Hostile takeovers in the face of the Business Judgment Rule

A comparative analysis between Sweden and the United States of America in regard to the Business Judgment Rule and the Unocal test.

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Summary

In cases concerning a hostile takeover occurring in the United States, the board of directors must fulfill the duties set forward by the Unocal test. If the board of directors succeed, it implies that the decision, regardless if it is a bad decision, is protected by the Business Judgment Rule.

The Business Judgment Rule presumes that the board of directors in good faith made an informed decision in the line of the corporations’ interests.

The Business Judgment Rule is inherently unique for American companies. In Sweden liability for directors is based on a culpa evaluation which in turn is based on principles deriving from tort law. This is the result from the corporate law only providing for a very limited part concerning liability.

In this thesis, the different judicial systems are explained with focus on differences and similarities based on duties of the board. Moreover, the different liabilities from a Swedish and an American perspective will be discussed.

Concluding, it is hard to distinguish a Swedish version of the Business Judgment Rule, however, the creation of one would most likely be beneficial since it, to a large extent, provides for a better business world.
Sammanfattning

Vid ett fientligt företagsförvärv i USA måste styrelseledamöterna visa att de uppfyller de krav som framställts genom Unocal-testet. Lyckas styrelseledamöterna uppfylla kraven så blir de skyddade från skadeståndsrättsligt ansvar i enlighet med the Business Judgment Rule, oavsett om beslutet ledde till en dålig affär. The Business Judgment Rule presumerar att styrelseledamöterna i god tro fattat ett välgrundat affärsbeslut som ligger i bolagets intresse.


I denna uppsats redogörs de olika rättssystemen med fokus på likheter och skillnader i styrelseuppdraget. Vidare diskuteras styrelseledamöternas skadeståndsansvar utifrån ett amerikanskt och ett svenskt perspektiv.

Slutligen visas det att det är svårt att se en svensk version till the Business Judgment Rule, men att en sådan troligen skulle vara att föredra då regeln ger effekter som bidrar till en bättre affärsvärld.
Preface

With this thesis, my studies at Uppsala University has come to an end. It has been quite the experience and I am forever grateful for the opportunity. There are many people who have been the support needed during my time at law school and for that I am thankful. Thank you for always believing in me.


Austin, Texas, 21 Oktober 2016
Abbreviations

AMF  Aktiemarknadnsärnämnden, *The market authority*.
BJR  Business Judgment Rule.
MBCA Model Business Corporation Act.
Prop. Proposition, *Government bill*
SkL  Skadeståndslagen, *Tort liability act*.
SOU  Statens offentliga utredningar, *Swedish government official reports*
1 Introduction

1.1 The legal Issue

The Business Judgment Rule (BJR) is a term common to the American world of corporations\(^1\). The rule is the basis for determining whether a company’s director has violated his or her duty of care. When the Courts apply the rule, they will assess whether the director, in general, acted in the best interest of the corporation.

The board of directors\(^2\) of a company has a central role in both private and public corporations as it manages the company’s affairs. They are the ones who are responsible for fulfilling the purpose of the corporation and the wishes of the shareholders, namely to create profit for the corporation.

When a takeover bid is made on the company, the role of the target company’s board is extended, as the board of directors undertakes certain obligations due to takeover regulations. While fulfilling its duties, the target company’s board of directors has to act in the best interest of the shareholders. The board of directors may therefore not let any self-interest or other stakeholder interests prevail in decisions and undertakings.

This master’s thesis aims at evaluating the Business Judgment Rule from a hostile takeover perspective. It will focus on comparing Swedish legislation and rules to the ones from the United States in the situation concerning a hostile takeover.

A takeover implies that one company, the \textit{target company}, is acquired by another company, also known as the \textit{acquirer}.\(^3\) There are two sorts of takeovers – friendly takeovers or hostile takeovers; depending whether the takeover bid is based on the approval by the board of directors or if the offer is made without the board’s consent. A rule of thumb is that when an acquirer holds more than 50 percent of the shares, the acquirer is considered to hold the control of corporation.

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\(^1\) No differentiation will be made between the term “corporation” or “company”, the reader will find both expressions used throughout this thesis.

\(^2\) Also known as managing boards etc. However, in this thesis the term board of directors will be applied.

\(^3\) Stattin, Takeover p 274.
One may wonder, what is difference between a friendly takeover and a hostile takeover? A takeover is, as mentioned, when an acquirer acquires a company, often known as the target company. The takeover is accomplished by going directly to the company’s shareholders or fighting to replace management in order for the acquisition to succeed. The difference between a friendly and a hostile takeover is generally that the target company’s management are resistant to see the acquisition succeed, and will therefore defend the company against the takeover by using certain defense-strategies.

Historically, hostile takeovers derive from the United Kingdom and the United States. Its primary intention was to enhance corporate systems efficiency as well as to raise the shareholder value of the corporation. Today, the purpose behind a takeover is still to rationalize corporate systems and to increase the value of the corporation. Thus its purpose is also based on a wish to allocate the resources within a company and to force the market to act more rationally and to make the corporation grow and the possibility of the corporation gaining access to new markets.

When facing the possibility of a hostile takeover there is usually a conflict of interest between the company’s shareholders and the managing board. The shareholders are, on one hand, eager to maximize the profit of the investment made in the company, whilst the managing board wishes to avoid the hostile takeover due to the risk of being dismissed if the takeover is successful. Hence, when facing a potential hostile takeover, the managing board tend to make use of hostile takeover defenses. To put it briefly: when the takeover bid is proposed, the board of the target company has an important decision to make; will they accept the offer or not?

When directors rejects a tender offer, they often base the decision on the “inadequacy of the bid, the nature and timing of the offer, questions of illegality, the impact on constituencies other than shareholders, the risk of non-consummation, and the basic stockholder interest at stake, including the past actions of the bidder and its affiliates in other takeover contexts”.

As previously mentioned, in the U.S., the decision the board makes relies on the Business Judgment Rule. However, when comparing the U.S. decision-making structure to other countries

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4 Generally known as a tender offer.
5 Example on defense strategies may be poison pill, the crown-jewel defense, or the Pac-man defense. These strategies are not to be evaluated in this thesis.
6 See the English case from 1742 of Charitable Corp. v. Sutton and the American cases Percy v. Milllaudon from 1829 and Bodell v. General Gas & Electric Corp. from 1926.
7 Ivanhoe at 1341-42.
such as Sweden a difference is apparent. Sweden does not have a full-fledged version of the Business Judgment Rule. Instead, the decision on what the board should do is usually decided by the shareholders in a general meeting, and any liability aspect is related to Swedish tort law. Concluding, this means that the U.S. interpretation gives the board more power than in Sweden.

1.2 Aim and Research Questions

This master’s thesis aims to evaluate the liability aspects when dealing with a hostile takeover from a Swedish and American perspective; the foundation for this will be the Business Judgment Rule and the Unocal test. Do the board of directors possess the best knowledge on whether to make use of hostile defense mechanisms or not?

The evaluation will focus on certain key questions namely:

- What are the advantages versus the disadvantages of using the Business Judgment Rule as the basis for decisions made by the board?
- What are the effects by using the Business Judgment Rule when it comes to the liability aspects of the board?

1.3 Methodology

The aim of this thesis is to evaluate American and Swedish concerning the board’s action in connection to when a takeover bid is proposed. Therefore, will the thesis contain comparative elements. Important to stress is that it is appropriate to make use of this specific method when examining corporate law since the legislation concerning corporate business usually aim at fulfilling a fundamental function. Thus, and particularly important to acknowledge, is the fact that different jurisdictions are distinctly dissimilar which naturally has effects on their legislation. Bearing this in mind, it is further important to examine the purpose behind the legislation. Therefore, another method that will be applied is the teleological method. This
method is appropriate for when the aim and purpose of the legislation is of importance. This method is, in particular, suitable for cases of corporate law since it, in cases of un-clarity, is required to look at the purpose.

Where appropriate, the method of studying legal sources will be used. This method is to some extent divided, implying that it follows a specific order where applied. The order is developed through the hierarchy of legal sources, first the study of the particular law, second the result from legal practice, when dealing with American law - namely the case law where courts have interpreted the laws and therefore including a de lege lata perspective. This is also a part of the basis for the teleological method that, as explained below, will also be a part of this thesis.

Finally, the legal commentary, in the shape of doctrine and articles, will be studied. An intention with this thesis, is to evaluate the advantages of different legislations, therefore a de lege ferenda interpretation is to be used throughout this thesis.

1.4 Scope and limitation

This master’s thesis will focus its presentation on the Business Judgment Rule in the context of corporations (public limited liability companies) and the relevant legislation applicable to these companies. For the purpose of this thesis the history of Business Judgment Rule will not be discussed.

The takeovers assessed will be hostile takeovers, implying tender offers made on the company without precedent discussions with the managing board.

Concerning the different legislations, the basis for evaluating American law is the Delaware legislation, which is the majority choice of legislation in the U.S. However, relevant case law which may have a persuasive effect will be still be used even thus it may not always derive from Delaware.

Further, Swedish legislation concerning corporations active on the stock-exchange market will be of focus. The national provisions are to a large extent based on EU regulations but concerning the law applicable to corporations, it is common that nations have their own legislation and interpretation for companies on a specific market, specifically in Sweden where corporations are to a large extent subject to self-regulation.
1.5 Outline

Chapter two will serve as an introduction to the Business Judgment rule, what the aim and purpose is and how the rule is applied, specifically from a hostile takeover perspective. Chapter three will examine the corporate U.S. law, the structure, relevant legislation, the different actors and liability aspects. Chapter four will discuss Swedish corporations, what statues are relevant and the duties of the different actors. Chapter five will deal with the liability aspects of the directors of a Swedish corporation. Chapter six will serve the purpose of further discussion and comparison, what are the advantages and disadvantages of the Business Judgment Rule, is the rule still relevant, is there a Swedish version to the rule. Chapter seven will briefly summarize the thesis and set forth the conclusion reached.

1.6 Definitions

1.6.1 Hostile takeovers

A hostile takeover is a situation where the target company receives an undesired offer for all or a part of the outstanding shares at a stated tender price from a corporate raider, who aim at acquiring a minimum of 50 percent in the company in order to receive majority representation on the board. Concluding, the bidder will typically own enough stock to control the corporation and therefore expel its current corporate officers and board of directors. The term hostile takeover has a negative denotation mostly because when a hostile bid is put forward, the shareholders are likely to be disadvantaged by the transaction whereas when a friendly, desired, offer is launched it is likely that it will increase the target company’s, as well as the acquires’ wealth. The difference between a hostile and a friendly takeover is not always clear, instead it is rather complex. At some occasions, a takeover may be considered hostile but may become a friendly

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8 Also known as ”unfriendly”, ”defended” or ”contested” takeovers. For the purpose of this thesis the term ”hostile” will be used.
9 50 percent of the shares is generally considered to be a rule of thumb.
takeover if negotiations are pursued and attitudes and expectations of the parties involved change.\textsuperscript{10}

Hostile takeovers are also a way to exercise management control, mainly through the aim of establishing a more efficient management in poorly run companies, but it is also a way to accelerate market and industry consolidation.\textsuperscript{11}

Takeovers usually concern corporations\textsuperscript{12}. Generally, corporations are listed on a stock exchange market. In Swedish corporations require a minimum share capital is 500 000 Skr in accordance to chapter 1, paragraph 14 ABL. In the U.S. corporations are companies that report under the Securities exchange act of 1934. Contrary to Swedish corporations, they do not have any share capital criteria, instead, a company is generally considered public when registered with the Security and Exchange Commission (SEC). Another feature for corporations is that they normally require a general shareholder meeting once a year.\textsuperscript{13}

Hostile takeovers are mainly done through a tender offer or through a proxy contest. A tender offer is when the acquiring company ask the shareholders to buy their stock and by that going around the board of directors. Proxy contest is when the acquiring company attempts to obtain votes of the sufficient amount of shareholders in order to gain control of the company.

### 1.6.2 Fiduciary duties

Fiduciary duties - In general, the fiduciary obligation of target management and directors in a change of control context is to act with due care and loyalty, in what they believe to be the best interests of the corporation.

Concern has been raised in determining to who the directors of the corporation owe the fiduciary duties. Some state that it is toward the corporation itself, other that it is toward the shareholders.

\textsuperscript{10} Gorzala p 8.
\textsuperscript{11} Supra note.
\textsuperscript{12} In the U.S. the term ’public companies’ or “corporations” are mainly used when referring to a company listed on the stock exchange market. These expressions will be used fluctuating throughout the thesis.
\textsuperscript{13} For example, Aktiebolagslagen chapter 7 paragraph 10.
1.6.3 Corporations

As briefly mentioned, the term *corporations* differentiate from a Swedish perspective and an American perspective. Corporations from an American perspective are companies which are governed by the law of the state in which it is incorporated (where it filed its charter).\textsuperscript{14} Some of the state laws may be based on the Model Business Corporation Act (MBCA), whilst others may differ entirely. Delaware is one of the states where the majority of corporations are incorporated, mainly because of the flexibility that the Delaware laws offer. An American corporation provides for limited liability for its shareholders and moreover a corporation is generally taxed as a C-corporation, meaning that the corporation is considered to be its own taxpaying entity.\textsuperscript{15}

Swedish aktiebolag are divided into two categories – private and public. The public aktiebolag is similar to a C-corporation, shareholders benefit from limited liability, and it is taxed as a separate entity. Most of the laws governing the public Swedish aktiebolag are the same ones governing the private version, however differences are made within the laws. Moreover, and something that will be mentioned later in this thesis, is that the public aktiebolag is subject to specific regulation since they have their stocks for sale on the market.

With regard to this thesis, and since there are great similarities between a C-corporation and a public aktiebolag, for the continuing of this thesis, the term used for both of the company forms is “corporations”.

\textsuperscript{14} Sjostrom, p 14
\textsuperscript{15} Sjostrom, p 15.
2 The Business Judgment Rule

2.1 Brief overlook

Business decisions generally require a delicate balance of corporate opportunities and competing alternatives. Shareholders may disagree with many decisions taken by the board and the first action they may take is to use the rules concerning the corporate democracy to defeat incumbent board or proposed transactions. The second alternative is to initiate legal action.

When detangling the different aspects of the Business Judgment Rule, it is important to begin with a very brief overlook of what the Business Judgment Rule actually is. Basically, the rule is used as a basis for the court to evaluate a decision made by a company’s board to determine whether it is made in good faith, with sufficient care and with the belief that the directors are acting in the best interest of the company; whether or not the corporate directors have satisfied their duties of care and loyalty in connection with their consideration of a transaction.\(^{16}\)

The Business Judgment Rule also creates a presumption that the corporate boardroom is the appropriate venue for making business decisions, and is therefore often the starting point in assuming that the directors fulfilled their duties by putting the burden of proof on the party challenging the board’s decisions.

What is essential to underline is the distinction between the fiduciary duties and the Business Judgment Rule. The fiduciary duties are duties which exist prior to the application of the Business Judgment Rule. As will be evident, in the case of *Cede*\(^{17}\), the court simply tried to put the fiduciary duties in a rule.

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\(^{16}\) Taylor, p 633.

\(^{17}\) *Cede & Co. v. Technicolor.*
2.2 The Business Judgment Rule in its essence

The Business Judgment Rule derives from the American Supreme Court case of *Aronson v. Lewis* in 1984. The court formulated the rule as “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 best interest of the company.”\(^\text{18}\) It was initially sought to balance interests of the company; the shareholders need for a possibility to deal with inefficient management of the company and the community’s need to have corporations that are willing to take risky decisions.

The rule started out with regard to the decision making process but throughout the years it has come to be employed in situations regarding several different situations where a company can find itself such as mergers, tender offers, lockup options as well as special litigation committees.\(^\text{19}\)

As stated by the court in *Corbus v. Alaska Treadwell Gold Mining Co.*:

> “The directors represent all the stockholders and are presumed to act honestly and according to their best judgment for the interest of all. Their judgment as to any matter lawfully confided to their discretion may not lightly be challenged.”\(^\text{20}\)

Put more simply, the Business Judgment Rule protects the director from liability for losses incurred as a result of a mistake in judgment if it honest and reasoned. It was also stated in *Hun v. Cary* that directors who “act in good faith within the limits of power conferred, using proper prudence and diligence ... are not responsible for mere mistakes or errors of judgment”.\(^\text{21}\) In conclusion, directors are not liable for simply making bad business decisions.\(^\text{22}\)

Almost a decade later, the court made used of the Business Judgment Rule in the case of *Cede & Co. v. Technicolor* where it places the rule in a wider context by connecting the rule to the

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\(^{18}\) *Aronson v. Lewis* at 812; Smith, The modern Business Judgment Rule p 1.

\(^{19}\) Walter, p 650.

\(^{20}\) *Corbus v. Alaska Tredwell Gold Mining Co.* at 455,463.

\(^{21}\) *Hun v. Cary* p 65.

\(^{22}\) *Aronson v. Lewis* at 805, 812.
judicial framework reviewing the director’s performance concerning fiduciary duties. It also linked the rule to statutory and policy bases; by statute that the business and affairs of a corporation are managed by or under the board of directors, who are purported with a fiduciary duty to protect the interest of the corporation and act in the best interest of the shareholders.\textsuperscript{23} The court continued in describing the rule is the be seen as an extension of the principles of fiduciary duties, and that the result of that will be that the court will not be the one to decide how a corporation shall manage its business.\textsuperscript{24}

In order to invoke the rule, the shareholder plaintiff must provide evidence showing the court that the directors, in reaching their decision breached any of their fiduciary duties.\textsuperscript{25} However, and what is interesting is that the duty of loyalty is rarely used to evaluate the fiduciary duty. Mainly because there is a presumption that the board of directors more or less always have a self-interest when making business decisions.

Nevertheless, the shareholder plaintiff may show breach of any fiduciary duty which concludes that the burden of proof \textit{initially} always lies on the plaintiff to demonstrate that the board of directors has violated the Business Judgment Rule. However, if the plaintiff fails to fulfill the initial duty of demonstrating failure to comply with the Business Judgment Rule, the directors will automatically be protected by the rule and be considered to have acted in compliance with the Rule. If the plaintiffs succeed in demonstrating that the directors have breached their duties, there is a shift in the burden of proof and the burden ends up lying on the directors to prove the entire fairness of a transaction.\textsuperscript{26} What the entire fairness doctrine implies is that the transaction had to be entirely fair to the shareholders in regard of fair dealing and fair price.\textsuperscript{27}

It is stated that the Business Judgment Rule shall not be considered an automatic liability shield for directors and their decisions; there is no assumption that they did not breach their duties.\textsuperscript{28} Professor Johnson claims that the Business Judgment Rule is more considered to be a

\textsuperscript{23} \textit{Cede}, at 360.
\textsuperscript{24} \textit{Supra Note}.
\textsuperscript{25} \textit{Cede} at 361.
\textsuperscript{26} \textit{Cinerama Inc.} at 1163; \textit{Cede} at 361.
\textsuperscript{27} \textit{Weinberger v. Uop Inc.} at 715.
\textsuperscript{28} Johnson, p 628; Smith, p 280.
non-review. He claims that on the basis of the court’s statement in Cede, “the courts will not second-guess these business judgments”; the Courts have viewed that it is only the process which the court feels to be within their competence and will therefore not evaluate the substance of the business decisions. When the burden has shifted it lies on the directors to prove that the business decision made was in line with the best interest of the company, another form of review is trigged, namely the entire fairness doctrine. Put short, the entire fairness doctrine becomes applicable when the Business Judgment Rule is defeated.

The entire fairness doctrine examines whether the transaction is entirely fair to the shareholders; that it was in the best interest of the corporation. The burden of proving the business decision, lies on the directors that has to show that the decision was made in regard to fair dealing and fair price.

2.3 Why do we have the Business Judgment Rule?

One of the main attractions of a corporation is the risk. The greater the risk the greater the earning if the business succeeds. However, we are all probably on the same note concerning the notion that corporate directors should be attentive, careful and prudent when making business decisions; after all, most of the decisions are made on the basis of investor money.

Davis explains it as a weak and a strong form of risk allocation when it concerns the Business Judgment Rule; the weak form implying that even the most potentially profitable business decisions entail some element of risk whereas the strong form supports the directors. Eminent Judge Ralph Winter summarized it with “shareholders to a very real degree voluntarily undertake the risk of bad business judgment”.

The weaker form of risk allocation is to some extent protected by case law, since accordingly the courts will not dig too deep into the business decision. The strong form relies on the fact that “to err is human”; however, when comparing it to an erroneous act when it comes to tort will have a completely different outcome. The reason, is according to Davis, the fact that tort law has

29 Johnson, p 631.
30 Cede at 361.
31 Davis, p 574.
a broader objective when it comes to risk distribution.\textsuperscript{32} In the case of \textit{Smith v. Van Gorkom}, the concern about directors not wanting to serve as board members arose.\textsuperscript{33} In reality, board directors are likely to demand a form of insurance in order to be protected from liability, something that may differ between Swedish and American law. But is it enough? And to what extent are bad decisions protected? In American corporations it is usual to have some insurance in order to protect the board of directors, however, in order to answer the question asked, the substance law has to be evaluated with regard to the rationality, implying that the decision has to have some sort of rational basis but should not be reviewed for its overall reasonableness.\textsuperscript{34} The test aim at evaluating, not what a reasonable director would have done, but what a rational director might have done.

The test is considered to be an objective confirmation of the subjective requirement that directors have a good faith belief that their decisions are in the corporation’s best interest.\textsuperscript{35}

\section*{2.4 The Business Judgment Rule from a hostile takeover perspective; \textit{Cheff, Unocal} and \textit{Unitrin}}

As explained above, in ordinary cases when questioning the decision made by the board of directors, the Business Judgment Rule becomes applicable; the normal setting in that case (when applying the Business Judgment Rule) is that the initial burden of proof is for the shareholders to prove the board of directors faulted. However, when it concerns decisions made by directors in a hostile takeover setting, there is a need to address the issue from a different perspective and with a heightened standard of review.

Normally, the tradition entails a duty to owe fiduciary duty by the directors of the company towards the shareholders of the corporation. But Delaware courts have during many years tried to define the fiduciary duties the board of directors owe in cases of hostile takeovers of a

\begin{footnotes}
\item \textsuperscript{32} \cite{Davis}: p 575.
\item \textsuperscript{33} \textit{Smith v. Van Gorkom} at 858.
\item \textsuperscript{34} Principles of Corporate governance: Analysis and Recommendations §4.01(c) 1992.
\item \textsuperscript{35} \textit{In re RJR Nabisco Inc. Shareholders Litigation}
\end{footnotes}
However, what needs to be stressed is the fact that the Business Judgment Rule is a doctrinal creation of judicial review in which the fiduciary duties owe a large part of.

In 1964 in the case of *Cheff v. Mathes*, the court stated that the directors earn protection if the decision was made in good faith; meaning that if the directors reasonably believed that they were acting in the best interest of the company. As may be evident, this criterion is similar to the one set forth in the Business Judgment Rule, but as may further noticed, the case where the Business Judgment Rule was first adapted came after the *Cheff* case.

When *Unocal Corp. v. Mesa Petroleum* reached the Delaware court, the court recognized that directors through their defensive measures sometimes act with the purpose of retaining control. Put simply, it is likely that directors will forsake the interest of shareholders in case of an hostile takeover. As a basis of this, the courts have shifted the burden of proof to the directors as put forward in the Unocal case. Consequently, the Delaware courts now apply what is known as the Unocal test before the directors are afforded the protection of the Business Judgment Rule.

In the Unocal case, the court states:

“Thus, unless it is shown by a preponderance of the evidence that the directors' decisions were primarily based on perpetuating themselves in office, or some other breach of fiduciary duty such as fraud, overreaching, lack of good faith, or being uninformed, a Court will not substitute its judgment for that of the board.”

Put more concrete, the court implies that the there is a dual burden for the board of directors; to start with they are required to prove reasonable grounds for believing that the corporate policy and effectiveness was in danger; further, they also need to show that the defensive measure taken were reasonable in response to the threat posted. The case ended up heightening the “baseline requirement” of good faith, as set forward in *Cheff*. If the directors were able to show these criterions, the burden of proof relies on the shareholder to prove fraud, bad faith etcetera. Courts

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36 Cara and Lane p 196-197.
37 *Cheff*, at 556.
38 *Unocal* at 946, 954; Cara and Lane p 208.
39 *Paramount Communications, Inc. v. Time, Inc.* at 79.
40 *Unocal* at 22.
41 Wong, p 169.
42 *Cheff* at 548, 555.
therefore tend to hold directors accountable when their judgment is flawed with bad faith, fraud or self-dealing. Hence, directors in Delaware have discretion in deciding what is in the best interest of the corporation and its shareholders. In the *Unocal* case, the criteria on proportionality was introduced which in turn set forward the test known as the Unocal test.

In 1995, the court decided in the *Unitrin* case to set yet another additional standard. The new standard requires that the defensive action taken by the directors precludes or coerces shareholder choice.

To conclude, the test which is known as the “Unocal test” sets out the following:

1) Directors must prove they conducted a “good faith and reasonable investigation” of both perceived threat and the corporation’s possible defenses. A possibility of fulfilling this burden is to show that the directors were not grossly negligent in reaching an informed decision. This requirement do not differ specifically from the test set out in the Business Judgment Rule, where it is required that a decision was made on “an informed basis, in good faith and in the honest belief that the action taken was in the best interest of the company”.

2) The second requirement is that directors response must be reasonable in relation to the threat posed. The focus is to determine the reasonableness by looking at the nature of the takeover bid as well as the corporate enterprise.

3) The defensive action taken by the directors was non-coercive and non-preclusive.

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43 *Smith v. Van Gorkom* at 858, 876.
44 *Unitrin Inc. v. American General Corp.* at 1387-88; Werkheiser G, Defending the Corporate Bastion: Proportionality and the treatment of Draconian Defenses from Unocal to Unitrin; Another criterion, which implies that if any other restrictive duties such as the ones set forward in the Revlon case is also part of the test, but will, however, not be subject of this thesis.
45 *Unocal* at 955; *Cheff* at 548.
46 *Moran v. Household Int’l Inc.* at 1346; *Smith v. Van Gorkom* at 858, 873.
47 *Aronson v. Lewis* at 812.
48 *Unocal* at 955.
49 *Ivanhoe* at 1341.
Put in perspective, the difference between the Unocal-test and the Business Judgment Rule is that the Unocal test puts a burden of proof at the directors while the Business Judgment Rule presumes this burden in the directors’ favor. If the directors fulfil the Unocal test by showing good faith and reasonable investigation as well as the response was reasonable in relation to the threat; and moreover, in accordance to Unitrin, show that the defense measure was non-coercive and non-preclusive, the director will have shown that the decision was made with a rational business purpose and are therefore protected by the Business Judgment Rule.
3 American law

3.1 Background

You as a reader may be up to date on how the American legal system works. However, in order to be able to compare the two legislatures, it is important to stress that American law is a common law country. This means that there are a few statues, instead most of the laws are created in court. Another important feature of U.S. law is that it is federal. This implies that the laws from each and every of the fifty states may differ in between each other. In many aspects, the laws are similar but there may still occur fundamental differences.

Thus, the U.S. also have a limited amount of federal legislation which is applicable to all states and which concerns directors’ responsibility within a corporation. Whilst the states have their own corporate code, the federal laws create the minimum standards for trading corporations. In the following a few relevant federal statutes will be mentioned.

3.1.1 Securities Act of 1933 and The Securities and Exchange Act of 1934

1933 regulates the initial offering of stocks whereas 1934 regulates the secondary sale. The first was made in order to ensure more transparency in financial stating and is the first response to the 1929 crash. The goal is to make investors reached an informed decision about investments and to create laws against misrepresentation and fraudulent activities. The 1934 act serves to govern the securities exchanges and the rules that govern the registration and regulation of broker-dealers.

The 1934-act also serves the purpose of creating the Securities and Exchange Commission (SEC). The SEC is responsible for enforcing securities laws in the U.S. and specifically to regulate tender offers.

Another act worth mentioning is the Williams Act of 1968 which is an amendment to The Securities and Exchange Act of 1934. It requires any person who makes an offeror a cash-tender offer to disclose certain information such as the sources of funds, the purpose of which the offer is made, the future plans if the takeover is successful etc.
The Williams act further prevents “sneak attack takeovers”.\textsuperscript{50}

3.1.2 Sarbanes-Oxley Act of 2002

The SOX is one of the reactions to the Enron scandal in 2001. Its main goal is to protect investors by enhancing the accuracy and reliability of corporate disclosure in order to prevent fraud. Generally, the act aim at certifying accuracy of financial statements and controls of how this process should be dealt with within the corporation.

3.1.3 Dodd-Frank Act of 2010

Also known as the “Wall Street reform”. The act prevents certain risk-taking within publicly trading companies. This act emerged from the housing crisis in 2008. It allows for financial monitoring of the corporations that are “too big to fail”, and whose failure could have tremendous effects on the economy.

3.1.4 Model Business Corporation Act and Revised Model Business Corporation Act

As evident by the name, this is merely a model act with the aim of making the corporate law within the United States more uniform. The Section of Business law at American Bar Association promulgated the Model Business Corporation Act (MBCA) in 1950 and has amended it on several occasions. They published a complete revision in 1984 which is known as the Revised Model Business Corporation Act, which is simply an updated and revised version of the MBCA. The fourth, and latest, edition was published in 2007 and includes all amendments. As of today, 32 states have incorporated some form of the MBCA however, and important to stress is that there should be no assumption that the states have adopted the MBCA verbatim

\textsuperscript{50} Williams Act of 1968 §78(a).
since the states are free to make changes or decide not to adopt amendments etc.\textsuperscript{51} Since a majority of the companies in the United States are incorporated in Delaware, it is important to point out that Delaware is one of the states that have not ratified the MBCA with the exception for a few similar provisions.

\textbf{3.2 Duties of the directors}

As mentioned in the introduction, in the case of a hostile takeover, the shareholders and the directors generally have a different aim, the directors interest dictate that the takeover shall be rejected and defensive measures be taken whilst the aim for the shareholders is simply to get cover the investments put in. Thus, the general reason for having a directorial organization is mainly that the directors are commonly chosen based on their knowledge. Normally, the directors and the shareholders serve the same aim – profit maximization. Shareholders want financial return (hopefully with profit) of their investment, and directors want to keep their position and upheld their reputation.\textsuperscript{52}

The directors of a company are, as previously stated, chosen by the shareholders in order to manage the corporation. In the Model Business Corporation Act (MBCA) §8.01 (b) it provides that:

\textit{“All corporate powers shall be exercised by or under the authority of the board of directors of the corporation, and the business affairs of the corporation shall be managed by or under the direction, and subject to the oversights, of its board of directors...”}

\textsuperscript{51} Sjostrom p 13.
\textsuperscript{52} Fenno, p 1123.
A similar provision is to be found in the Delaware General Corporation Law (DGCL) at §141 (a):

"The business and affairs of every Corporation organized under this chapter shall be managed by or under the direction of a board of directors, except as may be otherwise provided in this chapter or in its certificate of incorporation. If any such provision is made in the certificate of incorporation, the powers and duties conferred or imposed upon the board of directors by this chapter shall be exercised or performed to such extent and by such person or persons as shall be provided in the certificate of incorporation."

The board of directors do not make the day-to-day decisions; it is instead the elected officers (such as the CEO) who make these decisions. It may be compared to a form of delegated power, or as stated in the official comment to MBCA §8.01:

“The phrase “by or under the direction, and subject to the oversight, of”, encompasses the varying functions of boards of directors of different corporations. In some closely held corporations, the board of directors may be involved in the day-to-day business and affairs and it may be reasonable to describe management as being “by” the board of directors. But in many other corporations the business and affairs are managed “under the direction, and subject to the oversight, of” the board of directors, since operational management is delegated to executive officers and other professional managers.”

It is further mentioned in the official comment, that even if the law allows for the board of directors to delegate certain powers, the responsibility to oversee the exercise of the delegated powers still remains within the board of directors.⁵³

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⁵³ MCBA §8.01 Official comment.
3.2.1 The Duty of care

One of the thresholds for related to the application the Business Judgment Rule is the duty of care. Have the directors fulfilled a sufficient amount of care when deciding in a specific business related question? An important notion is to distinguish is the difference between the duty of care and the Business Judgment Rule. The duty of care is broader than the BJR; it encompasses both the actions taken by the board but also the inactions of the board, compared to the Business Judgment Rule which only applies to the decisions actually taken by the board.\(^{54}\)

Directors will not be held liable when it comes to poor judgment, however, they may be held liable when they fail to exercise any judgment.\(^{55}\) The care of *Graham v. Allis-Chalmers Manufacturing Co.* have been the guiding principle for the standard of care, it defined the care as “gross negligence”\(^{56}\). The case raised two questions, first one being to what amount of care is the director required by law to exercise and the second one being to what degree shall the directors exercise the duty of care in the supervision and control of officer-employees.

The court answered the first question by defining that directors need to have the “amount of care which ordinarily careful and prudent men would use in similar circumstances”\(^{57}\); the directors are not demanded the same amount of care as an specialist is in his or hers field of expertise.\(^{58}\)

The court continued by answering the second question and stated that the directors shall be able to rely on the honesty and integrity of their subordinates. It is not until something brings suspicion to the director that makes it a positive duty to monitor the activities of the subordinates.\(^{59}\)

What is important to stress is the fact that the duty of care may vary depending on the situation, in the case of *Case v. New York Central Railroad Co.*, the court lowered the standard of duty of care based on the fact that a majority-minority relation had appeared.\(^{60}\) However, in

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\(^{54}\) MCBA §8.30 (b).
\(^{55}\) Walter, p. 654.
\(^{56}\) As opposed to simply negligence, gross negligence is considered a voluntary disregard of the need to use reasonable care.
\(^{57}\) *Graham v. Allis-Chalmers Manufacturing Co.* at 130.
\(^{58}\) Walter, p 654 note 31.
\(^{59}\) *Graham v. Allis-Chalmers Manufacturing Co.* at 130.
\(^{60}\) Walter p. 657.
the case of *Treadway Companies, Inc v. Care*, the majority of the court acknowledged the lack of correspondence in case law and held that directors’ proper and good faith conduct insulate them from liability.\(^6\)

### 3.2.2 The Duty of loyalty

The main underlying purpose of the duty of loyalty is to prevent the directors to act in their own interest; to prohibit self-dealing that inheres in the fiduciary relationship.\(^6\)

As briefly mentioned in the beginning of this thesis, there is always a risk for a director, especially concerning a situation involving a hostile takeover, to put the interest of the corporation aside and give priority for the directors own interest. This possibility is inherent as in the situation of a takeover involves financial concerns. However, as it is a factor immensely evident, the courts are fully aware of this risk when assessing a case including the Business Judgment Rule. Hence, there is a specific level to which the court aims at reviewing when facing the concern of the duty of loyalty.

The Delaware Supreme Court stated in the case of Cede that a careful director shall exercise his or her duty of loyalty in order to protect the interest of the corporation, as well as, refrain from causing injury to the corporation through depriving it from its profit, advantage or enable it to make reasonable and lawful exercise of its powers.\(^6\)

Important to notice when viewing the duty of loyalty from a Business Judgment Rule perspective is that, the Delaware Supreme Court further stated that a claim stating that a director is self-interested without any further evidence does not trigger the Business Judgment Rule presumption.\(^6\)

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\(^6\) *Treadway Companies Inc. v. Care Corporation* at 382.

\(^6\) *NorlinCorp. v. Rooney Pace Inc.* at 255, 264.

\(^6\) *Cede* at 361.

\(^6\) *Cede* at 634.
3.3 Liability

Thus the liability aspect of the board has been put forward in relation to the Business Judgment Rule and the Unocal test, a short conclusion of the liability aspects that the board of directors may face is beneficial.

As mentioned above, the liability for the directors falls back to the Business Judgment Rule. If the directors fail in gaining protection by the Business Judgment Rule, the entire fairness doctrine becomes applicable. By then, an evaluation of the transaction was entirely fair in regard to fair dealing and fair price. Very important to stress is that this is only applicable when there is a dispute arising from a business judgment which is not in the context of a hostile takeover. As discussed in the chapter about the Business Judgment Rule, the Unocal test becomes applicable to determine the liability of the directors in the context of a hostile takeover.

Furthermore, and significant to point out is that the board of directors are not to be held liable as whole, instead certain directors may be held liable whilst other may not
4 Swedish law

4.1 Introduction

Sweden is a civil law country. This factor implies that most of the laws are to be found in different statutes. Important to know that case law from the Swedish Supreme Court have a significant value for the legislation. Another important notion is that Swedish laws are based on “SOU:s”, which are the fundamental basis for the laws in Sweden. It is where the government evaluates the proposed law and comments on it. It is used for interpreting the laws. Another tool of interpreting the law is provided by “propositioner”, which is the initial proposal for the law from the government (Regeringen) to the parliament (Riksdagen). Moreover, a case by the Supreme Court serves as precedents to similar cases in the future. Additionally, Sweden is a part of the European Union, which implies that regulations (which becomes immediately enforceable) and directives (which needs to be implemented) must be followed by Sweden.

As will be evident, Swedish corporations are subject to different statutes as well as different regulations if they are active on a share-market.

4.2 Swedish Corporations

The corporations in Sweden provide for limited liability, which, in theory, means that the corporation is potentially more desirous to take risks since the board of directors know that they will generally not be held liable. Normally, the charter of incorporation contains a provision where the purpose of the company is stated, nevertheless, if a purpose is not stated in the charter, it is still assumed that the corporations purpose is to generate profit. \(^{65}\) When comparing the Swedish “aktiebolag”, it may be seen as a mix between the American version of the limited liability company and a corporation. However, the fundamental aspects of a Swedish “publikt aktiebolag” (or as used in this thesis: corporation), is that it entails limited liability for the

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\(^{65}\) Dotevall, Skadeståndsansvar för styrelseledamot och verkställande direktör p 375.
directors, it may be public, meaning that it is open for sale on the stock-exchange market, or private, when the shares are not for sale at the stock-exchange market.

Swedish corporations are, as will evaluated below, subject to different types of statutes, mainly Aktiebolagslagen (ABL) which provides for general rules concerning the structure of the corporation as well as duties of the actors within the corporation. Further, if the corporation trades shares on the stock-exchange market it will be subject to rules governing that specific market, in this case focus will be on Nasdaq Stockholm and its statute. Another legislation is Lag om Offentliga uppköpserbjudanden på Aktiemarknaden (LUA) which also concern corporations trading shares on the stock-exchange market.

4.3 The Annual General meeting

The rules concerning a Swedish corporations’ annual general meeting are to be found in ABL chapter 7. An annual general meeting is defined in paragraph one to be “The shareholders right to decide the corporations’ business are to be exercised at the annual general meeting”.

This implies that the shareholders at the annual general meeting have the possibility to make decisions concerning the corporations’ businesses. The annual general meeting is the highest body of the corporation and shall make decisions concerning the organization of the business and also appoint or dismiss the board of directors; it cannot delegate these powers. Also, changes in the bylaws of the corporation as well as liquidation, dissolution or fusion are questions where the shareholders on the annual general meeting makes the decision.

Furthermore, there is a notion called “unwritten competence of the annual general meeting” (oskriven bolagsstämmokompetens) which implies that there are certain decisions that are far-reaching and therefore require shareholder approval at the annual general meeting. There is not clear definition when this notion is applicable, however, as stated by the commentary to ABL the decisions which should fall under this requirement are questions where the decisions’ actual

66 Zeteo kommentar ABL chapter 7 paragraph 1; See also ABL chapter 8 paragraph 8.
67 Supra note. Zeteo
68 Supra note; Båvestam & Lindblad p 224-225.
result is similar to decisions which needs to be taken by the annual general meeting in accordance with ABL.  

Moreover, the shareholders may give instructions to the board of directors and to the CEO. The board of directors and the CEO are obliged to follow these instructions as long as they are in compliance with law, with the bylaws of the corporation and with the statement of purpose, further it is not allowed to deprive the board of directors or the CEO of its function within the corporation.

In chapter 7, paragraph 11.3 the code states that at the annual general meeting it is to be decided whether the board of directors and the CEO will receive “freedom from liability” (ansvarsfrihet). This will be relevant further into the thesis since it will be relevant when discussing the comparative liability aspects of the board etc.

### 4.4 The Board of directors

The board of directors is one of the central organs of the corporation. The highest decision-making power is however, as mentioned, the shareholder meeting. Thus, the shareholders depends on another organ, namely the board of directors to deal with the overall business of the company. The provisions in ABL has a vague formulation, but it serves the purpose of flexibility since the provision applies to all types of corporations as well as different sizes of the corporations and therefore requires different

Accordingly, the shareholders need to elect a board of directors in accordance to ABL chapter 8 paragraph 8. In a corporation, the board of directors needs to consist of at least three members. Included in the board of director is also a CEO which manages the daily administration. The CEO and the board of directors are known as the corporations’ management. Their abilities are regulated in chapter 8 of ABL. In Swedish literature it is a common reference to “förvaltningskompetens”, which implies that the CEO and the board of directors are qualified

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69 Skog, Rolf et al. Commentary Zeteo chapter 7 paragraph 1 ABL.

70 ABL chapter 8 paragraph 41; Stattin, Bolagsorgan och Bolagsstyrning p 41.

71 Also known as Annual stockholders meeting or annual general meeting.

72 Aktiebolagslagen chapter 8 paragraph 46.
to manage the company. This qualification is also of importance when looking at the liability for damages, it is also important to determine the assignments of the CEO and the board.

The “qualification of management” is to be found in chapter 8 of ABL, the most central provision in this chapter ought to be paragraph 4 where it is stated that the board is responsible for the organization of the company as well as its business including its finances. Within the qualification of management, the board is also required to supervise the CEO of the company. According to chapter 8, paragraph 13, the general rule is that a director sits at the board until after the annual meeting that arrives after the director has been chosen; this regulation may be agreed upon differently in the bylaws if the corporation wishes for a director to sit longer than in one-year periods.

Important to point out is that Swedish law recognizes the directors as “agents” of the corporation. The requirements are therefore that the directors shall have sufficient amount of knowledge concerning the financial aspects of the corporation and some knowledge about corporate governance. In other words, some general knowledge about the life as a board member looks like. The notion of being an agent for the corporation is on the basis that the board of directors shall consider the different interests arising. However, considering that the purpose of a corporation is not make engage in good business and take dare to take risky decisions, the shareholders of the corporations would most logically prefer a board of directors who are knowledgeable in an area relevant for the corporation.

4.4.1 Duties of the directors

With regard to the agency-relationship the directors are seen to have with the corporation, there are some duties that follows the relationship. One of them being the duty of loyalty toward the corporation, the other one being the duty of care. Some authors chose to divide the two duties whilst other see them as part of each other. The different duties are not explicitly stated for in ABL but it may to some extent be read into the provisions concerning a conflict of interest (Jäv),

74 Keisu, Stattin, Bolagsorgan och Bolagsstyrning p 84.
75 Stattin, Företagsstyrning, p 363; Dotevall, Bolagsledningens skadeståndsansvar, p 160; Svernlöv Ansvarsfrihet, p 308.
which is to be found in chapter 8, paragraph 23 ABL as well as in chapter 8, paragraph 41, ABL where it is stated that the director shall not make decisions that may be affected by the directors own personal interest or that will benefit a specific shareholder or disadvantage the corporation or a shareholder of the corporation. Moreover, Stattin is of the opinion that the duty of loyalty is to be seen as a guide for how the directors shall behave towards the corporation, further, the duty of care specifies how the directors shall perform the duties given by the agency relationship with the corporation. The duty of care, is furthermore, an aim at balancing the aim of the corporation: to take risks, with the directors’ duty to administer the corporation wisely.

The duty for the directors during a takeover process is set forward in the rules set out by Nasdaq Stockholm. The targeting company’s duties are to be found regulated in II.17 of the Nasdaq takeover-rules where it is stated that “The board of directors in the targeting company shall in questions relating to the offer act in the interest of the shareholders”. In the commentary to the rule, it is stated that it is the shareholders of the corporation that has to decide whether to accept or decline the offer. This, however, does not imply that the board of directors are cut out from the process, the board of directors still have a duty to act in the best interest of the shareholders.

Further, II.19 of the Nasdaq Stockholm takeover rules, it is stated that the board of directors shall proclaim their perception of the offer given and explain how the offer will affect the corporation. In the commentary it is explained that the board of directors generally have a far better insight into the offer than the shareholders have, which is the reason to the provision. Depending on the effects of the offer, some offers require less explanation than others. However, it is important for the board of directors to guide the shareholders, especially since the board of directors generally possess a better knowledge of certain business related transactions than a shareholder may have.

Another provision worth mentioning is chapter 5 paragraph 1, LUA, which states that the board of directors may not, without permission from the shareholders, institute actions that will lead to a less valuable offer. Nevertheless, it does not pose a prevention for the directors to search for better offer and discuss with other offeror, supposed that it is in line with the interest of the shareholders and the corporation. The provision set out in LUA is therefore to connected to the duty of care for the directors to give the shareholders the best offer possible.

76 Stattin, Företagsstyrning p 363.
4.5 The CEO

In the hierarchy of the corporation, the CEO ends up at the last emplacement. In Swedish private limited liability companies, there are no requirement for the corporation to have a CEO, but when dealing with public corporations there is a requirement to be found in paragraph 50 ABL.\textsuperscript{77}

The CEO’s main task is to handle the administration of the business. What this implies is hard to tell, there is no specific provision that will provide an answer. Thus, it is concluded that the administrative business the CEO is responsible for concerns what the CEO is allowed to do. And what does this entail? Neither here will the statute provide an answer – instead, what the CEO is allowed to do is dependent on what type of business the corporation is involved in and what kind of contracts are required in order to keep the business running; more or less, what should be relevant considering the ordinary course of the corporation. As mentioned above, the board of directors may however limit the CEO’s authority by giving specific instructions to the CEO\textsuperscript{78}.

Similar to the board of directors, the CEO has an “agent” relationship with the corporation. In regard to the agent relationship the CEO has with the corporation, there is also an enhance responsibility to be found relied upon the CEO.

\textsuperscript{77} Compare to paragraph 27 of ABL.

\textsuperscript{78} SOU 1995:44 p 242.
5 Liability for Swedish directors

5.1 Introduction

The Swedish corporations are subject to different legislative provisions. One is the Swedish corporate code, Aktiebolagslagen (ABL), which provides for general rules concerning the structure of the corporation ABL is built on a structure on the basis of separation of powers which provides for reliability and foreseeability.79

Moreover, when a corporation has its shares for sale on the market, the corporation will also be subject to rules concerning securities exchange. Based on this, there may be several foundations for the liability of the directors. Swedish law generally differentiate, as will be discussed below, between liability towards the company itself and towards the shareholders.

5.2 Takeovers from a Swedish perspective

Thus the actual process of a takeover does not differ tremendously between how it is done in Sweden versus how it is done in the U.S. it is still beneficial to give some foundation for how a takeover is done in Sweden.

When a takeover is launched, it becomes applicable to chapter 1 paragraph 2 subsection 1 of LUA. The provision explains that a takeover is considered to be an “official offer to a shareholder with stocks at a Swedish or foreign corporation to assign all or a part of the stocks”80. What is important to stress it that the takeover does not require the aim of controlling the corporation, the rule permits a person to acquire a part, which may imply a minor part, of the corporations’ shares.

When a takeover is launched, the Swedish takeover rules becomes applicable for both the acquiring company as well as the target company. What kind of takeover rules becomes

79 Svernlöv, Ansvarsfrihet p 106.
80 Swedish: “ett offentligt uppköpserbjudande till innehavare av aktier som getts ut av svenskt eller utländskt aktiebolag att överlåta samtliga eller en del av dess aktier”
applicable depends on what market, commonly corporations will trade their stocks on the Nasdaq Stockholm, which makes the Nasdaq Stockholm takeover rules applicable. Nasdaq Stockholm demands the acquirer to comply with the Nasdaq Stockholm’s takeover rules.81 Worth stressing is that the board of directors are obliged to follow the rules set up by Nasdaq Stockholm, however, the directors cannot be held liable for a breach of the Nasdaq Stockholm rules and can therefore not be sanctioned by Nasdaq Stockholm; as will be evaluated below, the rules that applies for when the board of directors been acting culpable is the Swedish tort law.

Most importantly to mention may also be the creation of Aktiemarknadsnämnden, AMF, which is an organization created to promote good practice by the actors at the Swedish share market.82 AMF is able to evaluate a certain transaction in accordance to LUA chapter 7 paragraph 10. Another, co-existing organization that supervised the market in order to assure good practice on the market is Näringslivets börskommitté (NBK). The corporation is not automatically bound the recommendations made by NBK, however, it is beneficial to follow the recommendations provided as they, among the other organizations, are important in order to upheld good practice on the market.

As previously put forward the purpose of a corporation is to make risky decisions. In Swedish law, there is a provision to be found in ABL chapter 3 paragraph 3 which states that the purpose of the business is to make the shareholders profitable. When discussing the directors part of the corporation it was mentioned that in case of a takeover, the board of directors must consider the decision which is in the best interest of the corporation and make a decision in the interest of the shareholders.83 Ambiguously enough, a question arises to what extent the interests shall be considered: shareholders or investors specifically? As mentioned in the introduction to this thesis, the main purpose of a limited liability corporation is to promote risk-taking, it promotes investors as well as provide more profit to the shareholders of the corporation. As put forward by Stattin, the shareholder interest shall be guiding when the corporation is creditworthy.84 But does this still apply when facing a takeover? Probably, yes. Thus, the interest of the shareholders and the investors are likely to be very similar since both actors are “in it to win it”, implying that the

81 LUA chapter 2 paragraph 1; Prop. 2005/06:140 p 41.
82 http://www.aktiemarknadsnämnden.se/om-aktiemarknadsnämnden_25_2016-10-21
83 Rule II.17 Nasdaq Stockholm
84 Stattin, Takeover p 59
more the company is worth, the more money may be made out of it. The aim is however not to let the directors fear of being dismissed being the objective for avoiding a takeover.

5.3 Directors liability

The provisions provided for concerning the directors’ liability is not to differentiate from the ones concerning tort. The general rule concerning torts are provided for in chapter 1 paragraph 1 SkL, which serves as the default rule for when nothing else is specifically stated. Thus, in ABL there is a provision provided for concerning torts with regard to corporate law. Hence, the default rule does not become applicable, but what needs to be accented, is the fact that there is still a close connection between the rules applicable when the default rule becomes applicable and when the corporate-tort provisions become applicable.

When looking at the liability aspect for the board of directors, it is chapter 29 ABL that provides the first steps. In paragraph 1 you can find that a director who, in the line of work, intentionally or by carelessness, injured the company shall compensate the company. The provision also mentions if a CEO or a shareholder injured the company, but with regard to the focus of this thesis, this author will in the following only focus on the board of directors.

In ABL, the chapter concerned is, as stated above, chapter 29. The chapter provides for the liability for damages by the board of directors. The shareholders may through these provisions get remedies for both direct and indirect damages.

The Swedish tort system is built with the purpose of being reparative and not punitive. The liable party needs to repair the damage caused to the opposite party. In terms of corporate law, the provision set forth in 29:1 ABL holds the liable director responsible to repair the damage cause to the corporation. Moreover, Swedish tort law is, according to the eminent professor Ekelöf, supposed to act as a preventive measure, to adapt peoples’ behavior. Even thus the provisions in ABL concerning the liability of directors are distinguished from common tort law, the influence is still evident especially since the provision in chapter 21, paragraph 1 ABL states a reparative purpose when “the liable director shall compensate the company”.

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85 Eklöf, Rättegång I p 18.
86 Supra note.
The preventive aspects of tort law are generally included in between the lines, meaning that a natural cause of a sanction by being hold liable for a damage is considered to be preventative since the requirement to compensate the company will act as a preventive measure.\textsuperscript{87}

\textbf{5.3.1 Different types of liability}

Swedish law differentiates between internal and external liability. The internal liability concerns the corporation's right to damages whilst the external liability concerns the shareholders right to damages. The internal liability is to be found in the first sentence of chapter 29 paragraph 1 of ABL. According to the preparatory work to, the internal liability concerns both active and inactive negligence; meaning that the directors may be held liable towards the company for doing something as well as not doing something.\textsuperscript{88}

Essential for the liability is that the damaged must have been done when the director was acting as a director in the company. This implies that breach of the duty of loyalty and the duty of care are also a part which must be considered.\textsuperscript{89} Other things that may hold the director liable is the refusal to follow orders given by the annual meeting, breaching other laws etc.\textsuperscript{90} In theory it has the same result as with the Business Judgment Rule – a board may be held liable for certain decisions taken. Fundamental to stress is that the liability is divided to the different members of the board of directors; the board as whole may not be held liable.\textsuperscript{91}

Concerning the external liability, found in the second sentence of chapter 29 paragraph 1 ABL, aim at situation where the directors action injures the shareholders. Criterions for being held liable is that it was an injury caused by neglecting the company code, the annual financial statement code or the charter of incorporation.\textsuperscript{92}

\textsuperscript{87} Ekelöf, Rättegång I p 14.
\textsuperscript{88} SOU 1995:44 p 241.
\textsuperscript{89} SOU 1995:44 p 242.
\textsuperscript{90} Supra note.
\textsuperscript{91} Dotevall, Bolagsledningens skadeståndsansvar, p 81.
\textsuperscript{92} SOU 1995:44 p 242
The reason behind differentiating between internal and external is likely to be because of the fact that shareholders need to be able to trust their board of directors, after all the directors are chosen to take care of the company for the shareholders.

5.3.2 How liability is evaluated

The first requisite to be discussed is the requirement of an injury (skaderekvisit). May certainly come across a very basic requirement, but what needs to be accented is that the damages have to be fulfilled. Implying that the bad decision the directors voted for actually happened, or the takeover defenses the board of directors voted for was set into motion.

Worth mentioning is the existence of several different types of injuries that may, specifically, applicable when determining the remedy for a tort action. However, when dealing with tort in a corporate situation, the most common type of injury is an economic injury. Swedish law differs between economic injury that appears from another injury, such as bills after a bodily injury (allmän förmögenhetsskada), and other economic injuries that are not the result from another injury (ren förmögenhetsskada).93 For this thesis, the economic injuries which are not a result from another injury will be further evaluated, hence most of the cases concerning directors liability are subject to economic injuries not deriving from another injury.94 From the provision set out in chapter 29 paragraph 1 ABL, it applies for both damage caused by both action as well as inaction.95

The second requisite to be discussed is the one known as the requisite of duty (uppdragsrekvisit). As mentioned earlier, the board of directors are hired by the shareholders to fulfill the purpose of the corporation. In order to be held liable as a director of the board, the damage must have been caused when the director was doing his or her task, such as making a decision or taking measures in order to accomplish the task.

In order to be held liable, one must determine whether the specific task was part in the ordinary course of the directors’ duties or another duties that may be stated by ABL or by the

94 Svernlöv, Styrelse- och VD ansvar i aktiebolaget p 68.
bylaws of the corporation.\textsuperscript{96} With regard to the directors duties, the duties discussed in this aspect are not the duty of care and loyalty as previously discussed. In this case the actual duties that follow the job as a director of a board is the purpose such as the ones mentioned when discussing the boards “förvaltningskompetens”, as stated in chapter 8 paragraph 4 ABL. Thus, Svernlöv argues that the duties of the directors is beyond what is specifically stated in ABL, instead some flexibility is required and shall therefore be adapted to fit the nature of the task.\textsuperscript{97}

5.3.3 Culpa evaluation

In Swedish law, it is through tort law a director may be held liable for breach of any fiduciary duty and is limited to the courts’ culpa evaluation.

How a court defines culpa will depend on the situation and on the company, however, the requirements are that the damaged been caused by an intentional act or by an inattentive act.\textsuperscript{98}

To determine whether culpa exist, the question whether the directors could have acted in a different way must be answered.

Swedish law divides between an objective and a subjective side when looking at the culpa evaluation. The objective side entails a) that an injury has occurred, b) that there is a causality between the intentional or inattentive act, c) the damage, that the causality is adequate and d) that the action or inaction objectively caused the damage.\textsuperscript{99} A starting point for when determining culpa should be considered from a perspective of the duties which the directors owe the company. Moreover, certain duties stated in ABL and other statutes should also be deemed to be included in the culpa evaluation. However, if statutes or case law does not provide sufficient guidance, the Court shall evaluate whether there was an eminent risk for an injury to occur, the size of the injury, the possibilities of avoiding the injury and the possibility for the directors to foresee the injury.\textsuperscript{100} This is known as the “liberate culpa-evaluation” (fri culpabedömning).

\textsuperscript{96} Dotevall, Skadeståndsansvar för styrelseledamot och verkställande direktör p 83.
\textsuperscript{97} Svernlöv, Styrelse- och VD-ansvar i aktiebolaget p 55.
\textsuperscript{98} Svernlöv, Styrelse- och VD-ansvar i aktiebolaget p 57.
\textsuperscript{99} Dotevall, Bolagsledningens skadeståndsansvar p 60.
\textsuperscript{100} Hellner, Radetzki, p 127, 128.
The subjective side of the culpa evaluation is based on, exactly what it sounds like, the subjective side of the directors. What knowledge do they possess? Have they been in a similar situation? If the directors have certain knowledge, the risk for being held liable becomes greater. There is an assumption that the director with knowledge could have foreseen and prevented the damage. This relate to some extent to the duty of loyalty, assuming a director is aware of the effect a certain decision may have, presumed that making the decision is intentional, since the purpose of the decision may then have been the benefit the director.

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101 Svernlöv, Styrelse och VD-ansvar i aktiebolaget p 68.
6 Discussion and further analysis

6.1 The need for a heightened standard

The Business Judgment Rule is highly discussed around the world as is evident by this master’s thesis. The rule is the starting-point for when evaluating the liability of directors and it is in most situations concerning a business decision a presumption that the directors has done everything in their power in order to fulfill their fiduciary duties and therefore decided on an informed basis. When looking at the case of a hostile takeover, there is no more any presumption. Instead, the directors have to earn the protection provided by the Business Judgment Rule by showing the court that they in good faith did reasonable investigation, the response taken was reasonable and that it was non-preclusive. In short, they need to fulfill the Unocal-test as set out in chapter 2.4.

But why is that? Why do hostile takeovers demand the burden of proof to lie at the directors?

The court in Unocal stated that:

“We must bear in mind the inherent danger in the purchase of shares with corporate funds to remove a threat to corporate policy when a threat to control is involved. The directors are of necessity confronted with a conflict of interest, and an objective decision is difficult.” 102

The Court feared that the directors will always prevent the takeover since they, in most cases, will have a personal interest in avoiding the takeover. Interestingly, this sounds very similar to the duty of loyalty – something which is rarely looked at when applying the Business Judgment Rule.

A theory is therefore that the Courts wanted to expand the protection by upholding the duty of loyalty in a situation concerning a business decision made by the board of directors; to strike down on directors who made very bad decisions for the corporation in order to protect the directors’ self-interest.

102 Unocal at 955.
Another aspect is simply the proportionality. If a decision made by the board is questionable, the board of directors, if they made a decision in the best interest of the company will have no problem explaining this to the Court.

6.2 The role of the Special committees: Do they change the playing field?

During the last thirty years, there has been a new way of dealing with conflict of interests and director’s satisfaction of their fiduciary duties when dealing with both mergers and acquisitions. Delaware courts have addressed the corporate conflicts through special committees of independent and disinterested directors.\(^{103}\)

Since corporate transactions generally entail conflicts of interest that require management by corporate counsel as well as legal advisors, the creation of special committees serves a purpose of avoid potential litigation, personal liability and the inability to successfully complete the transactions by evaluating and negotiation transactions involving a change of control.\(^{104}\)

As mentioned under the section discussing the Business Judgment Rule, the initial burden of proof lies in the party challenging the decision made by the board of directors. However, when a special committee is established and where the court examined the effectiveness of the committee, the burden will shift back to the plaintiff. To put it more simple, when the Business Judgment Rule, where the burden of proof lies on the plaintiff, is defeated and the entire fairness doctrine becomes applicable, which puts the burden of proof on the directors, there is an exception if a special committee exist and functions effectively which makes the burden of proof switch, once again, back to the plaintiff.

The special committees create an exception, which in the end leads back to the same result as it would have been if the entire fairness doctrine did not become applicable: the plaintiff has the burden of proof. Thus, it may certainly be true that when a special committee is involved, it becomes harder to prove that the board shall be held liable for their breach of fiduciary duties since the burden of proof is on the plaintiff. However, when dealing with hostile takeover and

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\(^{103}\) Simpson and Brody, p 1117, 1118.

\(^{104}\) Supra note.
when the *Unocal test* becomes applicable, it does not become apparent how the special committees will change the playing field. Simpson and Brody implies that the special committees will have an effect when the entire fairness doctrine is applicable. In the case of a hostile takeover, the entire fairness doctrine does not become applicable since the board of directors initially have the burden of proof due to the Unocal test.

### 6.3 Liability and hostile takeovers: Does a Swedish Business Judgment Rule exist?

An important starting point is to acknowledge the lack of a Business Judgment Rule in Swedish law. However, it does not preclude that Swedish courts will still read in the purpose of the Business Judgment Rule in cases concerning directors’ liability. What needs to be assessed when analyzing whether a Business Judgment Rule exist in Sweden is the underlying principles that exist in Swedish and American law.

In American law, it is the board of directors who makes the business decisions and may therefore take necessary steps in order to prevent a hostile takeover.

In Swedish law, when a decision concerning how to act in case of a takeover and the question of whether or not initialize defense mechanisms are not in the hands of the board of directors. The board of directors shall be passive and wait for instructions by the shareholders on how to proceed.

However, when trying to assess whether a similarity to the Business Judgment Rule exist in Swedish law, the situation that needs to be assessed from a Swedish perspective is when directors have acted in good faith, with the sufficient care and with the belief that the act was in the best interest of a company but the outcome of the decision was still unfavorable. In the U.S. the business decision would still be protected in accordance to the Business Judgment Rule, but would that also be the case in Sweden? Bear in mind that the Business Judgment Rule does not provide for any protection if the plaintiff shareholder can show that the directors breached their fiduciary duties when making the decision.
When evaluating the possible existence of a Business Judgment Rule in Sweden, a comparison between the fiduciary duties in Sweden versus fiduciary duties in the United States must be made. Much of this have already been discussed throughout this thesis, but it is important to try to put the different notions side by side.

The American duty of care sets out that the directors must have applied sufficient amount of care when deciding in a specific business related question? The threshold stated is gross negligence and the court has stated that the amount of care necessary is the same which a careful and prudent person would use. However, in different situations the court has evaluated the duty of care by applying a lower standard, implying that there is no evident line to follow when evaluating the duty of care for directors of an American corporation. The duty of care for Swedish directors seem to be a duty to administer the corporation wisely and in the interest of the shareholders.

The duty of loyalty on the other hand appears to be the provision in order to avoid self-interest according to American standards. Sweden follows on that line, implying that the decisions shall not be made with the own personal interest in mind.

In order to be held liable for a breach of a fiduciary duty in Sweden, a culpa evaluation is made. The objective side stated that an injury must have occurred for the shareholders. The second requirement focus on the subjective side since it demands informed directors. Where the directors sufficiently informed but still made the decision which lead to an injury for the shareholders and the requirements of intentional or inattentive is fulfilled, the directors are held liable.

In the U.S., if the directors can show that the decision was made in good faith and after reasonable investigation, and the decision was reasonable and did not lead to shareholder preclusion, they will be protected by the Business Judgment Rule. This implies that in Sweden, it is not sufficient that the good faith of the directors is not sufficient if it nevertheless caused injury to the shareholders. Whilst in the U.S., if the directors can fulfill the Unocal test, their bad decision is not considered a basis for liability.

Concluding that it is difficult to see whether a Swedish version of the Business Judgment Rule exist. It may, nevertheless, be a tendency of the Swedish court to not interfere to a large extent in the decisions made by the directors of a company. However, if Sweden will have a full-fledged version of the Business Judgment Rule is something left for the Courts to decide.
6.4 Advantages and disadvantages of the American liability aspects

As became evident from the previous section, the Business Judgment Rule and the Unocal test seem to be a pure American way of dealing with liability aspects concerning the board of directors. However, is this something that Sweden should aim at creating?

Surely, the Business Judgment Rule provides a presumption that directors have acted in good faith, with sufficient information and with the belief that they made the right decision. If this is met, nevertheless if it is initially or after the having fulfilled the Unocal test, the Business Judgment Rule provides for protection from liability.

This naturally puts a heavy burden on the shareholders when deciding directors to sit at the corporations’ board. It further gives the board of directors much wiggle-room when making business decisions.

When looking at it from a different perspective, it would be less likely that directors would want to sit at a board of the corporation if they were not potentially rewarded the protection from the BJR. The directors are generally hired by the shareholders because of their expertise and experience, if shareholders then had the right to question every decision made by the board would lead to distrust of all directors.\(^\text{105}\)

Further, if courts were to intervene in how a business at a corporation should be done, it would probably lead to stacking of the entire world of corporations since judges are normally not business-experts.

The Business Judgment Rule opens up for a more flexible way for corporations to do business. However, this does not imply that Swedish courts are intervening in the corporations’ business. The Swedish way of dealing with director liability demands for an injury to have happened, only then may the directors’ actions and knowledge be questioned. This implies that the fact that proof of the existence of an injury will require the court to evaluate the business decision.

The Swedish way is not a business judgment evaluation, but it still protects directors and corporations from unnecessary court interference.

\(^{105}\) According to Johnson, this is known as the "Director rationale", see Johnson, Unsettledness in Delaware Corporate Law p 412.
Another question that arises is whether the same protection as the Business Judgment Rule provides offers the same protection? One of the first things that comes to mind is the protection from an insurance. What many fail to remember is that the insurance does not protect from liability. It simply compensates the corporation for damages. The damage, however, is still done and the liability is still on the directors.

An additional question is the notion of freedom from liability which in Swedish corporations may be granted the board of directors in accordance to chapter 7, paragraph 11 of ABL. The U.S. has a similar notion, namely the exculpation provision set out in DGCL §102 (b) (7) which limits the liability for the directors. Also in this case is the freedom from liability only for a limited amount of time, if a damage occurs there is no prevention from the shareholders to initiate legal proceedings. The freedom from liability’s provision is set out in order to avoid retroactive liability charges.

The provision to be found in DGCL differs a bit from the Swedish freedom of liability; it limits the liability to only include breach of the duty of care, acts in bad faith, misconduct or personal benefit. This is neither a notion comparable to the one provided by the Business Judgment Rule since it only limits the liability.

Concluding, the Business Judgment Rule provides for flexibility to the corporations and for not being interfered by the courts; it is and should be supreme. It stands as a lone survivor since it is the only notion to assume that there is no liability for the board of directors.
7 Conclusion

7.1 Concluding remarks

As is evident by this thesis, the Business Judgment Rule and its heightened standard set forth by the Unocal test are distinctly unique for the world of corporations in the United States of America. Sweden’s method of evaluating liability for the board of directors differs in regard to that an assumption of good faith, with sufficient information and with the belief that they made the right decision, since in Swedish corporations a damage needs to have occurred in order for the court do consider reviewing the directors aim and purpose. It has further been made clear that there is no notion similar to the one provided by the Business Judgment Rule in Sweden.

The Business Judgment Rule provides for a safety-net for the directors which enhances the willingness of the directors to fulfill their purpose – to take risks in the pursuit of making profit. Which in turn is beneficial for the market since it is dependent on corporations taking risks.

Moreover, the Business Judgment Rule centralizes the knowledge about business decisions to be created at the corporations and not in the court where rarely any judges are experts in how to run a corporation.

Concluding, the Business Judgment Rule something that promotes the welfare of the corporation, however, it also makes the process of electing directors to sit at the board more vital since the corporations’ decisions lies in their hands.
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