42.

⁶¹ *Id.* at 44.

board directors and the managing director.⁶² As residual claimants on the corporation's assets and earnings, the shareholders are entitled to the corporation's profits once the corporate creditors have been paid in a liquidation. Also, it is the board of directors, not the shareholders, that controls corporate information and decides how the corporation's earnings are to be spent. Thus, there is an inherent risk that the board of directors will act in an opportunistic manner, meaning that it might pursue self-interest at the expense of the shareholders.⁶³ Opportunism includes all failures to keep previous commitments. The failures may result from culpa cheating, negligence, oversight, or plain incapacity.⁶⁴

The risk of opportunism is referred to as "agency problems" or "principal-agent" problems. Agency problems arise whenever one party, termed the "agent," promises performances to another party, termed the "principal."⁶⁵ In this context, the board of directors is the agent for the shareholders and employed to run the corporation on behalf of the shareholders.⁶⁶ The board of directors monitors the managing directors to ensure that they do not act opportunistically, but the question arises as to how the board of directors as monitor is to be monitored.⁶⁷ The answer, at least theoretically, is that the shareholders must engage in costly monitoring of the board of directors to assure the quality of its performance. Monitoring costs are called agency costs. Agency costs increase whenever tasks undertaken by the board of directors are of great complexity or when the board of directors is given wide discretion.⁶⁸ It might appear reasonable that the shareholders should monitor the board of directors as their reward would correspond exactly with their success as monitors.⁶⁹ As demonstrated below, however, the shareholders have neither the practical ability nor the legal power to sufficiently monitor the board of directors. Instead, legal accountability mechanism can play an important role in monitoring the board of directors and reducing agency costs.⁷⁰

⁶² Berle & Means at 6; Bainbridge (2008) at 73; Bainbridge (2009) at 5.

⁶³ Bainbridge (2009) at 5; Dooley *The Business Lawyer* 1992 at 464-465.

⁶⁴ Dooley *The Business Lawyer* 1992 at 465.

⁶⁵ Armour, Hansmann & Kraakman at 29.

⁶⁶ Smith & Williams at 361.

⁶⁷ Bainbridge (2008) at 75.

⁶⁸ Armour, Hansmann & Kraakman at 29.

⁶⁹ Bainbridge (2008) at 75; Keay at 74.

⁷⁰ Armour, Hansmann & Kraakman at 30.

3 Organization and Structure of the American Corporations

3.1 Introduction

This chapter provides information about corporate structure in the United States, and the roles and general duties of the three constituents in charge of the management of the corporation, namely, the shareholders, the board of directors, and the managing directors.⁷¹ Finally, it explores the fiduciary duties of the board of directors.⁷²

3.2 Shareholders

The shareholders are said to be the owners and the highest body of the corporation.⁷³ They occupy important control rights, such as the right to vote on fundamental transactions, and as residual claimants, the right to obtain profits once the corporate creditors have been paid in a liquidation.⁷⁴ They also vote on amending the corporation's charter and the bylaws, approving mergers, the sale of assets not in the ordinary course of business, and the dissolution of the corporation. Furthermore, they act through voting at the annual meeting or by proxy in conjunction with the annual meeting.⁷⁵ Corporation statutes also permit the shareholders to demand a special meeting to vote on issues that may arise between annual meetings, DGCL § 221; MBCA § 7.02.

The shareholders have other control rights that might be more essential than those already revealed. They have the right to elect the board of directors at an annual meeting, DGCL §§ 211 (b); MBCA § 8.03 (c). With certain exceptions, they may also remove the board of directors with or without cause, DGCL § 141 (k); MBCA § 8.08 (a). Election of the board of directors and amendment of the bylaws are the only control rights that do not require approval by the board of directors before shareholder action is possible.⁷⁶ The

⁷¹ Smith & Williams at 197.

⁷² Hamilton & Booth at 571.

⁷³ Smith & Williams at 174; Dotevall (2017) at 35.

⁷⁴ *Id.* at 174.

⁷⁵ *Id.* at 201-202.

⁷⁶ Bainbridge (2008) at 54.

shareholders cannot control the board of directors with a unanimous vote.⁷⁷ The election right is an important disciplinary tool to limit agency costs and facilitate beneficial corporate control changes.⁷⁸ It is described as “the ideological underpinning upon which the legitimacy of directorial power rests.”⁷⁹ In practice, the incumbent board of directors controls the election process by nominating the next year’s board.⁸⁰ Therefore, the shareholders’ election right is limited. In fact, all of the shareholders’ control rights in Delaware are so limited that they scarcely qualify as part of corporate governance.⁸¹ This has caused several corporate law scholars to cast doubt on whether the shareholders are the owners and the highest body of the corporation because if one owns something, then one should have control over it.⁸²

3.3 The Board of Directors

Corporations can either have a one-tier or a two-tier board. One-tier board invests both managerial and supervisory responsibilities in the unified board of directors, while the two-tier board divides them between two corporate bodies.⁸³ Corporate boards in the United States are one-tier boards,⁸⁴ although they are no longer purely one-tier board as will be seen below.⁸⁵ The statutory power to manage and direct the business and affairs of the corporation is entrusted with the board of directors, except as may be otherwise provided in the certificate of incorporation, DGCL § 141 (a); MBCA § 8.01. The board of directors exercises the formal mechanism of control within corporations and represents the shareholders.⁸⁶

The board of directors manages the corporation primarily for the benefit of the shareholders. This is called the “shareholder primacy norm.”⁸⁷ Given the BJR, the board

⁷⁷ *Id.* at 34.

⁷⁸ Easterbrook & Fischel at 70-72.

⁷⁹ *Blasius Industries, Inc. v. Atlas Corp.*, at 659.

⁸⁰ Bainbridge (2008) at 54.

⁸¹ *Id.* at 53.

⁸² Keay at 76-77; Bainbridge (2008) at 27.

⁸³ Dotevall (2015) at 262, 229; Keay at 10-11.

⁸⁴ Keay at 10.

⁸⁵ Dotevall (2015) at 234.

⁸⁶ Smith & Williams at 174, 197.

⁸⁷ *Id.* at 384; *Dodge v. Ford Motor Co.*, at 684.

of directors has broad discretion to consider stakeholder interests, including consumers, employees, community members, the environment, and so on. The consideration must have some connection with long-term shareholder interests.⁸⁸ An interesting note is that there has been much debate as to whether the shareholder primacy norm should be replaced with stakeholder theory, which suggests that corporations should look beyond the shareholder primacy norm and consider other stakeholders. The shareholder primacy norm is argued to pressure the board of directors and the managing directors to take excessive risks to maximize shareholder profits,⁸⁹ which in turn, as seen in the introductory chapter, harms the society and the economy as a whole.

The board of directors performs three functions within the corporation. The first function is the so-called monitoring role, which consists of two parts. According to the first part, the board of directors needs to select, compensate, and make decisions regarding the retention of the managing directors.⁹⁰ Occasionally, it must also review and cleanse conflict of interest transactions between the managing directors and the corporation. The second part of the monitoring role requires the board of directors to oversee accounting, financial reporting, auditing, and disclosure. This allows investors and other stakeholders to assess the performance of the corporation and its management. These two monitoring functions aim to prevent opportunistic behavior by the managing directors. The second function requires the board of directors to assist the corporation in claiming and protecting its shares.⁹¹ The final function, which is called the service role, obliges the board of directors to formulate corporate strategy, act as a sounding board for the managing directors, and provide external input into the strategic process. If the managing directors are left alone, they become biased constructions of the corporation's strategic position, overconfident, and heavily invested in those beliefs. As a result, they refrain from seeking out information that would suggest that they might be wrong.⁹²

⁸⁸ *Id.* at 385.

⁸⁹ Bonsu *Journal of Finance, Accounting and Management* 2020 at 36-37; Keay *Richmond Journal of Global Law and Business* 2010 at 1-3.

⁹⁰ Langevoort *Georgetown Law Journal* 2001 at 801-802.

⁹¹ *Id.* at 802.

⁹² *Id.* at 802-803.

The many functions of the board of directors may appear challenging to fulfill, especially in large and complex corporations.⁹³ This is one of the main reasons the board of directors frequently delegates the managerial duties to the managing director while only fulfilling the monitoring function.⁹⁴ Also, the corporation's certificate of incorporation or bylaws can limit or prohibit such delegation, 141 (a) DGCL. Because of the change in how the managerial and monitoring function is divided, the boards in the United States are no longer purely one-tier boards.⁹⁵ In this regard, it shall be acknowledged that the ultimate responsibility for the management of the corporation and major business decisions must remain with the board of directors.⁹⁶

In discussing the board of directors, the United States distinguishes inside directors from outside directors. Inside directors are people who are both members of the board and full-time managing directors. Outside directors are people who are not employed by the corporation, other than as members of the board. Outside directors are considered independent if they do not have any other financial ties with the corporation. There has been an emphasis on having a majority of outside, independent directors on the board to enhance the quality of the boards' decision-making process and the monitoring of the managing directors' performance. It is also thought that having a majority of outside directors will create greater independence in the board's decision-making process and fewer conflict-of-interest situations.⁹⁷

3.4 The Managing Directors

The managing directors are appointed by the board of directors, DGCL § 142 (b); MBCA § 8.40 (a-b). They are in charge of the day-to-day operations of the corporation and can perform all actions that the board of directors has delegated to them. Because the managing directors receive their authority from the board of directors, they can only operate within the scope of the authority that has been granted to them.⁹⁸ The board of

⁹³ Welch & Turezyn at 74.

⁹⁴ Backer at 179; Cahn & Donald at 356; Gevurtz at 190.

⁹⁵ Dotevall (2015) at 234.

⁹⁶ Gevurtz at 11, 190; McAlinn, Rosen & Stern at 327.

⁹⁷ Smith & Williams at 198-199.

⁹⁸ Lane at 276.

directors' monitoring role requires it to monitor the managing directors and ensure that they meet their duties.⁹⁹ Corporate law contains only skeletal provisions regarding the duties of the managing directors.¹⁰⁰ The function of the managing directors is defined in the bylaws or resolutions adopted by the board of directors, DGCL § 142; MBCA § 8.41.

The managing directors have wider power within the corporation than what is suggested because they often control and dominate the board of directors as they play an instrumental role in selecting the board of directors.¹⁰¹ Consequently, the board of directors may feel a degree of loyalty toward the managing directors and serve at the pleasure of them instead of the shareholders. The board of directors' loyalty toward the managing directors can also cause it to refrain from sufficiently challenging the actions conducted by the managing directors and impact its ability to monitor the managing directors. This indicates that the powers of control in the decision-making process rest with the managing directors and not with the board of directors.¹⁰²

3.5 Fiduciary duties of the Board of Directors

The board of directors is viewed as fiduciaries of the corporation. As such, it owes fiduciary duties to the corporation and the corporation's shareholders. The fiduciary duty of the board of directors encompasses the duty of care, the duty of loyalty, and the duty of good faith.¹⁰³ The duty of good faith is not a freestanding duty, but rather an element of the duty of loyalty.¹⁰⁴ The fiduciary duties of the board of directors are extensively addressed in case law.¹⁰⁵ The DGCL does not contain any general statements regarding the fiduciary duties of the board of directors.¹⁰⁶

⁹⁹ Backer at 177.

¹⁰⁰ Smith & Williams at 174; Hamilton & Booth at 555.

¹⁰¹ Mace at 73.

¹⁰² Keay at 86-87.

¹⁰³ Smith & Williams at 361; Hamilton & Booth at 571.

¹⁰⁴ Hill & McDonnell Fordham Law Review 2007 at 1769; Radin at 788-789.

¹⁰⁵ Dotevall (2015) at 284.

¹⁰⁶ Smith & Williams at 362.

3.5.1 *Duty of Care*

As commonly articulated, the board of directors is bound to exercise the same care that ordinarily careful and prudent men would use in similar circumstances.¹⁰⁷ Specifically, in Delaware, the standard of review is gross negligence, MBCA § 8.30 (a) (2). Under the duty of care, the board of directors must, prior to making a business decision, inform itself of all material information reasonably available to them.¹⁰⁸ The board of directors must also be familiar with the fundamentals of the business in which the corporation is engaged, keep itself informed about the activities of the corporation, and must comply with the board's monitoring role. Furthermore, the duty of care requires the board directors to attend board meetings frequently and routinely review financial statements. The board of directors is not obligated to know everything that happens on an everyday basis within the corporation. Nevertheless, it cannot overlook any misconduct.¹⁰⁹ Beyond that, the duty of care restricts the board of directors from taking actions amounting to waste.¹¹⁰

Due to the BJR, the potential liability risk for breach of duty of care is near zero in the United States.¹¹¹ To the surprise of virtually everyone, the court in *Smith v. Van Gorkom* held the board of directors liable for breach of care as it was not sufficiently informed before making the disputed business decision.¹¹² The case caused significant controversy because it was seen as a threat to the free market and corporate capitalism.¹¹³ Reacting to the alarms set off by the opinions, the Delaware legislator enacted an exculpation clause that allows corporations to limit or eliminate the board of director's monetary liability for breaches of the duty of care, DGCL § 102 (b) (7). According to the same section, corporations are not allowed to exculpate breaches of the duty of loyalty, "act or omission not in good faith or which involve intentional misconduct or a knowing violation of law." There is a similar statute in the MBCA § 2.02 (b) (4), but which allows broader exculpation.

¹⁰⁷ Jones Iowa Law Review 2006 at 111.

¹⁰⁸ Aronson v. Lewis at 812.

¹⁰⁹ Francis v. United Jersey Bank at 814, 822; Bainbridge (2009) at 130-131.

¹¹⁰ Grobow v. Perot at 189; Michelson v. Duncan at 224.

¹¹¹ Smith & Williams at 362, 500.

¹¹² Smith v. Van Gorkom at 858; Honabach Washburn Law Journal 2006 at 307.

¹¹³ Lubben & Darnell Delaware Journal of Corporate Law 2006 at 599.

The negligence-like phrasing of duty of care does not require a showing of causation and damages.¹¹⁴ As a result, courts conflate the duties of loyalty and care and review them similarly. In contrast to the duty of loyalty, the duty of care should not be scrutinized under the entire fairness test after the BJR has been rebutted because the concept of entire fairness has no relevance to a duty of care case. In the first place, the relevant issue of the duty of care goes not to fairness but to negligence and errors of judgment, which is supposed to fall under the BJR. In the second place, an invocation of the entire fairness carries important remedial implications, for example, equitable or monetary relief, and rescissory damages. These remedial implications are appropriate in loyalty cases because it ensures that the wrongdoer retains neither its ill-gotten gains nor their tainted fruits. However, it makes little sense in cases raising duty of care because there are no ill-gotten gains to be recouped. The board of directors would have to return a benefit that it has never received.¹¹⁵

Similar to the duty of care, the duties of loyalty and good faith do not require the showing of causation or damages.¹¹⁶

3.5.2 *Duty of Loyalty*

When the board of directors conducts business with the corporation, it faces the temptation to benefit at the expense of the corporation.¹¹⁷ Therefore, the duty of loyalty requires the board of directors to put the interests of the corporation before its self-interest at all times.¹¹⁸ Having that said, conflict-of-interest transactions are not void if the transaction is approved by disinterested board directors, ratified by the shareholders, or if the transaction is fair to the corporation, DGCL § 144; MBCA § 8.61 (b) (1). The duty of loyalty also includes an obligation not to take corporate opportunities.¹¹⁹ In addition, it contains duty of full disclosure whenever the board of directors requests the shareholders to approve a transaction.¹²⁰

¹¹⁴ Bainbridge (2009) at 126-127; see *Cede & Co. v. Technicolor, Inc.*, at 370.

¹¹⁵ *Id.* at 128.

¹¹⁶ *Id.* at 163. Bainbridge explains why the duty of good faith raises the issues of causation in a way that loyalty concerns do not.

¹¹⁷ *Jones Iowa Law Review* 2006 at 112.

¹¹⁸ *Guth v. Loft* at 510.

¹¹⁹ *Broz v. Cellular Information Systems, Inc.*, at 155.

¹²⁰ *Arnold v. Society for Sav. Bancorp Inc.*, at 1270, 1276-1277.

Courts are more concerned about whether the board of directors has acted in its self-interests than if it has made poor judgments. As a result, courts review cases raising the duty of loyalty much more carefully than those raising duty of care issues.¹²¹ Nonetheless, as seen in sub-chapter 6.4.3, the liability risk for breach of duty of loyalty is still not particularly high because of the results of the BJR when combined with other protective devices in the DGCL.

3.5.3 *The different treatments of the Duty of Care and the Duty of Loyalty*

At first blush, the differing treatments of duties of care and loyalty can seem puzzling because both duties reduce shareholder wealth and seem to differ more in degree than in kind. Bainbridge argues that the duties indeed differ in kind and not just in degree. First, decisions implicating the duty of care are collective actions of the board of directors as a whole, in contrast to decisions regarding the duty of loyalty, which often involves misconduct by a single board director. When the board of directors makes decisions that implicate the duty of care issues, it is constrained to exercise reasonable care in decision-making based on market forces and social norms. Thus, Bainbridge states that judicial review is not only redundant but can have deleterious consequences for the efficiency of the board of directors' decision-making process.¹²² These arguments suffer from shortcomings. How the board of directors goes about when it breaches the duties of care and loyalty does not necessarily show that the duties differ in kind. Nevertheless, market forces and social norms do not only fail to explain how the duties differ in kind, but they lack the possibility of replacing the threat of legal accountability, which will be demonstrated in chapter 8.

Bainbridge further argues that breaches of the duty of loyalty can be harder to detect because the duty of loyalty only involves misconduct by single board directors. Moreover, the board of directors might be more inclined to conceal its defalcations as they often include some personal gain.¹²³ This argument does not explain dissimilarities between the duties of care and loyalty. More importantly, the argument is unconvincing as to why the duties should be treated differently because it is plausible that the board of directors

¹²¹ Smith & Williams at 402; Bainbridge (2009) at 141.

¹²² Bainbridge (2009) at 141.

¹²³ *Id.* at 141.

will make the same efforts to cover up severe breaches of the duty of care; hence, they will also be hard to detect. Cover-ups of breaches of the duty of care might even be harder to detect as the board of directors acts together.

Bainbridge additionally claims that when individual board directors violate the duty of loyalty, they destroy the internal team relations that characterize boards.¹²⁴ This point of view is dubious as it overlooks the fact that the internal team can be equally damaged if the board of directors continuously violates the duty of care. When unethical conduct becomes commonplace among the board of directors, the board of directors will more widely tolerate them.¹²⁵ A better argument, which Bainbridge later on also touches upon, is that violations of the duty of loyalty reflect greater moral culpability than violations of the duty of care.¹²⁶ The former can be said to be evil per se because they generally include personal gains for the board of directors. In contrast, the latter can be a result of honest mistakes, human frailty, and laziness. This argument sufficiently motivates why the duties of care and loyalty differ in kind and not only in degree, and thus why they should be judged differently. Yet, it does not explain why the risk for liability for breach of duty of care should be near nil as such violation will reasonably not only result from honest mistakes, human frailty, and laziness.

3.5.4 *Duty of Good Faith*

A breach of the duty of good faith requires affirmative bad faith.¹²⁷ There are three categories of situations that fall under bad faith. First, bad faith might occur when the board director intentionally acts with a purpose other than that of advancing the best interests of the corporation. The second category of possible bad faith is when the board director acts with the intent to violate applicable positive law. The third category is when the board director intentionally fails to act in the face of a known duty to act, demonstrating a conscious disregard of his or her duties.¹²⁸ According to the famously known Caremark standard, consistent with the third category, the board of directors can be held liable for failure to engage in proper corporate oversight if it fails to implement

¹²⁴ *Id.* at 141.

¹²⁵ Jones Iowa Law Review 2006 at 139.

¹²⁶ Bainbridge (2009) at 142.

¹²⁷ Hill & McDonnell University of Illinois Law Review 2013 at 859.

¹²⁸ In re Walt Disney Co. Derivative Litigation at 361.

any reporting of an information system, or having implemented such a system, consciously fails to monitor or oversee its operation.¹²⁹

¹²⁹ In re Caremark Intern. Inc. Derivative Litigation at 970-971; see also Stone v. Ritter and newer cases, specifically Marchand v. Barnhill and In re Wells Fargo & Company Shareholder Derivative Litigation.

4 Organization and Structure of the Swedish Corporations

4.1 Introduction

First, this chapter presents information about corporate structure in Sweden and the roles and general duties of the three constituents in charge of the management of the corporation. The three constituents include the shareholders, the board of directors, and the managing directors.¹³⁰ Second, this chapter outlines the fiduciary duties of the board of directors, which contain the duty of care and the duty of loyalty.¹³¹

4.2 Shareholders

Similar to Delaware corporate law, Swedish corporate law considers the shareholders to be the owners and the superior body of the corporation.¹³² Compared with the shareholders in Delaware, the shareholders in Sweden have a strong position within the corporation as they are given broad power and control rights. The board of directors and the managing directors are subordinate to the shareholders.¹³³

The shareholders have the right to make decisions about the affairs of the corporation at the shareholders' meeting, Ch. 7 § 1 of the SCA. The function of the shareholders' meeting is to ensure that the interests of the shareholders are protected.¹³⁴ The shareholders have the right to decide on practically all matters relating to the corporation.¹³⁵ Some of the matters entail amending the bylaws, approving a merger, liquidation, dissolution, and fusion.¹³⁶ Most importantly, the shareholders in Sweden have, like the shareholders in Delaware, the right to appoint and dismiss the board of directors, Ch. 8 § 8 of the SCA. According to the same section, the power to appoint the board of directors may not be delegated to the incumbent board of directors or a single

¹³⁰ Svernlöv (2012) at 30-31.

¹³¹ Dotevall (2015) at 267, 281.

¹³² Keisu & Stattin at 42-43; Dotevall (2015) at 204-205; Östberg at 91.

¹³³ Dotevall (2015) at 204.

¹³⁴ *Id.* at 204.

¹³⁵ Östberg at 92.

¹³⁶ Dotevall (1989) at 63.

board director. It is not uncommon for investors to require the right to elect at least one board director.¹³⁷ Still, the election right, which not only limits agency costs but enables changes in corporate control,¹³⁸ is not limited in Sweden.

Furthermore, the shareholders in Sweden have a notion called the unwritten competence of the shareholders' meeting.¹³⁹ There is no clarity as to when this notion is applicable. In spite of that, it implies that there are decisions that are so far-reaching that they require shareholder approval.¹⁴⁰ Finally, the shareholders have the right to give the board of directors and the managing directors directives regarding management issues.¹⁴¹ The directives must be followed if they are in compliance with the SCA, applicable annual accounts legislation, and articles of association, Ch. 8 § 41 of the SCA. The directives must also be in line with the purpose of the corporation and not deprive the board of directors and the managing directors of their general duties.¹⁴²

The shareholders' extensive power in the SCA is motivated by their economic interests in the corporation and their need to be protected from abuse of power by the board of directors and the managing directors.¹⁴³ Unlike the DGCL and the MBCA, the SCA appears to have a stronger confidence in the shareholders' ability to preserve their rights. The Swedish legislator believes that shareholders that take an active role in the development of the corporation and the business community have a positive impact on the country's economy.¹⁴⁴

¹³⁷ Östberg at 94.

¹³⁸ Easterbrook & Fischel at 70-72.

¹³⁹ Keisu & Stattin at 67.

¹⁴⁰ Båvestam & Lindblad JT 2007-2008 at 224-225.

¹⁴¹ Keisu & Stattin at 61; Dotevall (2015) at 205; Dotevall (1985) at 65.

¹⁴² *Id.* at 64-65; Östberg at 92.

¹⁴³ Östberg at 91.

¹⁴⁴ Prop. 1997/98:99 at 75.

4.3 The Board of Directors

Corporate boards in Sweden are influenced by the two-tier board structure but are from a structural point of view one-tier boards.¹⁴⁵ The boards in Sweden consist almost entirely of outside board directors.¹⁴⁶ The board of directors is one of the central constituents within the corporation.¹⁴⁷ It has largely identical duties to the board of directors in Delaware. Therefore, the duties will not be repeated in-depth.

Ch. 8 § 4 of the SCA stipulates that the board of directors is responsible for the organization and management of the corporation's affairs. Further, it must regularly assess the corporation's financial position, and ensure that the corporation's organization is arranged so that the corporation's accounts, asset management, and finances in general are satisfactorily monitored. If the board of directors delegates certain duties to one or more managing directors or other persons, it has a supervisory function. There are different views on what duties the board of directors can delegate.¹⁴⁸ Dotevall maintains that everything except the board of directors' managerial function can be delegated.¹⁴⁹

The board of directors in Sweden must manage the corporation to generate profit unless something else is provided in the articles of association, Ch. 3 § 3 of the SCA. Similar to the shareholders in Delaware, the shareholders in Sweden have a broad discretion to fulfill the business purpose.¹⁵⁰ Thus, it is also possible for the shareholders in Sweden to consider stakeholder interests if it is beneficial for the shareholders.¹⁵¹ What was said about the debate on whether stakeholder theory should substitute the shareholder primacy norm in sub-chapter 3.3 is equally relevant in Sweden.

The duties of the board of directors show that although the shareholders in Sweden have wide power in the corporation, it still depends on the board of directors to deal with the overall business of the corporation. Accordingly, the power of the shareholders in

¹⁴⁵ Dotevall (2015) at 229; Östberg at 107.

¹⁴⁶ Calkoen at 444.

¹⁴⁷ Keisu & Stattin 41.

¹⁴⁸ Östberg at 95.

¹⁴⁹ Dotevall (2017) at 117.

¹⁵⁰ Dotevall (2015) at 194.

¹⁵¹ Ohlson at 55.

Sweden should not be exaggerated. In this regard, it shall be stated that the managerial decisions of extraordinary nature fall under the shareholders competence.¹⁵²

4.4 The Managing Directors

The managing directors are appointed by the board of directors, Ch. 8 § 27 of the SCA. They are responsible for the day-to-day management of the corporation in accordance with guidelines and instructions issued and provided by the board of directors, Ch. 8 § 29 of the SCA. What is included in the managing director's day-to-day management depends on the size and the nature of the corporation. What is certain is that the managing director's day-to-day management does not include decisions that are unusual or of great importance.¹⁵³ The managing directors' duties in Sweden overlap with the duties of the managing directors in Delaware.

It is uncertain whether the Swedish managing directors, similar to the managing directors in Delaware, have more power than what is contemplated by the statutory scheme. The managing directors in Sweden do not appear to play an instrumental role in the selection of the board of directors. Consequently, the Swedish board of directors cannot be claimed to be captured by the managing directors. However, because the duties of the managing directors depend on the size and the nature of the corporation, they may have greater power in larger corporations. Nevertheless, it is imaginable that the board of directors and the managing directors act in the same way, irrespective of which country the corporation that they are employed by operates in. This is based on the idea that larger public corporations in different countries generally have comparable corporate structures, goals, and culture. Thus, what is said about the relation between the board of directors and the managing directors in Delaware may also be applicable between the board of directors and the managing director in Sweden.

¹⁵² *Id.* at 269.

¹⁵³ *Id.* at 268-271; Svernlöv (2008) at 37; Svernlöv (2014) at 95-96.

4.5 Fiduciary duties of the Board of Directors

4.5.1 Introduction

The board of directors in Sweden is equally bound by fiduciary duties to the corporation and its shareholders as the board of directors in Delaware. The fiduciary duties in Sweden include the duty of care and the duty of loyalty.¹⁵⁴ They can either be regarded as separate duties or as part of each other.¹⁵⁵ The meaning of the fiduciary duties in Sweden is still somewhat unclear and ambiguous.¹⁵⁶ This leads to legal uncertainty for the investors and the board of directors.¹⁵⁷ The case law raising duty of loyalty from the United States has been and continues to be influential and vital for the development of the duty of loyalty in Sweden.¹⁵⁸ This is because the United States is one of the world's largest economies and has a rich body of case law in this area. Before outlining the fiduciary duties in Sweden, it shall be pointed out that they are comparable to the fiduciary duties in Delaware.

4.5.2 Duty of Care

The duty of care has not been extensively addressed in Swedish case law. To make things even worse, the legal scholars' opinions about the duty of care are not consistent. However, it is safe to say that the board of directors needs to follow the ordinary care required by agents in general.¹⁵⁹ More precisely, the board directors need to act with ordinary care when managing the affairs of the corporation.¹⁶⁰ The duty of care requires the board of directors to prepare corporate decisions in an adequate manner and on an acceptable basis. It also mandates the board directors to perform their general duties and frequently attend board meetings. Additionally, the duty of care obliges the board of directors to refrain from taking unjustified risks.¹⁶¹

There is no exculpation clause similar to the DGCL § 102 (b) (7) and the MBCA § 2.02 (b) (4) in the SCA. Corporations are prohibited from adopting charter provisions that

¹⁵⁴ *Id.* at 267, 281.

¹⁵⁵ Stattin at 363; Dotevall (2017) at 160; Svernlöv (2008) at 308.

¹⁵⁶ Östberg at 24; Dotevall (2017) at 147-148.

¹⁵⁷ *Id.* at 24, 321; Stattin at 321.

¹⁵⁸ Dotevall (2017) at 147-148.

¹⁵⁹ Stattin at 362; Östberg at 321.

¹⁶⁰ Östberg at 321.

¹⁶¹ *Id.* at 322-323.

limit or eliminate the board director's monetary liability for breaches of the duty of care.¹⁶² The shareholders can, though, through a simple majority vote, free the board of directors from liability when they have breached a fiduciary duty.¹⁶³ Such a settlement may be concluded only on condition that owners of at least one-tenth of all shares in the corporation do not vote against the proposed settlement, Ch. 29 § 8 of the SCA. Furthermore, the settlement must not concern decisions or acts that violate the SCA or the articles of association.¹⁶⁴ This does not reasonably apply to the duty of care and the duty of loyalty as they are not explicitly regulated in the SCA.

The Swedish liability rule for the board of directors require showing of causation and damages. Therefore, causation and damages will not be discussed under the duties of care and loyalty.

4.5.3 Duty of Loyalty

Despite the fact that Swedish law acknowledges the duty of loyalty, it is not expressly regulated in the SCA. The duty of loyalty can instead be deducted through Ch. 8 §§ 23, 37, and 41 of the SCA. The duty of loyalty prohibits the board of directors from using its position to benefit its own interests. Rather, the board of directors needs to put the interests of the corporation first. The corporation's interests refer to the common interests of the shareholders. The duty of loyalty also prohibits the board of directors from taking corporate opportunities.¹⁶⁵ Not much more can be said about the duty of loyalty in Sweden because it is impossible to find a clarifying description of its meaning.¹⁶⁶

A transaction involving an interested director can be approved by the shareholders on the same conditions as breaches of the duty of care. However, transactions involving an interested director are not void solely because they are fair to the corporation.¹⁶⁷ This is different from what is regulated in the DGCL § 144 and the MBCA § 8.1.

¹⁶² Dotevall (2017) at 183.

¹⁶³ *Id.* at 84-86.

¹⁶⁴ *Id.* at 85.

¹⁶⁵ Dotevall (2015) at 282, 284, 286.

¹⁶⁶ Bergström & Samuelsson at 95.

¹⁶⁷ Dotevall (1989) at 291-295; Dotevall (2017) at 152-153.

5 Accountability of the Board of Directors in Corporate Governance

5.1 Introduction

There has been a lack of articulation of accountability as a concept in the context of corporate governance. One reason might be that accountability is a difficult concept to articulate because it is a complicated and elusive concept, possibly because it is multifaceted.¹⁶⁸ This chapter initially presents the meaning of accountability according to Keay.¹⁶⁹ It is impossible to grasp whether accountability is present and how it can be secured without first understanding the meaning of accountability.¹⁷⁰ Thereafter, this chapter goes on to explore both the rationales and the drawbacks of having an accountability mechanism for the board of directors. Finally, this chapter endeavors to examine what constitutes an appropriate balance between the values of authority and accountability.

5.2 Definition of Accountability

Keay sees accountability as having three elements. According to the first element, the board of directors must disclose and report information about its corporate decisions and actions. The shareholders need to be informed as to what has been done. This duty to disclose information could be the result of a statutory requirement or the result of legal proceedings.¹⁷¹ Alongside the first element of accountability, the board of directors must explain and justify its decisions, actions, omissions, risks, and dependencies. The second element acts as a check on the board of directors' decision-making process. The final element, which is where the concept of answerability is most patent, requires that the board of directors be questioned on its decisions and actions, and judged on how it

¹⁶⁸ Keay at 28, 34.

¹⁶⁹ *Id.* at 60-66.

¹⁷⁰ *Id.* at 36.

¹⁷¹ *Id.* at 60-61.

responds. This may occur at the annual or other general meetings of shareholders, in informal meetings between the relevant bodies, or at court hearings.¹⁷²

For full accountability to be present and meaningful, Keay asserts that there has to be some possibility of consequences for the board of directors.¹⁷³ Licht, on the other hand, does not accept that accountability includes a punishment element.¹⁷⁴ To decrease agency costs, inhibit opportunism by the board of directors, and retain the positive values of accountability discussed in the upcoming sub-chapter, the punishment element should be a component of the meaning of accountability. However, it might be unreasonable to require enforcement of accountability as it might damage the value of authority, which is vital for corporations to be feasible.

5.3 Rationales behind accountability

5.3.1 Agency theory

Accountability must be a feature of all agency relationships because it prevents agents from acting opportunistically and exercising power in their own interests rather than in the interests of the principals.¹⁷⁵ People's behavior improves when they know that they are being observed and may need to defend and justify their decisions and actions.¹⁷⁶

It is argued that this ground is not a rationale for accountability because shareholders cannot be viewed as owners of the corporation and thus not as principals to the board of directors. This is asserted because the shareholders generally lack adequate control rights within the corporation.¹⁷⁷ Proponents of the nexus of contract theory argue that the shareholders do not own the corporation but merely have a contractual claim against the corporation.¹⁷⁸ The nexus of contract theory teaches that corporations are nothing more than a collection of contracts between different corporate constituents.¹⁷⁹ Even if it is true

¹⁷² *Id.* at 63-64.

¹⁷³ *Id.* at 65-67.

¹⁷⁴ Licht Social Science Research Network September 2002 at 5, 29.

¹⁷⁵ Roberts Human Relations 2001 at 1549; Licht Social Science Research Network September 2002 at 20; Harlow & Rawlings European Law Journal 2007 at 547; Scott Journal of Law & Society 2000 at 39.

¹⁷⁶ Bentham The Business Lawyer 1993 at 1425.

¹⁷⁷ Bainbridge (2008) at 27; Keay at 76-77.

¹⁷⁸ Eisenberg Journal of Corporation Law 1999 at 825.

¹⁷⁹ Bainbridge (2008) at 24.

that the shareholders are not the owners of the corporation, accountability can be grounded on the rationales considered below. Nevertheless, as long as agency theory dominates corporate law and constitutes a competing theory to nexus of contract theory, this rationale should not be fully discarded.

5.3.2 *Shareholder vulnerability*

It is argued that the shareholders warrant special protection in corporate law because they are more vulnerable than other constituents within the corporation. The vulnerability of the shareholders should be taken into consideration because, as residual claimants, they only do well if the corporation succeeds, and they lose out if the corporation fails. The shareholders are said to be the most vulnerable constituents within the corporation because there is a power imbalance between the board of directors and the shareholders, as shown in sub-chapter 2.3.¹⁸⁰ Additionally, the shareholders are stated to be vulnerable because, in contrast to other constituents within the corporation, they cannot protect themselves under the terms of the contracts that they make with the corporation.¹⁸¹ Given the myriad of complex decisions that the board of directors must make within the corporation, any attempt to draft a contract between the shareholders and the board of directors to govern their relationship would be hopelessly incomplete.¹⁸²

The shareholders are also unique in that their investments are not associated with any particular property, making it challenging for them to obtain safeguards like those protecting other constituents.¹⁸³ Besides, it is argued that the interests of stakeholders are protected by regulatory law, while the interests of the shareholders are not.¹⁸⁴ Finally, it is stated that the shareholders, unlike for example creditors, are not always able to diversify their exposure to losses by holding a diversified portfolio of equity investments. Even if the shareholders can exit the corporation without any effort, they may take an economic hit by exiting because the corporation's finances can be in a bad state.¹⁸⁵

¹⁸⁰ Key at 91-92.

¹⁸¹ *Id.* at 91-92.

¹⁸² Tung Emory Law Journal 2008 at 813.

¹⁸³ Boatright Business Ethics Quarterly 1994 at 385.

¹⁸⁴ Sundram & Inkpen Organization Science 2004 at 355.

¹⁸⁵ Key 92.

It is dubious whether the shareholders are more vulnerable than other constituents within the corporation because many other constituents do not obtain protection due to unequal bargaining power, ignorance, or insufficient funds to pay legal costs. Moreover, stakeholders also suffer from informational asymmetry when they make contracts with the corporation.¹⁸⁶ Nevertheless, in recent decades, institutional investors have come to dominate the shareholder landscape. Given the resources that institutional investors have and the power they wield, any special protection is hardly justified.¹⁸⁷ Conversely, Bainbridge holds that there is relatively little evidence on whether institutional investors have significant power.¹⁸⁸

Some people might argue that the shareholders have more power than other constituents within the corporation as they possess the right to elect and remove the board of directors.¹⁸⁹ But, as discussed in sub-chapter 3.2, the shareholders in Delaware have limited election rights. Overall, their control rights are so weak that they hardly qualify as corporate governance. The shareholders in Sweden hold their election rights without any restraint and have in general great power within the corporation. Notwithstanding, the shareholders' power in Sweden should not be overemphasized because they still rely on the board of directors to deal with the overall business of the corporation. Nevertheless, Dooley notes that the shareholders' control rights cannot be the only shield against opportunism by the board of directors, given the collective action problems that impair fully effective exercise of the shareholders' franchise.¹⁹⁰ Collective action problems include the conflict of interests derived from separation of ownership and control and the fact that the shareholders cannot monitor the board of directors because of dispersed ownership, as discussed in detail in chapter 2.¹⁹¹

A better way of showing that the shareholders are not vulnerable is by stressing that they often diversify their exposure to losses sustained by their investment. In addition, the shareholders can always exit the corporation by selling their shares, but other

¹⁸⁶ *Id.* at 92-93.

¹⁸⁷ *Id.* at 93.

¹⁸⁸ Bainbridge *Northwestern University Law Review* 2003 at 571.

¹⁸⁹ Keay at 93.

¹⁹⁰ Dooley *The Business Lawyer* 1992 at 468.

¹⁹¹ Impavido at 140.

constituents, for example, employees, cannot always bailout from the corporation.¹⁹² This strongly suggests that the shareholders are not more vulnerable than other constituents with the corporation and do not need special protection in corporate law. Yet, it can be disputed whether one needs to be overall vulnerable to demand protection in cases where protection is needed. For instance, when the existence of an underlying conflict is beyond dispute.

5.3.3 The nature of the Board of Directors

Accountability mechanism is necessary to address the issues tied up with the nature of outside board directors, which may lead them to act in error and not in line with their corporate duties. An accountability mechanism could encourage them to carry out their duties appropriately.¹⁹³ The first issue is that the outside board directors suffer from information asymmetry because they are often given inadequate information by the managing directors who may be fearful of being criticized. This prevents them from making careful and thoughtful decisions.¹⁹⁴ Second, the outside board directors only spend limited time carrying out their monitoring task and do not delve deeply into the complicated activities of the corporation as they only are part-timers. To makes things worse, the time they do spend is misspent on regulatory and compliance matters rather than oversight.¹⁹⁵ Third, outside board directors also tend to lack firm-specific expertise.¹⁹⁶ Fourth, outside board directors are also managing directors of other corporations. Therefore, they may not monitor or make demands that they themselves would not like to hear as managing directors of other corporations.¹⁹⁷ Finally, as observed in sub-chapter 3.4, the board of directors in the United States is controlled and dominated by the managing directors. Consequently, it might refrain from sufficiently monitoring the managing directors and challenging their actions in a way in which they are intended. Sub-chapter 4.4 showed that this issue may also be a reality for the board of directors in Sweden.

¹⁹² Key at 94.

¹⁹³ *Id.* at 83.

¹⁹⁴ Langevoort *Georgetown Law Journal* 2004 at 293. Adams & Ferreira *The Journal of finance* 2007 at 217.

¹⁹⁵ Bainbridge *The Business Lawyer* 2019 at 286, 290.

¹⁹⁶ *Id.* at 286.

¹⁹⁷ Key at 89.

5.3.4 *Physiological limitations*

An accountability mechanism is justified by the board of directors' cognitive shortcomings that hinder the board from being independent.¹⁹⁸ One of the physiological limitations is structural bias. Structural bias teaches that the board of directors may favor one another and the managing directors rather than the shareholders of the corporation. Structural bias is a consequence of the common cultural bond, and natural empathy and collegiality that the board of directors normally share. It is also a result of the selection and socialization process that the board of directors go through. Further, structural bias is a product of the economical or psychological dependency that the board of directors has to the managing directors.¹⁹⁹

Structural bias is a manifestation of the psychological phenomenon ingroup-bias, which is the tendency to evaluate in-group members more positively than out-group members.²⁰⁰ Because the board of directors is a homogeneous group with strong cultural bonds, it is vulnerable to increased in-group bias.²⁰¹ The board of directors may also experience the concept of groupthink.²⁰² Groupthink is a psychological drive to obtain consensus in a decision-making group. This can cause members of the group to miscalculate the practical and moral consequences of their decisions.²⁰³

5.3.5 *Legitimizing the power of the Board of Directors*

Accountability enables the board of directors to acquire legitimacy.²⁰⁴ A central perception of political and social theory is that legitimate power must be partnered with an accountability mechanism.²⁰⁵ Legitimacy is a "generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs, and definitions."²⁰⁶ The board of directors is endowed with substantial power within the corporation. Therefore, it should be held

¹⁹⁸ *Id.* at 87-88.

¹⁹⁹ Velasco Washington University Law Quarterly 2004 at 824.

²⁰⁰ *Id.* at 861.

²⁰¹ *Id.* at 863.

²⁰² Key at 90.

²⁰³ Janis at 4, 78, 68.

²⁰⁴ Key at 95-102.

²⁰⁵ Thompson at 3.

²⁰⁶ Suchman The Academy of Management Review 1995 at 574.

accountable when using such power.²⁰⁷ The greater the power, the greater the accountability.²⁰⁸

The presence of legitimacy for the board of directors is central because it affects how people act toward the corporation and its board of directors, and how the public understands the board. When the board of directors is legitimate, it is perceived as worthy, meaningful, predictable, and more trustworthy,²⁰⁹ which is fundamental for the development of long-term business relationships.²¹⁰ The board of directors' legitimacy helps the corporation save money by persuading the shareholders and other stakeholders that the board of directors can be trusted,²¹¹ and makes it more likely for investors to supply resources.²¹² If the board of directors' decisions and actions were beyond questionable, then the shareholders and other stakeholders would be suspicious of nearly everything that the board of directors decided to do.²¹³

5.3.6 Benefit efficiency of the Board of Directors and its decision-making

Holding the board of directors accountable for its decisions and actions may have the effect of deterring the worst mistakes generally made. Moreover, accountability might encourage the board of directors to engage in more thoughtful and efficient decision-making, because the need to account will help concentrate the collective mind of the board of directors. The board of directors may even enhance the quality of its monitoring role.²¹⁴ Finally, the actions involved in accountability, such as disclosing material and providing justification, can allow the board of directors to see matters that warrant additional consideration or discover new methods to adopt in its decision-making process.²¹⁵

²⁰⁷ Koenig-Archibugi Government and Opposition 2004 at 236.

²⁰⁸ Key at 98.

²⁰⁹ Suchman The Academy of Management Review 1995 at 575.

²¹⁰ Seal & Vincent-Jones Accounting, Auditing and Accountability 1997 at 406; Siebecker Washington University Law Review 2009 at 136.

²¹¹ Key, at 97, 100.

²¹² Suchman The Academy of Management Review 1995 at 574.

²¹³ Key at 101; Bottomley at 74.

²¹⁴ *Id.* at 103.

²¹⁵ *Id.* at 104.

Arrow states that accountability can destroy the genuine values of authority,²¹⁶ which in the end can create inefficiency for the corporation.²¹⁷ Arrow's statement rests on the idea that "if every decision of A is to be reviewed by B, then all we have really is a shift in the locus of authority from A to B and hence no solution to the original problem."²¹⁸ This means that authority and accountability are competing values,²¹⁹ and that one cannot require greater accountability without greater shareholder empowerment.²²⁰ However, this assumption may be challenged. Moore argues that the values of authority and accountability should not be seen as competing values but rather as independent and mutually reinforcing. It is deemed that the value of authority is not sustainable if it is not supported by an effective accountability mechanism.²²¹ Arrow's statement can also be undermined on another ground. For instance, when government decisions and actions are scrutinized by the courts, it is rarely claimed that the government loses its power. Why should something else be alleged when the decisions and actions by the board of directors are reviewed? The board of directors may feel as though it loses its authority, but this can only be an illusion created by people's fear of being criticized.

5.3.7 *Enriches the Board of Directors*

An accountability mechanism is vital for the board of directors because it allows the board directors to obtain feedback, recognition, approval, and understanding.²²² This can help them to feel good about themselves and what they do.²²³ It can also sharpen their self-worth, their actions, and teach them that their actions make a difference.²²⁴ As they receive feedback, they can reflect, learn,²²⁵ and most probably grow in their roles as board directors. Nevertheless, when the board directors are accountable for their decisions and actions, society begins to regard it as moral and responsible.²²⁶ It also invokes the board

²¹⁶ Arrow at 78.

²¹⁷ Keay at 104.

²¹⁸ Arrow at 78.

²¹⁹ Bainbridge Iowa Law Review 2002 at 7-8.

²²⁰ Bainbridge (2008) at 16.

²²¹ Moore Law and Financial Markets Review 2015 at 10-11.

²²² Keay at 104-105.

²²³ Cooper & Johnston Accounting, Auditing & Accountability Journal 2012 at 611.

²²⁴ Roberts Accounting, Organizations and Society 1991 at 356.

²²⁵ Bovens West European Politics 2010 at 955.

²²⁶ Shearer, Accounting, Organization and Society 2002 at 545.

directors' feelings of fidelity toward the shareholders, and reminds them of their dependence on others.²²⁷ Finally, an accountability mechanism makes sure that the board directors are not subject to fear of damaging their professional and personal reputations, which undoubtedly is central in the current competitive labor market.²²⁸ When the board directors account for their misconduct, they demonstrate respect toward the shareholders who have granted them the power within the corporation.²²⁹

5.3.8 Public interest and stakeholders

A final rationale for holding the board of directors accountable for its activities is because the public expects that those involved in the markets will act properly, and if they do not, then they should be penalized. In the wake of the financial crisis, and the financial and social problems that resulted from it, the public has started to regard corporate behavior as a public matter.²³⁰ The public's hope is that if the board of directors is more accountable, it will produce market confidence, provide protection for investors, and enhance commercial morality, thus, leading to better corporate governance and increased social wealth.²³¹

It is important to consider the public's expectation because corporations derive their life from the government. Supporters of the nexus of contract theory will object to this argument as they argue that corporations exist as a result of the making of a contract.²³² A more neutral motivation as to why the public's expectations should be taken into account is that the public is impacted by the actions taken by the corporations and the board of directors. It is only morally right that those affected by a particular behavior have a say in that matter. The public might lose its trust in the corporations and the government if there is no possibility of holding the board of directors accountable. The public might even question why the board of directors, unlike regular people, should be above the law when its decisions and actions have caused harm.

²²⁷ Key at 105-106.

²²⁸ *Id.* at 106.

²²⁹ Licht Social Science Research Network September 2002 at 29-30.

²³⁰ Key. at 107; Hannigan Company Lawyer 2012 at 39.

²³¹ *Id.* at 107.

²³² *Id.* at 107-108.

The public might also expect an accountability mechanism to be in place as the debate on whether the stakeholder theory should replace the shareholder primacy norm has increased worldwide. As such, the board of directors must be accountable when it refrains from considering stakeholder interests in its decision-making process. This rationale assumes that the shareholders will take action against the board of directors if it does not consider stakeholder interests when it might be more reasonable to think that the shareholders will prefer the board of directors to prioritize them over the stakeholders. The shareholders are more prone to risk-taking than the board of directors, as will be indicated in sub-chapter 6.2.2. Thus, the board of directors should be protected from accountability rather than face increased accountability as the shareholders might question the board of directors when it considers stakeholder interests in its decision-making and takes smaller risks. However, this statement is somewhat dubious because it overlooks the fact that the shareholders are not the homogeneous wealth maximizers they once were thought to be.²³³

5.4 The drawbacks of having an accountability mechanism

5.4.1 Cost, Bureaucracy, and Loss of Directorial Time

There are not only rationales to accountability for the board of directors but also some drawbacks. An accountability mechanism for the board of directors can lead to greater compliance costs and maladaptation costs. The former involves all expenses that the corporation incurs to comply with the regulation, while the latter includes administrative inefficiencies associated with the introduction of a new accountability procedure.²³⁴ Accountability can also lead to bureaucracy, which generally frustrates the board of directors. Finally, it can result in a loss of valuable directorial time because the board of directors will need to address issues raised by the shareholders who have interests that diverge from those of other shareholders to avoid being criticized by the shareholders.²³⁵

These arguments create a strong case for reconsidering holding the board of directors accountable for its decisions and actions, at least to the extent that might be burdensome

²³³ Greenwood Southern California Law 1996 at 1026; Hayden & Bodie William and Mary Law Review 2010 at 2095-2096.

²³⁴ Keay at 244-245; Moore at 42.

²³⁵ *Id.* at 244-245.

and unjust. It is apparent that the agency costs need to be kept low to maintain the viability of the corporation and to attract sufficient investment,²³⁶ and there is little doubt about how important directorial time is, and why bureaucracy is frustrating for the board of directors. Yet, accountability should not be dismissed simply based on these arguments. As shown in the previous sub-chapter, accountability for the board of directors exists for other reasons than ensuring that shareholders receive greater benefits. Furthermore, an accountability mechanism for the board of directors can also save costs, though these might not always be quantifiable.²³⁷

5.4.2 *Inefficiency and Short-Termism*

Accountability is argued to reduce the efficiency of the board of directors. This argument originates from the belief that accountability burdens the board of directors and limits its directorial time.²³⁸ Accountability is also thought to undermine the board of directors' motivation and creativity,²³⁹ restricting its freedom to take risks and opportunities as they arise.²⁴⁰

Keay maintains that those who only focus on efficiency do not consider important values of having an accountability mechanism for the board of directors, for instance, fairness, respect, and justice. Keay also states that there is no empirical evidence that accountability impedes enterprise. Even people who endorse these drawbacks will most likely argue that there has to be some kind of accountability for the board of directors, if not for any other reason than it should, as a matter of propriety, explain and justify its decisions and actions.²⁴¹

In regard to the board of directors' risk-taking activity, it must be questioned whether it should be encouraged to take excessive risks. The introductory chapter showed that excessive risk-taking can cause corporate scandals and harm the shareholder, humankind, and the economy as a whole.

²³⁶ Moore at 83.

²³⁷ Keay at 245.

²³⁸ *Id.* at 246-247.

²³⁹ Holland Nonprofit Management and Leadership 2002 at 411.

²⁴⁰ Keay at 264.

²⁴¹ *Id.* at 264.

A further obstacle with accountability is that it can encourage a short-term approach by the board of directors that might harm the corporation in the long run. The board of directors is inclined to secure good results in the short-term merely to obtain the confidence of the shareholders and to avoid being criticized by the shareholders.²⁴² This is a strong objection because the board of directors' single-minded focus on short-term gains allegedly contributed to the financial crisis.²⁴³ However, because the shareholders no longer are a homogenous group,²⁴⁴ it is not possible to determine a short-term bias affecting the whole corporation.²⁴⁵

5.4.3 Board Life, Trust, and Expectations Gap

Sub-chapter 5.3.2 pointed out that the board of directors is subject to group dynamics that causes it to align with one another and the managing directors rather than with the shareholders. Here, it shall be noted that these group dynamics combined with accountability can make the board of directors adopt a “us or them” approach and start being defensive toward the shareholders.²⁴⁶ Accountability is also claimed to break, or at least reduce, trust between the board of directors and the shareholders.²⁴⁷ Some people may even assert that it is unfair for the board of directors to be held accountable because it cannot identify the expectations of shareholders in large corporations, notably as the expectations may differ between the shareholders. Furthermore, the shareholders' expectations on the board of directors can be unreasonably high and unrealistic.²⁴⁸

These arguments are certainly strong. They not only explain the importance of considering the drawbacks of accountability but also that the drawbacks might be greater than the corresponding benefits of having accountability for the board of directors. It is, of course, probable that most board of directors will accept that there has to be some kind of accountability; thus, these drawbacks will only become an issue when the level of

²⁴² *Id.* at 248-250.

²⁴³ Wilmarth Connecticut Law Review 2009 at 971.

²⁴⁴ Greenwood Southern California Law 1996 at 1026; Hayden & Brodie William and Mary Law Review 2010 at 2095-2096.

²⁴⁵ Keay 250.

²⁴⁶ *Id.* at 250-251.

²⁴⁷ *Id.* at 257; Seal & Jones Accounting, Auditing and Accountability 1997 at 406.

²⁴⁸ *Id.* at 251-252.

accountability is unreasonable and too demanding.²⁴⁹ This consideration might even be applicable to the risk of short-term bias that can be created by an accountability mechanism. If accountability measures are sensible, and the board of directors does not fear that it easily risks being held accountable, it might not feel the need to seek short-term gains.

5.5 Balancing the values of authority and accountability

Establishing an appropriate balance between the values of authority and accountability is the fundamental issue in corporate governance.²⁵⁰ However, it is also a daunting and challenging task because it is impossible to know exactly where the ideal balance lies.²⁵¹ Nonetheless, no number or percent can be provided on how much one is to have of each value. Notwithstanding the difficulties, a lot has been said about both values to make it easier to determine what constitutes an appropriate balance between the values of authority and accountability.

Chapter 2 illustrated that there is a tension between the values of authority and accountability, but that there has to be some accommodation between the values to ensure the survival of corporate businesses. The board of directors must be given great authority to effectively run the corporation's affair because the shareholders cannot make corporate decisions through a consensus. Nonetheless, the board of directors' authority must be accompanied by accountability as there is an inherent risk that it will act opportunistically and consider its own interests rather than the interests of the shareholders. The need to hold the board of directors accountable is equally important for the shareholders in Sweden because they depend on the board of directors to deal with the overall business of the corporation. Furthermore, the shareholders in Sweden cannot be protected against opportunism solely through the control rights stipulated in the SCA because collective action problems impair fully effective exercise of their franchise.²⁵²

²⁴⁹ *Id.* at 258.

²⁵⁰ Hutchison Loyola University Chicago Law Journal 2005 at 1116.

²⁵¹ Bainbridge (2008) at 108; Scott Journal of Law & Society 2000 at 39; Sharfman Journal of Corporation Law 2012 at 906.

²⁵² Dooley The Business Lawyer 1992 at 468.

Previous sub-chapters unfolded further reasons for having both values to have a well-functioning board of directors. Accountability might minimize opportunistic behavior by the board of directors and deter the worst mistakes that can be made. It may also encourage it to carry out its duties appropriately and enhance its self-worth. More importantly, it can enable the board of directors to acquire legitimacy and produce confidence in corporations and the markets generally. These arguments are valid and hard to undermine. The sole justification that cannot fully motivate accountability for the board of directors is the shareholder vulnerability. Yet, it can be questioned whether the board of directors needs to be vulnerable to demand protection when it is needed. These findings, while preliminary, suggest that the value of accountability should be favored. A note of caution is due here since there is a lack of evidence on which value should be preferred, and because there are drawbacks to accountability. Accountability can stultify enterprises, the effectiveness of the board of directors, and in the worst-case scenario, encourage the board of directors to seek short-term gains. However, this is more likely to happen if the level of accountability is too demanding, unfair, and unjust. Thus, this can arguably imply that the value of authority can be emphasized as long as it is not unreasonably burdensome for the board of directors. The points taken together indicate that an appropriate balance between the value of authority and accountability exists when the former value is favored as long as it does not destroy the genuine value of authority.

The conclusion drawn might be criticized by Bainbridge and Sharfman. Bainbridge, who accepts that there has to be some accountability and calls for an appropriate mix, associates accountability with loss of power and argues that there should be a presumption in favor of authority.²⁵³ Sharfman states that the use of accountability is legitimate only when it does not degrade the value of authority.²⁵⁴ Sharman's remark is reasonable considering what has been said about both values. Conversely, it can be argued that Bainbridge wrongly associates accountability with loss of power because authority and accountability do not need to be seen as irreconcilable. Rather, they can be understood as independent and mutually enforceable as demonstrated in sub-chapter 5.3.6.

²⁵³ Bainbridge (2008) at 16.

²⁵⁴ Sharfman Florida Law Review 2014 at 206.

A better obstacle to the conclusion might be that it can cause an overemphasis of the value of accountability, which can cause serious problems materializing. Therefore, even if the conclusion is based on sound premises, there might be a better answer to what constitutes an appropriate balance between the values of authority and accountability. For instance, Arrow states that neither the value of authority, nor accountability should be so preeminent that it is entirely dominant.²⁵⁵ This statement is rational because both values are vital, and it is difficult to say with certainty which of them should be preferred. Nevertheless, Arrow's view is congruent with Keay's statement that accountability should include a punishment element for full accountability to be present and meaningful. If the value of authority dominates, there will not be a possibility to hold the board of directors accountable. Consequently, this chapter establishes that the values of authority and accountability are appropriately balanced when none of the values are so preeminent that any of them completely dominate.

²⁵⁵ Keay at 265, quoting Arrow.

6 The Liability Rules for the Board of Directors under American law

6.1 Introduction

This chapter explores the meaning of the BJR and the entire fairness standard. Subsequently, this chapter evaluates whether the BJR balances the values of authority and accountability in an appropriate manner, wherein none of the values are so preeminent that any of them completely dominate. If the BJR does not balance the values in an appropriate manner, this chapter will present justifications commonly given for the BJR. Hereinafter, follows an analysis of whether the justifications can explain the existence of the BJR and its choice of value. This chapter will also highlight the underlying assumptions of the BJR. Answers to the questions in this chapter will impact whether the BJR should be introduced in the SCA.

Finally, this chapter will identify the results of the BJR when combined with other protective devices embodied in the DGCL. These protective devices include shareholder derivative lawsuit, the already discussed statutory exculpation for duty of care liability, indemnification and insurance agreements, and the size of penalties that the board of directors' face for breach of fiduciary duty. When a country debates on whether to incorporate a foreign rule in the forum law, it should not only observe the rule in a vacuum, but also consider what consequences it has when partnered with other relevant rules from the country where the rule originates. Such consideration may affect whether the rule should be incorporated into the forum law.

6.2 The BJR and the entire fairness standard

The BJR and the entire fairness standard are the twin pillars of enforcement of fiduciary duties in corporate law. The legitimacy of either depends upon the other.²⁵⁶ The BJR “is a presumption that in making a business decision, the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the

²⁵⁶ Velasco Washington University Law Quarterly 2004 at 827.

best interests of the company.”²⁵⁷ Under Delaware law, the BJR descends from the fundamental principle, codified in the DGCL § 141(a), giving the board of directors the formal mechanisms of control within the corporation by entrusting it with the power to manage the corporation.²⁵⁸ The implication of the BJR is that the courts will not substitute its judgment for that of the board’s unless the shareholders by a preponderance of evidence show that the board of directors’ decision involved a breach of fiduciary duty.²⁵⁹

The BJR operates only if the board of directors has exercised a business judgment.²⁶⁰ The board of directors is not protected under the BJR if it has abdicated its functions or, absent a conscious decision, failed to act.²⁶¹ In these circumstances, the board of directors violates the duty of care.²⁶² The duty of care, in this sense, is broader than the BJR because it encompasses both actions and inactions of the board of directors, MCBA § 8.30 (b).

When the BJR has been rebutted, the burden shifts to the defendant board directors to demonstrate that the transaction was the product of both fair dealing and fair price to the shareholder plaintiff.²⁶³ This is the so-called entire fairness standard.²⁶⁴

6.2.1 More about the BJR and the values of authority and accountability in an appropriate manner

The BJR presumes that the acts of independent board directors are made in good faith and with appropriate care,²⁶⁵ even when the acts are unwise, unreasonable, or stupid.²⁶⁶ It focuses the judicial inquiry on the adequacy of the process by which the board of directors reached its decisions, rather than the wisdom or appropriateness of the decision itself.²⁶⁷ Velasco asserts that the BJR is nearly irrebuttable with respect to substance.²⁶⁸ This brings us to the second question of this thesis, namely whether the BJR balances the values of authority and accountability in an appropriate manner.

²⁵⁷ Smith v. Van Gorkom at 872, quoting Aronson v. Lewis at 812.

²⁵⁸ *Id.* at 872; Smith & Williams at 373; Welch & Turezyn at 89.

²⁵⁹ Welch & Turezyn at 89.

²⁶⁰ Bainbridge (2009) at 110; Welch & Turezyn at 102.

²⁶¹ Aronson v. Lewis at 813.

²⁶² Welch & Turezyn at 102.

²⁶³ Cinerama, Inc. v. Technicolor, Inc., at 1161, 1163.

²⁶⁴ Welch & Turezyn at 90.

²⁶⁵ *Id.* at 90.

²⁶⁶ Radin at 19.

²⁶⁷ Jones Iowa Law Review 2006 at 114.

²⁶⁸ Velasco Washington University Law Quarterly 2004 at 830.

By presuming that the board of directors has acted properly and in good faith, and by focusing the judicial inquiry on whether the board of directors adhered to adequate and appropriate processes when making the challenged decision, the BJR noticeably embodies the value of authority. The BJR insulates most decisions made by the board of directors from review by limiting the judicial inquiry to how a decision came about rather than the wisdom of appropriateness of the decision itself.²⁶⁹ Furthermore, it precludes judicial review of the vast majority of board decisions, whether routine or extraordinary.²⁷⁰ Consequently, it provides the board of directors with a safe harbor from liability.²⁷¹ The value of authority is also upheld by the fact that the shareholders are placed with the burden to rebut the presumption of the BJR.²⁷²

Its favor of the value of authority is made more apparent when one considers the purpose of the BJR. The rule only intends to protect the authority of the board of directors,²⁷³ and it does so by allowing for the value of authority to trump the value of accountability, absent bad faith or self-dealing.²⁷⁴ Allegedly, the BJR attests to the value of authority to the extent that it sacrifices the value of accountability.²⁷⁵ This might not come as a surprise given that the BJR is said to be evidence of corporate law's respect for the authority of the board of directors.²⁷⁶ The foregoing indicates that the BJR considerably favors the value of authority and allows it to completely dominate. Therefore, the BJR does not appear to balance the values of authority and accountability in an appropriate manner.

Despite what has been said about how the BJR blends the values of authority and accountability, it might be argued that it is not the rule itself that is critical but rather the way the Delaware courts apply it. As intimated in sub-chapter 3.5., the Delaware courts apply the BJR generously in favor of the board of directors and adopt an inveterate attitude in cases raising duty of care, thus, weakening the duty of care as a viable and

²⁶⁹ Jones Iowa Law Review 2006 at 114.

²⁷⁰ Dooley The Business Lawyer 1992 at 471.

²⁷¹ Branson Valparaiso University Law Review 2002 at 632; Keay at 263.

²⁷² Welch & Turezyn at 89.

²⁷³ Dooley The Business Lawyer 1992 at 471.

²⁷⁴ Bainbridge (2015) at 235.

²⁷⁵ Velasco Washington University Law Quarterly 2004 at 824.

²⁷⁶ Bainbridge UCLA School of Law, Law & Economics Research Paper Series 2010 at 11.

meaningful accountability mechanism.²⁷⁷ It might certainly be accurate that the way in which the BJR is applied is problematic. For instance, Jones asserts that “the business judgment rule is applied beyond sensible limits to shield from scrutiny decisions so flawed that the implication of director bias is difficult to ignore.”²⁷⁸ Carry notes that the enabling statutes under the DGCL have watered the rights of the shareholders down to a thin gruel.²⁷⁹ This effect has been exacerbated by the Delaware courts because of their incestuous relationship with the Delaware legislator. Consequently, the Delaware courts have contributed to shrinking the concept of fiduciary duties and fairness.²⁸⁰ Even though Carry does not specifically speak about the BJR, what has been said should be equally relevant to the BJR because it is part of the Delaware corporate law.

Accordingly, it is possible to speculate that the BJR is problematic but that the way the Delaware courts apply it makes it more serious. The Delaware courts most probably show deference to the board of directors because they are impacted by the design and purpose of the BJR. They may also be affected by the fact that the Delaware legislator has adopted liberal corporate law to obtain the revenue that is produced when a state attracts corporate incorporations.²⁸¹ More precisely, the Delaware courts may seek to enable the state of Delaware to achieve revenue by applying the BJR generously in favor of the board of directors. This could, in fact, be the incestuous relationship that Carry is speaking about.

Taken together, these results suggest that the BJR should not be introduced in the SCA. An appropriate balance between the values of authority and accountability is necessary for the society, the survival of the corporation, and for a safe and confident market. Additionally, it is important that the fiduciary duties of the board of directors are not weakened because they are essential elements in the accountability framework. The fiduciary duties are useless unless they are enforced.²⁸² However, Swedish corporate law scholars may argue that the BJR is still desirable because no evidence indicates that the

²⁷⁷ See Keay at 208, 264.

²⁷⁸ Jones Iowa Law Review 2006 at 114.

²⁷⁹ Cary The Yale Law Journal 1974 at 666.

²⁸⁰ *Id.* at 690-692, 696.

²⁸¹ Fischel Northwestern University Law Review 1981-1982 at 915; Cary The Yale Law Journal 1974 at 666.

²⁸² Keay at 207.

Swedish courts will be deferential to the board of directors in order for Sweden to obtain revenue. They may also point out that cultural differences within legal systems can affect the development of a legal rule and how it is applied by the courts.²⁸³ To illustrate, Australia has embraced the BJR, but it has not placed much reliance on it and awarded it quite the same respect as Delaware. It does not appear to be quite the same judicial reluctance in holding the board of directors liable in appropriate cases in Australia as in Delaware. This may be because Australia provides the shareholders with more rights than Delaware.²⁸⁴ Accordingly, the Swedish courts might not show absolute deference toward the authority of the board of directors because the shareholders in Sweden are traditionally given extensive power within the corporations.

Still, the Swedish courts will most likely observe how the Delaware courts apply the BJR to understand how it ought to be applied and perhaps apply it in the same manner. After all, the BJR is a complicated rule to understand even for legal scholars and judges in the United States.²⁸⁵ This approach by the Swedish courts will be practical and timesaving, mainly because foreign case law can serve as an authoritative statement that a certain solution has been applied elsewhere and therefore should be applied by the national courts to achieve uniform results.²⁸⁶ The Swedish courts are not unfamiliar with looking at cases from the United States. Sub-chapter 4.5.1 showed that Swedish courts often consider cases raising duty of loyalty from the United States. The Swedish courts might also be reluctant in holding the board of directors liable solely due to the way the BJR is formulated and because the Swedish legislator will have implemented it to further protect the board of directors from liability. However, the Swedish courts will, in all probability, refrain from showing great deference to the board of directors if the BJR is articulated differently before it is introduced in the SCA. Alternatively, the Swedish legislator can in the preparatory work prescribe the BJR a dual function to protect both the authority of the board of directors and the need to hold it accountable for its decisions and actions. The Swedish courts will in principle comply with the preparatory works because these constitute the major legal sources in Swedish law. Delaware case law

²⁸³ See Dotevall (2015) at 25.

²⁸⁴ Keay at 208-209, 262, 264.

²⁸⁵ Bainbridge Vanderbilt Law Review 2004 at 83-84.

²⁸⁶ See Dotevall (2015) at 25-26.

concerning the BJR, thus, will only be a secondary source that the judges in Sweden may regard occasionally.

These discussions indicate that Swedish legislators should only consider introducing the BJR if it is articulated in a different way or given a dual function to protect both the authority of the board of directors and the need to hold it accountable for its decisions and actions. Because it is impossible to foresee how a foreign rule might develop in the forum law with absolute certainty, an introduction of the BJR must be done with great care.

6.3 Justifications for the BJR

The previous sub-chapter established that the BJR does not appear to balance the values of authority and accountability in an appropriate manner. Therefore, the Swedish legislator should only consider introducing the BJR in the SCA if it is articulated in a different way or given a dual function to protect both the authority of the board of directors and the need to hold it accountable for its decisions and actions. Given that it is impossible to foresee how a foreign rule will develop in the forum law, it must be assessed whether justifications generally given for the BJR can explain the existence of the BJR and its choice of value. This assessment will show whether the BJR should be introduced in the SCA without first being modified or given a dual function.

The traditional justification for the BJR is that it avoids judicial interference in areas where the judges have no expertise. The BJR is also believed to encourage the board of directors to serve, by limiting its exposure to liability.²⁸⁷ These justifications may appear remarkable considering other contexts. For instance, the law does not preclude judicial review of doctors whose treatment decisions turn out badly even though the judges are no medical experts.²⁸⁸ The law also does not worry about crushing the entrepreneurial spirit of a seller when it imposes liability for the late delivery of substandard materials.²⁸⁹ These justifications do not sufficiently motivate the existence of the BJR and its choice

²⁸⁷ Smith & Williams at 362; Bainbridge (2009) at 105-106.

²⁸⁸ *Id.* at 362.

²⁸⁹ Dooley *The Business Lawyer* 1992 at 470.

of the value of authority. However, these two justifications do not tell the full story about the BJR.²⁹⁰

Bainbridge states that one of the justifications for the BJR focuses on decision-maker incentives. By referring to Justice Jackson, Bainbridge stipulates that neither courts nor boards are infallible, but that someone must have the final word to avoid a never-ending process of appellate review. Bainbridge states that the board of directors should have the final word because the judges have less information about the needs of a particular corporation, and will therefore not be able to make better decisions than the board of directors.²⁹¹ In drawing this conclusion, Bainbridge states that the courts acknowledge that litigation is an imperfect device to evaluate business decisions because the circumstances surrounding a business decision are difficult to reconstruct in a courtroom years later. This is because business imperatives call for rapid decisions, inevitably based on imperfect information.²⁹² The courts will only be able to make superior decisions than the board of directors with the advantages of hindsight.²⁹³ This hindsight review is problematic because it causes the judges to assign a high probability of occurrence to an event simply because it ended up occurring, making them more willing to hold the board of directors liable for breach of fiduciary duty. Hindsight review also makes it difficult for the judges to distinguish between competent and negligent board directors. BJR is claimed to decrease the risk of hindsight bias by restricting the judges from making a substantive review of the merits of a business decision made in good faith and with due care.²⁹⁴

It is dubious whether the provided justification motivates the existence of the BJR and the dominance of the value of accountability. The justifications are undoubtedly equally applicable in many other contexts.²⁹⁵ To take some concrete examples: Circumstances surrounding decisions made by surgeons in the operating room or accountants up against a closing deadline are also not easily reconstructed in a courtroom years later. Still, the

²⁹⁰ Smith & Williams at 362; Bainbridge (2009) at 105.

²⁹¹ Bainbridge (2009) at 104, referring to *Brown v. Allen* at 540

²⁹² *Id.* at 104 and *Joy v. North* at 886.

²⁹³ *Id.* at 104.

²⁹⁴ *Id.* at 106-107.

²⁹⁵ Velasco Washington University Law Quarterly 2004 at 833.

judges are allowed, invariably with the benefit of hindsight, to second-guess the actions taken by surgeons and accountants.²⁹⁶ This justification is also questionable because it does not take into account that the judges are experts at evaluating past actions as it is one of their central responsibilities and therefore will not fall prey to hindsight bias to the same extent as most other people. However, it can perhaps be argued that it is still sensible to look at how a decision came about, not only in corporate law but also in other fields of law because the judges will not be able to fully concur hindsight-bias and avoid the difficulty of reconstructing circumstances surrounding a decision because of cognitive limitations. The judges' jobs can be made easier if they are limited to looking at the adequacy of the decision-making process, and decision-makers will be able to foresee how the judges will review their decisions. This justification briefly explains the existence of the BJR as well as why the value of authority is important. Yet, it does not justify the fact that the BJR precludes judicial review of the vast majority of the board of directors and allows the value of authority to dominate.

Velasco does not find the former justification strong as it is also applicable to other contexts. Instead, Velasco states that litigation concerning the management of a business is not as important as other types of litigation because there is something qualitatively different in the business contexts, namely that the shareholders, unlike regular people, are eager to take more risks to increase their expected rate of return. Therefore, it would be inappropriate for the shareholders to complain that things did not turn out as hoped.²⁹⁷ This statement is unsatisfactory because it fails to explain why the shareholders should lose the right to legal protection solely on the grounds that they are more prone to risk-taking than other people, particularly in circumstances when protection is needed. Moreover, Velasco makes a generalization that all the shareholders wish to maximize the value of their holding when they in reality also have other interests.²⁹⁸

Bainbridge states that another justification for the BJR is that market forces work a sort of Darwinian selection on corporate decision-makers, while no such forces constrain erring judges. As a result, the shareholders might prefer the risk of managerial errors to

²⁹⁶ Davis Wisconsin Law Review 2000 at 581.

²⁹⁷ Velasco Washington University Law Quarterly 2004 at 832-834.

²⁹⁸ Greenwood Southern California Law 1996 at 1026; Hayden & Bodie William and Mary Law Review 2010 at 2095-2096.

that of judicial errors as long as the managerial errors are motivated by a desire to maximize the shareholder wealth and not the board of directors' self-interest.²⁹⁹ However, as will be shown in chapter 8, market forces suffer from systematic market failures and imperfection and do not always impact the selection of the board of directors.

The final and the most important justification for the BJR is that it motivates the board of directors to pursue riskier businesses. The shareholders, as residual claimants, only obtain distribution on the corporation's profit when all other claims on the corporation have been satisfied. Therefore, the shareholders prefer business strategies that guarantee high returns at concomitantly high risk. Risk and return are presumed to be directly proportional. The shareholders have a high tolerance for risky business strategies because the doctrine of limited liability insulates them from the downside risks of corporate activity.³⁰⁰ The limited liability doctrine is a distinguishing feature of corporate law that holds that the shareholders are not liable for debt of the corporation and thus put a risk only to the amount of money that they invested in buying their shares.³⁰¹ The shareholders can also undertake greater risks because they generally hold a diversified portfolio of equity investments to eliminate firm-specific risk exposure.³⁰² The board of directors is risk-averse and therefore tends to deviate from this rational acceptance of corporate risk.³⁰³ In contrast to the shareholders, the board of directors holds corporate-specific human capital that cannot be diversified among various corporations. Corporate-specific human capital constitutes an investment upon which the board of directors can earn a return only if it remains within that corporation. Nonetheless, because the board of directors typically only has minor ownership in its corporations and little or no incentive compensation, it does not gain much from pursuing business strategies that involve significant risks.³⁰⁴

The final justification is valid because the board of directors needs to take appropriate risks to innovate and create value to succeed in the current competitive and complex

²⁹⁹ Bainbridge (2008) at 104.

³⁰⁰ *Id.* at 105.

³⁰¹ Easterbrook & Fischel at 40; Bainbridge (2008) at 6.

³⁰² Bainbridge (2008) at 106; Hoskisson, Hitt et al., at 326.

³⁰³ *Id.* at 106; Kershaw at 348.

³⁰⁴ *Id.* at 106; *Gagliardi v. TriFoods Intern., Inc.*

global economy.³⁰⁵ This needs to be respected because corporations employ millions of people, provide goods and services that people use in their everyday life, and provide benefits to communities.³⁰⁶ Even if appropriate risk-taking must be accepted, there might be a danger if the BJR allows the board of directors to take excessive risks by completely shielding it from liability. Excessive corporate risk-taking was one of the primary causes of the financial crisis, wiping out investors, good businesses, markets, and causing millions of people to lose their homes and jobs.³⁰⁷ It also led to a loss of substantial amounts of money belonging to corporations and thus the shareholders.³⁰⁸ These public consequences of the financial crisis led to the debate on whether the BJR should be modified to make it easier to impose liability for excessive risk-taking.³⁰⁹ This discussion illustrates that this final justification defends the existence of the BJR and the value of authority to some degree because reasonable risk-taking must be permitted as it is desirable not only for the corporations but also to the society. However, it still does not fully defend the BJR and certainly not primacy of the value of authority because it is not rational to shield the board of directors from liability for excessive risk-taking that causes systematic harm. This justification also raises the question of whether it is reasonable to assume that significant risk-taking will lead to an increased return, not only because of the harm that excessive-risk-taking may cause but also because there is a growing debate on whether the shareholder theory should replace the shareholder primacy norm.

In the light of these results, the BJR should be weakened and somewhat modified because neither of the justifications fully defend the BJR and the dominance of the value of authority. Insulation of the board of directors can go too far. The conclusion that the Swedish legislator should only consider introducing the BJR if it is articulated in a different way or given a dual function to protect both the authority of the board of directors and the need to hold it accountable for its decisions and actions remains the same. Nonetheless, it must be questioned how much of the rule can be reformed. For

³⁰⁵ Schwarcz *Emory Law Journal* 2015 at 541.

³⁰⁶ Keay at 1.

³⁰⁷ Schwarcz *Emory Law Journal* 2015 at 534, 536-537; Schwarcz *Notre Dame Law Review* 2016 at 3.

³⁰⁸ Hurt *Journal of Corporation Law* 2014 at 257-258.

³⁰⁹ Schwarcz *Emory Law Journal* 2015 at 562.

instance, if substantive review is allowed when the board of directors has taken excessive review, it will most probably repeal the BJR and go to the heart of it.

6.4 The underlying assumptions of the BJR

The former sub-chapter shows that the BJR is based on three underlying assumptions. The assumptions are important to highlight because they might not be valid in Sweden right now or perhaps in the nearest future. The BJR seems to assume that the primary role of the corporation is to maximize the shareholder value and that all the shareholders prefer the board of directors to pursue investment projects with the highest positive net present value regardless of their volatility. In addition, it assumes that the board of directors is subject to a credible threat of being sued by the shareholders for breach of the duty of care.³¹⁰

Even though the shareholder primacy norm prevails in the SCA, the Swedish legislator should consider how an introduction of the BJR in the SCA will go in hand with the shareholder theory if it were to substitute the shareholder primacy norm. Second, the Swedish legislator should consider that the shareholders have interests that diverge along a number of dimensions. Third, they must assess how beneficial the adoption of the BJR is when the board of directors in Sweden, unlike the board of directors in Delaware,³¹¹ does not face an extensive threat of being sued for breach of fiduciary duty.³¹² Introduction of a rule often generates costs for the government as different experts need to provide statements about whether the rule is desirable and should be introduced in the law. Nevertheless, there is a risk that future events will cause debates about increased accountability for the board of directors in the same way that corporate scandals and the financial crisis did. Therefore, it is essential that the Swedish legislator consider all aspects of the BJR.

³¹⁰ Aurelio Journal of Corporate Law Studies 2018 at 424-425.

³¹¹ Laguado Giraldo at Vniversitas 2006 at 128.

³¹² See Sandström at 399.

6.5 Other Protective Devices

Jones states that the BJR is not the only protective device embodied in corporate law that insulates the board of directors from judicial scrutiny. The board of directors is also shielded from liability through shareholder derivative lawsuit, a trio of contractual devices, and the size of the penalties faced by the board of directors for breach of fiduciary duties. The trio of contractual devices encompass an exculpation statute in the DGCL § 102 (b) (7) and the MBCA 2.02 (b) (4) that permits corporations to limit or eliminate liability for monetary damages for breach of duty of care, and indemnification and insurance agreements.³¹³ This sub-chapter presents the results of the BJR when combined with these protective devices.

6.5.1 *Shareholder Derivative Lawsuit*

A shareholder derivative lawsuit is the primary enforcement mechanism for the fiduciary duties of the board of directors.³¹⁴ It exerts its regulatory effect through the mechanism of deterrence and consequently regulates corporate conduct. Thus, the board of directors realizes, through the threat of litigation, that it might be held liable to its shareholders for the harms it causes and refrains from engaging in conduct that will harm the shareholders and induce them to sue.³¹⁵

When the board of directors breaches its fiduciary duties, often it is the corporation itself that is directly harmed and has the right to enforce a claim and receive the benefit of any recovery. However, the board of directors decides whether or not a claim is going to be enforced, that is, the very people who have violated their fiduciary duties. Of course, it cannot be expected that the board of directors will sue itself.³¹⁶ As a result, the shareholders are given the right to bring a derivative lawsuit on behalf of the corporation where they either make a demand upon the board of directors to rectify the challenged transaction or demonstrate that such demand would be futile, Delaware Chancery Rule 23.1. The board of directors can respond to a demand by either accepting the demand and failing the lawsuit themselves, resolving the matter internally or rejecting the demand,

³¹³ Jones Iowa Law Review 2006 at 108-109, 113-117, 148.

³¹⁴ *Id.* at 113.

³¹⁵ Baker & Griffith at 1-2.

³¹⁶ Smith & Williams at 463-464.

which is the typical response.³¹⁷ If the board of directors rejects the demand request, the shareholders can bring a derivative lawsuit and attempt to prove to the court that the board of directors rejected the demand wrongfully.³¹⁸ A court may excuse a demand as futile if the shareholders create a reasonable doubt that a majority of the board directors were disinterested and independent or that the challenged decision was a valid exercise of business judgment.³¹⁹

In the rare instances when courts excuse a demand,³²⁰ the board of directors may attempt to stop the litigation by appointing a special litigation committee to investigate the charges. The special litigation committee has to be composed of independent and disinterested board directors.³²¹ Such a committee, after completing its investigation, typically finds that continuing the litigation is not in the best interests of the corporation and moves to dismiss the action. Courts are more often than not receptive to such requests.³²² The demand requirement and the use of special litigation committees create nearly insurmountable procedural hurdles for shareholders who seek to challenge the decisions and practices of the board of directors through derivative litigation.³²³ A combination of the protective devices and the two procedural hurdles makes it impossible for the shareholders to prevail in a derivative lawsuit.³²⁴

6.5.2 A Trio of Contractual Devices and Penalties for Breach of Fiduciary Duty
Surprisingly, the board of directors is further protected by a trio of contractual devices that together insulate it from monetary exposure in the event of a shareholder derivative lawsuit.³²⁵ First, it is protected by the exculpation statute in the DGCL § 102 (b)(7) and the MBCA § 2.02 (b) (4), permitting corporations to adopt charter provisions that eliminate almost all monetary liability for breach of duty of care. Most large Delaware corporations have amended their charters to include such a provision.³²⁶ Second,

³¹⁷ Scarlett Florida Law Review 2008 at 596.

³¹⁸ Bainbridge (2009) at 221.

³¹⁹ Aronson v. Lewis at 814.

³²⁰ Jones Iowa Law Review 2006 at 115.

³²¹ Zapata Corp. v. Maldonado at 786.

³²² Jones Iowa Law Review 2006 at 115.

³²³ *Id.* at 114-115; Scarlett Florida Law Review 2008 at 295.

³²⁴ Jones Iowa Law Review 2006 at 108.

³²⁵ *Id.* at 116-117.

³²⁶ *Id.* at 116.

corporations often use their power to indemnify its board directors and managing directors for expenses and other losses associated with litigation and other proceedings, DGCL § 145 (a); MBCA § 8.51.³²⁷ In addition, corporations back up this commitment by purchasing director and officer liability insurance, as allowed according to the DGCL § 145 (g) and the MBCA 8.57.³²⁸ The directors and officer liability insurance, also referred to as D & O insurance covers litigation costs, most settlements of shareholder derivative lawsuit, and settlements of claims for which indemnification is prohibited by statute.³²⁹ This type of insurance disrupts the deterrence mechanism of derivative litigation by transferring the obligations of the board of directors to the insurer. When the board of directors is no longer personally at risk for the shareholders' losses, it is less likely to take care in avoiding them.³³⁰

The board of directors is also shielded from being liable because the penalties for violation of the fiduciary duties are so disproportionately high, in relation to the degree of wrongdoing that the courts are unwilling to impose the legal sanctions called for under existing law.³³¹

6.5.3 Results of the Combined Protective Devices

The combination of the BJR and the above-mentioned protective devices results in a no liability rule, meaning that the board of directors is rarely called upon to justify its actions.³³² Stout asserts that a board director is “more likely to be attacked by killer bees than she is to have to ever pay damages for the breach of the duty of care.”³³³ Jones states that Stout's killer bees analogy is equally applicable for the duty of loyalty breaches.³³⁴ These are somewhat troubling findings because they reveal that accountability as a concept is not present to capture the misconducts by the board of directors. Accountability requires that the board of directors is mandated to disclose and justify its corporate decisions and actions. It also demands that the board of directors is questioned about its

³²⁷ *Id.* at 117; Veasey, Finkelstein & Bigler *The Business Lawyer* 1987 at 404-408.

³²⁸ Black, Cheffins & Klausner *Stanford Law Review* 2006 at 1083.

³²⁹ *Id.* at 1085.

³³⁰ Baker & Griffith at 2; see also Hellner & Radetzki at 2.1.4.

³³¹ Jones *Iowa Law Review* 2006 at 108-109, 148.

³³² *Id.* at 108.

³³³ Stout *Delaware Journal of Corporate Law* 2003 at 7.

³³⁴ Jones *Iowa Law Review* 2006 at 117.

decisions and actions and judged on how it responds. Finally, there must be a possibility for the board of directors to face some consequences in order for full accountability to be present and meaningful.

What is surprising is that the no liability rule captures not only a breach of duty of care but also a breach of duty of loyalty. As mentioned in sub-section 3.5.2, courts consider cases that raise the duty of loyalty as more worrisome than those that raise the duty of care. Hence, the liability risk for breach of duty of loyalty should not be nil. Certain breaches of the duty of care should be tolerated because they can result from honest mistakes, human frailty, and laziness. The business environment forces the board of directors to make rapid corporate decisions based on imperfect information, which inevitably puts enormous pressure on the board of directors. However, there is no reason to accept a breach of duty of loyalty as it is unlikely to occur because of honest mistakes, human frailty, and laziness. Breach of duty of loyalty often involves situations where the board of directors has tried to benefit at the expense of the corporation. It is also worrisome that the liability risk for breach of duty of care is near zero because they can most likely also be a result of actions that should not be tolerated.

Corporate law's great deference toward board authority was never intended to be absolute,³³⁵ and it probably did not aim to result in a no liability rule. It is dubious whether a set of virtually unenforceable rules can deter mismanagement and opportunism by the board of directors.³³⁶ The no liability rule appears to deter the threat of legal liability as an effective accountability by the creation of the no liability rule.

These results constitute contributory factors suggesting that the Swedish legislator should only consider introducing the BJR if it is articulated in a different way or given a dual function to protect both the authority of the board of directors and the need to hold it accountable for its decisions and actions. Whether or not the BJR results in a no liability rule when it is combined with the protective devices in the SCA will be discussed in the upcoming chapter.

³³⁵ Rose & Sharfman Brigham Young University Law Review 2014 at 11.

³³⁶ Jones Iowa Law Review 2006 at 108.

7 The Liability Rules for the Board of Directors under Swedish Law

7.1 Introduction

This chapter begins by presenting information about the Swedish liability rule for the board of directors. It then goes on to analyze whether there is something similar to the BJR under Swedish law and reflects on Sweden's current situation and on a possible introduction of the BJR in the SCA. Finally, this chapter attempts to assess whether the BJR results in a no liability rule when combined with the protective devices embodied in the SCA. If the BJR results in a no liability rule when it is combined with the protective devices in the SCA, it will further support that the Swedish legislator should only consider introducing the BJR if it is articulated in a different way. Alternatively, if it is given a dual function to protect both the authority of the board of directors and the need to hold it accountable for its decisions and actions.

7.2 Determination of Culpability

7.2.1 Overview

According to Ch. 29 § 1 of the SCA, a founder, a board director, or a managing director who, in the performance of his or her duties, intentionally or through negligence causes damage to the corporation shall compensate such damage. The board of directors is individually liable. Individual liability means that one board director may be liable but not another.³³⁷ The shareholders have the burden of showing that the defendant board directors were negligent.³³⁸

The design of the Swedish liability rule for the board of directors differs from the design of the BJR in a number of aspects. For example, it does not presume that actions of independent board directors are made in good faith and with appropriate care. It also does not shield the board of directors' decision from review by limiting judicial inquiry into the adequacy of the process by which the board of directors reached its decision. The

³³⁷ Dotevall (2017) at 65.

³³⁸ *Id.* at 57.

Swedish courts are not precluded from reviewing the wisdom or appropriateness of the decision itself. These dissimilarities between the Swedish liability rule for the board of directors and the BJR manifest that the former does not uphold the value of authority in the same extent as the latter. Nonetheless, the Swedish liability rule for the board of directors is claimed to balance the need to hold the board of directors accountable for its misconduct and the interest of giving the board adequate authority to take corporate risks.³³⁹ In other words, the Swedish liability rule for the board of directors balances the values of authority and accountability. Other differences are that the Swedish liability rule requires a showing of causation and damages. Showing of causation rarely triggers any issues for the shareholder plaintiff, other than to investigate what happened in the particular situation, albeit this can be difficult in itself.³⁴⁰

The Swedish liability rule for the board of directors is based on the Swedish Tort Liability act (1972:207) but is more far-reaching.³⁴¹ The purpose of the Swedish liability rule for the board of directors is to ensure that the board of directors compensates for the damage it causes to the shareholders and that the board refrains from engaging in conduct that will harm the shareholders.³⁴²

The Swedish liability rule for the board of directors sets out four prerequisites that need to be met for a board director to become liable in Sweden. First and foremost, damage must have occurred. Second, the damage must have been caused within the board director's assignment. Third, the board director must have acted with intent or negligence. Fourth, there must be an adequate causal connection between the damage and the act or omission.³⁴³

7.2.2 *Damage*

A damage must have occurred, either by an act or a failure to act, for a board director to become liable. The damage has to be finalized and economically measurable. The Swedish liability rule for the board of directors applies to various types of damages. The most common damage that occurs in the business context is the so-called pure economic

³³⁹ Prop. 1997/98:99 at 75; SOU 1995:44 at 241.

³⁴⁰ Svernlöv (2012) at 71.

³⁴¹ Svernlöv (2008) at 38.

³⁴² Svernlöv (2012) at 32.

³⁴³ *Id.* at 51.

loss. A pure economic loss is financial damage that is not accompanied by any personal injury or property damage.³⁴⁴

7.2.3 *Damage within the Assignment*

The damage needs to have been caused within the board director's assignment. This means that the board director must have been formally appointed by the corporation. Liability might also arise when the individual in question has manifested to act as a board director.³⁴⁵ A board director can only be liable for decisions and actions specified in the SCA, the articles of associations, or decisions and action that can be attributed to the business of the corporation.³⁴⁶

7.2.4 *Negligence Assessment*

The board director must have caused the damage by intent or negligence. The intent and negligence of the board director are termed culpa.³⁴⁷ To determine whether culpa exists, courts need to compare how the board director should have acted and how the board director acted in a particular case. This comparison aims to show the necessary level of carefulness that was demanded in a particular case and whether the board director should have acted differently.³⁴⁸ The courts consider the SCA, the applicable Annual Accounts Act, and articles of association when determining culpa. They can also look at instructions from the shareholder and relevant case law.³⁴⁹ It is argued that culpability should be presumed if the board director has breached the SCA or any other regulation referred to by the SCA.³⁵⁰

If the culpa evaluation does not provide sufficient guidance, the courts can make an independent negligence assessment based on an assessment of the risk of damage, the size of the likely damage, the possibilities to avoid the damage, and the board director's possibility to have foreseen the damage. These elements must be weighed against one

³⁴⁴ *Id.* at 51-53; Dotevall (2015) at 360-362.

³⁴⁵ Dotevall (1989) at 79-80; Dotevall (2015) at 349-350.

³⁴⁶ Svernlöv (2012) at 54.

³⁴⁷ *Id.* at 57.

³⁴⁸ Hellner & Radetzki at 33.

³⁴⁹ Svernlöv (2012) at 59. See also 61-67 about what other materials the judges can take into account within the negligent assessment.

³⁵⁰ *Id.* at 59-60; Taxell (1963) at 28.

another to determine whether the board director should have acted in another way.³⁵¹ Greater risk of damage requires greater caution by the board director.³⁵²

7.2.5 Adequate Causal Connection

There needs to be a causal connection between the negligent act or omission and the damage for a board director to be held liable.³⁵³ Traditionally, causality is evaluated through sufficient- (*causa causans*) and necessary conditions (*conditio sine qua non*). The first condition is fulfilled if the act or omission leads to a damage. The second condition is satisfied if the damage would not have occurred if the act or omission did not take place. It is immaterial whether the act or omission was the main cause of the damage. Liability can arise even when the act or omission only was a contributing cause of the damage. The board director will not be held accountable for a damage had it occurred even without the negligent act or omission.³⁵⁴

The Swedish liability rule for the board of directors also requires the causal connection to be adequate for liability to apply. This requirement means that it must have been possible to foresee the resulting damage occurring.³⁵⁵ A board director is not burdened with consequences that are too remote and unexpected.³⁵⁶

7.3 The BJR under Swedish Law

7.3.1 Introduction

Several corporate law scholars argue that there is something similar to the BJR in Swedish law. Some of them base their claims primarily on relevant statutes and principles of the SCA, and others refer to case law. This sub-chapter will first consider some of the conclusions based on relevant statutes and principles of the SCA and thereafter conclusions based on case law.

³⁵¹ Stattin at 355, 367.

³⁵² Svernlöv (2012) at 68.

³⁵³ Dotevall (2015) at 358-360.

³⁵⁴ Svernlöv (2012) at 70.

³⁵⁵ *Id.* at 71.

³⁵⁶ Dotevall *The International Lawyer* 2003 at 14; Dotevall (2015) at 358-359.

7.3.2 *Conclusions based on the SCA*

Dotevall states that Ch. 3 § 3 of the SCA, which requires the board of directors to manage the corporation to generate profit for distribution to the shareholders unless something else is provided in the articles of association, is worded vaguely. Therefore, the board of directors receives substantial discretion to fulfill the business purpose and make corporate decisions in a way that is equivalent to the BJR.³⁵⁷ Dotevall fails to explain how the broad directorial discretion in itself can give rise to the BJR when the rule possesses clear prerequisites on how and when board decisions can be reviewed.

Other corporate law scholars argue in the same line as Dotevall. For instance, Östberg maintains that there is a similar principle to the BJR in Sweden, because Swedish law gives the board of directors great discretion and freedom to manage the affairs of the corporation. Liability for risky and speculative corporate decisions and actions arise only under extraordinary circumstances. The board can, however, require a more thorough and careful decision-making process.³⁵⁸ Samuelsson states that the board of directors is given sufficient discretion to make corporate decisions. Unlike Östberg, Samuelsson explains that the discretion derives from the principle stating that a corporate decision violates the business object and the interest of the corporation only if it noticeably deviates from the business object in the articles of association. The BJR may be considered when evaluating whether the board of directors has breached this principle.³⁵⁹ These statements suffer from the same weakness as the ones made by Dotevall.

Stattin and Ohlson do not believe that the BJR has an impact on Swedish law, although they do state that it is possible to argue in a similar way in Sweden. Ohlson contends that the board of directors is vested with great directorial discretion.³⁶⁰ Stattin and Ohlson's view on the role of business judgment rule in Sweden might be more convincing.

7.3.3 *Conclusions based on caselaw*

According to Johansson, there is reason to believe that there is something corresponding to the BJR in Swedish Law. The Swedish courts do not evaluate whether a corporate decision is poor or unwise and generally do not hold the board of directors liable for risky

³⁵⁷ Dotevall (2015) at 194, 374; Dotevall (2017) at 82.

³⁵⁸ Östberg at 449.

³⁵⁹ Nerep, Adestam, Samuelsson, Lexino, The comment of Ch. 29 § 1 the Swedish Companies Act.

³⁶⁰ Stattin SvJT 2012 at 639; Stattin at 370; Ohlson at 116.

and speculative decisions made within the ordinary course of business. These statements are based on a case from the Supreme Court of Sweden, involving a non-profit association. The Supreme Court explicitly stated that the review of a decision does not include whether the decision is appropriate.³⁶¹ Johnson's statements are not persuasive. To only state that the board of directors generally is not required to account for risky and speculative corporate decisions does not provide prerequisites about when the courts can review a business decision. The statements might also be weak as they are solely based on a case regarding a non-profit association and not a pure corporate law case.

Lindskog states that the Supreme Court of Sweden has started to approach the BJR by applying the method liability theory, which is supposedly a counterpart to the BJR. Method liability theory mandates the judges to consider only the adequacy of the process that led to the decision when assessing the liability of the board of directors. Furthermore, Lindskog asserts that corporate decisions need to be in writing if time permits as documentation enables the courts to review the decision. The Supreme Court of Sweden has presumed decision-makers to be negligent when they have failed to provide documentation. Lindskog references to the following cases when stating that the Supreme Court of Sweden has started to approach the BJR by the method liability theory.³⁶²

7.3.3.1 *NJA 2012 s 858*

In NJA 2012 s 858, a board director did not prepare necessary financial reports that are required under Swedish law. The board director had not made an active decision to not prepare financial reports. The question was whether the board director had been negligent.³⁶³ The Supreme Court of Sweden stated that the negligent assessment should focus primarily on whether the board director acts in a defensible manner in regard to the situation that the corporation is in. Decisions made during a time when a corporation is suffering financially should be reviewed more generously because it can be more challenging to make such decisions. The board of directors' decisions and actions rarely

³⁶¹ Johansson SvJT 1991 at 604.

³⁶² Andersson Advokaten 2017.

³⁶³ NJA 2012 s 858 note 1.

need to be questioned and reviewed by the courts if the board of directors has kept abreast of the information and made a serious evaluation of the corporation's situation.³⁶⁴

7.3.3.2 *NJA 2013 s 145*

In NJA 2013 s 145, the Social Welfare Committee of Landskrona municipality momentarily placed an underage pyromaniac at her mother's home while she was cared for under the Care of Young Persons Act. Later on, the underaged girl ran away from her mother's home and burned down a shopping mall. The insurer of the shopping mall sued the municipality for damages and claimed that the municipality was negligent for moving the girl to her mother's home.³⁶⁵ The Supreme Court of Sweden stated that it might be justified for the judges to only look at how a decision came about when assessing a complex decision by professional decision-makers. A decision is stipulated to be acceptable if it is based on good methodological order.³⁶⁶ What constitutes good methodological order is situation-based. It depends on who the decision-maker is, what the decision concerns, and how rapidly the decision in question needs to be made. The evaluation of the situation in which a decision is based must generally be documented by the decision-maker.³⁶⁷

7.3.3.3 *NJA 2013 s 842*

In the third case, NJA 2013 s 842, the Swedish Environmental Court wrongly imposed an environmental sanction fee on a corporation for violation of the Swedish Environmental Code (1998:808).³⁶⁸ The Supreme Court of Sweden stated that considerations made by a court that directly affect the outcome of the case need to be demonstrated in an open and explanatory manner in the court's reasoning.³⁶⁹ If the court can provide an adequate analysis of the legal situation, the court cannot be considered to have applied the law incorrectly, even though the analysis might deviate from the

³⁶⁴ *Id.* note 22.

³⁶⁵ NJA 2013 s 145 at note 1-8.

³⁶⁶ *Id.* note 56.

³⁶⁷ *Id.* note 57.

³⁶⁸ NJA 2013 s 842 at note 1-11.

³⁶⁹ *Id.* note 35.

applicable law.³⁷⁰ However, liability may arise if the court cannot provide adequacy analysis with regard to the circumstances of the case. The Supreme Court of Sweden referred to NJA 2013 s 145 and stated that negligence can, to some degree, be presumed if there have been deficiencies in the legal analysis.³⁷¹

7.3.3.4 *NJA 2014 s 798*

In NJA 2014 s 798, a trustee in bankruptcy waited for several years to sell shares and a promissory note in the hopes of receiving a higher purchase price. Unfortunately, the trustee did not get the expected purchase price.³⁷² The Supreme Court of Sweden stated that a trustee's act should normally be accepted on the precondition that the act has been made with careful considerations on an adequate decision basis. The consideration must enable an investigation. If the trustee has made a careful consideration, it is irrelevant in the negligent assessment if the act later turns out to be unfavorable and wrong. Nonetheless, the trustee must show that the act was done on an adequate basis for it to be considered to have done with the necessary care.³⁷³

7.3.3.5 *NJA 2015 s 1040*

In the final case that Lindskog refers to in NJA 2015 s 1040, an entrepreneur had built properties in accordance with a construction technique that was commonly used and in line with industry practice.³⁷⁴ The construction turned out to have substantial errors because of the construction technique that the entrepreneur had used. The Supreme Court of Sweden held that the entrepreneur should not have relied on whether the technique was used by others or that it was prevalent in the industry. Instead, the entrepreneur should have confirmed the durability of the construction before using the construction technique.³⁷⁵ Before making this statement, the Supreme Court of Sweden noted that the residents were individual consumers who could be financially harmed by the errors in the

³⁷⁰ *Id.* note 37.

³⁷¹ *Id.* note 38.

³⁷² NJA 2014 s 798 at note 1-3.

³⁷³ *Id.* at note 9.

³⁷⁴ NJA 2015 s 1040 at note 1-9.

³⁷⁵ *Id.* note at 25.

construction.³⁷⁶ The entrepreneur could not provide proof that any actual investigation had been conducted before the construction technique had been used. Therefore, the corporation was found negligent.³⁷⁷

7.3.4 Comments on the cases referenced by Lindskog

The question is whether Lindskog draws a correct conclusion that the Supreme Court of Sweden has started to approach the BJR by applying the method liability theory. Lindskog states that the method liability theory is equivalent to the BJR.

The cases show that the BJR and the method liability theory share mainly one key feature, namely that both forestall judicial scrutiny into the adequacy of the process by which the board of directors reached its decisions, rather than the appropriateness of the decision itself. However, the cases also demonstrate a number of important differences between the BJR and the method liability theory. Whereas the BJR mandates the courts to focus on the board of directors' decision-making process, the method liability theory does not explicitly require the Swedish courts to always review the considerations behind a business decision. Rather, in NJA 2012 s 858, the Supreme Court of Sweden stated that the board of directors' decisions and actions rarely need to be questioned and reviewed by the courts if the board of directors has kept itself informed and made a serious evaluation of the corporation's situation. In NJA 2013 s 145, the Supreme Court of Sweden stated that it might be justified for the judges to only look at how a decision came about when assessing a complex decision made by professional decision-makers.

These two cases also show that the method liability theory, in contrast to the BJR, does not provide clear prerequisites on when the courts may engage in substantive review of a business decision. Another difference between the method liability theory and the BJR is that the method liability theory does not presume that the decisions made by a decision-maker are made in good faith and with appropriate care. In NJA 2013 s 842, the Supreme Court of Sweden referred to NJA 2013 s 145 and stated that negligence can, to some degree, be presumed if there have been deficiencies in the legal analysis. One reference to another case can most likely not create a presumption similar to the BJR, especially as other cases following NJA 2013 s 842 did not continue to refer to NJA 2013 s 145. The

³⁷⁶ *Id.* note at 24.

³⁷⁷ *Id.* note at 26.

Supreme Court of Sweden does not even formulate the method liability theory in the same way in any of the cases. It is more reasonable to see the reference as an indication that a decision-maker must have a good methodological order when making a decision.

Furthermore, the method liability theory requires the decision-makers to present an adequate decision whilst the BJR does not. In Delaware, the board of directors is not obligated to demonstrate anything until the BJR has been rebutted by the shareholder plaintiff. Additionally, the BJR is applicable to all business decisions, whereas the method liability theory appears to only apply to cases that include special circumstances. In NJA 2012 s 858, the Supreme Court of Sweden stated that decisions made during a time when a corporation is suffering financially should be reviewed more generously because it can be challenging to make such decisions. In NJA 2013 s 145, the Supreme Court of Sweden spoke about complex decisions made by professional decision-makers when concluding that it may be justified for the judges to only look at how a decision came about. In NJA 2015 s 1040, the Supreme Court of Sweden acknowledged that the residents were individual consumers who could be financially harmed by the errors in the construction.

There are two further dissimilarities between the method liability theory and the BJR that should be pointed out. The BJR is only applied in pure corporate law cases. Method liability theory, on the other hand, seems to mainly have been applied in cases that have not involved a business decision. NJA 2012 s 858 involved a board director, but the board director had not made an active decision to not prepare necessary financial reports. As explained in chapter 6.2, the board of directors in Delaware is not protected under the BJR when it has abdicated its functions or, absent a conscious decision, failed to act. A final distinction is that the method liability theory's documentation requirement is not in line with the BJR. The fact that the Supreme Court of Sweden has presumed decision-makers to be negligent when they have not met the documentation requirement shows that corporate decisions are not reviewed in a similar way in Sweden and Delaware.

From this discussion, it can be construed that the courts might have started to approach or attempted to approach the BJR as Lindskog argues. But the underlying differences between the method liability theory and the BJR are obvious and fundamental. Therefore, nothing similar to the BJR can be said to exist in the Swedish law.

7.3.5 *Recent cases on the BJR*

In addition to the cases referred to by Lindskog, there are some cases from the lower court involving the BJR. This sub-chapter aims to investigate whether these cases show that there is something equivalent to the BJR in Swedish law.

In a court case from the Stockholm District Court, it was stated that there are no restrictions regarding what kind of corporate decisions the courts can review according to Swedish law.³⁷⁸ The court case suggests that there is nothing similar to the BJR in Swedish law. The Stockholm District Court, however, recently stated in another case that it is not up to the court to decide whether the challenged business decision should have been made or not from a financial- or another perspective.³⁷⁹ This was asserted after the Stockholm District Court had stressed that a circumstance of particular importance in the negligence assessment is the degree of care that the board of directors has taken to obtain an adequate decision basis and whether external expertise has been used.³⁸⁰ Later on, the Stockholm District Court referred to one of Dotevall's literature, where Dotevall argues that Ch. 3 § 3 of the SCA gives the board of directors a wide discretion to fulfill the business purpose and make business decisions in a way that is comparable with the BJR.³⁸¹

Svernlöv, who previously argued in the same line as Johnson,³⁸² now states that this last case, together with the ones mentioned by Lindskog, demonstrates that there is a business judgment rule in Swedish caselaw.³⁸³ Conversely, this last case, similar to the ones referred to by Lindskog, does not state that the courts must focus the judicial inquiry on the adequacy of the process by which the board of directors reached its decision. Moreover, the case also does not talk about any kind of presumption. The District Court of Sweden referred to Dotevall's literature. Also, Dotevall's arguments were successfully objected to in sub-chapter 7.7.2. Yet again, it is reasonable to conclude that there is nothing similar to the BJR in Sweden.

³⁷⁸ T 18024-04 at note 20.

³⁷⁹ T 15389-16 at 89.

³⁸⁰ *Id.* at 88.

³⁸¹ *Id.* at 90.

³⁸² Svernlöv (2012) at 58.

³⁸³ Andersson Advokaten 2019.

Even if it were true that there is something corresponding to the BJR, or even that the BJR already exists, the findings in this thesis are still relevant. The Swedish legislators can take them into consideration before introducing the BJR in the SCA, and the Swedish courts can consider the consequences if they apply the BJR in the same way as the Delaware courts.

7.3.6 Reflections on the current Swedish situation and a possible introduction of the BJR in Swedish Law

The preceding shows that there are uncertainties as to under what circumstances the board of directors in Sweden can be held liable for decisions that turn out to be flawed. Furthermore, there are also no clear prerequisites on how and when the Swedish courts might review business decisions made by the board of directors. The Swedish courts might have started to approach or are attempting to approach the BJR, but to accept that there is something similar to the BJR in Swedish law can lead to fallacies. The board of directors in Sweden might act in a way where it can be held liable under the SCA but not the BJR, and Swedish lawyers may advise their American clients in a way that is not in line with the current legal situation in Sweden.

The Swedish legislator needs to address the aforementioned uncertainties not only because they can cause fallacies, but also because they can harm corporations in Sweden and the economy as a whole. The board of directors must be able to take reasonable risks to compete in the current competitive and complex global economy without the fear of being held liable for decisions that turn out to be flawed. The uncertainties can also have a negative impact on the corporation's possibility to recruit board directors; moreover, foreign corporations might refrain from expanding their business in Sweden.

An introduction of the BJR might provide clear prerequisites on how and when the Swedish courts might review a business decision and, in some respect, solve the unclear situation that the corporations face. It might even be sensible to introduce the BJR because the Swedish courts seem to have started to approach or are attempting to approach the BJR. Nevertheless, as stated in 6.3, it can be desirable to focus on how a decision came about instead of the merits of the decision as long as it does not preclude a review of the vast majority of cases and insulate the board of directors in cases where the existence of an underlying conflict is beyond dispute. Finally, an introduction of the BJR in the SCA

could harmonize the liability rules for the board of directors between Sweden and countries that have implemented it. The BJR has not only been embraced by Australia but also by many European countries, such as Germany, Portugal, Romania, Croatia, and the Czech Republic.³⁸⁴ A harmonization of the liability rules for the board of directors can make foreign corporations more willing to do business in Sweden, which in turn can have a positive impact on the Swedish economy.

Despite these stipulated benefits of introducing the BJR in the SCA, the Swedish legislator should still only consider introducing the BJR in the SCA if it is articulated in a different way. Alternatively, if it is given a dual function to protect the authority of the board of directors and the need to hold it accountable for its decisions and actions. This is important because the BJR does not appear to balance the values of authority and accountability in an appropriate manner and because its existence and the dominance of the value of authority cannot be fully defended by the justification generally given for the BJR. It is also essential because the BJR could perhaps result in a no liability rule when it is combined with the protective devices in the SCA.

If the BJR were to be introduced in the SCA, the Swedish legislator must also introduce the entire fairness standard because the legitimacy of either depends upon the other.³⁸⁵ Besides making the above-mentioned adjustment on the BJR, the Swedish legislator can give the entire fairness standard a greater role in the liability assessment. The entire fairness standard embodies the value of accountability by providing a more exact scrutiny for claims of breach of the duty of loyalty.³⁸⁶ It is not uncommon for a foreign rule to be introduced with certain modifications. For instance, even though the above stated European countries have introduced the BJR, the burden of proof for compliance with the duty of care has been shifted to the board of directors.³⁸⁷ This shows that the European version of the BJR is less protective than the version used in Delaware. However, it is easy to prove compliance with the duty of care; accordingly, Sweden must go further in preserving the need to hold the board of directors accountable for its decisions and actions.

³⁸⁴ Told European Business Law Review 2015 at 729.

³⁸⁵ Velasco Washington University Law Quarterly 2004 at 827.

³⁸⁶ *Id.* at 827.

³⁸⁷ Told European Business Law Review 2015 at 731.

7.4 Other Protective Devices

7.4.1 Introduction

Sub-chapter 6.4 showed that a combination of the BJR, shareholder derivative lawsuit, and a trio of contractual devices – exculpation, indemnification, and insurance – results in a no liability rule. The no liability rule means that the board of directors is rarely called upon to justify its decisions or actions. As a result, accountability as a concept is not present to capture the misconducts by the board of directors. The no liability rule protects not only breaches of the duty of care but also of the duty of loyalty, which the courts generally find more worrisome. These results are of great concern because it is questionable whether a system of unenforceable rules can prevent mismanagement and opportunism by the board of directors. Therefore, the no liability rule appears to deter the threat of legal accountability as an effective accountability mechanism.

Given the seriousness of the no liability rule, this sub-chapter attempts to assess whether the BJR will result in a no liability rule when combined with the protective devices in the SCA. If that is the case, it strongly implies that the Swedish legislator should only consider introducing the BJR if it is articulated in a different way or given a dual function to protect the authority of the board of directors and the need to hold it accountable for its decisions and actions.

7.4.2 Shareholders Derivative Lawsuit

The regulation regarding shareholders derivative lawsuit in Sweden differs substantially from the rules in Delaware. According to Ch. 29 § 7 of the SCA, actions regarding damage to the corporation pursuant to Ch. 29 § 1-3 may be brought if the majority or minority comprising owners of at least one-tenth of all shares in the corporation has supported a general resolution meeting to bring an action for damages or, with respect to a board director or managing director, have voted against a resolution on discharge from liability. This paragraph is applicable to actions brought by corporations. In addition to this rule, Ch. 29 § 9 of the SCA gives owners of at least one-tenth of all shares in the corporation the right to bring an action regarding damage to the corporation pursuant to Ch. 29 § 1-3.

An action for damages can only be brought if the shareholders have addressed the issue of discharge.³⁸⁸ The shareholders are demanded to resolve whether or not to grant a discharge from liability to the board of directors and managing directors at the annual general meeting, Ch. 7 § 11 of the SCA. Under Ch. 9 § 33 of the SCA, the auditors are mandated to state in their audit report as to whether the board of directors and the managing directors should be discharged from liability in relation to the corporation. The discharge resolution generally follows the recommendation of the auditors.³⁸⁹ When the shareholders grant discharge from liability, the corporation loses the right to bring an action for liability against the board of directors and the managing director covered by the resolution for the relevant period.³⁹⁰ However, there are exceptions set forth in Ch. 29 §§ 11, 12 and 14 of the SCA. Ch. 29 § 12 of the SCA stipulates for example, that the board of directors may bring an action for damages incurred as the result of a crime.

Under Swedish law, the shareholders decide whether or not an action in damages is going to be brought against the board of directors.³⁹¹ In contrast to the shareholders in Delaware, the shareholders in Sweden do not face procedural hurdles when they seek to challenge the decisions and actions of the board of directors through derivative litigation. The SCA does not include a demand requirement, nor does it allow the board of directors to stop the litigation by appointing a special litigation committee to investigate the charges. This indicates that the shareholder derivative lawsuit in Sweden will not contribute to creating a no liability rule, albeit this result might not be completely accurate. For example, it is rare for the shareholders not to grant a discharge. Discharge is sometimes granted in cases where the board of directors evidently has mismanaged the corporation. This is because the corporation wants to avoid bad publicity or because the board of directors does not have money to pay in damages; thus, a shareholder derivative lawsuit would be meaningless.³⁹² A shareholder derivative lawsuit is generally

³⁸⁸ NJA 1990 at 286; Dotevall (2015) at 380.

³⁸⁹ Svernlöv The Swedish Corporate Governance Board 2007 at 3.

³⁹⁰ Svernlöv (2012) at 107; Svernlöv The Swedish Corporate Governance Board 2007 at 12.

³⁹¹ Svernlöv The Swedish Corporate Governance Board 2007 at 12.

³⁹² Svernlöv (2012) at 107; Taxell (1988) at 48.

uncommon in Sweden,³⁹³ perhaps because it is time-consuming and entails procedural expenses for the corporation.

Given what has been observed, it is imaginable that an introduction of the BJR will cause the shareholders to grant a discharge in more cases because the possibility to succeed in a shareholder derivative litigation might start to seem minimal to them because the business judgment presumption is nearly irrebuttable and works in favor of the board of directors.³⁹⁴ However, whether the shareholder derivative lawsuit in Sweden will contribute to creating a no liability rule depends on how the Swedish courts will apply the BJR. If the Swedish courts do not apply it generously in favor of the board of directors and the possibility to succeed in shareholder litigations does not appear to be near zero to the shareholders, they may not grant a discharge in more cases. Thus, it must be made certain by the Swedish legislator that the Swedish courts refrain from applying the BJR in such a manner. This can be secured if the BJR is articulated in a different way or given a dual function to protect both the authority of the board of directors and the need to hold it accountable for its decisions and actions. The shareholders may still grant a discharge in more cases for a period of time before they can observe how the BJR will develop and how the courts will apply it. But this behavior will most probably decline after the Swedish courts have applied the BJR a few times.

The BJR is strongly linked to the shareholder derivative lawsuit in Delaware.³⁹⁵ If the Swedish legislator decides to introduce the BJR, it should not implement similar shareholder derivative lawsuits as in Delaware because it could result in a no liability rule even if the BJR is modified or given a dual function.

7.4.3 A Trio of Contractual Devices and Penalties for Breach of Fiduciary Duty

The board of directors in Sweden is not protected from monetary exposure to the same degree as the board of directors in Delaware. As stated in sub-chapter 5.2.2, there is no exculpation clause similar to the DGCL § 102 (b) (7) and the MBCA § 2.02 (b) (4) in the SCA. Corporations in Sweden are not permitted to adopt charter provisions in the articles

³⁹³ Sandström at 399.

³⁹⁴ Velasco Washington University Law Quarterly 2004 at 830; Rosenberg Journal of Corporation Law 2006-2007 at 301-302.

³⁹⁵ Told European Business Law Review 2015 at 719.

of association that eliminate monetary liability for breach of duty of care.³⁹⁶ The board of directors may only be relieved from monetary liability for a breach of the duty of care by obtaining approval by the shareholders according to the conditions specified in sub-chapter 5.2.2. Furthermore, the corporations in Sweden, as opposed to the corporations in Delaware, are not allowed to have indemnification agreements requiring the corporation to cover litigation costs associated with the board of directors and the managing director's official duties. However, the corporations in Sweden are similar to the corporations in Delaware in that they are allowed to purchase D & O insurance. It is not uncommon for corporations in Sweden to have D & O insurance to protect the board of directors from monetary exposure.³⁹⁷ This type of insurance also disrupts the deterrence mechanism of the shareholder derivative lawsuit in Sweden.³⁹⁸ Even though there is not a trio of protective devices in the SCA as in the DGCL and the MBCA, the D & O insurance might, because of the deterrence effect on derivative litigation, on its own result in a no liability rule.

The penalties for breach of the fiduciary duties of the board of directors are also high in Sweden.³⁹⁹ However, the literature on Swedish corporate law does speak about the penalties being so high that the Swedish courts refrain from imposing legal sanctions on the board of directors when it has breached its fiduciary duties. Therefore, it is unclear whether penalties for breach of fiduciary duties in Sweden will contribute to creating a no liability rule.

Like the previous and this sub-chapter shows, there is a risk that the BJR will result in a no liability rule when combined with the protective devices in the SCA. This can happen despite the fact that Swedish law does not permit corporations to adopt provisions in the articles of association that eliminate monetary liability for breach of duty of care or any kind of indemnification agreement. Whether or not a no liability rule will emerge depends on if the Swedish courts will apply the BJR generously in favor of the board of directors. Consequently, this result constitutes a strong contributory factor wherein the Swedish legislator should only consider introducing the BJR if it is articulated in a different way

³⁹⁶ Dotevall (2017) at 183.

³⁹⁷ Dotevall (1989) at 23; Dotevall (2017) at 182; Hellner & Radetzki 2.1.4.

³⁹⁸ Hellner & Radetzki at 2.1.4.

³⁹⁹ *Id.* at 21.

or given a dual function to protect the authority of the board of directors and the need to hold it accountable for its decisions and actions.

8 Market Forces and Social Norms

8.1 Introduction

The no liability rule can be hotly contested because the effects of the no liability rule seem pernicious.⁴⁰⁰ Nevertheless, many corporate law scholars defend the no liability rule by stating that legal accountability is unnecessary because market forces adequately discipline the board of directors.⁴⁰¹ These market forces include the market for corporate control, managerial labor market, and product market.⁴⁰² An alternative defense of the no liability rule is that social norms motivate the board of directors to act responsibly and thus replace the threat of legal liability as an effective accountability mechanism.⁴⁰³ This chapter examines whether the market forces and social norms can provide an adequate safeguard against mismanagement and opportunism by the board of directors and consequently replace legal liability as an effective disciplinary tool.

8.2 Market Forces

8.2.1 Market for Corporate Control

The market for corporate control is reported to exert discipline on the behavior of the board of directors by responding to inept or unfair management practices through discounting the price that investors will pay for a corporation's stock.⁴⁰⁴ If the board of directors fails to respond appropriately, the lower stock price will make it easier for others to take over the corporation and install a new and more efficient board of directors.⁴⁰⁵ However, the threat of a takeover cannot be relied upon to sufficiently discipline the board of directors because the likelihood that a reduction in stock price would lead to a takeover that otherwise would not have occurred is small.⁴⁰⁶ Whether a takeover bid will be ousted

⁴⁰⁰ Jones Iowa Law Review 2006 at 119.

⁴⁰¹ Jensen & Meckling Journal of Financial Economics 1976 at 331; Easterbrook & Fischel at 95-96.

⁴⁰² Bebchuk Harvard Law Review 1992 at 1462-1467; Winter The Journal of Legal Studies 1977 at 264-266.

⁴⁰³ Jones Iowa Law Review 2006 at 121.

⁴⁰⁴ Winter The Journal of Legal Studies 1977 at 264-266; Easterbrook & Fischel at 18-22, 96-99.

⁴⁰⁵ *Id.* at 266.

⁴⁰⁶ Bebchuk Harvard Law Review 1992 at 1462-1463.

depends on several other components.⁴⁰⁷ Some of the components are whether the acquiring corporation finds the value of the corporation to exceed the sum of the market price,⁴⁰⁸ and the estimated transaction costs involved in such a takeover.⁴⁰⁹ Transaction costs include, among other things, the cost of obtaining accurate information about the target corporation.⁴¹⁰

8.2.1.1 Managerial Labor Market

Like the market for corporate control, the managerial labor market is stated to discipline the board directors.⁴¹¹ One mechanism that imposes such discipline is the board directors' compensation scheme. The board directors' compensation scheme often includes shares of the corporation's stock, thus giving the board directors a direct interest in the value of this stock and incentive to enhance the shareholder value and not act opportunistically.⁴¹² The managerial labor market also disciplines the board directors by using the success of the corporation to gauge their opportunities for continued employment and promotion at the corporation and their future employment possibilities at other corporations. Therefore, a reduction in shareholder value can have an effect on the board directors' employment opportunities.⁴¹³

Similar to the market for corporate control, managerial labor has fundamental problems. First of all, it does not induce the board of directors to avoid reductions in shareholder value when the size of the direct private benefit is larger than their compensation scheme. Second, a reduction in the shareholder value may have nothing to do with the board of directors' actions. As a result, the managerial labor market will only partly penalize the board of directors for a reduction in the stock price.⁴¹⁴

⁴⁰⁷ Winter *The Journal of Legal Studies* 1977 at 267-273.

⁴⁰⁸ Bebchuk *Harvard Law Review* 1992 see footnote 94.

⁴⁰⁹ Winter *The Journal of Legal Studies* 1977 at 269.

⁴¹⁰ *Id.* 269, 271.

⁴¹¹ Easterbrook *Delaware Journal of Corporate Law* 1984 at 554-555; Fischel *Northwestern University Law Review* 1981-1982 at 919.

⁴¹² *Id.* at 554.

⁴¹³ Fischel *Northwestern University Law Review* 1981-1982 at 919; Eugene *Journal of Political Economy* 1980 at 288, 292.

⁴¹⁴ Bebchuk *Harvard Law Review* 1992 at 1464-1465.

The managerial labor market might still be a strong market force because the media continuously scrutinizes the decisions made and actions taken by the board of directors. This can perhaps cause an ordinarily prudent consumer to react more vigorously against failed management. Unfortunately, today's news is often yesterday's history and consumers will most likely not react vigorously for a long time and particularly not toward several corporations at the same time. Nevertheless, the board of directors can cover up its mismanagement by falsifying the corporation's financial reports. This can prevent markets from appropriately pricing the corporation's securities.⁴¹⁵

Before turning to the final market forces, it should be questioned whether it is acceptable for the legislator and the courts to delegate their responsibility to discipline the board of directors to the actors of the market. The actors of the market should arguably devote their time to doing business and overlooking how their business can improve, especially in times when there is much confusion on how stakeholders' interests ought to be considered in the corporate decision-making process. Even though the actors might have an interest in disciplining the board of directors, they most probably do not wish to take on the role of judges.

8.2.1.2 Product Market

The product market as the final market force reveals that if the board of directors acts inefficiently, the corporation will contract or fail, thus, potentially leaving the board of directors with a shrunken empire or no empire at all.⁴¹⁶ In today's corporate world, corporations need to produce innovative products or desirable services to preserve their market shares and to thrive in competitive markets.⁴¹⁷ The disciplinary force of the product market is limited because the board of directors' opportunistic behavior will not always affect the corporation's possibility to deliver innovative products and desirable services.⁴¹⁸ Furthermore, because larger corporations operate in the market by

⁴¹⁵ Fairfax Houston Law Review 2015 at 428-432.

⁴¹⁶ Bebchuk Harvard Law Review 1992 at 1466.

⁴¹⁷ Easterbrook & Fischel at 4-5, 95.

⁴¹⁸ Bebchuk Harvard Law Review 1992 at 1466-1467.

oligopolistic or monopolistic competition, their survival is hardly threatened by the board of directors' misbehavior and operating inefficiencies.⁴¹⁹

The market forces may discipline the board of directors somewhat. Despite this fact, this sub-chapter has shown that there are significant flaws in the market forces because of systematic market failures and imperfections. These failures and imperfections undermine market participant's ability to detect whether the board of directors is competent and efficient and if it acts opportunistically. From this, it is possible to conclude that the market forces cannot adequately discipline the board of directors and replace legal accountability as an effective accountability mechanism. Thereby, market forces do not defend the no liability rule.

8.3 Social Norms

8.3.1 *Corporate Law and Norm Theories*

Rock and Wachter argue that social norms prevailing in the corporate world can replace legal governance. The fundamental reason for this view is that the board of directors conforms to such social norms to avoid social sanctions such as shaming, ostracism, or embarrassment.⁴²⁰ Despite the fact that Rock and Wachter acknowledge the importance of legal accountability for breaches of duty of loyalty, they ultimately argue that the courts should be careful not to undermine the norms for corporate governance by unduly interfering in internal corporation conflicts.⁴²¹ They support the BJR because it facilitates self-governance by reducing the need for judicial interference.⁴²²

Unlike Rock and Wachter, Stout and Blair do not believe that social sanctions sufficiently constrain opportunistic behavior within the corporation.⁴²³ Rather, Stout and Blair believe that promotion of values such as faith and trust can motivate the board of directors to perform responsibly.⁴²⁴ In their view, the judges should articulate social expectations that the board of directors will exercise due care in its decision-making

⁴¹⁹ *Id.* at 1467.

⁴²⁰ Rock & Wachter *University of Pennsylvania Law Review* 2001 at 1622, 1641.

⁴²¹ *Id.* at 1661-1663, 1666-1667.

⁴²² *Id.* at 1623.

⁴²³ Blair & Stout *University of Pennsylvania Law Review* 2001 at 1796.

⁴²⁴ *Id.* at 1738-1739.

process. Judicial opinions are said to influence the board of directors' internal preferences.⁴²⁵ The board of directors is likely to pay attention to comments from the judges even if it does not have external incentives for doing so.⁴²⁶ Judicial interference is deemed to run the risk of undermining the board of directors' internal motivation.⁴²⁷

8.3.2 *Theoretical and Empirical Flaws with Social Norms*

Jones states that the arguments presented by Rock, Watcher, Stout, and Blair are intuitive because people do not consider law in their day-to-day behavior. People's decisions and acts are automatic, reflexive, and driven by factors that they most often are unaware of.⁴²⁸ Jones also believes that it is correct to emphasize the importance of the board of directors' internal motivations and values in ensuring responsible job performance.

However, Jones asserts that corporate law and norm theorists place undue faith in the ability of social norms to motivate the board of directors to act appropriately when social norms in reality are fluid, vary between groups and thus do little to prevent corporate misconduct. Even when social norms influence the board of directors' behavior for the better, it does not provide a proper response to those who fail to comply with their fiduciary duties and corresponding social norms. Nevertheless, it is alleged that corporate law and norm theorists do not consider that the law both reflects and helps to shape norms; hence, norms cannot be expected to compensate for a failure to enforce the law. The courts' lax enforcement of the fiduciary duties of the board of directors implies to the board of directors, the shareholders, and society that the board of directors' fiduciary duties are less morally important than duties that the court more vigorously enforces. When the courts in their legal opinions state that a conduct is morally questionable, yet legally permissible, the board of directors will suppose that the conduct in question was not that bad.⁴²⁹

Besides these theoretical flaws with social norms, Jones states that empirical data also show that norms for corporate governance do not work as well as corporate law and norm

⁴²⁵ *Id.* at 1744.

⁴²⁶ *Id.* at 1797.

⁴²⁷ *Id.* at 1809.

⁴²⁸ Jones Iowa Law Review 2006 at 127; Kahneman American Psychologist 2003 at 698-699.

⁴²⁹ *Id.* at 130-131.

theorists claim.⁴³⁰ The board of directors' duties requires it to be engaged, skeptical, well-informed, independent, objective, and highly motivated.⁴³¹ Despite this, several studies have revealed that the board of directors was passive and avoided asking tough questions to the managing directors, and differed almost slavishly to the managing directors wishes, except in times of a crisis.⁴³² Jones stresses that many corporate scandals, such as the Enron scandal, is a result of the board of directors' failure to exercise effective oversight.⁴³³

8.3.3 *Social Psychological Objections to Social Norms*

Insight from psychologists on the basis of motivation in human behavior also casts doubt on social norms' ability to replace the need to have legal accountability for the board of directors. Because of certain psychological phenomenon, acceptable norms drift and become replaced with undesirable norms, even when the board directors are successful and motivated individuals with hard-earned reputations. The board of directors' passivity and deference to the managing directors, for example, have allowed chronic corporate governance problems to fester. This suggests that social norms are incapable of resolving the most intractable problems in corporate law.⁴³⁴

Human desire and tendency to conform to a group in order to be just like the group they admire is the first psychological phenomenon that undermines the board of directors' ability to exercise independent oversight.⁴³⁵ This tendency toward conformity can cause people to suspend their individual judgments and substitute the erroneous judgment of others for their own rational evaluations. The board of directors is exposed to stronger conformity tendencies than regular people because it is subject to the influence of an attractive or appealing group. This can explain why many undesirable norms prevail in the boardrooms.⁴³⁶ Accountability can counteract the tendency toward conformity

⁴³⁰ *Id.* at 133-139.

⁴³¹ Brountas at 49-54.

⁴³² Mace at 27-39, 41; Lorsch & MacIver at 93-95, 170-171.

⁴³³ Jones Iowa Law Review 2006 at 137-139.

⁴³⁴ *Id.* at 139.

⁴³⁵ *Id.* at 139-140; Aronson at 29.

⁴³⁶ *Id.* at 140-141.

because psychological studies show that a requirement to explain one's decision to others can weaken the strong pressure to conform to peer judgments.⁴³⁷

Another psychological phenomenon that undermines the board of directors' independence is the wish to act consistently with prior commitments. This is labeled as cognitive dissonance. Cognitive dissonance occurs when an individual holds two or more contradictory cognitions or beliefs.⁴³⁸ People put in great efforts to reduce dissonance by changing inconsistent cognitions or beliefs. They also often avoid dissonant information or seek out additional consonant information.⁴³⁹ Legal accountability may cause the board of directors to act more independent and objectively.⁴⁴⁰

Finally, the board of directors, similar to the general population, has a desire to justify and rationalize its actions. This can decrease the board of directors' willingness to acknowledge or remedy action in violation of fiduciary duties. People have a strong urge to justify their actions when immoral acts create dissonance with their otherwise positive self-concept.⁴⁴¹ The board of directors' desire toward self-justification is likely to be stronger than that of an ordinary person because it occupies a higher social status,⁴⁴² and because its actions have serious consequences for the corporation and the economy as a whole.⁴⁴³

This discussion shows that there is little evidence to suggest that social norms can replace the threat of legal liability as an effective accountability and defend the no liability rule. Legal accountability for the board of directors is evidently needed because neither market forces nor social norms can adequately discipline the board of directors. This is not to say that legal accountability is infallible because cases can be wrongly decided and statutes poorly drafted. This chapter merely contends that legal accountability cannot be replaced by market forces and social norms. Because legal accountability also possesses certain weaknesses, it can be asserted that there has to be a web of accountability

⁴³⁷ Quinn & Schlenker *Personality and Social Psychology Bulletin* 2002 at 472, 480.

⁴³⁸ Jones *Iowa Law Review* 2006 at 142.

⁴³⁹ Aronson at 154-156.

⁴⁴⁰ *Id.* at 143.

⁴⁴¹ *Id.* at 169.

⁴⁴² *Id.* at 170.

⁴⁴³ Jones *Iowa Law Review* 2006 at 144.

mechanisms in place. In other words, both legal accountability as well as market forces and social norms need to be in place to adequately discipline the board of directors.

9 Conclusion

9.1 Concluding Remarks

If it is true that history repeats itself, there will most probably again be events, which will leave the corporate law scholars and people in the business community with the pressing question of whether the board of directors is sufficiently accountable for its decisions and actions. Therefore, the Swedish legislator and corporate law scholars must absorb the knowledge that the corporate scandals and financial crisis yielded about the behavior of the board of directors and the concept of accountability. A thorough investigation must be conducted about which liability rule for the board of directors is preferable to introduce in the SCA.

This thesis shows that the BJR does not balance the values of authority and accountability in an appropriate manner because it lets the value of authority to completely dominate. An appropriate balance between the values of authority and accountability requires that neither of the values be so preeminent that any of them completely dominate. Striking a balance between the values of authority and accountability is necessary if one is to have effective and efficient corporate governance. If you require too much accountability, one might stultify enterprises and encourage a short-term approach by the board of directors but if you include too little, one might place too much power in the hands of the board of directors that as a result could camouflage self-interest. The board of directors must be granted power to get the job done. Nonetheless, it must also be subject to some review and consequences for any misconducts for its power to be legitimate. There has to be some possibility of consequences for the board of directors for full accountability to be present and meaningful. Additionally, it is important that the fiduciary duties of the board of directors are not weakened as they are essential elements in the accountability framework. The fiduciary duties are useless unless they are enforced.

The BJR is made more critical because the Delaware courts apply the BJR generously in favor of the board of directors and adopt an inveterate attitude in cases raising duty of care, thus, weakening the duty of care as a viable and meaningful accountability

mechanism. Given these findings, the Swedish legislator should only consider introducing the BJR if it is articulated in a different way. Alternatively, if it is given a dual function to protect the value of the authority of the board of directors and the need to hold it accountable for its decisions and actions. The BJR must be introduced in the SCA with great care because it is impossible to foresee with absolute certainty how a foreign rule might develop in the forum law.

The justification generally given for the BJR does not fully explain the existence of the BJR and certainly not the supremacy of the value of authority. Consequently, the conclusion as to if, and when the Swedish legislator should consider introducing the BJR in the SCA remains unchanged.

This thesis has also considered the benefits of introducing the BJR. It established that it can be logical to introduce the BJR in the SCA because it can perhaps provide clear prerequisites on how and when the Swedish courts might review business decisions. It might even be sensible to introduce the BJR because the Swedish courts seem to have started to approach or are attempting to approach the BJR. Moreover, it can be desirable to focus on how a decision came about instead of the merits of the decision as long as it does not preclude a review of the vast majority of cases and insulate the board of directors in cases where the existence of an underlying conflict is beyond dispute. Finally, an introduction of the BJR in the SCA could harmonize the liability rules for the board of directors between Sweden and countries that have implemented it, which in turn can have a positive impact on the Swedish economy. These benefits, however, do not change the conclusion of this thesis. They merely constitute a reason for introducing the BJR.

The conclusion is strengthened by the fact that the BJR may result in a no liability rule when combined with the protective devices in the SCA in the same way as it does in the DGCL, if the Swedish courts apply it generously in favor of the board of directors. The no liability rule should not be perceived lightly because it means that the board of directors is rarely called upon to justify its decisions and actions. Thus, accountability is not present to capture breaches of either duty of care or duty of loyalty. It is dubious whether a set of virtually unenforceable rules can prevent mismanagement and opportunism by the board of directors; hence, the no liability rule appears to deter the threat of legal liability as an effective accountability mechanism.

The no liability rule cannot be defended by market forces and social norms because they do not provide adequate safeguard against mismanagement and opportunism and thus replace the threat of legal accountability as an effective disciplinary tool. Market forces suffer from systematic failures and imperfections, and certain behavior phenomena prevent social norms from appropriately constraining corporate conduct. Legal accountability is also infallible because cases can be wrongly decided as statutes are poorly drafted. Therefore, there has to be a web of accountability mechanism in place, both legal accountability, market forces, and social norms to adequately discipline the board of directors.

Even though this thesis has concluded when the Swedish legislator should consider introducing the BJR, considerably more work needs to be done to determine whether it should be introduced in the SCA. Further research might explore the three assumptions about the BJR that this thesis has highlighted.

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