Swedish Company Legislation Over Six Decades – A Brief Outline

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Sweden has had legislation on companies since 1848. The 1848 Companies Act was very brief; it was based on a system of concessions. It very soon became clear, however, that a system in which companies needed the permission of – at that time – the King could not function in a modern society, and a new Companies Act was prepared. This new Act, which - together with a number of other pieces of legislation in the area of the law of associations – was passed in 1895, made it possible for those who wanted to form a company to do so if the conditions of the Act were observed. The 1895 Act was in turn followed in 1910 by a new Companies Act. In this enactment the experience gained during the first ten years of the old legislation was taken into account. The 1910 Act was in force both during the troublesome period during and after the First World War and during the depression, which threw many economies into convulsions in the 1920s and early 1930s. As regards Sweden, the depression resulted among other things in the financial empire created by Ivar Krueger coming to a turbulent end. As a consequence of this event, the government set up a Company Law Committee to investigate whether shortcomings in the Companies Act had contributed to the collapse of the Krueger empire. But this was not the only embryo for new legislation. Another was the fact that new laws were being prepared and adopted in many European countries during this period. New Companies Acts were adopted in the Netherlands in 1928, in England in 1929, in Denmark in 1930, in Switzerland in 1936 and in Germany in 1937. And important reforms also took place in France during these years. Also of importance, however, were the economic, social and political changes that had occurred in Sweden since 1910.

The task of the Company Law Committee was soon transferred to the Legislative Drafting Committee *(lagberedningen)*, which was in fact the Committee that was to propose new legislation on companies.

Among the questions that the Committee had to discuss was whether Sweden ought to introduce special rules for different categories of companies. Examples of this were found both in Germany and in France, where the *Gesellschaft mit*

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beschränkter Haftung (GmbH) and the *Société à responsabilité limitée (Sàrl)* existed alongside the old forms *Aktiengesellschaft* and *Société Anonyme*. But the Committee was also to consider how the management of a company should be organized, how the management body should be constructed, what its relationship should be to the shareholders, and the scope of its responsibilities for management. In addition, the question of auditing and questions concerning the payment of and changes to the share capital were to be examined in all their different aspects. Rules on the balance sheet were to be discussed in order to ensure that the financial position of any company could be determined. It was also important to regulate the relationship between parent companies and their subsidiaries. Finally, protection of the shareholder minority was to be taken into account.

Concerning first the question whether there should be two different categories of companies, the Drafting Committee (SOU 1941:8 and 9) came to the conclusion that this was not a suitable solution for Sweden. To make it easier to form small(er) companies, however, the Committee proposed that the one-man company should be accepted. The legislator followed the Committee's recommendations in both these respects when the new Companies Act was passed in 1944 (Prop. 1943:5).

In order to prevent the formation of criminal and inappropriate companies, the 1944 Companies Act contained detailed rules on the formation of companies – rules on the publication of information concerning new companies, and on payments for shares, for example in the form of contributions in kind, including deferred contributions of this type. The rules were very much the same as regards increases in the share capital. As for the question of management, the Act prescribed that smaller companies could have a board consisting of one or two members, but that any company with a share capital over a certain size should have a board made up of at least three members, and that in all companies with a board of that size the board should appoint a managing director. Both the board and the managing director were to be involved in the activities of the company, but the board could not be supposed to meet more than a limited number of times each year, while the managing director was to be employed by the board with the task of running the day-to-day activities of the company. The Act defined what was meant by day-to-day activities by stating that these included only activities which were in accordance with the objects of the company, with the further proviso that the activities in question were not of great (economic) importance to the company. This definition had implications both in relation to third parties and as regards responsibility for mismanagement of the company. Concerning relations with third parties, the Act stated that the board had a general power to represent the company in relation to third parties and that the managing director had the same power as regards day-to-day activities – with the exception of legal acts which by law were to be effected in writing. But since the borderline between what did and did not constitute day-to-day activities might be difficult to judge, the Act protected any third party who, acting in good faith, had misjudged the powers of the managing director, by stating that the company was nevertheless bound in the event of such a misjudgement. As for other situations where the board or any person with special autorization to sign for the company represented the company, the

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question whether or not the company was bound depended mainly on the good or bad faith of the third party. But, as indicated above, the division of powers between the board and the managing director also had implications as regards the responsibility in cases of mismanagement. The members of the board were responsible for mismanagement on their part, the managing director for mismanagement in his/her running of day-to-day activities. But these persons were also liable in relation to shareholders, creditors and other third parties for negligent violations of the Companies Act and the articles of association.

Detailed rules on the balance sheet, the profit and loss account and the directors' report, supplementing the rules of the Accounting Act, were introduced. Completely new rules on the accounts of groups of companies were introduced: a parent company was to submit a balance sheet not only relating to its own activities, but also for the group as a whole (a consolidated balance sheet). Furthermore, the Act included improved rules on statutory reserves. The size of the statutory reserve was largely dependent on the debts of the company. The statutory audit was further extended, as the Act sought to strengthen the position of the auditors in relation to the board and the managing director. The number of certified auditors in Sweden was too limited, however, to make it possible to prescribe that all companies were to have at least one certified auditor; such an auditor was, though, to be appointed in all companies with a share capital over a certain size. The Act also contained certain rules on auditors that were designed to protect shareholder minorities. Minorities were protected in other ways, too, for example by a rule intended to prevent the minority being deprived of any dividend on its investment. Finally, the Act contained rules on mergers of companies.

The 1944 Companies Act was long and full of detail and thus complicated and expensive to use by those who had to apply it. This fact was observed while the Act was still being drafted, and attempts were made to simplify it. But on the other hand it was said that the questions which the Act had to deal with were so complex that extensive regulation was difficult to avoid. Already in the 1950s, however, one of the members of the old committee, Professor Håkan Nial, was asked by the government to suggest amendments that could make the Act simpler. His proposals (SOU 1958:27) were – with one minor exception – laid aside when, early in the 1960s, Nial was given the task of proposing, in cooperation with committees from Denmark, Finland and Norway and representatives from Iceland, rules which as far as possible would be the same in all these countries. His terms of reference were also to propose legislation that was less complex than the 1944 Act. To assist him Nial had a number of experts from different areas of Swedish society – the Employers' Confederation, the trade unions, the Bar Association, the Registration Authority etc.

The situation in the area of company legislation was rather different in the countries whose laws were to be harmonized. Norway had a new Act from 1957, while the laws then in force in Denmark, Finland and Iceland were older, the Danish one being from 1930, the Finnish one from 1895 and the Icelandic one from 1921. And the Swedish Act was much more extensive than its Nordic counterparts. The work that Nial undertook consisted to a very high degree of giving up rules which in his opinion were not necessary to protect the interests that had to be taken into account in company legislation. The rules of the 1944

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Act concerning the division of powers between the board and the managing director and the powers of these bodies and of persons with special authorization to sign for the company in relation to third parties were retained according to the same principles as in the 1944 Act. The restriction preventing the managing director from representing the company with regard to legal acts which by law had to be effected in writing, however, was deleted. On the basis of Danish and Norwegian law, a limited prohibition against loans to shareholders and board members was proposed. But the rule requiring a statutory reserve was to a high degree given up in the proposals - the principles of accounting were, for example, assumed to provide better protection for the capital than rules on reserves related to the share capital and debts of the company. But there were also a great number of rules which Nial had to exclude because the other Nordic committees found them too far-reaching. To a very large degree, however, Nial was able to accept this on the basis that was excluded in any case followed from general principles of company law.

Already in 1970 the Companies Act was supplemented by rules which made it possible for larger companies to simplify their handling of shares and their registers of shares. These rules have later been further developed.

Nial's proposals were published in 1971 (SOU 1971:15). Before a new Companies Act was passed in 1975 (an act which is still in force), in 1973 the government proposed new rules on capital procurement (Prop. 1973:93). The main reason why such rules were urgently required was the need for fresh capital for Swedish industry. The 1944 Act only included rules on new share issues and, what is more, it normally did not allow any company to issue new shares to other persons than its existing shareholders. This was primarily for two reasons. The first was that shares were usually issued at a cost below their market (but not their nominal) value, and the second was that power at the general meeting depends on who holds the shares. Both the business world and other public and private bodies felt, however, that there was a need for alternative ways of rasing the capital that was needed for industry and trade, and also that it was necessary to abandon the exclusive rights of the existing shareholders. The 1973 amendment therefore opened up to companies the possibility of issuing convertible debt instruments, warrants and convertible shares through decisions taken either by the general meeting or by the board, and also of deciding by a simple majority – rather than the qualified majority proposed by Nial – to bypass their existing shareholders' preferential rights, even when there was no issue in kind. However, the legislator was aware of the risk that the possibility of bypassing the preferential rights of the old shareholders could be misused by those in power in a company (majority shareholders at general meetings, as well as board members and managing directors) to obtain shares at a lower price than the market was willing to pay and thus make a gain at the expense of the old (other) shareholders. Consequently, the 1973 amendment also included clauses – normally refererred to as the general clauses of the Companies Act – which prohibited decisions which might give a shareholder or a third party an undue advantage to the detriment of the company or any other shareholder.

But it was not only the rules on capital procurement that were removed from the 1971 proposal in 1973. So too was the proposal to prevent loans by the company to its shareholdes and board members unless the adopted balance sheet

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for the previous year showed that there was enough free capital to cover such a loan. Also dropped was a proposal to increase the minimum share capital from SEK 5,000 to SEK 20,000. In 1973 the government was of the opinion that small companies were often used to obtain improper tax relief for their shareholders, and its 1973 proposal therefore included the rule that the minimum share capital should be at least SEK 50,000 and further, that in principle any loan granted by the company – regardless of its economic status – not only to its shareholdes and board members but also to its managing director and certain close relatives of these persons, should be prohibited in the Act. Parliament deciced accordingly.

An area that had become more and more important during the late 1960s and the first part of the 1970s was that of industrial democracy. Swedish society, like many other societies in the Western hemisphere, was hit by student and worker "revolts". These events awakened the government, and it appointed a number of committees to propose legislation that would reform working life. Most of the legislation that resulted from these proposals is dealt with in the area of labour law, such as the 1976 Co-determination in the Workplace Act. Since these acts often confer the powers given to the employee side on the established unions, i.e. the unions that have collective agreements with the employers, the question of fair representation of both members and non-members needs to be raised. This is on the other hand a question closely connected to the law of associations, and one which I treated in a book published in 1981 (*Fackföreningarna och de anställda*, `Trade Unions and the Employees'). But an act more closely linked to the Companies Act was also adopted: the Act on Board Representation for the Employees. The first such act was passed in 1972, and it was later replaced by first an act of 1976 and later by an act of 1987. This last Act gives the established unions the right to appoint two board members and two deputy members in any company with at least 25 employees. If the company has activities in different industrial sectors and at least 1,000 employees, the number of employee representatives goes up to three, with three deputy members. The Act does, however, contain the general restriction that the number of employee representatives is never to exceed the number of board members elected by other parties.

In 1975 a new Companies Act based on the 1971 proposals was passed (Prop. 1975:103). Generally, Nial's proposals were accepted, but the 1975 Act nevertheless contained a number of innovations compared with them. Thus, for example, rules on a statutory reserve were reintroduced. In its bill to Parliament, however, the government generally declared that Nial's proposals did not cover questions of extending the public's and the employees' (more correctly, the established unions') insight into and influence over entreprises, since this had not been included in the terms of reference given to Nial fifteen years earlier. Therefore, the proposals put forward by Nial "cannot be used as a basis for legislation with the purpose of strengthening industrial democracy. My proposal therefore has the character of a technical revision of the law of companies," the Minister declared in the bill he put before Parliament (Prop. 1975:103, p. 71).

The 1970s were followed by the 1980s when rapid growth of the stock market began. The focus on employee problems was now followed by attempts to cope with market abuses. Not much of the legislation proposed was to affect the Companies Act, however, although one such proposal did lead to changes in the

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chapter on auditing. As from 1983, every company, irrespective of its size, had to have at least one certified auditor.

It was not long before the problems of undue advantage in connection with capital procurement which could in fact be foreseen when the 1973 amendment was adopted forced the legislator to act. Not that there was anything wrong with the wording of the general clauses of company law as such; it was just that those in power in different companies did not bother to follow them. If the decision was taken by the board, the shareholders were usually not even provided with the necessary information, and if they were, what could they do? In fact, they could vere rarely do anything. And board members and managing directors, and through them majority shareholders, used this new "opening" to promote their own interests. A new committee was therefore appointed by the government with the task of proposing a suitable solution. The result was the 1987 Act on Special Issues of New Shares in Stock Market Companies, i.e. an Act that supplements the Companies Act with regard to stock market companies (Prop. 1986/87:76). In such companies, decisions to issue shares, convertible debt instruments and warrants with a preferential right for, among others, board members, deputy board members, the managing director, the deputy managing director and other employees, must be taken at or approved by general meetings and with a highly qualified majority. And through an amendment of the Companies Act the legislator has ensured that shareholders are at least informed in advance about the proposed issues; they have also the possibility of bringing a complaint before the courts, which is a right that shareholders have if they are of the opinion that decisions at general meetings are not in accordance with the law. But – as indicated above – this protection for the shareholders is restricted to stock market companies, and it is still, for various reasons, difficult to make use of.

Early in the 1990s Sweden became member, first of the European Economic Area and later of the European Community, and was thus forced to implement the Community directives in the area of company law. The task of proposing the amendments made necessary by these directives was given to a new Company Law Committee, which, together with a committee specialized in accounting, published a number of proposals not only concerning the implementation of the directives, but also on other questions which the Committee was to discuss. Its terms of reference in fact went beyond simply proposing implementation measures.

The proposals based on the Community directives led to legislation already in the 1990s, while some of the Committee's other proposals are still under consideration. The idea is that the changes that have already been made, together with what will be enacted in the not too distant future, should be called the 200-- Companies Act. This Act is thus intended to replace the 1975 Companies Act.

In the first amendment based on a proposal from the Company Law Committee (SOU 1992:13), a prohibition on non-Swedish nationals owning shares in Swedish companies was deleted from the Act (Prop. 1992/93:68). The fear that foreigners would take over Sweden's natural resources had led to a restriction on land ownership by Swedish companies in which non-Swedes had more than a very limited number of shares (and thus influence). This restriction, however, was in conflict with the principles of the European Community. The

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deletion of the chapter of the 1975 Act regulating this prohibition took effect as from 1 January 1993.

In its second proposal (SOU 1992:83), the Company Law Committee raised the question whether or not Sweden should – like most of the countries in the Community – introduce a separate form for small companies (like the *GmbH* and *Sàrl*), but the Committee found – just like the Legislative Drafting Committee had done in 1941 – that one comprehensive act with certain special rules for smaller companies (called "private companies", as opposed to the others, which were called "public companies") would be a better solution. And this suggestion was accepted by the legislator in an amendment which took effect on 1 January 1995 (Prop. 1993/94:196). Private companies thus do not need to have as large a share capital as public companies, for which the lower limit is SEK 500,000 (equivalent to approx. €54,000). And private companies are not permitted to turn to the public to raise capital. But for the rest, the differences between the rules of the Companies Act for private and public companies are still (in 2003) fairly insignificant.

At the same time as the Companies Act opened the way for private and public companies, it acquired new rules on mergers, based on the EC directive in this area. As mentioned above, Sweden had in fact introduced rules on mergers back in 1944, but the new rules are more detailed than the old ones.

The 1944 Act contained rules for the situation where a company, within two years from the date of its registration, acquired property of a special kind and of a certain value – often referred to as a deferred contribution in kind. As noted earlier, Nial's terms of reference in the 1960s were to find as much common ground as possible with the other Nordic Company Law Committees, and the rule on deferred contributions in kind in the 1944 Act was abandoned. But now – on 1 January 1995 – the rule on deferred contribution in kind was reborn, except as regards acquisitions on stock markets and acquisitions which are part of the normal business activities of the company.

Following the 1973 amendments described above, the Companies Act contained rules that made it possible to bypass the preferential rights of the existing shareholders through decisions by a simple majority even in connection with cash issues. Now, however, this simple majority rule was replaced with the requirement of a qualified majority. A decision at a general meeting not to give the old shareholders the right to participate in an issue in cash, or a decision to deviate from what the articles of association might prescribe concerning preferential rights, has to be decided by both two thirds of the votes and two thirds of the shares (which is not necessarily the same, since there are still Swedish companies with shares carrying different numbers of votes).

A rule from 1975 that a reduction of the share capital could be decided by a simple majority was at the same time changed to a rule requiring a qualified majority.

An amendment was also made now which took away from a company the right to allege in a conflict with a third party that the board or the managing director had exceeded their powers in the light of the purpose of the company or some other restriction prescribed by the company. But the old rule that only third parties acting in good faith are protected when the managing director acts outside the area of his/her day-to-day activities is unhanged since 1975.

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At the same time, EC rules were included in the Companies Act on the right for a company to make objections based on what has and has not been registered at the Registration Authority.

The third phase of extensive amendments to the Companies Act took effect on 1 January 1999 (Prop. 1997/98:99). This time the amendments mainly concerned the rules on the boards of directors, the general meeting and the auditors. The reason for these amendments, according to the government bill, was to strengthen the status of the owners of a company, in order to make it easier for the majority to make the companies more efficient. The other side of the coin – the protection of minorities – was also taken into account. However, the proposals also concerned the chapter of the Companies Act which regulates under what conditions board members, managing directors, auditors and others involved in the decision-making or control of a company can be held liable for damages for acts and omissions. The old rules were retained with a minor adjustment.

As regards the questions mentioned so far, it can to some extent be said that the legislator has returend to the ideas of the 1944 Act, introduced quite detailed regulation – this time, however, with relatively short sections under subject headings and in more modern language than previously. These changes make the chapters fairly long.

But the 1999 amendments also affected the chapter on auditors. Among other changes a duty placed on the auditors should be mentioned, namely to report to both the board and a public prosecutor a suspicion of a number of criminal offences committed by board members and the managing director in their activities in the company. The crimes referred to in this section are mainly offences against property and various tax offences.

Certain other amendments made at the same time could also be mentioned.

Under the 1944 Act, a managing director was to be appointed when the number of board members was three or more. According to the new rule, a public company must have not only a board but also a managing director, while a private may have a managing director in addition to the board. And as provided in the 1944 Act, the number of board members depended on the size of the company while it now depends on whether the company is public or privat. The old rules made more sense than the new ones.

The Act now prescribes that any board with more than one member must adopt every year a schedule concerning the special obligations that its members have to observe, and that the board must normally also adopt instructions in writing concerning the organization of the company. The idea is that it will in this way be easier to decide who has caused damage in the event of any mismanagement.

As regards the general meeting, the legislator has tried to facilitate the participation of shareholders. They may thus, for example, now take with them two persons as assistants, rather than one as before – the questions to be discussed might require expertise in more than one area. The period within which the general meeting is to be convened has been revised, as have the rules on notice of the meeting as such – all in order to protect the right of shareholders to participate in the meeting. Likewise, the rules on decision making have been changed.

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And as from now only certified auditors are accepted as auditors. The auditing profession had developed very rapidly during the twentieth century, and the government did not consider it necessary to propose any exceptions for small companies. For cases where there is a need for lay control in addition to control by the auditors, a chapter on this subject was added to the Companies Act. Such control was assumed to be of particular value to companies owned by municipalities and cooperative societies.

Finally it should be mentioned that the rules of the Companies Act on the acquisition of a company's own shares were changed in 2000, and the rules on dissolution of companies in 2001.

Before I end this short review of Swedish company legislation, some words should be added on a question that has also been disussed over the last sixty years, but which I have only touched on earlier, namely the question whether the Companies Act should permit shares with more than one vote each. This question was discussed in connection with the legislation of the 1940s, when a limit of 1 – 10 was decided, and it was also discussed in connection with the legislation of the 1990s, when the government stated that the old rules should be left intact, since they were of value to Swedish business life.

A general remark that can be made after this brief outline of Swedish company legislation over the last six decades is that already the 1944 Companies Act was an unusually well designed piece of legislation which – many years and several EC directives later – can still function as a normative basis for the Swedish legislator. Recently the legislation has in fact returned to old principles which were given up in the enactments of 1973 and 1975 (but not in Nial's proposals from 1971). It seems in fact that the only areas in which real innovations have so far been made since 1944 are those concerning capital procurement, accounting and auditing.

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