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Reliance on Experts vs. Reliance on AI

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Initial trigger (I)

- “Can machines think?” (*Alan Turing, 1950*)
 - Evolution of AI: *generative AI, machine learning*
- Use of AI systems by a Board of Directors
 - Information & communication management
 - Monitoring (e.g. of profitability, risks, compliance)
 - Decision-making with respect to corporate strategy
 - Product development, pricing, sales etc
 - Investor profiling

Initial trigger (II)

- Pros

- offers a cost-effective and fast solution to the challenges of information processing and analysis
 - “AI, especially generative AI, can help overcome some of the problems affecting human decision making, such as limited working memory, short attention spans, and decision fatigue, especially when it comes to making decisions under pressure.” (*Konstantinos Mitsopoulos*)
- contributes to the avoidance of “groupthink” risks

- Cons

- Technology is still immature.
- Unintended bias. Need to train the program.
- Non-transparency
 - Commercial AI designers usually keep the training data and the learning algorithms confidential
- Regulatory concerns. Legal risks for boards.

Topic

- From the perspective of Corporate Law
 - Duty of Informed Decision-Making & Use of AI
 - Parallel to Reliance on Experts. Is the “Reliance Defense” comparable to relying on AI?

Reliance on Experts (I)

- Role of Experts (accounting firms, attorneys, consultants, rating agencies, investment banks etc)
- Four main approaches to the Reliance Defense
 - i) Good faith
 - Section 141(e) of the Delaware General Corporation Law: directors are entitled to rely on the advice of experts as long as they believe that the advice was within the expert's professional competence, the expert was selected with reasonable care, and reliance is *in good faith*
 - Narrow interpretation of good faith; e.g. a director adopts only favorable advice and rejects other experts' opinions
 - Directors not required to independently assess the substance of the advice

Reliance on Experts (II)

- ii) Reasonable reliance
 - California (*“so long as, in any such case, the director acts in good faith, after reasonable inquiry when the need therefor is indicated by the circumstances and without knowledge that would cause such reliance to be unwarranted”*)
 - New York
 - Model Business Corporation Act
 - New Zealand (similar to California provision)
- iii) Independent assessment
 - Australia

Reliance on Experts (III)

- iv) No special provision
 - UK
 - Germany
 - *Ision* BGH decision (2011); *Ision II*, (2015)
 - „Plausibilitätsprüfung“; no need for independent assessment.
 - „inhaltlich eingeschränkte Verständlichkeitsprüfung aus Laiensicht“ (Spindler)
 - Proportionality (duty of care intensifies where issues of particular importance are discussed)
 - *Ision* related to compliance with a legal duty; the trust principle applies also (and even more) in business decisions
 - Greece
 - No case law. Reasonableness assessment required, according to prevailing view

Reliance on Experts (IV)

- Conclusion: reliance is a fact-sensitive doctrine; a court should weigh all relevant factors
 - the magnitude and nature of the misbehavior
 - the issue the opinion was related to
 - (general course of management? In the preparation of financial statements or other public disclosures?)
 - the expert selection process
 - the efforts to understand the expert's opinion
 - the expertise of the director
- ... and then choose a suitable penalty from the ones available in the relevant jurisdiction
 - declaration of contravention, disqualification, monetary liability, etc.

Reliance on AI (I)

- AI is not an “expert”/ a 141(e) subject -> no direct application of reliance provisions
 - Still, in some cases AI serves not just as a technical support tool, but as a tool assisting decision-making (“*decision-shaping*”)
 - AI systems provide crucial capacity to manage ‘data overload’ and might provide sophisticated predictive models
- AI’s limits
 - Corporate goals are complex; difficult to measure variables often play a crucial role (external effects of corporate policies, reputational consequences, ethical policies, long-term risks etc) (*Armour/Eidenmüller*)
 - Therefore, the issue is how to incorporate AI-generated inputs into the board’s own decision-making process
 - Core functions cannot be delegated

Reliance on AI (II)

- Is the „*Plausibilitätsprüfung*“ an appropriate test?
 - Due to their „*black-box*“ nature, algorithmic decisions are not amenable to conventional explanation
 - This is a „*known unknown*“ a board can handle, just like many BJR scenarios (*Langenbucher*)
 - Cost-benefit analysis
 - Conservative approach with regard to compliance issues
 - Reliance has to be reasonable. Factors to be taken into account:
 - importance of the issue that the BoD is called upon to decide. Need to exercise meaningful oversight over operations that are central to the business (e.g. significant strategic decisions, financial statements, M&As)
 - type of AI tool (e.g. certain models are explainable- XAI)
 - steps to mitigate AI's risks

Reliance on AI (III)

- Duty of Care
- Mitigating AI's risks
 - Boards must supervise all AI-facilitated processes, ensure adequate data security controls and conduct at least annual reviews of AI vulnerabilities (*Sarkar*)
 - Gradually, board members (including independent directors) should have the requisite skills and knowledge to assess risks and understand how technologies are being used in their business. Seek advice from AI experts, if needed
 - Train employees
 - If needed, appoint an ethics officer/committee
 - Measures to identify/mitigate biases in AI systems
 - Conduct an Algorithmic Impact Assessment (AIA)

Reliance on AI (IV)


- Comply with AI Act
 - AI Act is aimed primarily at providers and not operators of AI systems
 - Increased requirements arise particularly for high-risk AI systems (Art. 26)
 - e.g. applications for hiring or evaluating employees
 - these requirements do not apply, where the AI system does not materially influence the outcome of decision making (e.g. in case it is intended to perform a narrow procedural task) (Art. 6 (3))

Conclusion (I)

- AI: a quandary for organizations
 - Pressure to move quickly to remain competitive
 - Risks to operation and reputation
- Risks for directors are not the same in various jurisdictions.
- The common denominator is that reliance has to be reasonable, taking into account all relevant factors

Conclusion (II)

- *"Directors are not specialists, like lawyers or doctors. They must have good sense, perhaps they must have acquaintance with affairs; but they need not--indeed, perhaps they should not--have any technical talent. They are the general advisers of the business, and if they faithfully give such ability as they have to their charge, it would not be lawful to hold them liable."*
(Learned Hand, Barnes v. Andrews, District Court, S.D. New York, 1924)



Thank you for your attention!

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