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Principles of danish company law[1]

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1. Sources

Danish company law is a complex system composed by rules of legislative nature and, above all in the last decade, soft law derivation. The most important sources of legislative order are the Companies Act (*Selskabsloven),* where is defined the company structure and are stated the fundamental principles of corporate law, the Securities Trading Act (*Værdipapirhandelsloven*) that contains the most of the capital markets regulation and the Financial Statement Act (*Årsregnskabsloven)* regarding the accounting regulation. In addition, it has to be mentioned the Act on Business Enterprises, regulating the different types of partnership, and the Act on Commercial Foundations (*Fondsloven)* concerning the particular phenomenon of industrial foundations.

The Code on Corporate governance constitutes, instead, an instrument of self-regulation, issued to provide for important recommendations about the most significant aspects of company's operation, and the allocation of powers among the different corporate bodies, with reference especially to public companies.

2.The Companies Act

The Companies Act identifies the essential characteristics of the Danish companies and the governance mechanisms. The actual structure of this body of legislation is more understandable in the light of a long process started during the beginning of the XX century.

The Act of Danish Register of Companies, issued in the 1930, is the first legislative act concerning the company regulation. While it remained in force, that is until the first half of the '70, the Danish company law has been strongly stable and capable to represent the basis for the future development of the corporate system.

The assumption behind this regulation was a deep influence of the Government in the business function. However, thanks to later emendations, company law has become more flexible and liberal, strongly aimed at boosting the basis for a complete establishment of the doctrine of freedom to contract and of the development of strong shareholder's powers. As a result of this process, the diffusion of three forms of ownership structure took place. In fact, still today family business, foundation-owned companies and, to a minor extend, public companies are the most common forms of business among Danish companies.

In 1972, as the outcome of the cooperation activity among Nordic countries for the creation of a homogeneous corporate legislation, a new Danish Corporate Act was issued. In particular, it provided stronger protections for external stakeholders, the employee representation on the board of directors and it gave a new definition of corporate group, above all with regard to accounting obligations. In the 1981 and later in the 1990, as a consequence of the implementation of the 1st and 7th directive, many significant emendations were introduced in the field of disclosure obligations and evaluation criteria of the consolidated financial statement. In addition, at the beginning of the '90, in the wake of the EU harmonization process, the lawmaker introduced the principle of the separation of CEO and Chairman roles and the possibility to start a one-person company.

Despite the gradual implementation of external stakeholders protections and the convergence towards the EU standards, the ownership structures, fostered by the law of 1930, continue to dominate in the companies sector , together with the cooperatives in the agricultural one.

At the beginning of the 2000s, two bodies of legislation, the Public Companies Act and the Private Companies Act, were issued to sum up the entire corporate law regulation.

Finally, in 2010, the New Companies Act entered into force to specify and complete the aim undertaken by the Public and the Private Companies Acts. In particular, it contains a collection of all the rules previously issued, structured in such a way to be the most coherent and flexible as possible. New legal notions, therefore, had to be enucleate in place of several concepts known and embedded in the previous legislation. The drafting technique, the lawmaker has employed, consists in the partition on the text in two areas: the first containing regulations applicable to the entirety of limited companies, the second addressed exclusively to the public limited ones.

3.*Public and Private Companies*

The Companies Act starts describing the essential of limited liability companies and distinguishes between public (*aktieselskab or A/S)* and private limited companies*(anpartsselskab or ApS).* As we already saw, there is a range of regulations provided for both those categories regarding the incorporation process, the company operation and the general governance mechanisms, so that the majority of the significant features are generally the same. In fact, the difference between public and private companies is that only the formers are eligible for listing. As a consequence, the Companies Act provides for a less flexible regulation of public companies, requiring more restrictions and formal requirements.

3.1 Incorporation

The company's incorporation is regulated by the Companies Act that, in turn, has implemented the EU directives concerning this topic.

In particular, the process of incorporation starts from the initiative of a number of promoters or founders that have to register the new legal entity at the Danish Commerce and Companies Agencies (DCCA). The registration procedure can take from a couple of day up to four weeks but, the registration time can be reduced thanks to a service (called "*webreg*"), recently introduced by the DCCA, which allows persons or entities already registered to undertake online the incorporation. Until the conclusion of the registration process, whoever acts on behalf of the new entity is considered personally liable for the contracted obligations.

3.2 Articles of association

Once approved and subscribed by all the members, the articles of association have to be filed with the DCCA in order to proceed with the registration. The Companies act provides a minimum of information[2] that have to be compulsorily indicated, however, the shareholders can include further provisions (as long as they are compatible with these provided by law) in order to organize the company in such a way they believe is more adequate.

On the other hand, since the articles of associations are available to the public from the moment they are filed at the DCCA, the members commonly include only the information required by law: more detailed provisions will be embedded in the shareholders agreements, not subjected to any kind of disclosure. In fact, it is necessary to specify shareholders agreements have no binding effect on the company but only among the shareholders, contracting parties.

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[2] 1. the company's name and any secondary name(s); 2. the company's object(s); 3. the amount of the share capital and the number or nominal value of the shares; 4. the rights attaching to the shares; 5. the company's governing bodies; 6. notice of general meetings; and 7. the company's financial year.

3.3 Memorandum of association

The memorandum of association is a document, including the articles of association where information[3] about the company's capital structure and some aspects of the corporate operation are specified.

In addition, the shareholders can decide to insert others information such as special rights or benefits to be granted to promoters or others, any agreement entered into with promoters or others that may impose a major financial obligation on the limited liability company, whether shares may be subscribed against contribution of assets other than cash.

3.4 Share capital

The Companies Act provides for a minimum share capital for the limited liability companies to be indicated in Danish kroner or euro. For the public companies, it is required a minimum share capital corresponding to DKK 500,000, whereas the private companies must have a share capital at least of DKK 80.000.

The 25% of the share capital, not less than DKK 80.000, is to be paid up all times. As shares could be issued at a premium (considered as a distributable reserve), which is to be entirely paid up, even if the corresponding part or share capital is not paid up.

It is possible to proceed to the payment of shares by contribution in cash or in kind. In case of in kind contribution, they must be valuable in economic terms, so that, the undertaking to perform a work or render a service are not

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[3] 1. the names, addresses and Central Business Register (CVR) numbers, if applicable, of the promoters of the limited liability company; 2. the subscription price of the shares; 3. the time limits for subscribing and paying for the shares; 4. from which date formation takes legal effect; 5. from which date formation takes effect for accounting purposes ; 6. whether the limited liability company must pay the initial expenses and, if so, the estimated amount of such expenses.

acceptable as contribution. If the share capital is entirely or partially paid up by way of noncash contributions, the share capital must be totally paid up.

The supreme governing body can ask, in any time, the shareholders to pay the share capital subscribed but not yet paid up. However, all the shareholders are legitimated to make the payment, notwithstanding any formal request.

In section 34, the Companies Act states "The rights of a shareholder under this Act subsist regardless of whether their shares are fully paid up". On the other hand, the section continues clarifying that, in case the shareholder to whom the central governing body has addressed a request, has not proceeded for the payment of the amount outstanding on a share, he cannot "exercise the voting rights and his shares will be considered unrepresented at the general meetings until the amount has been paid to and registered by the company". Despite that, the shareholder preserves the right to dividends and other payments, even if he cannot subscribe for new shares in case of capital increase.

3.5 Shares

The articles of association has to indicate if the capital stock is to be represented by nominative or bearer shares, and whether they are freely transferable or non-negotiable instruments. This choice has important consequences on the kind of measures shareholders should take to protect their stake against third parties, and also determines if share certificates have to be issued or not.

The governing body decides on the issuing of formal share certificates (paper certificates). However, the choice becomes obliged if the issuing is required by shareholders representing at least 10% of the nominal share capital value, the shares are negotiable instruments and bearers. Therefore, from a formal point of view, if shareholders do not ask for certificates confirming their ownership situation, the issuing of shares in unlisted companies requires only the indication of the relevant entries (name, registered office and registration number of the company, and the serial number, size or nominal value of the share, whether the certificate is to be registered in the name of the holder or whether it may be issued to bearer, the date or month of issue) into the register of shareholders.

Specific provisions are supplied in reference to listed companies. In fact, public companies must issue their shares as "dematerialized securities" through a securities centre, so that they cannot issue formal share certificates. The only danish securities centre actually in existence is the VP Securities A/S.

3.6 General meeting

The Companies Act gives a clear and organic overview of the operation and tasks of the general meeting. Undoubtedly, important rules has been introduced aimed at making the convening and holding of the general meeting more flexible.

The general meeting is responsible for:

1. adoption of the annual report;

2. appropriation of profit or loss as recorded in the adopted annual report;

3. any change to a resolution about auditing the limited liability company's future annual reports if the company is not subject to audit obligations under the Danish Financial Statements Act or any other statute; and

4. any other business to be transacted by the general meeting pursuant to the company's articles of association.

The general meeting has to be convened at least once a year to approve the annual report in such a way for the company to comply with the deadline for filing the annual report. In fact, the audited and approved annual report has to be submitted to the DCCA no later than five months for non-listed and four months for the listed companies after the end of the financial year. The governing body, the auditor, any shareholders for the private companies and shareholders representing at least 5% of the share capital (or the minor percentage prescribed by the articles of association) for the public ones, can convene extraordinary general meetings to consider specific issues, giving the notice fixed by the articles of association.

General meeting has to be convened with a minimum notice of two weeks and a maximum of four weeks before the meeting date, but the articles of association can provide for a longer period of notice. Specific provisions are set for listed companies: notice must be given no earlier the five weeks and no later than three weeks before the meeting date. It has to be provided in accordance with the procedure indicated in the articles of association and the general meeting can decide it is to be indicated on the company's web site: such a resolution is to be inserted in the company's articles of association.

In addition, notice must be given only to persons included in the register of shareholders, indicating the time and place of meeting and the agent items are going to be dealt with at the general meeting. In case the general meeting is called to consider the adoption of resolution to amend the articles of association, the main subjects must be identified in the notice. The full text of the proposed resolution has to be pointed out if are to be passed in accordance with particular provisions requiring a reinforced qualified majority.

The New Companies Act has set important rules to promote active ownership also to improve the shareholders directive. The provisions about electronic general meetings are among the most significant development from this point of view. The central governing body can determine the possibility for shareholders to attend general meetings electronically. The general meeting can be partly electronic in case the central governing body decides that shareholders have the right to electronically attend general meetings, in addition to the opportunity to attend physically. However, the general meeting may choose, issuing a resolution, to hold meeting by only electronic means, giving shareholder no chance to physically attend. The resolution is to be recorded in the articles of association and must illustrate the system electronic means can be used to attend meetings. In both cases, the central governing body has to specify in the notice, convening the general meeting, the requirements to use electronic means for conducting meetings electronically hold and it has to explain how shareholder can register to attend the meetings electronically.

Each shareholder may ask to include specific issues to be discussed in the agenda. In public companies, the inclusion is conditional on the submission of a wrote request to the central governing body, at least six weeks before the meeting date, specifying the issues to be dealt with. If the shareholder fails to comply with the final date for the submission, the central governing body may evaluate the possibility of including the issue anyway. Whatever issue, if not contained in the agenda, cannot be discussed by the general meeting unless shareholders give their consent unanimously.

In addition, during the conduct of the meeting, shareholders can individually address questions to the directors about the balance sheet and the issues included in the agenda. Directors have the duty to give a proper answer, unless, by answering, are likely to cause a significant detriment to the company. If they are not able to give a satisfying answer during the meeting, they must provide for the information required not later than two weeks after the meeting.

Defining the limited liability company's financial structure, the Companies Act establishes the principle "one share, one vote": shareholders' contributions are represented by shares conferring equal rights. However, the memorandum of association can provide for the creation of different categories of shares, specifying the characteristics and the percentage of share capital respectively represented. Therefore, the mentioned principle is applicable relatively the different classes of shares.

Limited liability companies may issue shares void of voting rights and quantitative limits may be set on how many votes each shareholder can exercise (voting ceiling) and shares may be owned (ownership ceiling). Therefore, limitations of voting rights do not imply, as a principle, a recognition of privileges on the occasion of distribution of dividends, given the complete freedom in the characterization of different categories of shares.

As a rule, decisions taken by the general meeting are made by simple majority, whereas is sufficient a relative majority for the election of the board of directors, if not differently stated in the articles of association. A qualified majority of 2/3 of the votes cast and of the share capital representes, is required for essential changes in the articles of association such as the issuing of new shares. In case of a tie, the proposed resolution is considered as not approved, whereas, if it is about election of the members of a company body, it may be resolved by drawing slots. A supermajority of 9/10 of the cast votes and of the represented share capital is required for resolutions to be passed, when they concern fundamental issues such as the introduction of a voting ceiling or the reduction of the right to profits in favor of third parties.

Actual limitations provided for the purpose and conditions under which shareholders can confer a proxy, have been disposed in the view of promoting active ownership. In particular, the Companies Act maintains stronger restrictions for the proxies conferred to the company bodies (board of directors and executive board), so that they are valid only for a period of twelve months and for a specific general meeting. On the other hand, proxies issued to anyone other than a member of those bodies may be indefinite and general, so that it is inferable the possibility to still grant "blank proxies" for to anyone other than them.

3.7 Distribution of dividends

Resolutions about distribution of ordinary dividends are to be issued once a year by the general meeting. Distribution cannot occur above the amount available as recorded in the financial statement. In any case, the general meeting is not allowed to distribute dividends for an higher amount than that proposed or accepted by the company' central governing body.

In addition, the central governing body, with the prior authorization of the general meeting, can proceed with the distribution of extraordinary dividends, once presented the first financial statement.

Extraordinary dividends may be made up to the amount available for distribution as recorded in the financial statements and profit for the current financial year up to the date of the decision on distribution ,if they have not been distributed, appropriated or tied. If any distributable reserve does exist, it may also be distributed as extraordinary dividends.

If a public company is to distribute extraordinary dividends, the decision has to be accompanies by a balance sheet. The adequacy of the balance sheet from the latest annual report has to be assessed by the governing body, otherwise an interim balance, demonstrating that sufficient funds are available for distribution, has to be prepared in accordance with the rules on preparation of the limited liability company's annual report.

In private limited companies an interim balance sheet is required only if the resolution on the distribution of extraordinary dividends has been approved more than six months after the balance sheet date as fixes in the company's latest adopted annual report. If the company is subject to audit obligations, the interim balance must be audited by the company's auditor.

4. Governance structure

Under the Companies act, three different governance structures can be adopted by a limited liability company : traditional, two-tier and one-tier model.

4.1 Traditional model

The traditional corporate governance system involves three company's bodies: the board of directors, the executive board and the general meeting.

The members of the board of directors are appointed by the shareholders convened in the general meeting. The articles of association may provide public authorities or other parties with the right to appoint one or more members of the board of directors. In any case, the majority of the board has to be appointed by the general meeting in such a way it has always a crucial influence on the board composition.

The board of directors is a collective company body composed at least of three members. Only natural persons can be part of the board and, under the Copenhagen Stock Exchange Listing Rules, they must possess the necessary skills to perform their managerial tasks. The board of directors chooses its own chairman, unless differently provided by the articles of association. The chairman is responsible for directing the work of the board and convening the meeting, and, in general, is the person who represent the company outside. The board adopts its procedural rules, covering the issues it is responsible for, including supervision of the executive board, adequate organization of the business structure and procedures and the ongoing direction of the company's finances. Consequently, there is a specular duty to set proper reporting procedures and internal control systems. The board can proceed in taking decisions with a quorum of at least half its members, and decisions are taken by a simple majority, unless the articles of association set higher requirement both for a quorum and for a majority as well as giving the chairman the casting vote.

The board of directors appoints the members of the executive board and is entitled of its supervision. As it is an appointment and not an election, the board of directors can dismiss a member of the management at its discretion and without notice. The fact that the member will have an employment contract, under which has the right both to notice and severance pay, does not affect the right of the company to release him from his functions without notice.

The executive board is responsible for the "day-to-day management" in accordance with the guidelines indicated by the board of directors. The members of the executive board submit the board of director every issue outside the ordinary conduct of business.

Although the executive board may be composed just of one person, usually, above all in public companies, is a collective body. However, one of the managers has generally seniority over the other members and is called the managing director "*administrerende director*", strongly similar to the American Chief executive officer.

Since they are both executive bodies, the members of the executive board can be also members of the board of directors, but neither the chairman or the majority of the board may be part of the executive board. The reason of this restriction is that the board of directors performs not only executive functions, being also responsible for the supervision of the executive board members.

The structure, we have just described, represents the result of a long legislative evolution and consists in a interesting and peculiar interpretation of the principal-agent dynamic.

The governance system originally adopted by the Nordic countries at the beginning of the XX century, was very similar to the Anglo-Saxon one-tier system. There was a board of directors responsible for the overall management of the company and, in the major companies, one of its members was appointed to handle the ordinary business, just as a CEO.

The company law reform, in the 1930, took into consideration the fact that the regulation of liability in the field of corporate governance was particularly inadequate because applicable only to the board of directors not also to the CEO. In fact, company law did not provide for a specific parameter to identify the liability with reference to the "day-to-day management". For this reason, the lawmaker started to consider the management as a distinct company body, subject to the board of directors and responsible exactly for the ordinary affairs concerning the company. This change in the company organizational set up was made mandatory for all the companies after a brief transitory period.

The World War II stopped the debates about company law system all over the Scandinavia, apart from Sweden (remained neutral), where a new Corporate Act was approved just in these years. In the post war period the reform restarted and a new governance model began to broaden in the other Scandinavian countries and created the basis for the actual structure.

Indeed, the one-tier model has been maintained since the executive board comes to represent a body subordinate to the board of directors and subjected to its decisions. The members of the executive board can be also part of the board of directors, however, limitation to the possibility of personal overlapping between the two body it has been fixed to reinforce the supervisory function of the board. In particular the chairman of the board of directors cannot be simultaneously member of the executive board and, in case the management constitutes a collective body, its members are not to represent the majority of the board of directors.

The main responsibility of the executive board consists, still today, in the "day-to-day management", that is, the ordinary affairs occurring in the routine of the company conduct. However, the extent of its competences has to be assessed case by case in such a way that if the members consider a situation -they are dealing with- to be out of the ordinary business or concerning a general issue, they has to submit it to the board.

Another fundamental characteristic of the Scandinavian system consists in the twin nature of the functions of the board of directors. In fact, the board is entitled of executive tasks referring to the extraordinary affairs and the overall management but also of the supervision of the executive board's performance. Therefore, it is possible to define this governance structure a as dual system because of the coexistence of those two bodies entitled of the company's management. To guarantee a hierarchic system where the executive board is subordinated to the board of directors, the later has been attributed the power to appoint and repeal the members of the executive board at his discretion.

As regards the shareholders' role, the Nordic governance corresponds essentially to a one-tier system with a internal organization of managerial powers distributed between two executives bodies hierarchally ordered.

It is probably more correct to define the Nordic governance structure as a "one string system", because it has a strongly hierarchical organization of the company's bodies which assures the subordinate body is established and repealed by the higher one. The body at the top is the general meeting, with almost unlimited powers, immediately below there is the board of directors, in turn higher in hierarchy than the management.

The idea of the shareholders' supremacy is so strongly embedded that company law requires the majority of the board of directors to be, at any time, appointed by the general meeting so that, anyone, owning the majority of the voting rights, has the possibility - to the extent voting ceiling mechanisms do not exist- to choose all the members of the board of directors. It the law maker himself that promotes a system devised to guarantee dominant shareholders to run the company.

A such organized system gives rise to a significant risk of abuse of major shareholder rights. Company law efficiently solves the issue concerning the possible influence major shareholder can exercise on the management setting a general clause under which resolutions of the general meeting, giving certain shareholders or others an undue advantage over other shareholders or the limited company, are deemed invalid. In addition, not only the directors, but also the major shareholders are considered liable for eventual abusive conducts.

In addition, since the shareholders, in view of their limited liability, can easily decide the assumption of incautious ricks, on the one hand all the executive functions has been assigned to the board of directors and its members are considered personally liable in case of unreasonable risks, limiting the possibility of the dominant shareholders to impose unscrupulous decisions, on the other, dominant shareholders, engaged in the "abusive" decision-making process, are deemed personally liable.

The key principle of Scandinavian corporate governance is that company's organization is better if run by shareholders convened in the general meeting. The shareholders, as residual claimants, have the greatest incentive so that the company's conduct is efficiently and gainfully managed.

The reason why it is convenient for a person to invest and become a major shareholder, spending pecuniary resources just to monitoring the company, is not to be found in the probability and perspective to obtain personal benefits on the occasion of distribution of dividends. In fact, sustaining these costs to increase the return of the invested capital, by concentrating the resources just in one company, is considered more profitable than crumbling the available assets in a crowd of entities, taking an higher risk because of the lack of effective control.

The sharing of benefits consisting in the increase of the company's profitability, derived from the efforts of the major shareholders does not prevent from considering the investment as convenient. As a consequence, the direct influence of shareholders is deemed as absolutely beneficial and as much positive is considered the presence of dominant shareholders, since they are capable of monitoring the management on behalf of all the shareholders, including the minor ones.

4.2 Alternative governance models

The new companies Act has introduced the possibility for limited liability companies to choose between two other models, alternative to the traditional one. We can define them respectively as one-tier or two-tier model depending on the presence or absence of a supervisory board distinct from the executive body.

In particular, as regards the two-tier system, three different company bodies are involved: the executive board responsible for the overall management, the supervisory board which appoints and defeats the members of the executive board as well as is responsible for monitoring their performance. the supervisory body is in turn appointed by the general meeting.

The one-tier model imply the presence of a executive board with overall management tasks. To assure an efficient control of the board conduct, the majority of its member has to be composed by non executive directors. This system can be adopted only by private companies to whom the employee representation regulation is not applicable.

4.3 Employee representation

The company law requires permits the company employees to appoint representatives' to the supreme governing body if the company:

- has more than 35 employees from at least three years
- its subsidiaries have more than 35 on the whole.

The employees are entitled to appoint a number of representatives corresponding to half the members appointed by the general meeting, so one third of the whole board, with a minimum of two members in the same company, three in case of corporate group. The decision to exercise the right to have representatives on the board depends on the results of a referendum.

The representatives have the same tasks and duties of the other members of the board and, in addition, they have to give adequate and precise information to the employees.

5. Foundation ownership

As just saw, the nordic companies' ownership structure is characterized for the broad diffusion of foundations owners of the majority of the issued shares or of the voting right in a limited liability company. Foundation ownership is without doubt one of the most particular features that mark out the Scandinavian corporate governance, the Danish one the most (just think, for instance, to companies such as Carlsberg, Novo Nordisk, Lego, Lundbeck).

The phenomenon of commercial foundations has been deeply analyzed because of the theoretical issues it implies, concerning the structure of commercial enterprise and of its business run in a corporate form, but also relating to the real nature of private property as well as to the principle of freedom to contract.

Commercial foundations are non-profit legal entities, organized to administer a large or – more commonly- a majority stake in a limited liability company. The foundation is, generally, constituted by the company's founder and endowed thanks to the ownership stake in the company. Under tax law, the founder's gift of its stake in the company must be irrevocable and the charter purposes must be charitables. In particular, the charter must provide purposes of some social significance such as, for instance, acting in the best interest of the company and to use company's profits for charitable aims.

From a traditional principal-agent view, the phenomenon of commercial foundation seems to represent a paradox because, being completely absent the "ownership" component, there is not any profit perspective which creates the necessity of an effective control on the directors conduct. From the 70's, it has been developed a large consensus on the opinion under which risk diversification and financial incentives have a fundamental role for having an efficient management of the business in whatever commercial enterprise.

Non-profit entities could be a possible exception but, this organizational model cannot be competitive without an external economic support (such as, commonly, tax benefits) and can be used only in particular sectors (universities, hospitals, libraries, charitable entities). Therefore, under this assumption, the use of non-profit entities beyond those sectors should be rare and their economic performance below the average. Consequently, foundation owned companies should not be capable of running a business efficiently in terms of profitability, increase and valorization of the invested capital.

And yet, this kind of companies are not in fact less effective than others, considering some significant indices such as value creation, firm value and risk-adjusted stock return. Several empirical researches have been conducted which have demonstrates how economic performance of foundation owned companies is not worse than that of companies with a "normal" ownership structure. On the contrary, if there are not significant differences in terms of return of invested capital, companies controlled by foundations have a better equity/assets ratio.

Therefore, commercial foundations represent an enigma and the reasons of controlled companies' good performance remain yet completely not understood.

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