Liability of Members of the Board of Directors and the Managing Director—A Scandinavian Perspective

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I. Introduction

In Scandinavian countries, questions concerning the liability of the company management have attracted great interest in recent years. Due to several highly publicized financial scandals that took place in the early 1990s in Denmark, Norway, and Sweden, these countries extensively revised their Companies Acts during that period. In general, the amendments made to the Companies Acts involved modifications to management's obligations. Also, on several occasions over the past ten to fifteen years, Scandinavian courts have issued rulings concerning board member and managing director liability.

The Companies Acts in the Scandinavian countries are similar, but not identical. They differ in how they treat private versus public business forms. The private form aims at regulating relationships in companies conducting business with few partners, in which the shares are not publicly traded. Conversely, a public company is a company whose shares may be traded on the stock exchange. For example, in Sweden, both private and public companies are regulated in the Companies Act (Aktiebolagslagen). In contrast, Denmark and Norway have various legislation schemes for each different company form. Under this construct, the Public Companies Act consists of mandatory rules whereas the private companies do not. However, under Swedish company law, the private form is subject to mandatory rules.[1]

The objective of this article is to consider certain questions regarding the board of directors' and the managing director's liability to the company under Scandinavian law.

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1. In Denmark the public company is called "aktieselskab"; the private company "anpartsselskab." The public company in Norway is called "allemannaksjeselskaper" and the private form "aksjeselskaper."

II. Functions of Corporate Bodies under the Swedish Companies Act

A. Internal Relationship between Corporate Bodies

In Sweden, the rules governing company organization and its management in Chapter 8 of the Swedish Companies Act show only a few occasional differences regarding the two company types.[2] This is also the condition in Denmark and Norway.

Under the Swedish Companies Act, an important point of departure from other countries when determining the company management's liability to the company is that each company shall be hierarchically organized. Shareholders constitute the superior body of the company, to which both the board of directors and the managing director are subordinate. Directives submitted by the highest organ of the company shall be followed, unless they are contrary to the law or to the articles of association under the provisions of Chapter 8 section 34 of the Swedish Companies Act. This organizational structure exempts the managing director from liability if the measures undertaken by him have received the support of the board of directors or the shareholders.

There are two main ways of approaching the regulations concerning the formal organization of a company. The first, which can be called 'dualistic', means that one of the company's management bodies has a monitoring function only, while another body leads the company's operations and represents the company externally; the second, which may can be called 'monistic', stipulates that each company contains only one management body. The purest form of the dualistic system is constituted by the organizational rules of the German Aktiengesetz. Company organization under American and English law constitutes an example of the monistic system.

The Swedish Companies Act in particular, but also the acts in Denmark and Norway, perceive management of the company's affairs as a uniform set of duties, in which the managing director shall be liable under the provisions of Chapter 8 section 25 of the Swedish Companies Act for the day-to-day management of the company. A characteristic feature of Scandinavian law is that the board of directors does not have a purely monitoring function, in contrast to applicable German law with regard to public companies. For this reason the Scandinavian model is closer to the monistic system. Under the provisions of Chapter 8 section 14 of the Swedish Companies Act, the monitoring function of the board of directors is emphasized because the chairman of the board of directors of a public company may not be the managing director of that company at the same time. It is furthermore emphasized in Chapter 8 section 4 of the Companies Act that the board has a special obligation to monitor the company's operations, and, as a consequence of the hierarchical structure, to ensure that the managing director discharges his obligations. The board must also monitor the company's financial position in general, and the group's financial position, where applicable.

B. The Board of Directors' Mandate

The board of directors is a collegial body. This means that a member of the board is not entitled to act on his own behalf and independently from the board of directors. The only

2. The Swedish Companies Act 1975: with excerpts from the Accounting Act 1976 (3d ed., Federation of Swedish Industries 1992) (1976) [hereinafter Swedish Companies Act].

way for a member of the board to obtain information about the company is by raising the question about it in the board meeting.

A member of the board has personal liability exposure. A member shall be exempted from liability if he has made reservations against a decision by having his opinion recorded in the report of the company proceeding. However, a member of the board who has made reservations in the above described manner may still become liable if he subsequently participates in the enforcement of the decision. In the majority of case law, enforcement of a decision has been regarded in the majority of cases as a subsequent acceptance of the decision by the member of the board. Consequentially, when a member of the board is appointed as the company signatory, for example, he may not enter into the agreement without risking liability to the company.

Additionally, a board member may have personal liability exposure due to treatment of the position as a personal commission. For example, the personal character of the commission means that a member of the board cannot be granted authorization to form a quorum.[3] When a permanent member of the board cannot be present, a deputy-member shall be appointed. Thus, if the member participated in making decisions of a more principal character at some earlier stage, he will hardly avoid liability if the board makes more concrete decisions in his absence in accordance with the guiding principles decided upon earlier.[4] Furthermore, repeated absences from the meetings of the board of directors may also imply that the member of the board has neglected his monitoring duty, subjecting the member to additional liability.

A deputy-member also has liability exposure for decisions he made while participating in the meeting of the board of directors as a board member.[5] However, a deputy-member who participates in a board meeting on a separate occasion will not be treated as strictly as the ordinary member who has been following the business activities regularly. Further, the deputy-member's liability depends on the nature of his involvement. If his involvement in the decision includes participation in the meetings and access to all the material possessed by the remaining members of the board, the deputy-member's liability can hardly be treated differently than the permanent members of the board.

C. Liability for Damages of a Member of the Board of Directors and of an Employee

In some companies, the company's management may be organized somewhat differently than as provided for in the Swedish Companies Act. A company may institute committees, for example, that will examine and prepare certain questions to be discussed afterwards by the boards of directors. Members of such committees are not liable, unless they are also members of the board.

The provisions of the Swedish Companies Act concerning liability for damages probably should not be applied analogously to other leading officers of the company.[6] The reason is

3. *See* Danish UfR 1981.262; Thorbjørn Sofsrud, Bestyrelsens beslutning og ansvar 70 (Akademisk Forlag 1999).

4. *See* Rolf Dotevall, Bolagsledningens skadeståndsansvar 62 (Norstedts Juridik 1999).

5. *See* Carl Svernlöv, Aktiebolagets suppleanter: suppleantinstitutet i svensk aktiebolagsrätt 62 (Norstedts Juridik 1998).

6. *Cf.* Swedish Supreme Court NJA 1997 p. 418.

that the differences concerning the prerequisites for liability under the provisions of the Swedish Companies Act relating to the company's members of the board of directors, on the one side, and the rules concerning liability of employees under Chapter 4 section 1 of the Swedish Tort Liability Act,[7] on the other hand, should be maintained. Extraordinary reasons are necessary for an employee to be liable according to provisions of the latter Act. The possibility of holding an employee liable should grow together with the employee's rise in the company's hierarchy, since it is this circumstance that is considered important according to the Act. Nevertheless, even here a distinction should be made between the employees' and the board members' liability with respect to the different premises on which liability is based. A deputy managing director who has not taken a permanent board member's place will not be liable in this capacity under the provisions of the Swedish Companies Act, but will be liable under the provisions on employees of Chapter 4 section 1 of the Swedish Tort Liability Act.[8]

A person working on assignment, who is not employed by the company, shall be liable under the general provisions of Chapter 18 of the Swedish Commercial Code concerning the manager's liability for loss or damage caused by negligence.[9] Thus, a person working on assignment is not protected in the same way as an employee.

This analysis becomes more difficult when a member of the board of directors is also employed by the company. It may sometimes be unclear in which capacity he has caused damage. As mentioned before, the premises for liability differ depending on the capacity in which the tortfeasor causes damage—whether as an employee or as a member of the board.

This delineation is quite straightforward regarding decisions made by the board of directors, because the liability provisions of company law stipulated in Chapter 15 of the Swedish Companies Act will always apply. Even when a member of the board has been given a special assignment by the board to undertake certain measures regarding the company's operations, he shall be liable under the liability provisions of the Companies Act.

If a member of the board is more or less permanently active, performing assignments on behalf of the board, a problem may arise in relation to the managing director's liability. Under Chapter 8 section 25 of the Companies Act, it is the managing director who is responsible for the day-to-day management of the company. If the company should decide to institute other provisions that will affect this area of responsibility, the managing director may risk becoming liable for loss caused by the holder of that position. Chapter 8 section 3 of the Swedish Companies Act stipulates that in such situations the board of directors shall issue written instructions setting forth the allocation of duties of the managing director and any other bodies that the board of directors may establish. Such division of duties will diminish the managing director's liability by an equivalent degree.

Drawing a line between the liability provisions of the Swedish Companies Act and the Swedish Tort Liability Act is more complicated if the duty of loyalty is at issue. The duty of loyalty also covers a board member's behavior outside the meeting of the board of directors. The higher the position of an employee in the company's hierarchy, the more complicated it is to draw a line between the two. If damages have been caused due to a

7. Tort Law Act of 2 June 1972, SFS 1972:207, as amended.
8. Tort Law Act of 2 June 1972, SFS 1972:207, as amended.
9. Swedish Commercial Code.

breach of the duty of loyalty, liability should always be treated according to the provisions of Chapter 15 of the Swedish Companies Act. For example, if a member of the board disseminates confidential information about the company's affairs, or if he engages in competitive practices, this provision applies.

III. Determination of Culpability

A. What Criteria shall be Used?

When determining liability, the Scandinavian legal system usually divides the culpability requirements into subjective and objective elements.[10] The objective requirements are that a given act or omission shall be indefensible and contrary to law. The subjective requirements are that circumstances pertaining to the wrongdoer shall be taken into consideration.

The objective criteria used for the determination of a board member's or the managing director's liability are constituted by the provisions of the Swedish Companies Act and the articles of association, as well as by the obligations usually connected with the managerial position of a person.[11] Even Scandinavian law will tolerate, however, certain mistakes of the board of directors or the managing director in business decision-making, provided that these mistakes remain within the framework of the business operations' objectives and that they have not been made in order to directly or indirectly further the decision-makers' own interests.[12] This tolerance can be justified by the fact that a company must often make business decisions in situations characterized by a lack of certainty. Coupled with the fact that it is often necessary to take risks, this means that it is not a simple task for the courts to determine, *a posteriori*, the suitability of the company management's decisions. This is the strongest argument for the business judgment rule. It is only natural that this rule should exhibit some discretionary features. It is hardly possible to determine the exact level of risk or uncertainty that shall be tolerated.[13] What is necessary, on the other hand, is for the board to have based its decisions on sufficiently comprehensive documentation. Thus, in a complicated merger it is not enough for the board of directors to be satisfied with a short oral report, without any further written documentation concerning the question.[14] In conclusion, for a failed business endeavor not to create potential liability, it is necessary that the authority of the company's bodies not have been overstepped, and that the members of the board not have undertaken measures that have directly or indirectly promoted their own interests.

In addition, an omission may form the basis of liability in cases where there is an obligation to act. In recent years a view has been promoted in Scandinavian law, which has received support from American law, that omissions shall be deemed, at least in certain cases, more strictly than active conduct.[15] An example of this kind of omission would be the board of directors' failure to phase out the operations of a slumping business area in order to reduce the losses of the company's creditors. Such an omission would not be covered by

10. *Cf.* Jan Hellner & Svante Johansson, Skadeståndsrätt 125 (6th ed., Norstedts Juridik 2000).
11. *See* Dotevall, *supra* note 4, at 46.
12. *See id.* at 85; K. Norman Aarum, Styrelsemedlemmers erstatningsansvar i aksjeselskaper 324 (1994); J. Schans Christensen, Ledelse & aktionærer 52 (1992). *Cf.* Swedish Supreme Court NJA 2000 s. 404.
13. *Cf.* Sofsrud, *supra* note 3, at 143, for the opposite view.
14. *See id.* at 151.
15. *See id.* at 131.

the business judgment rule with regard to liability. In such cases the board members' knowledge concerning the company's financial situation shall be examined in great detail. The ordinary level of tolerance for wrong business decisions that is normally applied in Scandinavian law decreases if the financial situation of the company is weak.[16]

B. The Importance of the Qualifications of the Tortfeasor

When determining culpability, it is impossible to wholly disregard the qualifications of the member of the board or the managing director. In Chapter 8 section 9 of the Companies Act only formal requirements have been explained regarding the board member's or the managing director's qualifications. These requirements include attainment of the age of majority and no previous declaration of bankruptcy by board members or managing directors.

In view of the fact that boards of directors are usually quite heterogeneous, it is probably impossible to find some common, minimal standard that would apply to the board of directors' mandate.[17] The fundamental requirement is that the member of the board shall have sought the mandate of his own free will, being therefore personally responsible for having sufficient experience and qualifications to succeed in his undertaking. If it can be shown later on that he has not met the requirements placed on him, it is reasonable to demand that he should resign.[18]

A member of the board is not required to possess special knowledge of the sector in which the company conducts its business. Such a requirement would promote one-sided composition of boards of directors, which would not enhance the quality of the works of such boards. On the other hand, it is necessary that a member of the board shall possess a general ability to learn about the business of the company.

The question is whether the board member's liability may be treated as so-called professional liability. In determining professional liability, greater consideration is given to the question of whether the objective criterion for what is considered as acceptable conduct has been upheld, whereas circumstances concerning the tortfeasor and other issues of the individual case are of lesser importance. In my opinion, professional liability does not apply in this sense to a member of the board. Instead, subjective circumstances should be considered when determining culpability in order not to prevent inexperienced persons from seeking board mandates. Danish case law shows that in cases where the term of office of a board member was short, and loss was sustained because a prospectus had been issued containing wrong information about the company's financial situation, the member is exempt from liability.[19] In the Danish Supreme Court, it has been confirmed that board members who had recently assumed their duties were not liable for an agreement concluded by the managing director.[20] The board members in question had assumed their duties five months prior to the conclusion of the contract.[21] The members could not be expected to

16. *See* Swedish Companies Act, *supra* note 2, ch. 13, §§ 17–18; Rolf Dotevall, Skadeståndsansvar för styrelseledamot och verkställande direktor 197 (Norstedts 1989).

17. *See* Lars E. Taxell, Ansvar och ansvarsfördelning i aktiebolag 57 (Åbo Akademi 1963).

18. *See id.* at 56.

19. *See* Rolf Dotevall, Några frågor som rör prospektansvar, Nordisk Tidsskrift for Selskabsret 331 (2000).

20. Danish Supreme Court UfR 1961.515.

21. *Cf.* Sofsrud, *supra* note 3, at 394.

become properly acquainted with the company until a certain time in office had passed. This view of liability should be applied even to persons who hold several boards of director's mandates. Since each company has a character of its own, it is difficult to talk about a specific board of director profession.

The question of liability is treated in a different way regarding the managing director. The managing director is supposed to be active on a full-time basis. Under the provision of Chapter 8 section 25 of the Swedish Companies Act he is responsible for the day-to-day management of the company. In view of this function, it is reasonable to place higher demands on the managing director than on an individual board member.

Board members' responsibility varies depending on, inter alia, their working tasks and the amount of remuneration received by them. It may be necessary, for example, to involve an expert in a certain area of the board's work. Such a person will carry greater responsibility than the other members of the board with regard to damage or loss sustained by the company within his field of expertise.[22] This view may be disputed, however, on the grounds that a board of directors is a collegial body. This means that an individual member of the board shall not bear the primary responsibility for decisions made within a certain area. In my opinion, the allocation of working tasks should reflect the distribution of responsibility when an expert has been engaged by the board. If the shareholders appoint an expert in a certain field, they expect that person to contribute with his special knowledge to the work of the board. Likewise, if a certain member of the board receives higher remuneration than the other members, this reflects that in the allocation of working tasks the member has a greater responsibility than the remaining members for the supervision of the company's operations.

A specialist who is also a member of the board bears greater responsibility than if he acted as an external advisor only. In contrast, a lawyer who works on a special assignment for a company has well-demarcated liability in that he has a duty to carry out his assignment in the best possible way. For example, it may be that the external adviser has not been given full information concerning all the circumstances of importance for the board's decision, and his advice will hence be treated as only one of the components of the final decision. A lawyer who is also a member of the board has much more extensive responsibility. Like the other members of the board he enjoys access to all information, and it is his duty to obtain any additional information that may be necessary for him to make well-grounded decisions. In addition, he owes a duty of loyalty to the company, which means that he should show regard to the company's interests at all times.

IV. Determination of Loss

It is hardly possible or even necessary to try to define a universally applicable concept of loss. This means that the concept of loss must be formulated for each situation.[23] At the same time, a normative concept of loss appears somehow insufficient, which is why a few general premises ought to be formulated.

Loss in the present context means a financially measurable financial loss that the plaintiff has suffered unwillingly or against his will. For a company, such loss may consist of costs,

22. *See* TAXELL, *supra* note 17, at 56.

23. *See* HÅKAN ANDERSSON, SKYDDSÄNDAMÅL OCH ADEKVANS; OM SKADESTÅNDSANSVARETS GRÄNSER 298 (Iustus förlag 1993).

loss of income, or depreciation in the value of the company's property. This means that loss includes factual depreciation in the value of the company's property as well as occurrences depriving the company of earnings or income. This can be the case, for example, when a board member, disregarding his duty of loyalty towards the company, engages in competitive practices.

In order to determine the amount of loss, the total assets of the injured party can be compared with the hypothetical situation that would exist if the damage-causing act had not occurred.[24] Thus, the loss constitutes the difference between the hypothetical and the actual course of events. One difficulty of this method is that it may not be easy to reconstruct the hypothetical course of events.

Where no loss has been sustained, the board members will not be liable even if they have neglected their duties. For example, a board member may be thought to have acted negligently by voting for an excessive salary for the managing director, especially when he has hardly done any work for the company. Nevertheless, if the money has not been paid out, the board member cannot be made liable, since the company has not sustained any loss.

V. The Requirement of Adequate Causal Connection

Regarding the company management's liability for damages, the general principle of the law of damages stipulates that there shall be a causal connection between the sustained damage and the culpable act or omission. Where several members of the board are liable for damage the casual connection must be determined individually. Each member of the board shall be liable only for that part of the damage that he has personally caused.

Traditionally, for liability to apply the causal connection must be adequate. This requirement screens out liability for consequences that are too remote and for unexpected consequences.[25] The adequacy criterion makes it possible to separate out the legally relevant causes from a complex chain of causes that led to damage. The object of an adequacy test is the causal connection itself. Adequacy does not refer so much to the identification of a causal connection, but rather to the evaluation of the causal connection.[26] Determination of adequacy thus aims at deciding whether the causal connection is sufficient to support a liability determination.

In order to evade the most unexpected or remote consequences of an act or omission, the doctrine of normative protection may be applied.[27] By investigating the objective of a given norm and the interests that it was originally meant to protect, the problem of determining the causes of recoverable loss may be solved. The normative protection doctrine is based on the notion that the risk of the incurred damage has increased due to the fact that the existing norms have been violated.[28] There are several similarities between this mode of procedure and the determination of liability in negligence. The function of the normative protection doctrine is to identify which losses shall be compensated. It is natural to wish to mitigate the requirement of foreseeability when a rule of the Companies Act or of the

24. *See* JAN HELLNER, SPECIELL AVTALSRÄTT II, 2ND BOOKLET. ALLMÄNNA ÄMNEN 207 (3d ed., Juristförlaget 1996).

25. *See* HELLNER & JOHANSSON, *supra* note 10, at 195.

26. *See* ANDERSSON, *supra* note 23, at 95.

27. *See id.* at 365. *Cf.* 2 BILL W. DUFWA, FLERA SKADESTÅNDSSKYLDIGA 1017 (Juristförlaget 1993).

28. *See* ANDERSSON, *supra* note 23, at 39.

company's articles of association has been violated, but at the same time liability should not arise for loss or damage of an extraordinary character.[29]

Under the normative protection doctrine, liability arises even in connection with loss or damage that can be described as remote or that is close but unexpected. This view of the requirement of adequacy is based on the conditions applicable to a person exercising control over some property that does not belong to him. In these cases, a strict view of liability is applied to the person in control of the property if the property is damaged or its value decreases. Based on the principle of *casus mixtus*, liability may be imposed even for loss or damage that may be denoted as having an inadequate causal connection.[30] This principle probably plays some role in the determination of adequacy in relation to the managing director's or a board member's liability to the company.

The rules concerning the company's financial accounting, which serve primarily to protect share purchasers, may play an important role in the determination of liability to the company. Under the provision of Chapter 2 section 3 of the Swedish Annual Reports Act, one of the fundamental requirements concerning annual reporting is that the annual report shall provide a true picture of the company's financial position.[31] It is especially important that a company appear trustworthy if it is in a period of vigorous expansion or if it has recently been listed on the stock exchange. If, due to incorrect bookkeeping, the company reports a much better profit than should rightfully be reported, and this is discovered, the company's credibility will suffer. If, over time, the company is declared insolvent, and the drop in the company's earnings cannot be explained by a general decline in the economy, this may indicate that there is an adequate causal connection between the incorrect accounting and the loss sustained by the company through its insolvency. In my view, if the estate in liquidation commences an action for damages on behalf of the company against a member of the board, the company's interests should be interpreted more widely, and should cover even the company's creditors. In this way, the shareholders, as well as the company's creditors, will receive compensation for the indirect damage they suffered following the company's insolvency.[32]

VI. The Supervisory Duty

Under the provisions of Chapter 8 section 3 of the Swedish Companies Act the board of directors shall be charged with the organization of business activities. The provisions of Chapter 8 section 25 of the Act do not state explicitly that the managing director has an equivalent obligation. However, this obligation ensues from the fact that the managing director shall be responsible for the day-to-day management of the company, and it is therefore his duty to monitor the company's everyday operations.[33]

The board of directors' obligation to organize the company's business activities has been made more concrete by the requirement set forth in Chapter 8 section 3 of the Swedish

29. *Cf.* TAXELL, *supra* note 17, at 32.

30. *See* HELLNER, *supra* note 24, at 207.

31. Swedish Annual Reports Act, ch. 2, § 3.

32. *See* Rolf Dotevall, *Liability of Members of the Board of Directors and the Managing Director*, 41 SCANDINAVIAN STUD. IN L. 41 (2001).

33. *See* Reports of the Government Commissions ("SOU series") 1941:9, p. 324 and Swedish Government Bill 1975:103, p. 374.

Companies Act stipulating that the board of directors shall issue written instructions concerning the allocation of duties to the company's management and other organs that may be instituted. The provisions of Chapter 8 section 4 stipulate that the board of directors shall issue written instructions setting forth the rules for the reporting of information concerning the company's business activities, which shall form the basis of the board of directors' assessment of the company's financial position.[34]

The Swedish Companies Act is based on the premise that the company's business activities shall be managed by the board of directors and the managing director, respectively. In order to achieve effective organization of a company it is frequently necessary to delegate various tasks. However, the possibility of delegation has certain limitations. One such limitation is the requirement that any delegation of tasks must be done in an efficient way, so that the different office-holders are able to co-ordinate their functions and working tasks. Since the management of the company has been charged with the organization of the company, negligence in this respect may result in liability for damages.

The Swedish Companies Act does not impose any explicit limitations on the company management's power of delegation of administrative tasks. This great freedom of organization provided for by the Act should not be interpreted, however, to suggest that the possibility of delegation is unlimited. For example, delegation of powers whereby the board of directors and the managing director renounce all responsibility is impossible. Similarly, the board of directors or the managing director may not delegate authority they do not possess.

Each administrative and management task specifically indicated in the Swedish Companies Act or the articles of association may be delegated in one way or another. The limitations on delegation of administrative tasks follow from the supervisory duty of the board members and the managing director. Thus the supervisory duty is the only duty that cannot be delegated. The scope of the supervisory duty depends on the scope of delegation. For example, as delegation of tasks increases, so does management's supervisory duty to ensure that tasks are performed correctly. Even after delegation a hierarchical relationship between the delegator and the person entrusted with the performance of the tasks is maintained. The duty of the delegator is reduced to the supervision of the performance of the tasks, and ensuring that they will be discharged appropriately. This remaining authority cannot be further delegated.

Even after the delegation of tasks, the principle remains that the members of the board of directors and the managing director are formally liable for any damage caused by the person entrusted with the performance of the tasks. However, for liability to arise it is required that there be negligence on the part of the board or the managing director due to (1) selection of the task performer, (2) inadequate instructions to the latter, or (3) flaws in the supervision of the performance of the task. The fact that liability arises only on these grounds manifests the fundamental principle of the law of damages that liability arises only through one's own fault.[35]

Supervision of the company's operations is not something static, but must be continuously adjusted to occurring changes. Chapter 8 section 4 of the Swedish Companies Act clearly stipulates that the board of directors shall regularly assess the company's financial

34. Swedish Companies Act, *supra* note 2, ch. 8.

35. *See* DOTEVALL, *supra* note 4, at 98.

position, making the supervisory duty the fundamental obligation of each member of the board.[36] A member of the board has an obligation to regularly check the company's financial position, irrespective of the degree of his actual involvement in the company's business. This requirement is consistent with the current situation and practice, showing that the board of directors in larger companies has a supervisory function.[37]

Following the hierarchical structure, the basic principle stipulates that the supervisory duty of the managing director includes the monitoring of the daily business activities of the company, in which fulfillment of the obligations by the company's employee is of primary importance. In comparison, the primary task of the board of directors is to monitor the company's operations in general, ensuring that the managing director fulfills his duties. This delineation of responsibilities follows from the structure of the Swedish Companies Act. This means that the managing director is primarily liable for damage caused by his employees. Only in exceptional cases, perhaps primarily in smaller companies, may the members of the board become liable.

Regarding the scope of the supervisory duty, a member of the board does not normally have to investigate every aspect of the managing director's administration. It is not the duty of a board member to go so far in his supervisory activity as to review each decision made by the managing director. If there are reasons to suspect that the managing director mismanages his work, the member of the board should get more information, perhaps from the company's auditor. Otherwise, the board of directors shall devote itself to the central problems of the company's business operations, with emphasis placed on the company's or its subsidiaries' financial position, whereas the managing director shall attend to the daily operations of the company. It is therefore not required that a member of the board have the knowledge of or be involved in each detail of the company's business.[38] A formally appointed managing director cannot avoid liability if he has completely neglected his supervisory duty in the belief that someone else is in charge of certain tasks associated with the position (for example, the company's accounting).

The scope of supervisory duty is not elucidated by the Swedish Companies Act. Thus the exact scope of the duty depends on the organization and business activities of each particular company. It is ultimately a pragmatic judgment. Nevertheless, even though the scope of supervision must be decided primarily on the basis of the circumstances in each particular case, certain general principles may be noted.

The provisions of Chapter 8 section 4 of the Swedish Companies Act indicate that supervision shall be carried out through a reporting system.[39] In the exercise of the supervisory duty, the degree of confidence placed in the information supplied by the subordinate employer is of great importance. One starts from the premise that members of the board shall be able to rely on the information provided by employees concerning the conditions prevalent in the company until something arises that gives them reason to suspect that something is wrong.[40] Furthermore, a member of the board is not obliged to further monitor the company's business activities if the report from the managing director is in good order.

However, in certain cases more extensive supervision is required.[41] For example, the supervisory duty becomes more stringent if the company's operating capital is insufficient

36. Swedish Companies Act, *supra* note 2, ch. 8.
37. *Cf.* SOFSRUD, *supra* note 3, at 162, with further references.
38. *See* Norwegen Supreme Court NRt 1979 p. 46.
39. Swedish Companies Act, *supra* note 2, ch. 8.
40. *See* DOTEVALL, *supra* note 16, at 229.
41. *See* Swedish Government Bill 1975:103, p. 375.

with regard to the scope and risk of the operations conducted by the company. This situation includes the company that is dependent on a small number of customers or business transactions in progress, the company whose turnover decreases, the company who's most important customers experience financial difficulties, or the company whose management comes to be dominated by one person.[42]

VII. What Interests should be considered by a Board Member and the Managing Director?

The term "company's interests" usually means the interests of all the shareholders of the company.[43] Are there any special interests that have to be considered with regard to subsidiaries? Under the Swedish Companies Act there are various special legal effects that are associated with subsidiary companies. This applies to consolidated annual reports as well as to certain rules regarding information exchange between the parent company and its subsidiaries. Nevertheless, subsidiaries do not constitute separate legal entities. This means that a member of the board or the managing director should only take into account the interests embraced by his mandate.

When a subsidiary of a group company enters into a contract, the subsidiaries of the group company may be perceived by a third party as one entity. The board mandate that arises with regard to the parent company is based on the legal rules of authorization. The fact that a subsidiary shall not be regarded as an entity from the point of view of company law means that the board of directors of that subsidiary cannot give consideration to the interests of other subsidiaries at the expense of the subsidiary's own interests.[44] In this regard, the general clause of Chapter 8 section 34 of the Swedish Companies Act means that transactions between subsidiaries shall be conducted preferably on strictly business lines, unless it is the question of the distribution of profits.[45]

If the parent company is in actual charge of the management of the subsidiary, it can be liable under the provisions concerning liability of shareholders provided in Chapter 15 section 3 of the Swedish Companies Act.[46] The parent company may avoid such liability if formal decisions are made at the annual general meeting.[47] If the members of the board of directors or the managing director enforce a given decision despite the fact that it contravenes a provision of the Swedish Companies Act, the company's management will become liable. Under Chapter 8 section 34 of the Swedish Companies Act the company's management must always ascertain that directives received from superior bodies of the company are consistent with the articles of association of the company and the Companies Act.[48]

Vicarious business liability cannot be applied to hold a parent company liable for acts committed by a subsidiary's board of directors.[49] Chapter 3 section 1 of the Swedish Tort Act is not applicable here because a member of the board or the managing director of a

42. *See* DOTEVALL, *supra* note 4, at 102. *Cf.* Swedish Companies Act, *supra* note 2, ch. 13, §§ 17–18.

43. *See* DOTEVALL, *supra* note 4, at 112; NORMANN AARUM, *supra* note 12, at 363; ERIK WERLAUFF, SELSKABSMASKEN: LOYALITETSPLIGT OG GENERALKLAUSUL I SELSKABSRETTEN 72 (Gad 1991).

44. *See* S. FRIS HANSEN, EUROPEISK KONCERNRET 315 (1996); SOFSRUD, *supra* note 3, at 263.

45. Swedish Companies Act, *supra* note 2, ch. 8.

46. Swedish Companies Act, *supra* note 2, ch. 15.

47. *See* PAUL K. ANDERSEN, STUDIER I DANSK KONCERNRET 631 (Jurist-og Okonomforbundets Forlag 1997).

48. Swedish Companies Act, *supra* note 2, ch. 8.

49. *See* SOFSRUD, *supra* note 3, at 277.

subsidiary company is formally involved in the aforesaid capacity in a different legal entity. They have been appointed as such by the annual general meeting of the subsidiary. The fact that they are also employees of the parent company cannot lead to vicarious liability. However, it must finally be noted that Scandinavian legal practice shows that the parent company may sometimes become liable for the undertakings of its subsidiary company despite the lack of legislative support. This may take place if the subsidiary company engages in similar business activities as those pursued by the parent company as well as having the same board of directors.

VIII. The Meaning of the Duty of Loyalty

A. The Duty of Loyalty Under the Swedish Companies Act and Articles of Association

Not all of the duties of the managing director and the board of directors can be determined on the basis of the Swedish Companies Act. The mandate of a member of the board of directors as well as obligations usually connected with the managerial position of a board member and the managing director, are accompanied by a duty of loyalty towards the principal (such as all the shareholders). The duty of loyalty is described in more specific terms in the general clause and the provisions on the conflict of interests in Chapter 8 of the Swedish Companies Act.

The general clause set forth in Chapter 8 section 34 of the Swedish Companies Act states that the board of directors and the managing director may not undertake measures that might provide an undue advantage to a shareholder or other person to the disadvantage of the company or another shareholder.[50] All shareholders shall be treated alike. If the special treatment has no support in the Companies Act or the articles of association, then nobody shall profit at the cost of the company or any individual shareholder.

A conflict of interests may be of a more subtle character than, for example, where property has been wrongly evaluated. Even an agreement concluded on strictly business lines may be disadvantageous to the company. It may be the question of property that is very difficult to sell, so that the company has a small chance to sell it, if it should wish to do that, without loss. An acquisition of property is compatible with the object of business operations only if the company can sell the property within a reasonable period of time without loss.

With regards to business objectives established by the articles of association, the Supreme Court established in 2000 that members of the board neglect their duties by undertaking measures not encompassed by the business objectives of the company.[51] Prior to 2000, case law held only a serious deviation from the business objectives constituted neglect of duties.[52] In my opinion, it is not very suitable to scrap the requirement of a serious deviation from the business objectives. Business objectives are frequently formulated in such a way that it can be difficult to draw a clear line. Imposing on the board of directors the obligation to gain support for a planned measure is hardly suitable, taking into consideration the delays that may be caused and the risk that sensitive information about the company's business operations may be exposed. The 2000 decision of the Supreme Court may be suitable for

50. Swedish Companies Act, *supra* note 2, ch. 8.
51. Supreme Court NJA 2000 p. 404.
52. *See* Swedish Supreme Court NJA 1987 p. 394.

companies with a small number of shareholders, but is not suitable for public companies with extended shareholdings. For these companies, the requirement of a serious deviation should be applicable.

The provisions of Chapter 8 sections 20 and 28 of the Companies Act state that a member of the board or the managing director may not participate in decisions regarding agreements between himself and the company.[53] In such cases there will be a conflict of interests irrespective of the content of the contract. Regarding an agreement between the company and third parties, the member of the board or the managing director shall not have a material interest in the matter that may conflict with the interests of the company.

What are the criteria that should be used to determine how serious a given deviation from the business objective is? The normal view in Scandinavian law is that such a deviation occurs when it is a question of a large shareholders' percentage in the legal entity being constituted by the opposing party.[54] Conflicting interests of serious character also arise with respect to contracts between the company and the spouse or relatives of the member of the board or the managing director.[55]

The expression "take part in matters regarding . . ." appearing in the provisions concerning conflicts of interest means that a member of the board or the managing director may not participate in any stage of the decision process.[56] In Danish law, the conflict of interest rule does not preclude a member of the board to whom the rule applies from providing information of a factual character to the remaining members of the board.[57]

The provisions on conflicts of interest may not prevent a member of the board from exercising pressure on the remaining members of the board without the member being regarded as having acted against the interest of the company under the provisions of the Swedish Companies Act. This is applicable particularly in situations in which a member of the board is a party to an agreement. One way of reducing this risk is to discard the formal rule on conflicts of interest in agreements between the company and board members or the managing director in favor of a substantive rule that the factual character of the decision shall be examined. Thus, in order to show that a given member of the board or the managing director was partial, the company would have to show that the agreement was disadvantageous to the company.

B. Competitive Practices

When speaking of competitive practices, a member of the board or the managing director must have an interest that is in conflict with the company's interests. Practices are to be regarded as competitive if they are encompassed by the business objectives stipulated in the articles of association. The involvement of a member of the board or the managing director in the competitive practices must be strong enough to be regarded as a breach of the duty of loyalty.

It is of no importance whether the company is financially capable of conducting the business activities in question or not. The objective of the duty of loyalty is to prevail upon

53. Swedish Companies Act, *supra* note 2, ch. 8.
54. *See* Dotevall, *supra* note 4, at 129.
55. *See* Swedish Supreme Court NJA 1982 p. 1.
56. Swedish Companies Act, *supra* note 2.
57. *See* Sofsrud, *supra* note 3, at 364, with further references.

the members of the board and the company's management to devote all their strength to the business operations of the company. The provisions on the conflicts of interest of the Swedish Companies Act show that competitive practices must be quite extensive to be regarded as representing a breach of the duty of loyalty.[58]

The question arises whether members of the board involved on a full-time basis in the work of the company should be treated differently from members who only hold the board of directors' mandate, but who are not actively involved in the work of the company. The Swedish Companies Act does not differentiate between the obligations of board members who are employed by the company and those who only hold mandates in the board of directors.[59] This means that even board members who are not employed by the company may not engage in competitive practices. A more extensive financial involvement in the competitive practices of a board member not employed by the company would be necessary, however, if such conduct were to constitute a breach of the duty of loyalty.

One problem that is connected with the question of the degree to which a board member may be involved in competitive practices may be the member's opportunities to enter into business transactions that he knows about for personal gain. The theory of corporate opportunities, developed in American law, has strongly influenced European law.[60] This theory entails that it is a board member's duty to let the company profit by the business opportunities falling within the company's sphere of business activities.

The question is whether any distinction should be made between companies based on their size. In such a case, a more general outlook should be applied to public companies. In these companies, board members who were not employed by the company would have certain opportunities to use for themselves business opportunities falling within the company's sphere of activities. In contrast, this sort of thing would be totally prohibited in the case of board members employed by the company. In smaller companies, each case would have to be tried separately in order to establish whether the company has economic possibilities to make use of a given business opportunity. If a business opportunity is directed at a subsidiary of a group of companies whose business activities are different from those of the parent company, the duty of loyalty of a board member towards the parent company's management does not cover the business activity of the subsidiary.

IX. Right to Institute Proceedings

Under Chapter 15 section 7 of the Swedish Companies Act proceedings with respect to damage incurred by the company may be brought not only by the majority of the shareholders, but also by a minority consisting of the owners of not less that one-tenth of all the shares of the company.[61] Chapter 15 section 14 of the Act says that even an estate in liquidation may institute proceedings for damages.[62] The issue that has recently been discussed concerns the question of whether the limitation of 10 percent of share ownership may be set aside, so that shareholders with a lower percentage of shares may also be permitted to

58. Swedish Companies Act, *supra* note 2.
59. Swedish Companies Act, *supra* note 2.
60. *See* DOTEVALL, *supra* note 16, at 271–72.
61. Swedish Companies Act, *supra* note 2, ch. 15.
62. Swedish Companies Act, *supra* note 2, ch. 15.

bring a claim for compensation for damages. In American law, the derivative suit is a possible alternative for shareholders who only possess one share.[63]

Despite the disadvantage of increased litigation that may be connected with the shareholder's right to institute derivative proceedings against members of the board, it plays an important role as a safety measure for the shareholders' minority. This is evidenced by the changes in German law where derivative proceedings of shareholders in private companies (GmbH) have been regarded as acceptable. The same course of development may be observed in English law.[64] Therefore, there is substantial support for the view that such proceedings should be allowed with regard to companies with a small number of shareholders, but not to public companies.

X. Concluding Remarks

Regarding liability of the board members and the managing director to the company a clear pattern has been discerned in recent years indicating that there is a limit to the degree of failure that can be tolerated with regard to the company's business activities. This means that a member of the board may not be disloyal to the company by promoting his own interests, either directly or indirectly. The term "company" in Swedish law does not only refer to the existing shareholders, but even to future shareholders of the company. Further, the company's management ought to show caution when the company's financial position is weak. In these cases the supervisory duty becomes stricter.

With regards to the company management's obligations, the recent amendments to the Swedish Companies Act and the division into public and private companies indicate that the supervisory duty of the board member has become especially important. The supervisory duty entails not only that attention should be paid to the financial circumstances of the company, but also to the question of whether the company's business activities fall within its business objectives, and whether they are in line with the object of the company's operations. Adjudications of the courts show more stringency in that a measure is regarded as contrary to the obligations if it is in variance with the business objectives stipulated by the articles of association. The earlier requirement of a serious neglect of obligations has not been maintained, which is rather unfortunate. A more subtle distinction should be made between companies with few shareholders, where a stricter line should be drawn, whereas greater tolerance against violations of business objectives in public companies can be shown.

With regard to the duty of loyalty of a board member and the managing director, it has been established that their involvement is considerable. This implies that a higher degree of proprietary interests shall be required. It is possible that greater involvement is required from a board member employed by the company, as compared to a member who is not employed by the company. Further, attention should be paid to whether the company is a public or a private company. In public companies a more general outlook can be applied regarding the assessment of whether a business opportunity shall accrue to the company or whether it may be freely used by the board member. A board member who is not employed by the company would be able to use such an opportunity.

63. *See* A. L. I.: PRINCIPLES OF CORPORATE GOVERNANCE AND STRUCTURE: ANALYSIS AND RECOMMENDATIONS, § 7.02 (1994).

64. *See, e.g.*, DOTEVALL, *supra* note 4, at 178.