

Boards of Limited Companies: Internal Governance Structures

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1 Introduction

There are two fundamental elements in the rights, privileges and powers etc. of a shareholder: the power to play a part in the governance of the company, and the right to a share in its profits. Close companies, with few owners, frequently offer good opportunities for shareholders to monitor – and perhaps take active part in – the administration of the company's affairs. Once a company's ownership grows beyond a certain size, however, relations between shareholders change, practical reasons making it impossible for all of them to be involved in company administration. As a result, shareholders who do not participate actively in the administration of the company are exposed to a risk: the financial gain from their investment may turn out to be less than expected in consequence of the active group's having secured benefits for themselves at the other shareholders' expense. Here we perceive one of the classic problems with limited companies, and one of the hardest to solve: how can we minimise the unfavourable effects which arise when shareholding is separated from participation in corporate governance?

To begin with the legal technicalities of the issue, corporate law distributes influence over administration by means of a hierarchic structure of organs. From a principal point of view, the shareholders' general meeting is the superior organ, usually appointing the board of directors. The board is a collegiate organ, responsible for the organisation of the company and the administration of its affairs. The board may, in its turn, appoint a managing director whose job it is to run the company's day-to-day business in accordance with guidelines and directions issued by the board. As Chapter 8, Section 6, and Chapter 9, Section 29 of the Swedish Companies Act prescribe that a board of directors should be elected

by way of a simple relative majority; whoever exercises the decisive influence over the company is able to appoint a board in accordance with his own preferences.¹ By means of profitable compensation schemes controlling owners may create bonds of loyalty to people in managerial positions, inducing them to identify what is best for the company with these owners' interests.²

Although the majority rule says that the board of a limited company may be appointed by a controlling owner, and although most companies do have such an owner, many companies have boards that also comprise persons who do not belong to the immediate majority circle. Such a composition is the outcome of permanent or temporary agreements between shareholders. In fairly large and medium-sized companies (often family-owned) shareholders' agreements play a comparatively conspicuous part in creating these mixtures. Agreements of this kind may result in a different division of power from that which an application of the majority principle would produce.³ There is a danger that greater diversity on a board of directors might result in conflicts of interest disturbing the board's collegiality and hampering its modes of operation. If such tensions become severe, the chairman may choose to subject certain board members to special treatment (in an unfavourable sense), thereby preventing them from participating in the management's work on the same terms as the others.⁴ At a critical juncture relations between board members may even assume the character of an adversarial relationship. This problem complex constitutes the framework of the present article.

Apart from the quorum rules in Chapter 8, Section 18, subsection 2, the Companies Act used not to contain any detailed instructions on how board-work as such should be performed. To some extent, that situation changed when the wording of Chapters 8 and 9 was modified as from 1 January 1999. As before, the Act prescribes that a board must have a chairman and that this chairman shall convene the board whenever necessary, and always if a member of the board or

¹ It transpires from Govt. Bill 1975:103, at 245, and Govt. Bill 1997/98:99 at 122 ff. that the Companies Act rests on the principle according to which the right to make decisions in a company belongs with the holder of the majority of its votes; *see also* Bergström, C. & Samuelsson, P., *Aktiebolagets grundproblem*, Stockholm (2nd edition, 2001), where the meaning of the majority principle is explained.

² Bergström & Samuelsson, Chapter 6.

³ *See* Roos, C. M., *Avtal och rösträtt*, Stockholm (1969), as well as Kansmark, J. & Roos, C. M. *Aktieägaravtal*, Stockholm (2nd ed., 1994).

⁴ *See* Scogin, Hugh T., *Withdrawal and Expulsion in Germany: A Comparative Perspective in the 'Close Corporation Problem'*, 15 Mich. J. Int'l L. 127 (1993), where a comparative analysis is supplied of how legislation in the United States and Germany respectively solves conflicts of this kind. For another comparative investigation which sheds light on the general nature of the problems involved, *see* Miller, S. K., *Minority Shareholder Oppression in the Private Company in the European Community: A Comparative Analysis of the German, United Kingdom, and French 'Close Corporation Problem'*, 30 Cornell Int'l L. J. 381 (1997).

the managing director requests it.⁵ Although it would still be correct to describe the convening and conducting of meetings as matters for the board to handle according to its own discretion, the Act does insist – under Chapter 8, Section 5 – that the work of the board be planned and rules of procedure be adopted, the latter specifying, among other things, how often the board is to meet.⁶ Even if board memberships belong to different groups of owners, the minority's opportunity to take active part in the administration of the company's affairs through the agency of the minority's "own" board representatives will be highly dependent on how these matters are handled by that owner who exercises a controlling influence on the board by deciding who is to fill the post of chairman.

The rules in Chapter 8, Section 18, subsection 2 of the Companies Act constitute further support for minority representatives on the board. According to these rules, every member of the board is entitled to be supplied with satisfactory materials for basing decisions on, and to take part in the handling of matters before the board. Ideally, rules of procedure may – assuming they were competently designed – make it harder for a dominant owner to abuse his power. Among the factors which may be influenced by such rules is the flow of information. The removal of obstacles to that flow increases board-members' level of preparedness, as well as their ability to safeguard their power to take part in the administration of the company's affairs on the same terms as other members. The legislator's decision thus to regulate these aspects of the internal workings of the board may be regarded as a way of counteracting the danger that some of the most fundamental rules in corporate law might be circumvented. In this case, the intention was to protect the collegiate mode of decision-making in the company.

2 The Ensuing Presentation

The next section, 3, briefly reviews the principle of collegiality and its significance in the context of board-work. The analysis then focuses on the rules in Chapter 8, Section 18, subsection 2 of the Companies Act, which – as we have seen – attach legal status to some crucial procedural aspects of the principle of collegiality. These directives rarely attract attention, as they are primarily – for

⁵ Under Chapter 8, Section 14, subsection 1 of the Companies Act, this applies on condition that the board has more than one member.

⁶ See Govt. Bill 1997/98:99. See also Section 56 in the Danish Companies Act. The present regulation was considered as early as SOU (the Swedish Government Official Reports) 1941:9, at 330, then also according to a Danish model (what used to be Section 47 in the Danish Companies Act). In its report -- SOU 1995:44, at 195ff. -- the Corporate Commission proposed that regulations be introduced about rules of procedure for boards in limited companies. In Govt. Bill 1997/98:99, at 81, this proposal returned, becoming valid law on 1 January 1999. The main difference between the new law and the Commission's proposal is that the regulations pertaining to rules of procedure for boards did not carry penal sanctions. See also Rodhe, K., *Aktiebolagsrätt*, Stockholm (20th ed., 2002), for a survey of these regulations.

historical reasons – associated with the interests of employee board-members.⁷ However, the preparatory materials of the Act contain a significant statement regarding the interpretation and application of Chapter 8, Section 18, subsection 2 of the Companies Act. According to that statement, it seems well advised as a matter of principle to locate the required regulation of internal workings of the board within the framework of the Companies Act, as the need for protection against abuse also applies to other minority representatives on the board than the employee members.⁸ In other words, even from its inception the regulation in Chapter 8, Section 18, subsection 2 of the Companies Act was regarded as a general measure directly intended (along with providing employee-member protection) to satisfy the need for protection that any individual board member might have who was chosen as a representative by the shareholders' meeting.⁹

Whenever the modes of operation that characterise the work of a company's board are discussed against the background of Chapter 8, Section 18, subsection 2 of the Swedish Companies Act, three aspects are inevitably foregrounded:

- 1 the right to a reasonable time for consideration or consultation and for the convening of a meeting;
- 2 the right to be provided with satisfactory materials to base decisions on; *and*
- 3 the right to participate in the processing of matters before the board.

Penalties for the infringement of regulations in Chapter 8, Section 18, subsection 2 of the Companies Act are supplied under Chapter 19, Section 1 of the Act. Consequently, the board's modes of operation possess more than one legal dimension, being relevant not only to corporate law but also to special penal law. The following pages concentrate on the former aspect. Appropriate periods of notice for the convening of board meetings and so on are not expressly regulated in the Companies Act. Nor do such matters, according to Chapter 8, Section 5 of the Act, form a compulsory feature of the board's rules of procedure. That notices convening meetings are duly served at a certain point in time before the meeting must instead be regarded as following from the right to participate in the processing of matters before the board. Apart from these rules of procedure, the extent to which the regulation on challenges to impartiality in Chapter 8, Section 20 of the Act restricts a board-member's right to be present is reviewed. The managing director's right to be present at board-meetings then follows,

⁷ Concerning the Act (1987:1245) on board representation for employees in private enterprise, see Johansson, S., *Nials svensk associationsrätt i huvuddrag*, Stockholm (8th ed. 2001), at 114f.

⁸ Govt. Bill 1975/76:166, at 150.

⁹ See the general points on employee-representative collaboration in the internal workings of the board made in Moberg, K., *Anställda i styrelsen. Lagen om styrelserepresentation för anställda*, Stockholm (1988).

whereupon the question is asked whether violation of the rules of procedure may be invoked as grounds for invalidity.

3 Collegiality

It is the duty of the board to make decisions on the company's strategies and organisation on the basis of the substance of company activity as stated in the articles of association and the purpose of the activity, which usually consists in generating profits for the shareholders. Hence, the board's job does not amount to 'interpreting the owners' intentions' or anything of that kind, letting a more or less free interpretation of those intentions govern the formulation of the company administration's focus and aims.¹⁰ Shareholders are – like the persons who serve on the corporate organs – bound by the purposive structure that emerges when the relevant law and the articles of association are subjected to objective interpretation. Proceeding from the legal framework provided by these sources, it transpires that all the internal workings of the board should be designed as a collegiate form of management.¹¹

The collegiate type of management is deeply rooted in Sweden, especially in the Swedish civil-service and judiciary traditions. Ever since the 17th century this has been the customary mode of operation within national Swedish administration; however, from the 19th century onwards it has been less common outside the courts of law and authorities of a judicial character. In the 1960s this form of management had something of a renaissance, not least at some Swedish universities where it was tried and still remains in use. Applied to a limited company, it means that board-members are *jointly* responsible for the company's administration. Under the guidance supplied by the chairman, the appropriateness of various measures is analysed on the basis of the company's fundamental objectives. Every board-member is expected to utilise his entire competence and capability for the good of the company. Decisions are made following the casting of votes (if necessary) by members, who give due consideration to the views of their colleagues. Ideally, a board of directors operates as one body dedicated to the best interests of the company; in such a case the collegiate mode of internal workings of the board is a way of safeguarding maximum quality in the joint decision-making, as far as the composition of the board allows.

When a board has to decide what means to adopt in order to realise the overarching goals set up for the company's activities, it is of course impossible to avoid conflicts between members completely. Different members may have dissimilar ideas as to how the articulated aims would be best achieved. Even so, a board will usually be able to function smoothly as an organ able to consider

¹⁰ Cf. Styrelseakademin 'the Board Academy'), *Vägledning till god styrelsesed*, Stockholm (2003).

¹¹ Dotevall, R., *Skadeståndsansvar för styrelseledamot och verkställande direktör*, Stockholm (1989), at 121.

various options in a spirit of neutrality, without having its objectivity compromised by interest-related bias. Another, and much more serious, potential type of conflict arises when individual members fail – for whatever reason – to consider the best interests of the company, serving other purposes instead. Such conflicts of interest may be detrimental to a board's ability to function optimally.

Chapter 8, Section 18, subsection 2 of the Companies Act regulates some central procedural aspects of the principle of collegiality as a form of management. The aim of these specifications is to ensure the highest possible quality in decision-making and to eliminate some potentially harmful (to the company) effects of the coexistence of dissimilar but vigorous interests within a company board. When it comes to assessing and valuing the legality of decisions made by the board, other regulations come into play.

4 Reasonable Time for Consideration, Consultation and for the Convening of Meetings

Under the Companies Act, the board of a company is intended to function as a collegiate organ, with no right for an individual member to make decisions for, or to act on behalf of, the company in that capacity. Consequently, the very basis for the administration implemented by the board is that it shall be a joint undertaking. It stands to reason that such a form of management cannot be maintained unless all members have opportunities to take part.

Since all board members are in the same position, none of them must be excluded from internal workings of the board in consequence of decisions or any other actions. This form of management presupposes *prima facie* that board meetings are convened in an appropriate manner, and that a sufficient number of members are present for the quality of the board's decision-making to be satisfactory. Members have considerable latitude when it comes to deciding how they want their meetings to be organised. There are hence no formal directions regarding the manner in which summonses to meetings should be issued, unlike the serving of notices convening general shareholders' meetings.¹² Judging from Chapter 8, Section 5, subsection 1 of the Companies Act, however, the legislator appears to have presupposed that the distribution of summonses to meetings will be laid down in a set of rules of procedure for the board: according to that section of the Act, the board's rules of procedure shall contain directions regarding the participation of deputies in board-meetings and state how those deputies should be summoned to meetings.¹³ As there are such rules pertaining to deputies, ordinary members should not be at a disadvantage in comparison with

¹² Johansson, at 193f.

¹³ The position of deputies is thoroughly discussed in Svernlöv, C., *Aktiebolagets suppleanter*, Stockholm (2nd ed., 2002).

them.¹⁴ True, deputies will know when regular meetings take place; but unlike ordinary members they are not always aware of when their presence will be required at a meeting.

Although the Companies Act does not expressly specify periods of notice and other formal aspects, the motives behind the Act supply some guidance in this respect. One of the reasons for the reform of the *Act (1976:351) on board representation for the employees of limited companies and incorporated associations* was that certain undesirable conditions had been discovered. For instance, materials for board-meetings were occasionally dispatched very late, and sometimes they would be incomplete; this meant that employee-representative members had limited opportunities to familiarise themselves with the relevant issues and consult with their contact and reference groups prior to board-meetings.¹⁵

It is essential for any board-member to be given sufficient time for consideration and consultation, because absence from a board-meeting does not automatically absolve him from responsibility for decisions made by present members. Absence without acceptable reasons may be regarded as neglect of one's duties, in that it entails a risk that a certain kind of competence is withheld from the work of the board. Another aspect which emphasises the need for a board to set up suitable routines for its meetings and summoning procedures is that it will otherwise be incapable of maintaining the firm grip on the company administration which a board is expected to have. That may also be held to constitute a dereliction of duty. The importance of rules for convening meetings is also apparent when those rules are scrutinised in the light of what constitutes the board's obligations. Once the board's areas of responsibility etc. have been specified for an individual company, decisions can be made as to how routines for meetings should be designed so that members can fulfil their obligations on reasonable terms.

A formal summons is to be dispatched in time before the meeting, at the very least one week in advance. This applies to internal workings of the board of a regularly recurring kind. If all members come together and their meeting was not originally planned as a board-meeting, such a get-together may be formalised if all members agree on this. If one or several board-members do not agree that the spontaneous get-together should be considered as a board-meeting, this is sufficient for formal inadequacies to be present, which means that no board-meeting took place.

If the chairman of a board is of the opinion that a meeting must be convened immediately, to avoid damage or to be able to utilise a commercially advantageous situation, the following considerations are likely to be relevant. It is clear from Chapter 8, Section 25 of the Companies Act that the managing director of a company is permitted to adopt a measure which is – in view of the extent and character of the company's activities – of an unusual nature, or of major significance, without the prior authorisation of the board, if a delay pending the

¹⁴ Govt. Bill 1997/98:99, at 209, 215.

¹⁵ Govt. Bill 1975/76:166, at 147.

board's decision would entail a serious drawback to company activities. In exceptional cases, then, a managing director is able to depart from those restrictions that normally follow from the fact that his scope for action is limited to current administrative measures. The existence of this rule reduces the need for summarily convened board-meetings to some extent, since the managing director is able to make most necessary decisions on his own. Even so, it is essential to observe that this extended right of representation only comes into operation when a reaction to certain circumstances is required in order to avoid trouble or to ensure that a profitable opportunity is utilised; in this respect, the limit to the right of representation is reactively rather than actively determined.

Even if board decisions are characteristically of the majority-decision type, a majority that exists at any one time is not allowed to sidestep the demand for due summoning by arguing that they would have won the vote in any case. The reason is that it cannot be excluded that some member or members might have changed their minds if the others had in fact been present and able to state their views of the matters discussed at the meeting.¹⁶ By introducing such a rule, the legislator aimed to prevent part of the board from ganging up and keeping the others out. The regulations prescribing that a board must adopt rules of procedure (Chapter 8, Section 5 of the Companies Act) lend additional emphasis to this aim and should induce boards to draft routines for summoning, even though the legal text does not expressly require it.

Oral summoning is also a possibility, if the rules of procedure admit it. In such a case a member's response can be confirmed immediately, so that a deputy may be summoned if the ordinary member is unable to attend. There is a fairly self-evident limitation: the board is a collegiate organ and must be given the opportunity to act as such. True, it is possible to convene a meeting at very short notice; but the relevant period of time has to be set following consultation with the other board-members. The choice of time will be made on the basis of how urgent it is to have a board-meeting, and with reference to the outcome of joint deliberation among members. The ambition must be to find a point in time which will allow the maximum number of members to attend. The importance of the issue to be debated will then be related to the chairman's efforts to gather the board as a whole at the earliest opportunity.

When rules on summoning procedure are drafted, the following aspects should also be taken into account. Suppose it is essential for members to show up at short notice, because a crucial issue is to be discussed. Two out of seven members cannot come as quickly as desired. Their deputies are able to attend, though. In this situation, the chairman should ask himself first whether the desirable quality in the board's decision-making can be maintained if the two ordinary members cannot be present, and second whether the deputies are really capable of familiarising themselves with the matter in hand. He must also assess what constitutes *satisfactory preparatory materials* for these two persons, who

¹⁶ This viewpoint has been expressed in preliminary materials pertaining to Swedish law ever since the Companies Act of 1910; *see*, for instance, Section 61 in that Act.

may not have been present at previous meetings and were hence unable to monitor the board's internal dialogue. When a meeting is occasioned by a crucial issue, knowledge of such discussions may be required as part of the necessary framework of the decision that the board is intended to make.

If ordinary members, on being summoned to a board-meeting (immediately or within a couple of hours' time), reply that they cannot be present for practical reasons, or that they need more time for consideration and preparation, the chairman is obliged to take their objections into account. This follows from the fact that the over-arching aim of the regulation is to create conditions enabling the board to operate in a meaningful way while counteracting attempted coups.

As we saw, the Swedish Companies Act says nothing about the frequency of board-meetings. The only thing it states is that the board shall decide on a board-meeting frequency once a year (Chapter 8, Section 5). Beyond that, it is the job of the chairman to ensure that meetings are held as required (Chapter 8, Section 15). The idea is that the frequency of meetings should be governed by the need for them, but that some planning is to take place on an annual basis. In other words, it is not certain that the planned frequency of meetings will turn out to be sufficient in view of the company's needs as they evolve in the course of the year.

How a summons to a board-meeting is to be designed, when it is to be issued, and what information should be made available to board-members prior to the meeting were reviewed in RH 1981:129. The core issues were the application of Chapter 8, Section 9, subsection 1, second and third sentences (now Chapter 8, Section 18, subsection 2), and Chapter 19, Section 1, item 2 of the Companies Act. The case concerned summonses etc. to a board-meeting in a limited company owned by a municipality. The mode of operation practised by the board in question was virtually identical with the ways in which municipal (local) committees and boards usually function. This everyday routine was deemed to be essential to the question of whether intent or negligence was involved, and the upshot was that the prosecution's case was dismissed. The assessment of the Court of Appeal underlines the importance of every board's settling its own mode of operation in its rules of procedure, and of board-members' being thoroughly acquainted with the board's mode of operation in those respects that are affected by legal rules.

In a 2002 court case, a district court was charged with the job of assessing – among other things – the content of a summons.¹⁷ In the course of a board-meeting on 4 May 1999, the board of the Stockholm local transport authority, *Stockholms Lokaltrafik (SL)*, decided to accept the intention of selling 60 per cent of the shares in its subsidiary *SL Tunnelbanan* (the Underground) *AB*, and to instruct the managing director to conclude negotiations concerning this deal. Most board-members knew of these plans a week in advance, whereas some were only informed an hour or two before the meeting. According to the rules of

¹⁷ The District Court of Stockholm, Case No. B2409-01 (17 May 2002). An appeal was lodged with the Court of Appeal, but the case had not been settled at the time of writing.

procedure adopted by this board, a summons accompanied by preparatory materials should normally be dispatched a week in advance. The deal described above was not mentioned in the summons. The District Court ruled that the chairman of the board had submitted information too late, being guilty of an intentional violation of the Companies Act regulations on a chairman's obligation to ensure that all members are in a position to participate in the handling of a matter before a decision is made.

5 Satisfactory Preparatory Materials

Apart from being entitled to the period for consideration and consultation referred to above, board-members shall receive an agenda stating what matters are to be addressed at the board-meeting. It must be clear from the summons or the agenda what factual points will be discussed. This must be considered to constitute a minimum level, which any chairman will be able to comply with at any one time. Normally, each item on the agenda should be accompanied by satisfactory materials preparing members for participation in the handling of all matters before the board.

Under Chapter 8, Section 18, subsection 2 of the Companies Act, decisions must not be made unless all board-members have received such satisfactory materials beforehand. Naturally, the point at which this demand for quality is to be considered fulfilled must be determined on an individual basis; but the chairman of the board and the company's managing director should work together to ensure that this demand is always met. The chairman's role is not the least important one here, as he should be in a position to decide how much in the way of preparatory materials members will require. According to the motives behind Chapter 8, Section 18 of the Companies Act, everything that is essential to the treatment of a matter should be contained in, and be clear from, the materials supplied. If not, those materials do not constitute satisfactory preparatory materials for decision-making purposes.¹⁸

The motives also stress that the preparatory materials should be as intelligible and informative as possible. When these instructions are exemplified, a main rule is presented: all documents and presentations shall be in the Swedish language. The materials should also be of suitable proportions and be reasonably easy to survey.¹⁹ There is, in other words, something of a *paedagogical obligation* on the part of the person in charge of compiling and distributing materials before board-meetings. Although the managing director is usually the person responsible for this job, Chapter 8, Section 14 of the Companies Act invests the chairman with a degree of responsibility for seeing to it that the materials continuously correspond to the board's requirements.

¹⁸ Govt. Bill 1975/76:166, at 174.

¹⁹ Govt. Bill 1975/76:166, at 173-174.

The question is whether the demand that satisfactory materials be supplied to members in plenty of time before the meeting, as far as this is feasible, can be considered to be met if no materials are distributed at all. The relevant legislation is based on the notion that written materials and oral presentations should complement each other. The managing director often plays a central role in these presentations. The written materials are necessary if board-meetings are not to become unreasonably protracted; but if no materials can be distributed beforehand, the managing director and the chairman of the board take it upon themselves to provide, in the course of the meeting, that background information which is necessary for ensuring that everything possible is done to comply with the demand for satisfactory materials to base decisions on.

What happens if a member claims that a decision cannot be made because he has not received enough in the way of preparatory materials? If the materials provided were identical for all members and he is the only person to hold this view, the managing director may be able to see to it that further clarification is supplied. That is in the best interests of all board-members, who may have their attention drawn to additional aspects of the relevant issue. If the recalcitrant member then sticks to his opinion, all he can do is to register a reservation if the board goes ahead and makes a decision despite his objections. The option of making a reservation has its limitations, though, in that a member must have access to information in order to know what he is making a reservation against. Generally speaking, making a reservation owing to deficient preparatory materials is not an entirely appropriate reaction. In this context, it might be pointed out that there should be no written reservations drafted before the meeting during which the issue giving rise to the reservation will be dealt with. Every member should participate in the discussion of the relevant matter and only make up his mind to make a reservation after that – a reservation which is then entered into the minutes in the customary manner.

The way in which Chapter 8, Section 18, subsection 2 has been drafted suggests that it is in fact a rule involving competence to make decisions. If that is so, any infringement of the regulation entails the effect of invalidity. As no individual member is in a position to argue that invalidity prevails, however, it is not meaningful to speak of such a legal effect. Rather, the consequences that might arise here involve liability to pay damages, or – in extreme cases – criminal liability. Under Chapter 15, Section 1, subsection 1 of the Companies Act, the former case requires somebody to have suffered financial damage, which is by no means a necessary corollary of a violation of the regulation in question.

One reason why all board-members must be supplied with not only identical but also satisfactory materials to base their decisions on becomes apparent when we look at the regulations on damages in Chapter 15, Section 1 of the Companies Act. If important information is withheld from certain members, their position may become exceedingly precarious in relation to the law on liability for damages, as well as being extremely hard to assess. If the worst comes to the worst, a person who suppresses information or acts in a fraudulent manner will render certain members liable to pay damages by denying them the opportunity to discharge their duties as board-members in the manner that shareholders are entitled to expect, and that the regulations in the Companies Act proceed from. It

follows that the entire system of regulations surrounding the board's work and position presupposes a considerable measure of integrity on the part of the chairman of the board and the managing director in relation to the board as a collective unit. This is emphasised by the fact that penalties under Chapter 19 of the Act may be incurred even in cases of negligence: consequently, great demands are made on the person responsible for compiling and distributing information to the board. At the same time, the motives state that penalties should only be considered if an applied procedure appears to be patently inappropriate when all the circumstances in the case are considered. There is hence after all a considerable latitude for misjudgement and miscalculation.²⁰

Let us suppose that a summons contains an agenda with two items on it, distributed a very short time before the meeting is scheduled to take place. First, the financial situation of the company is to be discussed; the second item is "any other business", an item which is usually reserved for the dissemination of information and not for important issues calling for decisions to be made during the meeting to which the summons refers. A curious board-member may contact the chairman to find out what is actually expected to be raised under the second heading. If, in reply to a direct question, the chairman announces that this will become clear during the meeting although it would in fact have been possible to answer the question then and there, his reply may well be in contravention of the regulation in Chapter 8, Section 18, subsection 2 of the Companies Act: it cannot be excluded that the chairman, by acting in this manner, denies board-members the right and the opportunity to prepare themselves before a board-meeting. In that case, such behaviour might constitute grounds for legal proceedings against the chairman. However, if the latter then objects and says that while he did realise the importance of what was to be discussed, he could not release any further information as all members were already (in his view) familiar with all the salient facts in the matter, a lawsuit would not be likely to result in a conviction. After all, a chairman cannot be called upon to indemnify himself against penalties by stating which parts of existing materials are particularly relevant to assessments and decisions pertaining to issues that will be dealt with during the board-meeting. If the chairman chooses to provide additional information, another dilemma arises: in that case, all members should receive the same information. If they do not, all members will not have been provided with identical materials prior to the meeting.

²⁰ Govt. Bill 1975/76:166, at 173.

6 Limited Right to be Present in Cases where a Member's Impartiality may be Challenged

So far, the presentation has dealt with the implications of legal requirements designed to protect the collegiate mode of management in a limited company. In some cases, though, the collegiate mode calls for one or several members to be excluded from the handling of certain issues. If a board-member pays more attention to certain specific owner interests than to the best interests of the company, the question arises whether such attention to certain interests might come under the application of the regulation on disqualification owing to partiality (Chapter 8, Section 20 of the Companies Act). If a person's impartiality is challenged, that constitutes an objection to his competence to act in a certain capacity when, according to the objection, circumstances prevail that may be considered to give rise to partiality in a decision-making situation. Trying to prevent such situations from arising on a board may be described as an expression of loyalty towards the company. A characteristic feature of a context involving loyalty is that Smith can only be loyal to Jones if there is an interest X that competes with Jones's interests. X may of course be (but does not have to be) identical with Smith's own interest; but it may also be an interest in respect of which Smith is neutral.

The regulation in Chapter 8, Section 20 of the Act specifies three situations in which a challenge to impartiality necessarily arises, prohibiting the board-member concerned from participating in *the processing of matters concerning a planned agreement* between:

- 1 the relevant board-member and the company;
- 2 the company and a third party, if the member has a significant interest which may conflict with that of the company;
- 3 the company and a legal person whom the relevant board-member may represent, on his own or in conjunction with some other person.

To judge from NJA 1982 p. 1, the term "agreement" definitely includes all legal acts pertaining to property law. In the three situations listed above, the board-member concerned lacks competence, and it is incumbent on the chairman of the board to supervise the position of board-members in this respect. With regard to the first item, a member's impartiality is challenged, and he hence disqualified, when the competing interest is identical with the person's own. The second item corresponds to the same kind of conflict of interest, according to the matrix set out above. Finally, the third deviates from the others in that it presupposes the existence of a legally sanctioned duty of loyalty both to the company and to the legal person whom the member intends to make an agreement with.

The stipulation in item 1 is intuitively easy to comprehend, but one aspect should be stressed here: a person who, in order to secure gains for himself, is able to influence both parties in a negotiating situation may imperil that interest (the company's) which he undertook to serve. The second item is somewhat more problematic than the first, as it is not clear exactly what constitutes a *significant interest*. If we accept that the purpose of company activities is exclu-

sively that of earning profits for shareholders, a point of reference is provided which may be used to delimit the meaning of the prerequisite. If, however, the argument is made that the picture of interests with a bearing on decision-making in the company is less clear-cut, item 2 above will only be applicable when the interests of the company and of the relevant board-member have been defined. Once that has been done, the question of whether the individual board-member's interest is significant will be determined by the chairman of the board.

The import of the 'significant interest' prerequisite was touched on in NJA 1982, p. 1. Here, partiality was found to exist in connection with the issuing of a promissory note to a board-member's wife.²¹ In this case, the board-member was considered to have a 'significant interest' which conflicted with the company's, and he should therefore not have taken part in the handling of the matter. Irrespective of the situation as regards the division of property in the spouses' marriage, the Swedish Supreme Court was of the opinion that the board-member must, *in his capacity of spouse*, have had a significant interest in matters pertaining to such a contractual relationship. The decisive point here was not the financial gain that might have ensued from the promissory note's being issued to the wife, but the nature of their relationship. If the financial interest was not decisive when it came to engendering significant interest of a kind that would entail partiality, the crucial factor in the assessment would be the loyalty between the spouses. This is an interesting point, in that the case involves a recognition of the possibility that such a moral obligation may acquire legal implications.

When a board-member – on his own, or together with another person – is at the same time a representative of another legal person, the situation raises the possibility of disqualification for partiality in accordance with the third listed item above (representative partiality), even if the member has no identifiable interest that might conflict with that of the company. There is held to be a risk that he might be affected by double loyalties.²² In such a situation, it is difficult to tell which object of loyalty – that is, which of the companies concerned – will suffer from this conflict.

Judging from the way in which the regulation on disqualification owing to partiality was designed, there is no obstacle to individual members' *de facto* regarding themselves, now and again and at a general level, as representatives of a certain particular interest. An example might be provided by way of illustration. A board-member A, appointed by a bank which has lent large sums of money to the company, may have other ideas about changes in the company's capital structure than the other board-members. Suppose the company is to make a deci-

²¹ See also NJA 1981, at 1117, according to which the regulation on disqualification owing to partiality is intended to protect the interests of the company, i.e. ultimately the shareholders' interest in gaining a profit.

²² S. Andersson, Johansson, S. & Skog, R., *Aktiebolagslagen. En kommentar. Del 1*. Stockholm (2003) 8:47; Govt. Bill 1997/98:99, at 94ff.; and Olinder, R. *De nya bestämmelserna om ställföreträdarjäv – ett skydd mot skadligt inflytande från främmande intressehänsyn i bolagsförvaltningen*, Rättsvetenskapliga studier tillägnade minnet av Knut Rodhe/Studies in jurisprudence in memory of Knut Rodhe, Stockholm (1999), at 303ff.

sion regarding the acquisition of capital, and there are two alternatives: a new share issue, or a loan from a bank that offers better conditions than the bank represented by the member A. A may then recommend a new issue. Irrespective of A's attitude to the capital acquisition, I cannot see that the issue of disqualification owing to partiality, in the sense articulated by the Companies Act, would arise in this situation: after all, there is no question of *the processing of an intended agreement* between the company and any person to whom the regulation on partiality would apply. However, if A were to advocate borrowing more money from A's own bank as an alternative solution to the current funding problem, a situation entailing a challenge to A's impartiality would of course arise. Nor would the composition of the board at the time when the decision on capital acquisition was made give rise to concern about the violation of any other duty of loyalty to the company that might be concretised in legal rules. Even so, I believe most people would feel that there is a potential conflict of interests between A (and the interests represented by A) and the company. Does this mean that there are some conflicts of interest that do not affect a board-member's competence? Strictly speaking, it is of course impossible to argue otherwise. Here, then, we discern a limit to the duty of loyalty under Swedish corporate law.

The regulation pertaining to disqualification on the grounds of partiality in Chapter 8, Section 20 of the Companies Act may be seen as an expression, and an explicit clarification, of the principle of loyalty. Viewed from this perspective, it defines a minimum level of loyalty that a board-member is required to observe in relation to the company.

7 The Managing Director's Right to be Present at Board-meetings

Under Chapter 8, Section 16 of the Companies Act, a company's managing director has a right to be present when the board meets, even if he is not a board-member. According to Chapter 8, Section 21 he is also entitled to having a dissentient opinion entered in the board minutes. In practice, one might say that internal workings of the board is hardly feasible without the active participation of the managing director, the person who knows more about the company's business than anybody else.

Normally, then, the managing director of a company should be present at board-meetings, irrespective of whether he is a member of the board.²³ This applies unless the board has decided otherwise in a particular situation, for instance because the issue of dismissing the managing director is an item on the agenda. In most cases it is the managing director who is responsible for the implementation of board-meetings, and the agenda is drafted by him and the chairman to-

²³ This view of the managing director's obligation to be present was first discussed in the report preceding the Companies Act of 1944, SOU 1941:9, at 329; *see also* Govt. Bill 1997/98:99, at 215.

gether. This distribution of duties confirms the expected co-operation of these two company organs, as well as their interdependence. Current administrative measures (the managing director) must be linked to long-term strategic choices (the board).

While it is perfectly possible to conduct a board-meeting in the absence of the managing director, the situation becomes somewhat difficult if one of the members feels that his presence is indispensable. Suppose the critical member argues that a decision cannot be made without an adequate description of the current situation by the managing director. Should the chairman, or some other member, fail to make up for this particular deficiency, or to produce valid reasons why a decision should nevertheless be made, it is hard to escape the conclusion that this situation touches the area covered by penalty clauses. The argument that the critical member may voice a dissenting view on the basis of Chapter 8, Section 21, subsection 3 of the Companies Act is inadequate here, as a reservation should not be resorted to in a situation where the member cannot be certain whether he agrees with the others or not. The option of submitting a reservation is no substitute for the right to be provided with satisfactory materials to base a decision on.

8 Violation of *Procedere* as Grounds for Invalidity

The board of directors is appointed by the shareholders' general meeting for the purpose of administering the company. Therefore, an infringement of a board-member's right to participate in the work of the board constitutes, by extension, a violation of the shareholder's rights. The problem is accentuated if the work of the board is affected by a conflict between different owners. Hence it would be possible to consider – as Johansson has done – whether a violation of *procedere* might not be punishable by invalidity, rather than by a penalty.²⁴ However, such an argument is flawed where employee-representative board-members are concerned, since their right of representation cannot be derived from the rights of shareholders. This circumstance might go some way towards accounting for the legislator's electing to introduce a penalty under special criminal law rather than resorting to invalidity as a way of promoting these board-members' interest in being able to take part in the work of the board. It does not, however, explain why these sanctions pertain to all board-members.

According to Andersson, Johansson, and Skog, a decision made by a board of directors is invalid if it has not been made in the appropriate manner.²⁵ In this context, invalidity means that there is no board decision; the fact that nobody is obliged or even able to implement such a decision underlines that dimension. One example of a situation in which invalidity comes into play is the violation of

²⁴ Johansson, at 193f.

²⁵ Andersson, Johansson, & Skog 8:43, at 2.

the regulation on impartiality in Chapter 8, Section 20 of the Companies Act.²⁶ Invalidity may also arise in the case of an infringement of, for instance, Chapter 8, Section 18, subsection 2 of the Act. Suppose a few members were neither given the opportunity to participate in the processing of the matter in hand, nor were they provided with satisfactory materials to base their decision on. If invalidity arises in this situation, does that mean that no decision by the board exists, and in that case, who is in a position to insist that such a legal consequence obtains? Chapter 8, Section 34, subsection 2 of the Companies Act states that company representatives are not permitted to implement an invalid decision; but if that were to happen anyway, how should the situation arising from such an implementation be regarded?

NJA 1928, p. 433, is illuminating in the present context.²⁷ In this case, the Articles of Association of a company called Varbergs Snickeriaktiebolag (a carpentry firm) stipulated that the board should consist of three members (the managing director being one, *ex-officio*) and one deputy member. In the Supreme Court's opinion, the board was unable to make a decision on a matter unless three members whose impartiality could not be challenged *had taken part, or been summoned to take part* in the processing of the relevant matter. Apparently it would have been sufficient for a quorum if the deputy had been summoned, even though he did not appear at the meeting; this was because the Articles of Association did not contain any directives pertaining to the grounds for the board's competence to make decisions. In this case the board-meeting took place with the three ordinary members, and as one of them was disqualified on the grounds of partiality, the deputy should have been summoned. According to the Supreme Court, the board was consequently not competent to make a decision regarding remuneration to the managing director. Judging from the grounds for the Court's judgment, the decision would probably have been valid if only two members had made it; but in that case the managing director could not have been one of them, and the deputy should at least have been summoned to take part in the handling of the matter. It is also clear from this case that the relevant formal inadequacies must have affected the decision if invalidity is to arise. If that is patently not the case, the general opinion is that the decision may be implemented.²⁸

The Companies Act does not establish the consequences under civil law of non-compliance with the rules on *procedere* in Chapter 8, Section 18, subsection 2. It merely states that decisions must not be made under such conditions. The conclusion that the relevant decision does not exist, and is hence a nullity, seems closest at hand. That conclusion is problematic, though, as a nullity is only a nullity if a court of law can confirm it. This does not *per se* mean that such a confirmation is required, but it must be possible to obtain one. If not, the matter

²⁶ See NJA 1981, at 1117.

²⁷ The case is described in detail by Åhman, at 758.

²⁸ See Åhman, at 743 with references.

does not involve any kind of sanction, and hence no legal consequence arises. Suppose a vote on the board would have yielded the same conclusion as the putatively invalid decision even if *procedere* had been observed. If so, and if this can be shown to be the case, the invalidity consequence appears too Draconian and stereotyped. Should the relevant criticism amount to a board-member's not having been provided with satisfactory materials to base his decision on, the same conclusion obtains. In this context, the rules on the company organs' right of representation – in Chapter 8, Section 35 of the Companies Act – must be taken into consideration as well. A board-member who has serious objections to make against a certain decision-making procedure is unlikely to possess the competence required to initiate legal proceedings as a way of protesting against the alleged invalidity.

To a certain extent, procedural safety measures contained in Chapter 15 of the Swedish Judicial Procedure Act may be utilised by a minority in order to prevent or delay the implementation of *a decision made by a shareholders' general meeting*, if that decision is felt to be in contravention of the Companies Act.²⁹ Whether the same procedure can be resorted to as a means of staying the execution of *a decision made by a board of directors* is not clear, however. If a board's decision is to be made the object of safety measures because *procedere* has not been observed, the question of who is entitled to take legal action comes up again. If the relevant conflict exists within the board itself, an individual member might wish to resort to a procedural measure of the type involved here; but as an individual board-member, he would lack the required competence and would hence not be in a position to sue.³⁰ Even if a representative is the only person authorised to sign for the company, the issue of who is entitled to take legal action usually comes to nothing because competence under the Companies Act does not comprise measures of this kind.³¹

The only realistic alternative available seems to be for the disadvantaged member (or members) to address the shareholders' general meeting and draw its attention to the matter. If, having done so, the complaining board-member finds that majority conditions are such that there is insufficient support for redressing measures, it would seem that as far as the board is concerned, all options with a bearing on the question of invalidity have now been exhausted. The conclusion should be that invalidity (meaning that the relevant legal action is not valid with regard to its content) cannot be held to constitute the ordinary legal consequence of a board decision's not having been made in the proper manner.

²⁹ For a discussion of these matters, see P. Westberg, *Civilprocessuella tvångsåtgärder – ett instrument för konfliktlösning?* SvJT (1990), at 161ff.; and S. Johansson, *Interimistiska åtgärder vid aktiebolagsrättsliga processer*, SvJT (1991), at 601ff.

³⁰ See NJA 1993, at 605, where a similar question concerning the right to take legal action is presented and discussed. The owner of all shares in a debtor company took action on the latter company's behalf, insisting that the decision to declare the company bankrupt be rescinded.

³¹ See NJA 1997 at 168.

9 Concluding Remarks

In cases involving violations of the rules reviewed above, the penal sanctioning in Chapter 19 emerges as the central remedy, rather than invalidity. This appears both peculiar and inconsistent. Why, for example, are inadequacies in the summoning of shareholders to general meetings not the object of corresponding remedies? One reason for choosing this type of sanction is that a penalty is really only intended to arise when interests that cannot be legitimated with reference to shareholders' rights are to be protected. In corporate law, the connection between individual board-members and shareholders is usually so patent that any serious deficiencies where decision-making is concerned may at least be followed up at the level of ownership. This possibility is not open to employee-representative board-members; they therefore find themselves in a state of organisational disharmony in relation to those institutional conditions under which limited companies exist, and as a result a remedy of the kind outlined here is necessary. If that is correct, clarification is called for; besides, the pertinent rules in penal law should be unambiguously linked to the law on board representation, instead of – as is now the case – constituting a general form of sanction under corporate law.

The rules on summoning in the Companies Act of 1975 constituted a tightening-up in relation to previous corporate law. This greater stringency was a consequence of legislation concerning board representation for employees in private enterprise, the intention being to eliminate the risk of sabotage to employee participation in the work on company boards. The legislator chose to counter this risk by imposing penal sanctions on violations of the rules on information and procedure. The fact that a breach of the rules on summoning carries a penal sanction is not necessarily advantageous for a board minority, though. True, the state can be made to bear the costs of litigation, as the pursuit of redress may be set in motion following a representation to the public prosecutor; but at the same time the minority will be dependent on what the prosecutor thinks about the prospects of securing a conviction. As certain actions and omissions constitute criminal acts, it is also reasonable to assume that the necessity of providing corroborating evidence will reduce the likelihood of the remedy being deemed applicable except in the case of apparent and gross transgression. In fact, the problem of what constitutes a typical act is generally hard to solve where crimes of this kind are concerned. Even if it is possible to arrive at some sort of delineation of what 'sound board practice' amounts to, every single board of directors must still design its own modes of operation within the framework of far-reaching freedom of action – a necessary freedom if the board is to function optimally. Consequently, it is an exceedingly problematic business to assess the penalty value of a certain mode of action – or a certain kind of negligence – that is specifically orientated towards the internal aspects of the workings of the board and thus not necessarily connected with company activities. Even if a board's modes of operation are flawed in one or several respects, those deficiencies need not affect the business of the company, or its shareholders, in such a way that financially measurable effects arise.