CORPORATE LAW AND
INTERNATIONAL CORPORATE LAW AND FINANCIAL MARKET REGULATION
INTERNATIONAL CORPORATE LAW AND FINANCIAL
INTERNATIONAL CORPORATE LA
INTERNATIONAL CORPORATE LAW AND FINANCIAL MARKET REGULATION
INTERNATIONAL CORPORATE LAW AND FINANC
AND FINANCIAL
MARKET REGULATION
INTERNATIONAL CORPORATE LAW AND FINANCIAL MARKET REGULATION
AND FINANC

INTERNATIONAL CORPORATE LAW AND FINANCIAL MARKET REGULATION

Perspectives in Company Law and Financial Regulation

EDITED BY MICHEL TISON,
HANS DE WULF,
CHRISTOPH VAN DER ELST AND
REINHARD STEENNOT

CAMBRIDGE

8

The Nordic corporate governance model – a European model?

JESPER LAU HANSEN

I. A need for further harmonization?

Depending on your temper, there may be something slightly saddening about looking at the European directives on company law; a feeling that a great momentum has ground to a halt. Then again, you may feel relief.

In the beginning harmonization appeared to be as easy as one, two, three: the First Company Law Directive on publicity and company formation,[1] the Second Company Law Directive on capital[2] and the Third Company Law Directive on mergers.[3] But there soon came the first major stumble, when the proposal for a Fifth Company Law Directive on corporate governance[4] was first brought to a halt, then forgotten and finally abandoned.[5] Although new directives would continue to be adopted with

[1] First Council Directive 68/151/EEC of 9 March 1968 on coordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 58 of the Treaty, with a view to making such safeguards equivalent throughout the Community [1968] OJ L65.

[2] Second Council Directive 77/91/EEC of 13 December 1976 on coordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 58 of the Treaty, in respect of the formation of public limited liability companies and the maintenance and alteration of their capital, with a view to making such safeguards equivalent [1977] OJ L26.

[3] Third Council Directive 78/855/EEC of 9 October 1978 based on Article 54 (3) (g) of the Treaty concerning mergers of public limited liability companies [1978] OJ L295.

[4] Proposal COM/72/887 for a fifth Directive on the coordination of safeguards which for the protection of the interests of members and outsiders, are required by Member States of companies within the meaning of Article 58, second paragraph with respect to company structure and to the powers and responsibilities of company boards [1972] OJ C131.

[5] See the Commission's decision to withdraw this proposal and others in OJ C 5, 9.1.2004, 2.

the Sixth Company Law Directive on the division of companies, this was not quite the same, as this Directive was optional in its entirety.[6] Later, a proposal for a Ninth Company Law Directive on corporate groups was never even adopted by the Commission,[7] which left a gap between the Eighth Company Law Directive on auditing[8] and the Eleventh Company Law Directive on branches,[9] a gap that was widened by the stalling of the proposal for a Tenth Company Law Directive on cross-border mergers.[10] And when that Directive was eventually passed[11] – due, as is so often the case, to the gentle but firm assistance of the European Court of Justice[12] – it no longer carried a number in its title, leaving a permanent gap in the numbering. In omitting its number, it emulated the Directive on takeover bids[13] which had originally been presented as a proposal for a Thirteenth Company Law Directive[14] before suffering a humiliating defeat at the

[6] Sixth Council Directive 82/891/EEC of 17 December 1982 based on Article 54 (3) (g) of the Treaty, concerning the division of public limited liability companies [1982] OJ L378.

[7] The lack of European harmonization within this area was lamented by the Forum Europeaeum, *Corporate Group Law for Europe*, (Stockholm: Corporate Governance Forum, 2000).

[8] Eighth Council Directive 84/253/EEC of 10 April 1984 based on Article 54 (3) (g) of the Treaty on the approval of persons responsible for carrying out the statutory audits of accounting documents [1984] OJ L126.

[9] Eleventh Council Directive 89/666/EEC of 21 December 1989 concerning disclosure requirements in respect of branches opened in a Member State by certain types of company governed by the law of another State [1989] OJ L395.

[10] Proposal for a tenth Directive of Council based on Article 54(3)(g) of the Treaty concerning cross-border mergers of public limited companies, COM(84) 727, later revised as COM(1993) 570 final. The proposal was withdrawn in 2004, see footnote 5 *supra*.

[11] Directive 2005/56/EC of the European Parliament and of the Council of 26 October 2005 on cross-border mergers of limited liability companies [2005] OJ L310.

[12] The right to carry out a cross-border merger in accordance with provisions in national law was upheld by the ECJ on the basis of Articles 43 and 48 of the EC Treaty (i.e. primary European law) in its decision of 13 December 2005 in Case C-411/03, *SEVIC Systems*, [2005] ECR I-10805, making the adoption of the Directive the only way for the Member States to regulate this activity under secondary European law. On this judgment, see M. M. Siems, 'SEVIC: Beyond Cross-Border Mergers', *European Business Organisation Law Review*, 8 (2007), 307–16, noting the further implications of the judgment on related problems such as the transfer of a company registered office.

[13] Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids [2004] OJ L142.

[14] Proposal for a thirteenth Council Directive on company law concerning takeover and other general bids in COM(88) 823 final, which was revised in COM(90) 416 final of 10 September 1990, and revised again more thoroughly in COM(95) 655 final of 7 February 1996.

hands of the European Parliament,[15] and it was only passed after all its controversial parts had been made optional,[16] leaving it vulnerable to the accusation that it did not comply with the principle of subsidiarity enshrined in Article 5 of the EC Treaty.[17] With the recent declaration by Commissioner Charlie McCreevy that the proposal for a Fourteenth Company Law Directive on the cross-border transfer of a company's registered office will not be proceeded with, as no further action is deemed necessary in this area,[18] it would appear that the Twelfth Company Law Directive on single-member companies adopted in 1989 will be the last of the line.[19] Indeed, when the Directive on shareholders' rights was adopted, it was not presented as a Company Law Directive, but more as an appendix to the regulation of publicly traded (listed) companies as it does not apply to all companies, or even to all companies of the PLC type, but only the sub-set of companies whose securities are admitted to trading on a regulated market.[20] Regulation of company law *per se* seems to have been superseded by the regulation of publicly traded companies in order to enhance the working of the financial markets.

As the harmonization of national company law has ground to a halt, the situation has hardly been any better with European company law

[15] On the defeat of the proposal by the European Parliament in 2001 and the preparation of a new proposal that was eventually passed, see J. L. Hansen, 'When less would be more: The EU Takeover Directive in its latest apparition', *Columbia Journal of European Law*, 9 (2003), 275–298.

[16] The controversial parts are Article 9 (requiring the board of a target company to remain passive in face of a takeover bid) and Article 11 (providing a 'breakthrough rule' which allows a bidder, upon acquiring at least 75% of the capital, to call a general meeting at which all shares carry votes in proportion to their capital and all other limitations on voting are set aside). Article 9 conflicts with the German corporate governance model which allows management considerable discretion to decide on the welfare of the company. Article 11 conflicts with the ubiquitous use of multiple voting shares in the Nordic Member States. Both Articles 9 and 11 are optional for the Member States, though a Member State cannot prevent a national company from applying these provisions, see Article 12.

[17] Article 5, second paragraph reads: 'In areas which do not fall within its exclusive competence, the Community shall take action, in accordance with the principle of subsidiarity, only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States and can therefore, by reason of the scale or effects of the proposed action, be better achieved by the Community.'

[18] Speech by Commissioner McCreevy on 3 October 2007 at the European Parliament's Legal Affairs Committee in Brussels, (SPEECH/07/592).

[19] Twelfth Council Company Law Directive 89/667/EEC of 21 December 1989 on single-member private limited-liability companies [1989] OJ L232.

[20] Directive 2007/36/EC of the European Parliament and of the Council of 11 July 2007 on the exercise of certain rights of shareholders in listed companies [2007] OJ L184.

as such. For many years the only truly European company entity was the European Economic Interest Grouping (EEIG) adopted in 1985.[21] As an entity without limited liability and without the capacity to conduct business, the EEIG remained unwanted by many and unknown to most. What should have been the flagship of European harmonization, the creation of a European public limited liability company to challenge the various national forms of company while sailing under the grand Latin name of *Societas Europaea* (SE), remained unfinished for more than forty years while successive rounds of negotiations chipped away at it until the resulting hulk was so diminished and so full of holes that the SE could not possibly keep itself afloat above the jurisdictions of the Member States, as originally envisioned.[22] Thus the true European SE does not exist; what exists is a national SE, e.g. a Danish SE as opposed to a German SE, and so far very few SEs have been formed.

A survey of the harmonization efforts so far reveals that it is the issue of corporate governance that most often has delayed or even hindered harmonization. In particular the participation of workers (co-determination) appears to have been a contentious issue. Although a solution of sorts has been provided by the model invented for the SE company,[23] the organization of a company and the internal distribution of powers remain controversial and thus remain unharmonized.

This is not to belittle the extent of the harmonization that has been achieved over the years, but compared to the high degree of harmonization of financial market law on banking, insurance and securities trading, it is undeniable that the harmonization of company law so far is considerably more modest.

The lower level of harmonization of company law than of financial market law is not necessarily a failure. A similar distinction has been observed in the United States of America, where securities trading and exchange law has been harmonized to a great extent by federal law, while company law remains a matter of state jurisdiction, with

[21] Council Regulation (EEC) No 2137/85 of 25 July 1985 on the European Economic Interest Grouping (EEIG) [1985] OJ L199.

[22] Council Regulation (EC) No 2157/2001 of 8 October 2001 on the Statute for a European company (SE) [2001] OJ L294. Article 5 in particular springs a major leak in the vessel as it refers all questions of capital to national law. Although some harmonization of capital requirements has been provided by the Second Company Law Directive (note 2, above), this broad reference to national law means that an SE is stuck in the jurisdiction where it is formed.

[23] Council Directive 2001/86/EC of 8 October 2001 supplementing the Statute for a European company with regard to the involvement of employees [2001] OJ L294.

only some harmonization by way of the Model Business Corporation Act (MBCA).[24] It has been argued that the distinction between federal securities regulation and state company law mirrors the distinction in Continental European law between public and private law.[25] This has some merit, as private law is characterized by having less extensive regulation, because individual parties are expected to be able to negotiate in their own interests, whereas public law relies on more extensive regulation, because the parties and interests involved are not equally capable of protecting themselves. Thus, the distinction between more harmonized financial market law and a less harmonized company law may reflect the fact that harmonization is required for financial market law but is unwarranted for company law.

Support for this proposition can be found in the fact that the company law of most European jurisdictions is traditionally of an enabling nature, leaving considerable discretion to the participants in the company to negotiate the arrangements between them, except for provisions on capital where the protection of creditors as 'outsiders' is deemed necessary. To the extent that the national jurisdictions of the Member States abstain from regulating corporate governance issues to allow for greater flexibility, then the EU should follow suit, in compliance with the principle of subsidiarity.

The brief survey of harmonization at the start of this article is a reminder of something else. All secondary European law must have a basis in primary European law. In the case of the harmonization of company law that used to be Article 54 of the EEC Treaty, now Article 44 of the EC Treaty, notably its subsection (3)(g) which concerns 'safeguards' for the protection of the interest of members and others, that is, creditors. However, since the Single European Act of 1986 had the aim of introducing an 'internal market' in lieu of the 'common market' that had eluded the politicians of the Member States, the aim of harmonization appears to have been broadened. A case in point is the Directive on shareholders' rights, which refers both to Article 44 on 'safeguards' and Article 95 on the establishment and functioning of the internal market.[26] Where Article 44 is more modest in scope and strives to harmonize these

[24] The MBCA and the revised MBCA is prepared by the Committee on Corporate Laws of the Section of Business Law of the American Bar Association. It has been adopted by many states, but some jurisdictions of major importance for company law have not adopted it, notably Delaware.

[25] See A. N. Licht, 'International Diversity in Securities Regulation: Some Roadblocks on the Way to Convergence', *Cardozo Law Review*, 20 (1998), 227–85.

[26] On the Directive, see note 20, above.

'safeguards', Article 95 is much more open to the argument that any difference, no matter what, should be subject to harmonization in order to iron out any hindrances to cross-border activity. The principle of subsidiarity and the related principle of proportionality, both laid down in Article 5 of the EC Treaty, would prevent this kind of argument. When it comes to corporate governance, there is even more reason to object to a harmonization aimed at creating a single European model. There is no empirical evidence to suggest that a superior corporate governance system exists. Nor is it likely that one could be identified by academics or lawmakers when the market participants themselves have been unable to do so through generations of competitive market behaviour. Indeed, as noted by the Commission, all available expert evidence cautions against imposing one model of corporate governance to fit all.[27]

Consequently, the fact that the harmonization of company law appears to have slowed down and may even have stopped altogether (except for issues pertaining to regulated markets and listed companies) may be due to the fact that the necessary harmonization has been achieved and that those parts where national jurisdictions differ, notably in the field of corporate governance, should remain unharmonized, as there is no single model that would be best for all. Different corporate governance models may suit different needs. If there is any need for harmonization, it ought to be in providing flexibility for the citizens of the EU, so that different jurisdictions should offer a choice of the different corporate governance models available throughout Europe. However, even here there may be no need for European legislation, as the ECJ has already provided such flexibility by its judgments granting the freedom to choose any jurisdiction for the formation of a company and the freedom to move that company within the EU.[28]

[27] Communication from the Commission to the Council and the European Parliament – Modernising Company Law and Enhancing Corporate Governance in the European Union – A Plan to Move Forward, COM(2003) 284 final of 21 May 2003, pp. 10–12.

[28] The landmark decision was the judgment of 9 March 1999 in Case C-212/97, *Centros Ltd.*, [1999] ECR I-1459. The judgment relied on previous decisions, notably Case 270/83, *Commission* v. *France*, [1986] ECR 273 and Case 79/85, *Segers*, [1986] ECR 2375. The judgment in the earlier Case 81/87, *The Queen* v. *Treasury and Commissioners of Inland Revenue, ex parte Daily Mail and General Trust*, [1988] ECR 5483, established that a company had no right to transfer its registered office as this was not in accordance with Article 220 of the EEC Treaty (now Article 293 of the EC Treaty). However, in its judgment of 5 November 2002 in Case C-208/00, *Überseering BV v. Nordic Construction Company Baumanagement GmbH*, [2002] ECR I-9919, the ECJ pointed out that *Centros* concerned recognition of foreign companies and the resulting freedom of establishment, whereas *Daily Mail* concerned a transfer of registered office, see paragraph 40. See

II. A distinct Nordic model?

The corporate governance debate in Europe is dominated by the distinction between the one-tier model known in English law, where there is only one company organ (the board of directors) below the general meeting of shareholders, and the two-tier model where there are two company organs below the general meeting (the management board and the supervisory board) known in German law. At first glance, the Nordic model would appear to be a two-tier model, because there are two company organs below the general meeting (the board of directors and the management board, that is, a dual executive system). However, if the purpose is to place the Nordic system in relation to this prevailing dichotomy, the model must be seen as belonging to the one-tier group.[29]

The model was first developed in the reform of the Danish Companies Act of 1930. Before the reform, the prevailing corporate governance model was the one-tier model with a single administrative company organ: the board of directors. During the deliberations on reform of the law, it was argued convincingly that liability should follow capability, and in very large companies the board of directors was not alone in running the company; the senior management headed by the chief executive officer (CEO) would effectively decide all the daily business, subject of course to the instructions of the board, but often with considerable autonomy. Consequently, the Act of 1930 provided that large companies[30] should have another company organ below the board of directors, that of the management board. This model was adopted by Sweden in the reform of its Companies Act in 1944, and later spread to the other Nordic countries, Finland, Norway and Iceland. As the Nordic countries entered either the EU or the EEA,[31] they had to introduce the originally German distinction between public companies and private companies.[32]

on this distinction, J. L. Hansen, 'A new look at Centros – from a Danish point of view', *European Business Law Review*, 13 (2002), 85–95. With its judgment in the *SEVIC* case, the ECJ has in effect made it possible to transfer the registered office by way of a cross-border merger, see footnote 12 *supra*.

[29] On the Nordic corporate governance model, see J. L. Hansen, *Nordic Company Law*, (Copenhagen, DJØF Publishing, 2003), 57 – 141.

[30] Companies with a paid up share capital of DKK 100,000, a considerable sum at the time.

[31] Denmark joined the European Community along with the United Kingdom and Ireland in 1973. Finland, Iceland, Norway and Sweden joined the European Economic Area in 1994. Finland and Sweden later joined the EU in 1995.

[32] The distinction was introduced in Germany in 1892 with a separate law on the GmbH, a private limited liability company, that was to be regulated more lightly than the AG,

At that time, the dual executive system became mandatory for all public companies, whereas it remained optional for private companies.[33] In its present form, the corporate governance model of the public company is identical in all five Nordic countries, except for the minor fact that the management board in Denmark and Iceland can be a collective body with more than one member, while in Finland, Norway and Sweden it is a one-member body comprising the CEO.

Several features indicate that, in a European context, the Nordic dual executive system is a one-tier model. The system is strictly hierarchical. The general meeting of shareholders is the supreme company organ with all the residual powers not explicitly denied it by legislation. However, the general meeting does not have executive powers and must thus rely on the two executive organs to carry out its instructions. Of the two executive organs, the board of directors is the senior organ and can instruct the management board. The management board deals with the day-to-day running of the company, under the instructions of the board of directors and submits to the board of directors any extraordinary or far-reaching decisions. To ensure the hierarchical nature of the model, the upper level appoints and dismisses members of the lower level. Thus, the general meeting of shareholders appoints the directors and may dismiss a director at any time and the board of directors hires and fires the managers.[34] Others may also have a right to appoint directors, if the articles of association so provide, and the employees may appoint

a public limited liability company. The stricter regulation of public limited companies compared to private companies is reflected in the European directives, notably the Second Directive on capital (footnote 2 *supra*) which only applies to public companies. In order to avoid the stricter regulation of all limited companies, new Member States had to introduce a similar distinction. It should be noted that a public company is public by its choice of company form and not because it is publicly traded on a stock exchange (regulated market), as would be the understanding in US law. Since most of the protection afforded to investors is given in respect of publicly traded companies, and since the revision of the Second Company Law Directive by Directive (2006/68/EC) has eased the strict regulation of capital, the distinction in company law between a 'public' company and a 'private' company is moot and should be replaced by a distinction between publicly traded companies and other companies with limited liability.

[33] If a private company is subject to co-determination, it may be obliged to have both a board of directors and a management board.

[34] The power to dismiss a director at any time prevents the occurrence of 'staggered boards' which may curtail shareholder influence, as is known in some American jurisdictions. The power to dismiss a director or a manager without reason is different in German company law, where a member of a management board (*Vorstand*) can only be dismissed for good reason, see AktG § 84, subsection 3.

directors according to legislation on co-determination,[35] but the majority of directors must always be appointed by the shareholders in a general meeting. As the board of directors decides by simple majority, this mandatory provision ensures that the shareholders enjoy actual power over the board. The strict hierarchy of the dual executive system is very different from the two-tier model known in Germany, where the power of shareholders is limited and the management board is entrenched. Another difference is that under the Nordic system, managers may serve as directors (dual capacity), which is unlawful in the German model. However, in the Nordic model, managers may only constitute a minority on the board of directors and a manager cannot serve as a chairman of the board of directors, which enhances the supervision of the management board by the board of directors.

Although clearly related to the one-tier model and quite distinct from the two-tier model, the Nordic model also has characteristics which set it apart from the one-tier model. Most notable is the allocation of powers between the board of directors and the management board, both being independent company organs with distinct powers and responsibilities. It may be argued that the English corporate governance model has evolved in the same direction since the Cadbury Report of 1992, which emphasized the need to separate the functions of executive and non-executive directors to enhance supervision of the former by the latter.[36] However, there is still a greater emphasis on this separation in Nordic law than in English law. Another minor difference is that the Nordic model is governed by legislation, while the English model relies much more on the soft-law recommendations of the Combined Code of the London Stock Exchange. However, here it is the Nordic countries that appear to be emulating the English approach in providing more regulation by soft law, in the form of codes rather than by legislation.[37]

That the Nordic corporate governance model is different from the models more commonly known in the European corporate governance debate is apparent from the Regulation on the SE statute, where it is difficult to fit the Nordic dual executive system in between the Regulation's

[35] Co-determination, where employee representatives serve as directors, is known in Denmark, Norway and Sweden, and to some extent in Finland, but not in Iceland.

[36] Report of the Committee on the Financial Aspects of Corporate Governance, 1 December 1992.

[37] See J. L. Hansen, 'Catching up with the crowd – but going where? The new codes on corporate governance in the Nordic countries', *International Journal of Disclosure and Governance*, 3 (2006), 213–32.

two corporate governance models of either a one-tier or a two-tier system.[38] It is also evident that the Commission's Recommendation on the role of directors relies on the distinction between a unitary board system and a dual board system akin to the one-tier/two-tier and not the Nordic dual executive system.[39]

However, what really sets the Nordic model apart is not the law but the reality on the ground. There is a predominance of controlling shareholders who either on their own or together with a few others hold enough votes to control the decisions of general meetings; this is even the case in publicly traded companies. In the Nordic corporate governance debate, the active governance of shareholders is seen as a good thing, something to be encouraged, because shareholders will strive to make the company as profitable as possible. As there will only be profits when all other stakeholders have been paid their dues, shareholders are considered to be the best ultimate decision makers. It is sometimes argued that shareholders may pursue short-term gains and that it would be better for a company to pursue long-term gains. However, as at any given time the value of a share depends on the discounted future earnings, there is no difference between the short and the long term when investing in shares, because the price of the share reflects its long-term value and even short time variations reflect changed expectations about the future consequences of present decisions on long-term performance. The problem of shareholder power is more that shareholders enjoy an asymmetrical risk profile with a limited downside and an unlimited upside, which may make then dangerously risk-willing. However, this problem is solved by removing all executive powers from the shareholders in the general meeting and vesting them in the management who are then held personally liable for their executive decisions. Hence, the shareholders may govern the company but cannot

[38] On the Regulation, see note 22, above. The Nordic corporate governance model with its dual executive system is made available by Article 43, Subsection 1, that permits the appointment of a 'managing director' under the same conditions that are known in the national company law of the home Member State. Whether this reference to national (Nordic) law is enough to provide for at separate company body for day-to-day management remains doubtful.

[39] Commission Recommendation 2005/162/EC of 15 February 2005 on the role of non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board, [2005] OJ L52/51. Section 2 relies on the distinction between a unitary board and a dual board, which leaves out the non-executive director (dual board) known in the Nordic model. Nonetheless, the overall distinction between executives and non-executives or between supervisory directors and managing directors makes it clear that the Recommendation aims at the directors who are not also serving as managers.

run it without the acceptance of the management who are personably liable for not abusing the limited liability of the company.[40] Consequently, in the Nordic corporate governance debate dominant shareholders are viewed favourably and the legislation is fine-tuned to provide for their dominance, while protecting minorities against any abuse of power.

III. Challenges to the Nordic model

Although the one-tier and two-tier models appear to represent two very different approaches to corporate governance, in reality they combine to form a quite threatening hegemony when viewed from a Nordic perspective. In the two-tier model shareholders are afforded a very limited role and the management is entrenched to prevent shareholders having undue influence; in other words, shareholders are viewed with considerable suspicion. In the one-tier model shareholders are formally on top, and even the latest reform of the English Companies Act in 2006 was based on the idea of 'enlightened shareholder value'. However, where publicly traded companies are concerned, dominant shareholders are equally viewed with suspicion. Because dominant shareholders are relatively unknown in the UK, and especially so in the USA, their presence is considered highly unusual and possibly harmful. Apparently the suspicion is that the only justification for dominant shareholders not diversifying their investments like everybody else must be that they want to use their powers over the company to extract private benefits from the company to the detriment of the other shareholders. The fact that monitoring and disciplining of management may sufficiently increase the reward on the investments of dominant shareholders, even if they have to share some of that reward with the minority shareholders, appears not yet to have been fully appreciated in the corporate governance debate. Consequently, both sides of the one-tier/two-tier debate consider that dominant and influential shareholders are potentially harmful and possibly illegal.

The few measures on corporate governance that have been adopted at European level have mostly been directed at publicly traded companies. But this is exactly the area in which the Nordic model, with its reliance on

[40] Strictly speaking, there is no such thing as limited liability for a company, but only for the shareholders who invested in the company. And limited liability is always accompanied by private liability by those who can decide on behalf of the company, that is, the management. In Nordic company law, as in many other jurisdictions, the personal liability of the management may be extended to shareholders if in fact they act as managers (shadow director liability).

dominant shareholders, is most at odds with the major European powers. A brief overview will show the challenges that have appeared so far.

A. Proportionality of votes and capital

Votes are a way of providing security by reducing risk in an investment in shares. As such, it is similar to a mortgage or a pledge, as the preferred security of lenders. How many votes you get for your share depends on how much you are willing to pay and how eager the company is to get your money; it is a business transaction like any other. To invoke the concept of 'shareholder democracy' is just plain wrong; votes can be bought and sold, and even in a company with only one class of shares, one person may hold more votes than others. To argue that there must be proportionality between capital and votes in order to provide an incentive for the proper governance of the company disregards the fact that shares may be bought at different times and prices and consequently there is hardly ever proportionality between the prices different shareholders have paid for their shares and the associated voting rights even in companies with only one class of shares. To consider shares with multiple votes unfair compared to shares of the same size but carrying fewer votes is as unfounded as to find it unfair that some lenders enjoy collateral for their loans while others do not.

As shares with multiple voting rights are often used to maintain concentrated control, it is a measure that enhances the position of dominant shareholders. As such it is viewed favourably in the Nordic countries. Nonetheless, for a long time the Commission has argued in favour of a one-share/one-vote regime. Commissioner McCreevy initiated a major report to investigate control-enhancing mechanisms.[41] As the report found no clear link between these mechanisms and economic performance,[42] Commissioner McCreevy announced that there was no reason for further action.[43] It is all too rare to see a politician refrain from action simply because it is unwarranted, and there is all the more reason to praise the courage and good sense of the Commissioner.

[41] Report on the proportionality principle in the European Union – ISS Europe, ECGI, Shearman & Sterling, 18 May 2007.

[42] Economic surveys of this kind are notoriously difficult to undertake. One may wonder whether it is at all possible to compare the economic performance of companies with control-enhancing mechanisms and those without, as the former have little incentive to value their assets highly, and the latter have every incentive to inflate their assets to avoid takeovers.

[43] See speech of 3 October 2007 (footnote 18 *supra*).

However, the assault on multiple voting rights is not over. Article 11 of the Directive on takeover bids contains a breakthrough rule that is intended to set aside multiple voting shares under certain conditions. The rule is made optional according to Article 12, because it was fiercely resisted by the some Member States, notably the Nordic Member States. As the Directive is up for revision, a survey has been conducted to investigate the use of the opt-out in Article 12.[44] The survey concluded that the vast majority of Member States had not imposed or were unlikely to impose the breakthrough rule. It could be argued that this calls for the rule to be made mandatory, in order to ensure compliance by all Member States. However, it could equally be argued that a rule which most Member States would not apply voluntarily should not be made mandatory. It rather depends on whether you believe that the Member States are capable of making a sound decision.

Since the Directive already exempts shares where different voting rights are not assigned on issue but accrue over time,[45] even though such shares do actually hinder takeovers contrary to ordinary multiple voting shares that are covered by the Directive[46], and since the Directive also exempts non-voting shares and thus accepts a deviation from proportionality between capital and votes,[47] it would be better to give up this campaign against multiple voting shares altogether and accept

[44] Report on the implementation of the Directive on Takeover Bids, SEC(2007) 268, 21 February 2007. On Article 12 of the Directive, see footnote 16 *supra*.

[45] According to Article 2, Subsection 1(g) the Directive only covers shares of different classes with different voting rights, in other words where the difference was already present when the shares were issued and as such known to the investor and publicly by way of the articles of association. In the case of shares where multiple voting rights accrue over time, it is not possible for investors or the public in general to know the distribution of votes, because this depends on how long the shares have been owned by the individual shareholders.

[46] Shares that always carry multiple voting rights can be acquired with their full votes by a bidder as part of a takeover. Shares where multiple voting rights accrue over time would lose their extra votes if acquired by a bidder, which creates a lock-in effect.

[47] Article 11, Subsection 6 exempts 'securities where the restrictions on voting rights are compensated for by specific pecuniary advantages'. The reach of this provision is unclear. It may aim at voteless shares which carries a preferential right to dividends. However, as shares with no (or less) voting rights are always compensated by a lower price upon subscription and in later market transactions compared to shares with the same right to dividends but carrying better voting rights, all non-voting shares could be covered by this Article. Either way, the acceptance of that fact that sometimes shareholders accept less votes than other shareholders if they like the business investment offered should have been applied to all other shares with different voting rights rendering the breakthrough rule unnecessary.

that it is up to the company and its investors to determine what rights should be carried by shares issued by the company and subscribed by the investors.[48]

B. Independent directors

The Commission's Recommendation on the independence of directors could be viewed as yet another challenge to the Nordic corporate governance model.[49] The Nordic model is very specific in making each director directly accountable by ensuring that whoever appoints them may dismiss them again without notice and without reason. Furthermore, the legislation mandates that the majority of directors must be appointed by the shareholders in a general meeting, and as dominant shareholders are ubiquitous at least half and possibly all of the board will often have been appointed by a dominant shareholder. In the Nordic model there is no room for an independent director, as each director is appointed by some person or persons and accountable to them and is liable to be removed if they fail to fulfil their expectations. Independent control of management is provided by the auditor who is also elected at the general meeting, and there is no need to insert yet another controller inside the board. That at least is the law as it stands, but recent Nordic corporate governance codes have now followed the Commission Recommendation and recommend the appointment of independent directors to the board.[50]

The reasoning behind the Recommendation, the prevention of mismanagement, is sound, but the chosen solution defers to the corporate governance models which distrust major shareholders and it is difficult to reconcile it with the Nordic model. One may ask how a director can be truly 'independent' when they are appointed by a dominant shareholder and are conscious of that fact that they are subject to immediate removal by that shareholder? And if a director really feels independent,

[48] If the breakthrough rule were abandoned, it would probably be wise to abandon the 'board passivity' rule in Article 9 as well. It would make the shareholders vulnerable to the conflict of interest of a management faced with a takeover bid, but if the Germans and others have chosen a corporate governance model where management is entrenched and the interests of shareholders deferred, then there is little reason to challenge that choice in the absence of firm empirical evidence of the existence of a problem.

[49] On the Commission's Recommendation, see footnote 39 *supra*.

[50] On the Nordic corporate governance codes, see note 37, above. All codes have, at the very least, implemented the Commission Recommendation, and some have gone further, notably the Danish code.

will the director then feel accountable to the shareholders or to the other directors they are supposed to monitor?

From a Nordic perspective, it would appear that the Recommendation has overlooked how these problems are solved in the Nordic model. A director is accountable to the shareholders, but owes a duty of loyalty to the company and all its stakeholders; directors are personally liable if they set the interests of 'their' shareholders above those of others. If a conflict of interest arises, a director cannot participate in the decision and the decision is voidable if they do. Control of daily management, that is, the executives of the company, is guaranteed by the requirement that a majority of the board of directors cannot be made up of managers. That is what is understood by independence in Nordic company law.

C. *Insider dealing*

The ban on insider dealing in the securities of a publicly traded company is well justified and was part of the law in the Nordic countries long before it was mandated by European law.[51] It is also sensible to prevent selective disclosure of inside information, because the less inside information is disseminated before its publication to the securities market, the less risk there is of insider dealing.[52] There is an exception to the ban on selective disclosure where the disclosure is 'made in the normal course of the exercise of [a person's] employment, profession or duties'. The exception is necessary as it is often important that inside information is passed on to others, even if there is a risk of abuse of the information.

In the Nordic corporate governance model, where active participation by shareholders in the governance of the company is encouraged and where the presence of dominant shareholders ensures that there is such participation, it is normal to inform major shareholders of issues relevant to the running of the company even in publicly traded companies. This is especially the case where decisions would ultimately be made at the general meeting and thus depend on the consent of the majority shareholders. For example, it would be a waste of time to negotiate a

[51] A ban was introduced by Council Directive 89/592/EEC of 13 November 1989 coordinating regulations on insider dealing [1989] OJ L334. The Directive was replaced by Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003 on insider dealing and market manipulation (market abuse) [2003] OJ L96 (hereinafter: MAD).

[52] The ban on selective disclosure of inside information is found in Article 3(a) of MAD (note 51, above).

merger if the dominant shareholder is going to veto it, so it is better to inform the dominant shareholder confidentially in advance. The right to appoint and in particular to dismiss a director at will is a clear indication that the directors are accountable to the shareholders. Dominant shareholders may appoint themselves to serve as directors or appoint somebody else on their behalf, either way their right to govern the company is the same.[53]

However, the corporate governance debate is dominated by the UK and USA where the experience is that shareholders are small and dispersed, which leaves the board isolated or even 'independent' of them. Communication between a director on the board and a shareholder is viewed as highly unusual, and perhaps even downright illegal. This approach, however, risks a too-narrow interpretation of the exception to the ban on selective disclosure of inside information that may effectively sever communication between directors and shareholders, and by extension prevent the participation by shareholders in the governance of the company which the Nordic model relies upon.

Fortunately, when a case came before the ECJ on the interpretation of the ban on selective disclosure,[54] the Court wisely chose to point out that what constituted 'normal' disclosure for the purposes of the exception to the ban would depend on the national corporate governance model and for that reason the Court limited itself to stressing that where such disclosure was normal, the ban would require a strict understanding of

[53] Only natural persons can serve as directors, so legal persons are dependent on appointing a natural person as director on their behalf which only underlines the need to receive information in confidentiality.

[54] See Judgment of 22 December 2005 in Case C-384/02, *Grøngaard and Bang*, [2005] ECR I-9939. The case concerned Danish criminal proceedings against an employee representative serving on the board of a publicly traded company who had disclosed to his union president that a merger offer was imminent. The director was also a vice-president of the union and had learned of the news both from serving on the board and from his participation on a cooperation committee. The union president disclosed the information to a union employee who used the information for trading and was convicted of insider dealing. Both the employee representative and the union president were convicted by the City Court of Copenhagen for violating the ban on selective disclosure of inside information. The conviction was upheld by the Eastern Division of the High Court in its judgment of 15 January 2008, but contrary to the City Court, the High Court accepted that disclosure could be made confidentially between a director and his 'constituency', i.e. the union, in order for the union to prepare for the merger and the expected lay-offs. However, the disclosure had been made to a greater extent than necessary, hence the conviction. The judgment may be appealed to the Danish Supreme Court.

whether the disclosure really was necessary, taking into account the risk of insider dealing. The judgment has thus made it possible to uphold the Nordic corporate governance model, but there is a risk that national supervisory authorities or even national courts may be influenced by the international corporate governance debate and construe the sound limitations put forward by the ECJ to narrowly and thereby prevent the Nordic model from functioning.

IV. Conclusion

The Nordic corporate governance model, with its dual executive system, is closely related to the English one-tier model but has unique features. The most distinctive feature is probably the dominant role given to the shareholders, and the prevalence of major shareholders ensures that this role is taken up even in publicly traded companies. The risk of dominant shareholders, that they may pursue private aims and exploit the minority, has been countered by the provisions of companies legislation. Over the years, a highly sophisticated and investor-friendly model has evolved and major scandals have been few and far between.

Although the harmonization of company law has been carried on for many years and covers many areas, the area of corporate governance has largely remained outside the scope of harmonization. The few examples of harmonization have proved to be of limited value and some measures are difficult to reconcile with the Nordic model.

It is argued that the harmonization of corporate governance should only be pursued with great care and only to the limited extent necessary to protect parties who cannot be expected to fend for themselves. There is no need to seek a single European model to replace the many different national models of corporate governance. The existence of a variety of different corporate governance models should not be viewed as an obstacle to the internal market, but as an asset. The recent case law of the ECJ has made this asset available to all investors in the European Union, so there is even less reason to legislate in this area. Better to have many different European corporate governance models than just one.

SECTION 2

Corporate governance, shareholders' rights and auditing