THE ALLOCATION OF POWER BETWEEN THE MANAGEMENT AND THE GENERAL MEETING OF SHAREHOLDERS

BY

SVANTE JOHANSSON

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INTRODUCTION

The legal structure of a limited-liability share company generally consists of at least two organs: the general meeting of shareholders and the board of directors. In many countries, e.g. Germany and Sweden, the power that is not reserved for the general meeting can or must be divided between two or more company organs.[1] In German limited-liability share companies[2] there must be an *Aufsichtsrat,* the supervising organ that also appoints the members of the *Vorstand*, the executive organ. Large Swedish companies must have both a board of directors and a managing director. There are, of course, problems connected with the distribution of power between the board of directors and company organs other than the general meeting. This article, however, is limited to the relations between the general meeting and the other company organ or organs. Consequently, the use here of the term "board of directors" does not exclude the possibility that company organs or representatives other than the board may be affected by the rules being discussed.

Before dealing with the legal regulations governing the distribution of power within companies, it must be noted that the way power is exercised in companies is under constant development, which of course affects the interpretation of the rules. As early as 1941 J.Burnham noted that the board of directors of a modern company tended to deal only with more important decisions, leaving day-to-day decisions and almost all implementation to other employees, e.g. the officers of the company, and reducing the tasks of the general meeting mainly to the election of directors.[3] This trend can still be observed in many countries.[4]

[1] See concerning this e.g. G. Lindencrona, *Arbetstagare och aktieägare i aktiebolagsstyrelser*, Stockholm 1978, pp. 45 ff., with critical aspects on the Swedish system, and K. Schmidt, *Gesellschaftsrecht*, 2nd ed., Köln, Berlin, Bonn and München 1991, pp. 331 ff. and 675 ff.

[2] German: *Aktiengesellschaften.*

[3] See J. Burnham, *The Managerial Revolution. What is happening in the world?*, New York 1941.

[4] See e.g. J. H. Farrar, *Company Law*, 2nd ed. London 1988, pp. 275 ff.; S. Johansson, *Bolagsstämma*, diss. Stockholm 1990, pp. 150 f.; H. Nial, *Svensk associationsrätt*, 5th ed. in co-operation with S. Johansson, Stockholm 1991, pp. 111 f.; K. Rodhe, *Aktiebolagsrätt*, 16th ed. Stockholm 1993, pp. 169 ff.; J. Thorbek, *Aktieselskabsorganernes kompetence i EF*, København 1973) p. 438 and L. E. Taxell, *Aktiebolagets organisation*, Åbo 1983, pp. 99 and 103 f.

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This article compares the legal status of the general meeting in Great Britain, the United States of America, the Federal Republic of Germany, Denmark, Norway and Sweden. The law in Finland is also considered.[5] The study of company law—corporation law—in the United States of America raises particular problems. Under the Securities Act (1933) and the Securities Exchange Act (1934) the federal authorities have passed some legislation in the area of company law, but the main items of company legislation are found in enactions of the separate states. It is necessary, therefore, to choose some states to study. Following the principle of many American universities, this article mainly considers the acts of California, Delaware, Illinois and New York. These four states represent somewhat differing views of the problems connected with legislation in the field of company law.

A possible way to find more multi-national answers to the questions of distributing power within companies could be to study the directives enacted by the EEC. However, no EEC directive in force deals with the internal legal structure of companies. Structural questions are treated in the proposal for a fifth directive on company law,[6] but the proposal can be interpreted in different ways and therefore gives no help with present problems.

In all the countries investigated, the primary task of the general meeting is to elect directors to the board, while the business and the affairs of the company shall be managed by, or under the direction of, the board of directors.[7] In addition to electing directors, the general meeting is normally the only organ that can pass resolutions on matters of great importance to the shareholders. Such resolutions can be, for example, a decision to liquidate the company[8] or to increase or decrease the share capital,[9] or the appointment of accountants.[10]

Two main two issues will be dealt with. The first is whether the general meeting of shareholders is competent to give binding instructions to the board of directors and, if so, how far such instructions may be given. However, there will be no consideration of how the borderlines for the obvious limitation on the general meeting's power that follows from im-

[5] Sources available only in Finnish have not been considered at all.

[6] [1992] O.J.C 131/49. Latest official amendment in [1991] O.J.C 321/9.

[7] See e.g. sec. 300 (a) California General Corporation Law.

[8] See e.g. chapter 13 sec. 1 para. 1 of the Norwegian Companies Act. (Norwegian: *Aksjeloven*. Abbreviated: AL.)

[9] See e.g. sec. 29 para. 1 and sec. 44 para. 1 of the Danish Companies Act. (Danish: *Aktieselskabsloven*. Abbreviated: ASL.)

[10] See e.g. chapter 10 sec. 1 para. 1 of the Swedish Companies Act. (Swedish: *Aktiebolagslagen*. Abbreviated: ABL.)

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perative law are drawn. The second issue is whether the resolutions to be passed at a general meeting, if at all, are confined to what has been conferred on it by legislation or by the articles of association, or whether there is any kind of resolution that *must* be passed at a general meeting, even though no such requirement is explicitly stated in legislation or the company's articles.

INSTRUCTIONS FROM THE GENERAL MEETING OF SHAREHOLDERS

There seem to be two different ways of approaching the question of shareholders' power. In some countries, the main rule is that the general meeting cannot instruct the board of directors in matters that are within the board's authority. This standpoint is taken in Great Britain, where in e.g. *John Shaw & Sons (Salford) Ltd. v. Shaw*[11] a general meeting was found to lack the power to order the board to withdraw a suit claimed on behalf of the company.[12]

In Britain, there are some peculiar rules that imply not formal, but actual, limitations on the power of the general meeting, even in matters that refer to the meeting's exclusive power. Under sec. 303, para. 1 of the Companies Act, the general meeting can always, with or without cause, by a resolution passed with an absolute majority, remove a director from his position. However, in what is now sec. 122, para. 1 (g) of the Insolvency Act 1986[13] it is stated that a company may be wound up by a court, if the court considers that such winding up is just and equitable. In *Ebrahimi v. Westbourne Galleries Ltd.*[14] the House of Lords found it just and equitable that a company was wound up on account of the removal of one of its directors. The fact that the director had been removed by a resolution passed in accordance with sec. 184 of the Companies Act 1948[15] was no obstacle to the judgment. The possibility, following sec. 122 of the Insolvency Act, of forcing a company to wind up because of the removal of a director, only exists under certain circumstances.[16] It must be noted in passing that the importance of sec. 122, para. 1 (g) of the 1986 Insolvency Act has dimin-

[11] [1935] 2 K.B. 113, [1935] All E.R. Rep. 456.

[12] See further J. H. Farrar, *op.cit.* (in footnote 4), pp. 311 ff.; L. C. B. Gower, *Principles of Modern Company Law*, 5th ed. London 1992, p. 149 ff. and R. R. Pennington, *Company Law*, 6th ed. London 1990, pp. 572 ff.

[13] Earlier sec. 517 para. 1 (g) Companies Act.

[14] [1973] A.C. 360, [1972] 2 All E.R. 492.

[15] Sec. 184 Companies Act 1948 corresponds with sec. 303 Companies Act 1985.

[16] See e.g. J. H. Farrar, *op.cit.* (in footnote 4), pp. 395 ff. and L. C. B. Gower, *op.cit.* (in footnote 12), pp. 154, 662 ff. and 668.

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ished with the emergence of sec. 459 of the Companies Act as a remedy available for oppressed minority shareholders.[17]

In the United States, too, shareholders are prevented from giving binding instructions to the board of directors on matters within the board's power.[18] In some states though, a private company[19] may be organized without a board of directors,[20] in which case company business is managed directly by the shareholders.

The most pronounced limitation on the power of the general meeting is found in German *Aktiengesellschaften*. The German legislation on co-determination at work[21] empowers the employees of a company to appoint a significant number of the directors. If the general meeting in a German company could give binding instructions to the board of directors, employees' rights would of course be of minor importance. Therefore, the general meeting of an *Aktiengesellshaft* can pass resolutions in the area of the board's authority only when the board so demands, sec. 119, par. 2 of the German Companies Act.[22] On the other hand, with respect to private companies,[23] the system is very similar to what is presented below for Denmark, Norway and Sweden.[24]

In Finland, also, it has been stated that the power of the general meeting of shareholders is restricted to matters conferred on it by law or articles of association.[25]

The most interesting point in connection with the power of the general meeting in Germany, Great Britain and the USA is of course what kind of matters are referred to it. This is dealt with in the next section.

The second way of approaching the problem of distributing power

[17] See concerning this J. H. Farrar, *op.cit.* (in footnote 4), pp. 398 ff.

[18] See e.g. *Stokes v. Continental Trust Co.*, 186 N.Y. 285, 78 N.E. 1090.

See further e.g. W. L. Cary & M. A. Eisenberg, *Cases and Materials on Corporations*, 6th ed. New York 1988, p. 207 and D. E. Pease in R. F. Balotti & J. A. Finkelstein, *The Delaware Law of Corporations and Business Organisations* Vol. 1, New York and Washington 1986, p. 410 (§ 7.58).

[19] Private companies are in the USA called close corporations.

[20] See e.g. sec. 351 Delaware General Corporation Law and sec. 1212 (a) Illinois Close Corporation Act.

[21] *Gesetz über die Mitbestimmung der Arbeitnehmer in den Aufsichtsräten und Vorständen der Unternehmen des Bergbaus und der Eisen und Stahl erzeugenden Industrie* (abbreviated: Montan-MitbestG), *Gesetz zur Ergänzung des Gesetzes Über die Mitbestimmung der Arbeitnehmer in den Aufsichtsräten und Vorständen der Unternehmen des Bergbaus und der Eisen und Stahl erzeugenden Industrie* (abbreviated: MitbestErgG) and *Gesetz über die Mitbestimmung der Arbeitnehmer* (abbreviated: MitbestG).

[22] German: *Aktiengesetz*. Abbreviated: AktG.

[23] German: *Gesellschaften mit beschränkter Haftung*. Abbreviated: GmbH.

[24] See sec. 37 para. 1 in the German Act on Private Companies. (German: *Gesetz betreffend die Gesellschaften mit beschränkter Haftung.*) See further e.g. M. Lutter & P. Hommelhoff, *GmbH-Gesetz*, 13th ed. Köln 1991, pp. 368 (§ 37, Rn. 1) and 373 ff. (§ 37, Rn. 17 ff.).

[25] See L. E. Taxell, *op.cit.* (in footnote 4), pp. 48 and 99.

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within companies is found in Denmark, Norway and Sweden, where the general meeting of shareholders is regarded as the supreme authority of the company. Consequently it can, with the few exceptions dealt with below, pass resolutions and give binding directions in all matters concerning the company.[26]

One example of the general meeting's power is found in a case decided by the Swedish Supreme Court in 1960.[27] The general meeting of shareholders in a Swedish company lacks the power to appoint a managing director. In the 1960 case the general meeting nevertheless dealt with the terms of employment for the managing director of the company.[28] The Court of Appeal and the Supreme Court found that the fact that the general meeting lacked the power to appoint a managing director was no obstacle to its dealing with the director's terms of employment.

As appears from the foregoing, the power of the general meeting of shareholders in Danish, Norwegian and Swedish companies is not completely unlimited. The general meeting lacks the power to bind the company in relation to a third party.[29] The possibility of letting the shareholders—*qua* shareholders—run the affairs of the company (which, as mentioned above, is possible in private companies in some states in the USA) has no statutory support in Denmark, Norway or Sweden. A resolution passed at a general meeting can only be implemented by the board of directors.[30] In its turn, the board is not allowed to implement a resolution passed at a general meeting if the resolution is invalid because contrary to the Companies Act or the company's articles of association.[31] The general meeting, therefore, has no chance of having implemented, against the board's will, a resolution that exceeds the limits set by the legislation and the articles.[32]

The fact that the general meeting in Danish, Norwegian and Swedish

[26] See e.g. the Danish case UfR 1940 p. 376; B. Gomard, *Aktieselskaber og anpartsselskaber*, 2nd ed. København 1992, p. 208; H. F. Marthinussen & M. Aarbakke, *Aksjeloven*, 3rd ed. Oslo 1991, pp. 227 f. (§ 8–7, 4) and H. Nial, *op.cit.* (in footnote 4), pp. 102.

[27] NJA 1960 p. 698.

[28] Cf. for Denmark UfR 1966 p. 739.

[29] At this point, the laws of Denmark, Norway and Sweden correspond with the main rules in other countries. See for the USA e.g. sec. 300 (a) California General Corporation Law, sec. 141 (a) Delaware General Corporation Law, sec. 8.05 (a) Illinois Business Corporation Act and sec. 701 New York Business Corporation Law.

[30] See e.g. S. Johansson, *op.cit.* (in footnote 4), pp. 98 ff.
Implementation of a resolution passed at a general meeting can of course also be entrusted by the board to the managing director or some other representative of the company. See e.g. sec. 60 ASL.

[31] See e.g. chapter 8 sec. 13 par. 2 ABL.

[32] Another matter is that the general meeting has the power to replace the directors. See e.g. chapter 8 sec. 1 par. 2 AL and below.

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companies cannot, in relation to a third party, run the business of the company, is extended to a rule that the general meeting may not act instead of the board, even in the internal relations of the company.[33] The position of the board of directors in the company is defined by law, and the directors also have a heavy responsibility in tort as company organs, as provided in sec. 140 of the ASL and chapter 15, sec. 1 of the AL and ABL. With a few exceptions, the general meeting may therefore pass resolutions on every *single* subject concerning the company, but cannot extend its power to every detail of its daily affairs. The limits of the general meeting's power here are very unclear, but the uncertainty seems to be of minor practical importance.

The power of the general meeting is also limited with respect to some specified decisions. First, and maybe most importantly, a resolution declaring shareholders' dividends must be passed at the general meeting, but the meeting has not, as a main rule, the power to declare dividends in a larger amount than proposed or accepted by the board.[34] Consequently, the board also has the power to veto a resolution on reduction of the company share capital, if the funds made available by the reduction are placed at the shareholders' disposal or to be paid to the shareholders.[35]

The board's right of veto in questions concerning the declaration of dividends has two grounds. First, the board is regarded as being best able to judge how far the company itself will need its capital in the long run, while the shareholders are assumed to desire rapid returns on their investments. The board's right of veto on a declaration of dividends can therefore be regarded as guarantee of the company's continued existence.[36] On the other hand, it has been argued that there are no objective reasons supporting the opinion that shareholders, more than board members, are inclined to approve such a high dividend as to jeopardise the company's existence.[37]

Secondly, the board's right of veto has been justified out of consideration for the employees. In Denmark and Norway as well as in Sweden, the employees of larger companies have the right to appoint some directors to the board.[38] To empower the board to set limits to resolutions declaring

[33] See S. Johansson, *op.cit.* (in footnote 4), pp. 151 f, with further references.
[34] Sec. 112 ASL, chapter 12 sec. 6 para. 1 AL and chapter 12 sec. 3 para. 2 ABL.
[35] Sec. 44 a para. 2 cf. para. 1 point 2–4 ASL, chapter 6 sec. 1 para 3 cf. para. 2 point 2–4 AL and chapter 6 sec. 2 para. 2 cf. sec. 1 para. 1 point 2 and 3 ABL.
[36] See *SOU* 1971:15 p. 315. See also J. Sandström, *Hembud och lösningsrätt vid övergång av aktie*, Stockholm 1976, p. 173.
[37] See *prop*. 1975:103 p. 237.
[38] See sec. 49 ASL, chapter 8 sec. 17 AL and the Swedish Act on Board Representation for Private Employees. (Swedish: *lagen (1987:1245) om styrelserepresentation för de privatanställda*.)

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dividends accords with the struggle to increase employee influence over company affairs.[39]

However, the importance of the board's right to limit dividends should not be exaggerated. It does not extend to a power to stop minority shareholders from using their right to demand the declaring of dividends as a protection against what is termed starvation.[40] Further, in the Nordic countries, the general meeting can always, with or without proper cause, remove those directors that have been appointed by a general meeting.[41] Consequently, as a last resource, the shareholders can remove their directors, and instead appoint persons that share the shareholders' opinion regarding suitable dividends.[42] The general meeting's power to remove directors is of course, like all other matters, limited by the framing of the

In larger Norwegian companies there must be a special organ called *bedriftsforsamling*, chapter 8 sec. 18 AL. In such companies the directors are appointed, not by the general meeting, but by the *bedriftsforsamling*. The members of the *bedriftsforsamling* are appointed partly by the general meeting and partly by the employees of the company, chapter 8 sec. 18 AL. The *bedriftsforsamling*, therefore, can easily be compared with the German *Aufsichtsrat*. See further about the *bedriftsforsamling* T. Bråthen, *Bedriftsforsamlingen i aksjeselskaper*, Oslo 1982, and *id.*, "Nye norske regler om ansattes medbestemmelsesrett", *TfR* 1988, pp. 727 ff.

[39] See *prop.* 1975:103 p. 237.

[40] See J. Skåre & G. Knudsen, *Lov om aksjeselskaper*, 3rd ed. Kolbotn 1987, Tano, p. 314 (§ 12–6, 2) and S. Johansson, *op.cit.* (in footnote 4), pp. 151 and 308.

In Denmark, there is no explicit statute that gives the minority a right to demand declaration of dividends. Instead, protection of minority shareholders is intended to follow from the general rules on minority protection, especially sec. 80 ASL. See UfR 1985 p. 183; N. Thomsen, *Aktieselskabsloven med kommentarer*, 4th ed. København 1990, p. 332 (§ 112, 2) and E. Werlauff, *Generalforsamling og beslutning*, Viborg 1983, pp. 215 ff. If dividends declared by a general meeting are so low that the resolution infringes the general clause in sec. 80 ASL, the court can declare the decision null and void, but it has been asserted that the court cannot alter a decision on dividends by raising the amount to be paid. See E. Werlauff, "Udsultning af minoritetsaktionærer", *UfR* 1985 B p. 195. The question of whether minority shareholders can overrule the board's power to limit dividends is therefore of no interest in Denmark.

[41] See for Denmark, sec. 50 para. 1 ASL and sec. 33 para. 1 in the Danish Act on Private Companies. (Danish: *Anpartselskabsloven*. Abbreviated: ApL.) See B. Gomard, *op.cit.* (in footnote 27), pp. 179 and 184 f.; N. Thomsen, *op.cit.* (in footnote 41), p. 255 (§ 50, 4) and E. Werlauff, *Generalforsamling og beslutning*, Viborg 1983, pp. 121, 122 f. and 455.

See for Finland, chapter 8 sec. 2 para. 1 in the Finnish Companies Act. See L. E. Taxell, *op.cit.* (in footnote 4), pp. 57 f.

See for Norway, chapter 8 sec. 3 para. 1 AL. See P. Augdahl, *Aksjeselskapet efter norsk rett*, 3rd ed. Oslo 1959, pp. 264 f.; H. F. Marthinussen & M. Aarbakke, *op.cit.* (in footnote 26), pp. 211 (§ 8–3, 3) and 212 f. (§ 8–3, 6) and J. Skåre & G. Knudsen, *op.cit.* (in footnote 40), p. 146 (§ 8–3, 2).

See for Sweden, chapter 8 sec. 2 para. 1 ABL. See *SOU* 1971:15 p. 205; *prop* 1975:103 p. 370; S. Johansson, *op.cit.* (in footnote 4), pp. 365 f; G. Kedner & C. M. Roos, *Aktiebolagslagen* Del I, 4th ed. Stockholm 1991, p. 197 (8:2.01); H. Nial, *op.cit.* (in footnote 4), p. 103 and K. Rodhe, *op.cit.* (in footnote 4), p. 191.

[42] See *prop.* 1975:103 p. 237. Cf. G. Kedner & C. M. Roos, *Aktiebolagslagen* Del II, 4th ed. Stockholm 1991, p. 236 (12:3.01) and K. Rodhe, *op.cit.* (in footnote 4), p. 171 f.

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agenda notified to shareholders before the meeting,[43] but the ultimate power to declare dividends rests with the shareholders.

Another example of a decision where the general meeting of shareholders has no power to pass resolutions is the appointment of the managing director.[44] The managing director is a company organ who is to run its daily affairs. He or she is supervised by the board, and is obliged to obey its directions.[45] The power to appoint the managing director therefore rests exclusively with the board.[46]

If a general meeting should pass a resolution which by its wording appoints a person managing director, that resolution is null and void, and the person does not become managing director in the meaning of the law. However, the person elected by the general meeting can of course be appointed if the board so chooses. Nor does there seem to be any reason not to regard the board's subsequent action as equal to a decision to appoint a managing director.[47] In addition, even if a person elected managing director by a general meeting is not so legally, he or she certainly ought to be viewed as some kind of an agent of the company, hence as having an agent's liability when acting on behalf of the company.

From the foregoing, it can be concluded that the general meeting cannot decide concerning matters where the board has exclusive power, but the meeting cannot on the other hand be prohibited from making resolutions recommending the board to make some decision.[48] However, such a recommendation cannot be regarded as a directive binding on the board. Were it possible for the general meeting to give binding directions to the board, concerning e.g. the appointment of a managing director, the

[43] See B. Gomard, *op.cit.* (in footnote 26), pp. 209 f. and S. Johansson, *op.cit.* (in footnote 4), pp. 299 f.

[44] Here, the managing director is treated as only one person. However, in Denmark there may be several managing directors, sec. 51 para. 1 ASL. Also with regard to Norwegian law it has been asserted that it is possible to appoint more than one managing director. See H. F. Marthinussen & M. Aarbakke, *op.cit.* (in footnote 26), p. 215 (§ 8–4, 3).

[45] Sec. 54 para. 2 and 3 ASL, chapter 8 sec. 7 para. 2 and 3 AL and chapter 8 sec. 6 ABL.

[46] Sec. 51 para. 1 ASL, chapter 8 sec. 4 para. 2 AL and chapter 8 sec. 3 para. 1 ABL. See e.g. N. Thomsen, *op.cit.* (in footnote 40), p. 228 (§ 51, 1). See for another opinion P. K. Andersen, *Aktie- og anpartsselskabsret*, 3rd ed. København 1991, p. 220.

In this respect, the Norwegian act contains one exception. In Norway the articles of association can empower the general meeting to appoint a managing director, chapter 8 sec. 4 para. 3 AL. See on this H. F. Marthinussen & M. Aarbakke, *op.cit.* (in footnote 26), p. 216 (§ 8–4, 4).

[47] As a follow up action that could have the same effect as a formal appointment of a managing director, can be mentioned the filing of a notification for registration of the person elected as managing director by the general meeting. Cf. e.g. sec. 62 ASL and chapter 8 sec. 15 para. 1 ABL.

[48] Cf. e.g. N. Thomsen, *op.cit.* (in footnote 40), p. 228 (§ 51, 1).

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board's exclusive power to appoint the managing director would be rather meaningless. Consequently, if a general meeting recommends the appointment of a certain person but the board appoints someone else, it is the board's appointee that becomes managing director in the meaning of the law. Furthermore, the directors will not be liable for any damage caused by non-compliance with the recommendation of the general meeting.

EXCLUSIVE AUTHORITY OF THE GENERAL MEETING WITHOUT STATUTORY SUPPORT

The questions discussed in this section have been raised in countries with legal systems as different as Germany's, the USA's and Sweden's. The basic problem is that most jurisdictions grant the power to pass resolutions in some specific matters exclusively to the general meeting, while—at least as a main rule—the board can decide in all matters not referred to the exclusive power of the general meeting. The question is whether the statutory statements are exhaustive, or whether there are matters, beside those mentioned in the different acts, that for some reason are equated with the subjects that *must* be dealt with by the general meeting. A practical problem of non-statute-based power for the general meeting is of course that general meetings cost money and require comprehensive preparation, whereby important decisions can be delayed.[49]

In Denmark, the matter appears not to have been put to the test. Some legal authors assert that the board is never obliged to give the general meeting the opportunity to pass resolutions in matters not legally within the meeting's competence.[50] It is recognized that such an obligation would create complications when a board, in defiance of an obligation to refer the decision to the general meeting, itself commits the company to a contract with a third party.[51] Other writers consider that general principles of law require that very important decisions be made by the general meeting of shareholders.[52]

In the Danish case UfR 1955 p. 887, the court found that the board of a

[49] Cf. e.g. K. Beusch, "Die Aktiengesellschaft—eine Kommanditgesellschaft in der Gestalt einer juristischen Person?", *Festschrift für Winfried Werner*, Berlin and New York 1984, p. 19 and B. Grunewald, "Rückverlagerung von Entscheidungskompetenzen der Hauptversammlung auf den Vorstand", *AG* 1990 p. 134.

[50] See e.g. B. Gomard, "Aktieselskabsledelsens erstatningsansvar", *UfR* 1971 B pp. 126 f. and *id.*, *Aktieselskaber og anpartsselskaber*, 2nd ed. København 1992, pp. 208 f. Cf. UfR 1970 p. 795.

[51] See e.g. J. Thorbek, *op.cit.* (in footnote 4), pp. 453 ff.

[52] See e.g. P. K. Andersen, *op.cit.* (in footnote 46), p. 221 and E. Werlauff, *op.cit.* (in footnote 41), pp. 97 and 146 f.

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company had the power to enter into a specific contract on behalf of the company. The court justified its decision by establishing that the contract did not contain such extraordinary dispositions that they should have been dealt with by the general meeting. The findings of the court may imply that the judgment would have been different had the contract been of a more exceptional nature.

Opinion in Finland and in Norway seems to be that the board *in dubio* has no obligation to submit extraordinary decisions to the general meeting.[53]

Great Britain appears to be the country where the question discussed here is most easy to answer. It is not the Companies Act that empowers a British board to manage the business and affairs of the company: this is regulated in the company's articles of association.[54] It is therefore understandable that the question of exclusive, non-statutory power for the general meeting never appears to have been discussed in Britain.

As mentioned above, sec. 119 para. 2 of the German AktG prescribes that the general meeting of shareholders can pass resolutions concerning the management of company affairs only when the *Vorstand* so requires. In the absence of such a requirement, the *Vorstand* is independent and leads the company under its own responsibility (sec. 76, para. 1, AktG). The meaning of the Act's system for allocating power has been intensively discussed in Germany. Some authors asserted that its provisions are comprehensive, and that exclusive managerial power for the general meeting would be inconceivable.[55] Other writers claimed not only that the Act is not explicit but also that it follows from general principles of law that the *Vorstand* in some situations has an obligation to let the general meeting decide in some matters.[56]

In the *Holzmüller* case,[57] the Supreme Court of Germany[58] sided with the

[53] See for Finland, L. E. Taxell, *Aktiebolagsstyrelsens kompetens att rättshandla*, Åbo 1946, p. 251 and *id.*, *Aktiebolagets organisation*, Åbo 1983, p. 102. See for Norway, H. F. Marthinussen & M. Aarbakke, *op.cit.* (in footnote 26), p. 227 (§ 8–7, 3).

[54] See R. R. Pennington, *op.cit.* (in footnote 12), p. 572.

[55] See e.g. K. Beusch, *op.cit.* (in footnote 49), pp. 1 ff.; B. Keuk-Knobbe, "Das Klagerecht des Gesellschafters einer Kapitalgesellschaft wegen gesetz- und satzungswidriger Maßnahmen der Geschäftsführung", *Festschrift für Kurt Ballerstedt*, Berlin 1975, pp. 251 f.; W.-G. Freiherr von Rechenberg, *Die Hauptversammlung als oberstes Organ der Aktiengesellschaft*, Heidelberg 1986, pp. 66 ff. and 127 ff. and K. Schmidt, *op.cit.* (in footnote 1), pp. 703 f and 730.

[56] See e.g. P. Hommelhoff, "100 Bände BGHZ: Aktienrecht", *ZHR* 151 pp. 506 f.; M. Lutter, "Zur Binnenstruktur des Konzerns", *Festschrift für Harry Westermann*, Karlsruhe 1974, pp. 347 ff.; *id.*, "Zur Wirkung von Zustimmungsvorbehalten nach § 111 Abs. 4 Satz 2 AktG auf nahestehende Gesellschaften", *Festschrift für Robert Fischer*, Berlin and New York 1979, pp. 419 ff. and E. Rehbinder, "Ausgründung und Erwerb von Tochtergesellschaften und Rechte der Aktionäre", *Festschrift für Helmut Coing* Band II, München 1982, pp. 429 ff.

[57] BGHZ 83 p. 122.

[58] German: *Bundesgerichtshof*. Abbreviated: BGH

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latter opinion.[59] In this case, a limited-liability share company was taking part in the formation of a KGaA.[60] To cover its share of the capital in the KGaA, the company transferred a great deal of its assets to the KGaA. The decision on the transfer was made by the *Vorstand*, the general meeting of shareholders being given no chance to express its opinion. One of the shareholders went to court, and demanded that the decision should be declared null and void.

Sec. 361 of the AktG contains a provision that a contract by which a company undertakes to transfer all its assets is valid only with the consent of the general meeting. Since the assets covered by the contract in question were only a part of the company's assets, the BGH found that sec. 361 AktG was not applicable in the case.

After rejecting the use of sec. 361 AktG, the Court went on to state that despite the main rule that the *Vorstand* is free to make its own decisions where nothing else is prescribed in the Act, there are some matters that affect shareholders' rights so deeply that the *Vorstand* is neglecting its duty of loyalty[61] if it does not—following sec. 119 para. 2 of the AktG—require a resolution from the general meeting. The decision to transfer the assets was of a kind that should have been submitted to the general meeting. The reason for the Court's opinion here was that when assets are transferred to a subsidiary, all power over them is really concentrated to the board of the parent company. The BGH found it especially dangerous for the shareholders that the parent company's board should have the power to issue new shares in the subsidiary, and to direct them to persons outside the company.

However, even though the Court found that the asset transfer ought to have been decided—or at least consented to—by the general meeting, the shareholders' action was dismissed in this part. The BGH found that although the *Vorstand* was at fault, the fault could not prevent the *Vorstand* from representing the company according to sec. 82 para. 1 of the AktG, and therefore implementation of the decision could not be altered.[62]

Should the decision not be declared null and void, the plaintiff had, as the second line, requested that the company be ordered to ensure that increases in the KGaA capital would be treated by the parent company's

[59] See for GmbH, AG 1988 p. 335.

[60] German: *Kommanditgesellschaft auf Aktien*. The term KGaA can not be translated directly into English. A descriptive translation would run something like "a partnership limited by shares".

[61] German: *Sorgfaltspflicht*.

[62] The *ultra vires* doctrine has no application in German company law.

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general meeting. The court considered that the circumstances in the case led to such great danger for the parent-company shareholders that this second line was upheld.

The *Holzmüller* case has been criticized,[63] but the general opinion appears to be that certain matters must be dealt with by the general meeting, even though no such power appertaining to the meeting can be derived directly from the Act.[64] The problem, of course, is to determine *what* matters. Discussion in Germany seems at present to centre on the question of how much of a company's assets can be transferred to a subsidiary by *Vorstand* decision.[65]

In Sweden, discussion of an exclusive, non-statute-based, power for the general meeting of shareholders seems to have begun with H. Nial's legal opinion in the case NJA 1968 p. 375. A managing director had contracted to let premises for a restaurant on very special terms. In his legal opinion, Nial stated that probably not even the board could have entered this particular contract without the consent of the general meeting, and consequently the managing director certainly could not. The Supreme Court judgment concurs, but the Court, naturally, did not take a stand regarding any limitations of the board's power.

In some precedents, all from before 1968, the Supreme Court has found that the selling of a company's entire assets is to be treated as a decision to liquidate the company.[66] In none of the cases have the courts had reason to take an explicit position on the possible existence of an exclusive, non-statute-based power for the general meeting. However, given the Supreme Court statement that not even the general meeting could resolve to sell all the company's assets without considering the special liquidation rules, it appears obvious that the board, which cannot decide on liquidation at all, is not competent to decide to sell all the company's assets.

[63] See e.g. F. Kübler, *Gesellschaftsrecht*, 3rd ed. Heidelberg 1990, p. 202 with footnote 37, with further references, and E. Rehbinder, "Zum konzernrechtlichen Schutz der Aktionäre einer Obergesellschaft—Besprechung der Entscheidung BGHZ 83, 122 'Holzmüller'", *ZGR* 1983 pp. 98 f. See also Beusch and von Rechenberg (in footnote 55) and Hommelhoff (in footnote 56).

[64] Examples of critical legal authors that accept the conclusions in the judgment are H. Brandes, "Die Rechtsprechung des Bundesgerichtshofs auf dem Gebiet des Aktienrechts", *WM* 1984 p. 294; P. Hommelhoff, *op.cit.* (in footnote 56), pp. 506 f.; G. Hueck, *Gesellschaftsrecht*, 18th ed. München 1983, p. 224 and K. Schmidt, *op.cit.* (in footnote 1), p. 731 f.

[65] See e.g. B. Grunewald, *op.cit.* (in footnote 49), pp. 134 ff.

[66] See NJA 1903 p. 19, 1924 p. 186 and 1967 p. 313. See also SvJT 1924 rf. p. 83, where the Court of Appeal found that a decision to sell all the assets of a company was to be treated as an alteration of the articles.

Courts in Denmark have taken the opposite standpoint. See UfR 1936 p. 35, 1937 p. 631 and 1943 p. 448. Cf. also UfR 1970 p. 795, and about this case e.g. J. Thorbek, *op.cit.* (in footnote 4), pp. 301 and 313.

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In addition, in chapter 8 sec. 6 para. 1 ABL it is provided that the managing director shall run the daily business and affairs of the company. This statute is meant to be interpreted *e contrario*. The managing director cannot, with some exceptions, decide in matters not relating to the daily business and affairs of the company.[67] In the same paragraph it is stated that the board of directors shall deal with the organization of the company, and with the management of its business. Logically, the different sentences in chapter 8 sec. 6 ABL should be interpreted in the same way, leading to the conclusion that there is a general limitation on the powers of the board besides those explicitly prescribed.[68]

The conclusion from the foregoing seems to be that in Swedish law there are some matters that have to be dealt with by the general meeting of shareholders, even though no explicit provision to this effect can be found in the Companies Act. This standpoint appears to be accepted in many Swedish legal sources.[69]

In the USA, the acts in all states today require that the shareholders shall decide in certain specific matters, while the business and affairs of the company shall be managed, and all corporate power exercised, by or under the direction of a board.[70] At first sight, it may appear that the board has the power to make decisions in all matters that are not referred by law to the general meeting. However, at least in the case of granting compensation for expenses arising in a proxy contest, the courts appear to have found a specific matter that must be decided by the general meeting, even though there is no support for this opinion in the applicable acts.

In *Rosenfeld* v. *Fairchild Engine & Airplane Corp.*,[71] a proxy contest had been lost by the old board. During and after the contest approximately $ 261 000 was paid out of the company's assets to both the old and the new directors. The payments were made as compensation for expenses incurred in the contest, and the reimbursement to the members of the winning group was expressly ratified by a majority vote of the shareholders. One shareholder, however, brought an action against the company, and sought to compel the return of the money.

The Court of Appeal of New York first stated that directors' soliciting of

[67] See e.g. NJA 1958 p. 186 and 1968 p. 375.

[68] See S. Johansson, *op.cit.* (in footnote 4), p. 160.

[69] See e.g. *Ds Fi* 1986:21 pp. 6, 66 and 69 (but cf. pp. 71 f.); R. Dotevall, *Skadeståndsansvar för styrelseledamot och verkställande direktör*, Stockholm 1989, p. 177; H. Nial, "Till frågan om kompetensfördelningen mellan stämma och styrelse i aktiebolag", *Festskrift till Knut Rodhe*, Stockholm 1976, pp. 329 ff. (see especially pp. 341 f.) and *id.*, *Svensk associationsrätt*, 5th ed. Stockholm 1991, p. 109.

[70] See e.g. sec. 300 (a) California General Corporation Law.

[71] 309 N.Y. 168, 128 N.E.2d 291. See also *Steinberg v. Adams*, 90 F.Supp. 604.

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proxies, where there is no proxy contest, can be in the interest of the company; that is, at least in large companies where shareholders' indifference might make it difficult to procure a quorum. Also, in the event of a proxy contest, directors may answer challenges from outside groups and in good faith and for the information of the shareholders defend their actions with respect to company policy. Were such a defence not allowed, the directors and the company might be at the mercy of persons seeking to wrest control for their own ends. For these reasons the payments to the members of the old board were admitted by the Court. Concerning the payments to the new board—i.e. persons who were not directors when the expenses were incurred—the court found that there was no reason why the shareholders should not be able to use the company's assets to render reimbursements. Accordingly, even the payments to the members of the new board were admissible. However, the Court emphasized that such a payment *requires shareholder approval.*[72]

Above, it was pointed out that there are two fundamentally different approaches to the problem of allocation of power between management and shareholders. However, the matter of a possible exclusive, non-statute-based power for the general meeting does not seem to follow the division between these two approaches. In legal systems as similar as the Norwegian and the Swedish, quite opposite solutions have been recommended. On the other hand, the answers have been almost identical in countries with legal systems that—on this point—differ as much as the Danish and the German.

It is concluded that it is not possible to lay down a general—i.e. international—principle that the general meeting of shareholders enjoys any exclusive, non-statute-based power. However, it seems difficult to believe that, for instance, a Norwegian court would accept that a board has the power to liquidate the company just by making decisions whose wording is not directly aimed at liquidation. If this is a correct assumption, the problem discussed so far in this section of the article might be more a question of drawing borderlines than of material law.

In those countries where the general meeting does enjoy an exclusive, non-statute-based power, the question arises what kind of decisions—besides those following from statutory provisions—have to be dealt with by the general meeting. There seems to be little doubt that such exclusive power can apply only where the contemplated decision involves serious interference in the rights of the shareholders.

[72] See also M. A. Eisenberg, "Access to the Corporate Proxy Machinery", 83 *Harv. L. Rev.* p. 1517.

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Once an extended power for the general meeting is recognized, it appears obvious that a board of directors cannot be allowed to make decisions that have the same actual effects as those that *must* be passed by a general meeting. Further, it seems reasonable that decisions whose effects are similar to those of "general-meeting-only" decisions should also be passed by resolutions at general meetings. An example of the latter type of decision is the selling of all of a company's assets, which is a decision comparable to the liquidation of the company.[73]

Turning to decisions that are not directly comparable with those that explicitly require treatment at a general meeting, it is more difficult to estimate when, if ever, such treatment is necessary, and, generally speaking, probably impossible to determine the borderlines in detail. Conclusions must instead be drawn *in casu*. However, some guiding examples seem possible.

1. The use of the company's assets for some purpose that is not in the direct interest of the company may require a resolution by the general meeting.[74] This kind of decision may, at least for fairly large sums, be viewed as close to the declaring of dividends, or to decisions that are *ultra vires*.

2. Decisions to enter into long-term contracts that bind a larger part of a company's assets can be regarded as requiring shareholders' approval.[75] The reason to require a resolution from the general meeting here is that the assets committed are no longer freely available to the shareholders. On the other hand, a general-meeting power of this kind may, in some countries, lead to serious difficulties in determining the company's relationship with third parties, and consequently power which is exclusive to the general meeting can be seriously questioned.

3. A decision to enter a totally new, maybe hazardous, line of business might, even if not *ultra vires*, require a resolution by the general meeting.[76] This is because the shareholders have acquired company shares on certain assumptions, and therefore ought to be consulted before these assumptions are altered. A company's basic conditions are given chiefly in its articles of association, but the shareholders may also have the right to require that a line of business established over a long time be looked upon as a prior condition of their purchase of shares.

4. In legal proceedings to which the company is a party, the question

[73] See above at footnote 66.

[74] Cf. *Rosenfeld v. Fairchild Engine & Airplane Corp.*, 309 N.Y. 168, 128 N.E.2d 291.

[75] Cf. UfR 1955 p. 887, 1970 p. 795, NJA 1958 p. 186 and 1968 p. 375.

[76] Cf. H. Nial, "Till frågan om kompetensfördelningen mellan stämma och styrelse i aktiebolag", *Festskrift till Knut Rodhe*, Stockholm 1976, p. 341.

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may arise as to whether the company shall admit the other party's claim. If the claim is such that the board has not been able to make a corresponding decision of its own, it ought to be prevented from admitting the claim.

5. Finally, the transfer of all or a large part of a company's assets to a subsidiary must be mentioned as a kind of decision that may require a resolution by the general meeting.[77] In Germany, the BGH has established an exclusive power for the general meeting in this situation. The present author has earlier suggested that, because the general meeting in Sweden generally has a wider power than its German counterpart, the *Holzmüller* outcome would be even more likely in Sweden than in Germany.[78] However, the Swedish, but not the German, general meeting has the power to intervene in the work of the board. Therefore, the differences between the Swedish and the German system might lead to an opposite conclusion.

The significance of the existence of a exclusive, non-statute-based power of the general meeting appears in various cases. If the board through negligence makes and implements a decision that should have been referred to the general meeting, the members of the board can be liable for damages incurred by their action. Furthermore, in some countries a third party in bad faith cannot demand execution of a contract based solely on a decision of the board, if the contract is one that requires shareholder approval. Finally, an obligation to refer a specific matter to the general meeting has the effect of ensuring that shareholders are informed about what is going on in their company; an effect that can be valuable in connection with e.g. lawsuits.

SUMMARY

Comparison of different legal systems shows that there are two fundamentally different ways of regulating the distribution of power between management and the general meeting of shareholders. First, the power of the general meeting can be restricted to matters that relate to its sphere of exclusive power, while the board of directors is free to make its own decisions on other subjects. This solution is found in Germany, but also in Great Britain and the USA.

Secondly, the power of the general meeting can be extended to the passing of resolutions in almost every matter concerning the company, while the directors are obliged to abide by a resolution passed at a general meeting. In this system, the board can, within the limits of its authority, act

[77] Cf. BGHZ 83 p. 122.
[78] See S. Johansson, *op.cit.* (in footnote 4), p. 161.

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on its own as long as there is no restricting resolution by a general meeting. In countries where this system operates, it has been considered necessary to impose some restrictions on the power of the general meeting, e.g. in connection with passing of resolutions on dividends. This second solution is found in Denmark, Norway and Sweden.

Concerning the question of whether there are any matters that must be dealt with by the general meeting even though no such requirement can be found in any act, it could be assumed that the wish to protect the shareholders—and especially the minority shareholders—would lead to such an exclusive, non-statute-based power of the general meeting existing in countries where the meeting lacks the power to intervene in the board's work. At the same time, one is tempted to assume that such a power should exist in the countries where the general meeting theoretically wields ultimate power in all matters concerning the company. The latter assumption would rest on the view that the general meeting's quality as the superior organ creates an obligation upon the board to procure shareholder consent to decisions that could radically affect the shareholders' rights.

The material presented in this article indicates that both the above assumptions are to some extent correct. Protection of shareholders has by some courts in the USA been adduced as an argument for requiring shareholders' consent to a decision to reimburse members of a challenging group for their costs in a proxy contest,[79] and the same reasons have been used by the German BGH when requiring that a resolution be passed at a general meeting when a company wishes to sell a great part of its assets to a subsidiary.[80] In Denmark, a court has, in its grounds, suggested that a contract can involve such extraordinary dispositions for the contracting company that it requires a resolution passed at a general meeting.[81] In Sweden, courts have found that a decision to sell all of a company's assets is equal to a decision to liquidate the company,[82] a decision which can be taken only by the general meeting.

[79] Cf. *Rosenfeld v. Fairchild Engine & Airplane Corp.*, 309 N.Y. 168, 128 N.E.2d 291 and *Steinberg v. Adams*, 90 F.Supp. 604.

[80] See BGHZ 83 p. 122.

[81] See UfR 1955 p. 887.

[82] Cf. NJA 1967 p. 313.

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