CHAPTER 11
Empowering Minority Shareholders

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§11.01 INTRODUCTION

The limited company is an extraordinary legal invention. Its charm is based on legal personality and limited liability, combined with a flexible ownership construction with units (shares) that can be traded individually without affecting the business as such. This makes the company independent of its owners and potentially able to outlive its shareholders in eternally. However, the main usage of the limited company is not for this reason. Most companies are small- and medium-sized enterprises (SMEs) and closely held, i.e., run by a few numbers of owners who are also managers and active in the day-to-day business.[1] This makes the company indeed dependent on its shareholders and on a functional collaboration between them. It also means that conflicts among the shareholders can pose a serious corporate governance problem in SMEs, as they affect the management of the company, due to the overlap of roles.

The purpose of this chapter is to evaluate if company law regulation is in need of new instruments to enhance good governance when tacking shareholder conflicts in SMEs. For this purpose, I first need to explore statutory and contractual regulation and its function in situations where there is a disagreement or a conflict between controlling and minority shareholders in owner-managed SMEs. This discussion is divided into three phases: before an individual becomes a minority shareholder, during the co-ownership, and when a conflict has arisen leading to a collapse of the collaboration.

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1. *See, e.g.*, Brian Robert Cheffins, *Company Law: Theory, Structure, and Operation* 48–49 (Clarendon 1997).

In each of these phases, statutory or contractual regulation can empower the minority shareholder. The analysis will, however, show that traditional shareholder protection rules can increase the conflict rather than solve it and hereby hinder the company to run properly. Consequently, I discuss three instruments on how to empower minority shareholders in SME-conflicts while also promoting good governance.

The chapter is organized in sections as follows: In §11.02, a theoretical background to the tension between minority and controlling shareholder(s) is introduced, and how ownership issues inevitably affect management and board work in closely held companies. In §11.03, the origins of disagreements or conflicts in SMEs are explained based on diverse interests and a combination of financial and non-financial goals. Section 11.04 starts with an overview of regulatory techniques used by the legislature to protect minority shareholders. Regulatory tools discussed in the chapter include procedural safeguards, disclosure, mandatory prohibitions, standard based review, and statutory exit rights. I continue the section by discussing how conflicts in SMEs are, or fail to be, prevented, counteracted, or solved by these regulatory techniques also taking into consideration contractual aspects such as bargaining power. As a response to identified regulatory shortfalls, three instruments to help overcome shareholder conflicts as a corporate governance problem are analysed and suggestions on how to regulate this in the companies act or by contractual means are put forward in §11.05. The chapter ends with concluding remarks including some suggestion for future research avenues.

§11.02 THE CORPORATE GOVERNANCE DILEMMA IN SMEs

SMEs represent 99% of all businesses in the European Union (EU) and are often referred to as the backbone of Europe's economy.[2] According to the EU definition, SMEs are enterprises which employ fewer than 250 persons and which have an annual turnover not exceeding EUR 50 million, and/or an annual balance sheet total not exceeding EUR 43 million.[3] Notably, the EU definition says nothing about the ownership structure of these firms, and such data is much harder to collect. However, studies show that most limited companies have only one shareholder. Among companies with several owners, two shareholders are most common, followed by three to four shareholders, and five or more shareholders are actually quite rare.[4] Further, in a typical SME, the shareholders are also engaged in the daily business activities.[5] For these firms, with an overlap of roles between shareholders, board members, and managers, I use the term owner-managed companies.

2. https://ec.europa.eu/growth/smes_en.
3. *See* Commission Recommendation of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises.
4. *See, e.g.*, Nykredit, *Ejerlederanalysen 2018*, 5; Morten Bennedsen & Kasper Meisner Nielsen, *Ejerledelse i Danmark – Rapport 1: Ejerledelse – baggrund og udbredelse* (Center for Ejerledede Virksomheder, Copenhagen Business School 2015).
5. *Ibid.*, p. 34 which report an overlap of 84% in Danish private limited liability companies (anpartsselskaber).

Corporate governance is the overall system of rules, norms, processes, and practices to manage and control a business entity. The essence of corporate governance mechanisms is to address divergence of interests between involved parties. The dominating theory to describe the governance mechanism of a limited company is agency theory as developed by Jensen & Meckling. They defined a principal-agent relationship: 'as a contract under which one or more persons (the principal(s)) engage another person (the agent) to perform some service on their behalf which involves some decision making authority to the agent'[6] In the 'modern firm', as defined by Berle & Means in 1932,[7] the shareholders are the principal and the managers are its agent, and the agency costs origin from the risk of suboptimal decisions or opportunistic behaviour taken by the agent.

However, Jensen & Meckling have also shown that agency cost appears in all type of collaborations: businesses, public bodies, cooperatives, universities, etc. as well as in collaborations between equal parties.[8] Consequently, more than one principal-agent relationship can be identified in limited companies. Three agency problems are commonly addressed in company law, with the first relationship between owners and managers.[9] The second principal-agent relationship lies among shareholders where the shareholder(s) with decision-making power is the agent for all shareholders. In other words, minority shareholders are the principals relying on the controlling shareholder(s).[10] Finally, the third agency problem, which will not be further developed in this chapter, is between the company and creditors or other outside stakeholders.[11]

In owner-managed companies, the first agency problem could be non-existent if there is a full overlap between shareholders and managers in the firm.[12] However, even if full overlap is not the case, the agency costs are typically lower in small firms as the principals and agents are few and visible for each other resulting in, e.g., low-monitoring costs.[13] The opposite could however be the case for the second agency

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6. *See* Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 (4) J, Financ. Econ. 305, 308 (1976).
7. *See* Adolf Augustus Berle & Gardiner Coit Means, *The Modern Corporation and Private Property* (9th ed., Harcourt 1932).
8. Jensen & Meckling, *supra* n. 6, at 309.
9. *See, e.g.*, John Armour, Henry Hansmann, & Reinier H. Kraakman, *Agency Problems and Legal Stategies*, in *The Anatomy of Corporate Law: a comparative and functional approach*, 29–31 (Reinier H. Kraakman, et al. eds, Oxford University Press, 2017).
10. In family business literature, this relationship is sometimes called principal-principal. *See, e.g.*, Sanjay Goel, Iiro Jussila, & Tuuli Ikäheimonen, *Governance in Family Firms: a Review and Research Agenda*, in *The Sage Handbook of Family Business*, 239–240 (Leif Melin, et al. eds, SAGE Publications, 2014).
11. *See, e.g.*, Jonathan R. Macey, *Corporate Law and Corporate Governance – A Contractual Perspective*, J. Corp. Law 187 (1992/93).
12. *See, e.g.*, Guido Corbetta & Carlo Salvato, *Self-Serving or Self-Actualizing? Models of Man and Agency Costs in Different Types of Family Firms – A Commentary on 'Comparing the Agency Costs of Family and Non-Family Firms: Conseptual Issues and Exploratory Evidence'*, 28 (4) Entrepreneurship Theory and Practice, 360 (2004). *See also,* Mette Neville, *Conflicts in Small and Medium-sized Enterprises*, in *Shareholder Conflicts*, 89–90 (Paul Krüger Andersen, et al. eds, Thomson Reuters 2006).
13. *See* Frank H. Easterbrook & Daniel R. Fischel, *Close Corporations and Agency Costs*, 38 (2) Stanf. Law Rev. 271, 274 (1986).

problem. Conflicting interests and opinions which in companies with dispersed ownership could lie between the shareholders and managers would instead typically lie between controlling owners and minority shareholders.[14] In addition, the close relationship between owners, and consequently between owners and managers, can both be an advantage and handicap for the business, i.e., it can both reduce transaction costs and be the source for them.[15] Due to the overlap of roles in owner-managed firm, disagreements or conflict among the owner are likely to affect both strategic decision and the daily management of the company. Therefore, shareholder conflicts become a corporate governance problem. Worse case scenarios include deadlocks, oppression, and possible liquidation of the company. Hence, in closely held companies, ownership issues become business issues, as the overlap of roles make it close to impossible to separate the two spheres.

Overall, the essence of corporate governance is to address divergence of interests between agents and principals, and in closely held businesses this is often divergence of interests between the majority and the minority shareholders. Corporate governance instruments can both be statutory, i.e., provided by law, or contractual. Before discussing such instruments in §11.04 and §11.05, let us examine some typical origins of disagreements or conflict in SMEs.

§11.03 DISAGREEMENTS AND CONFLICTS IN SMEs

Owner-managed firms are dependent on a functional and fruitful collaboration between shareholders. The shareholders are often key employees, and full-time dedication in the firm is sometimes regulated in a shareholders' agreement or simply a tacit assumption for the collaboration. However, just as the business is being put to the test during its lifetime, so are the shareholders. In difficult times, such as regression or any financial restraints for the company, even minor disagreements might become vital. When each individual is important, every opinion matters.

One characteristic of closely held businesses that increases this complexity is diversified goals. Research shows that an important part of the ownership logic of closely held businesses, including family firms, is the combination of both economic and non-economic goals. Goals are an embedded part of the owners' idiosyncratic

14. *See, e.g.*, Mette Neville, *Corporate Governance i mindre og mellemstore virksomheder*, in *Corporate Governance i Danmark: Om god selskabsledelse i et dansk og internationalt perspektiv,* 221, fn 14; James J. Chrisman, Jess Huan Chua, & Reginald A. Litz, *Comparing the Agency Costs of Family Firms and Non-Family Firms – Conceptual Issues and Exploratory Evidence*, 28 (4) Entrepreneurship Theory and Practice 339 (2004); Øyvind Bøhren, *Eierne, styret og ledelsen: corporate governance i Norge* 50 (Fagbokforlaget, 2011); Daniel Stattin, *Aktieägares rätt till information*, in *Aktieägares rättigheter* 49 (Carl Svernlöv ed., Stockholm Centre for Commercial Law, Iustus, 2009).
15. *See, e.g.*, Mette Neville, *A Statutory Buy-Out Right in SMEs – an Important Corporate Governance Mechanism and Minority Protection?*, in *Company law and SMEs* 251 (Mette Neville & Karsten Engsig Sørensen eds, Thomson Reuters, 2010).

vision.[16] For example, reputation and social status are important aspects of running the business.[17] Studies have also shown that owner-managers uphold good relations with co-owners and/or family members as a goal itself, as well as responsibility towards employees and the local community.[18] The latter is often explained by the fact that the owners are resident where the business is situated, they are known in town and are often involved in a set of local activities.

Based in empirical studies, Neville concludes that owner-managers primary motivation often is freedom and autonomy.[19] In a Danish survey from 2010, owner-managers listed reasons for running their company. The most common answers were to work within their interest, to be autonomous, and to pursue their entrepreneurial vision. Only 3.3% answered that high salary and dividend was their main reason to pursue business, and merely 3.8% stated economic gain by selling the shares as their main goal.[20] Similar results are found in a Finnish survey from 2002, where the three most common reasons of the respondents were (1) to be among the top three companies in the main business, (2) to provide financial independence to the owning family and, (3) to maximize profitability.[21] High dividend came as number eight on the list of ten fixed alternatives, and to sell the firm when opportunity arises came absolute last. Mustakallio et al. use this data to study corporate governance structures of Finnish family firms. They conclude that family firms need to develop governance structures that promote cohesion and shared vision among owners and reduce harmful conflict. When it comes to non-financial goals, implementation of social control mechanisms that promote social interaction and the formation of a shared vision is crucial.[22]

Considering all possible combinations of both financial and different non-financial goals, it is easy to understand that a joint vision of the business is difficult to uphold. In particular, if the majority and minority shareholders enter the business with different perspectives, it is hard to imagine a complete consensus. For example, imagine a second-generation family business owner with majority vote who is aiming to let the third generation enter the company, while the minority shareholder is a key

16. The notion is used by Zohar Goshen & Assaf Hamdani, *Corporate Control and the Regulation of Controlling Shareholders*, in *The Law and Finance of Related Party Transactions* 28 (Luca Enriques & Tobias Tröger eds, Cambridge University Press 2019) to capture an entrepreneur's business idea or their method for pursuing it.
17. Cf. Ronald J. Gilson, *Controlling Shareholders and Corporate Governance: Complicating the Comparative Taxonomy*, 119 (6) Harv. Law Rev. 1663–1664 (2006) who discuss non-pecuniary private benefits of control.
18. *See* Ethel Brundin, Emilia Florin Samuelsson, & Leif Melin, *Family Ownership Logic: Framing the Core Characteristics of Family Business*, 20 (1) J.Manag Organ. Vol. 6 (2014), Theme 4.
19. *See* Mette Neville, *Corporate Governance and Strategic Change in SMEs in a Digital Age – the Board as a Digital Catalyst?*, in *Festskrift till Rolf Skog* 978 (Ronald J. Gilson, et al. eds, Norstedts Juridik 2021).
20. *See* Nykredit, *Ejerlederanalyse 2010 – Potentiale for vækst i ejerledede virksomheder* 26 (2010). *See also,* Neville, *supra* n. 15, at 252–258.
21. *See* Mikko Mustakallio, *Contractual and Relational Governance in Family Firms – Effects on Strategy Decision-Making Quality and Firm Performance* 166 (Helsinki University of Technology, Institute of Strategy and International Business, 2002).
22. *See* Mikko Mustakallio, Erkko Autio, & Shaker A. Zahra, *Relational and Contractual Governance in Family Firms: Effects on Strategic Decision Making*, 15(3) Fam. Bus. Rev. 205 (2002).

employee who was once offered some shares mainly as a sign of appreciation and as incitement to stay with the company. Or imagine the minority shareholder in such family business as a local investment firm.

When conflicts occur, the complexity can be increased by the personal relationship between owners because both the professional and personal spheres are affected simultaneously.[23] A disagreement might, for example, result in a deadlock where investments or strategic decisions are blocked by one shareholder, perhaps based on a so-called consensus clause in a shareholders' agreement. This would paralyse board work. Studies by Neville indicate that disagreements on daily management issues and on future investments for growth are typical grounds for deadlocks, as well as disagreements and disappointments on how much time and effort a co-owner puts into the business.[24] Deadlocks are particularly cumbersome in companies owned 50:50, i.e., to equal share by two parties. Another consequence of disagreements could be that the minority shareholder is not re-elected as a member of the board at the general meeting, i.e., by the controlling owners.[25] By such resolution, the minority shareholders will lose not only his/her influence over the business but also the main channel for information. This will result in further information asymmetry between the parties, and the minority shareholder could struggle with lack of transparency leading to lack of trust.

If the disagreement or conflict is severe or long lasting, then the final solution would be to end the collaboration. However, the minority often finds it difficult or even impossible to sell the shares to anyone beside the controlling shareholder(s), who might not be so willing to negotiate a deal that would benefit both parties. Shares in closely held companies are normally illiquid for two reasons. First, there is no open market for the shares. Personal relationship, such as family ties or friendship, is the primary foundation of the co-ownership. This limits the pool of potential buyers significantly to individuals who are willing to enter that particular ownership constellation while also being accepted by current owners.[26] In reality, this often mean that only current co-owners are potential buyers. Alternatively, all shares must be sold at the same time, or the share must be redeemed by the company, *see infra* on shareholder exits. Second, the shares are often subject to transfer restrictions in the articles of association or in shareholders' agreements. The purpose of such regulation is to control ownership transfers and avoid unwanted new shareholders. In sum, a minority shareholder has few alternatives in shareholder conflicts other than relying on the tools for minority protection offered by the legislature or negotiate with the controlling shareholder(s) on the terms for leaving the collaboration.

23. *See, e.g.*, Neville, *supra* n. 12, at 91–92; Manfred F.R. Kets de Vries, *The Dynamics of Family Controlled Firms: The Good and the Bad News*, 21 (3) Organizational Dynamics 61–62 (1993).
24. *See* Mette Neville, *Konfliktløsning*, in *Den nye selskabslov* 212 (Mette Neville & Karsten Engsig Sørensen eds, Jurist- og Økonomforbundet 2009).
25. Cf. Manne Airaksinen, *Conflicts between Shareholders and How to Solve them in the Legislation*, in Shareholder Conflicts 249–250 (Paul Krüger Andersen, et al. eds, Thomson Reuters, 2006).
26. *See also,* Susanne Kalss, *The Transfer of Shares of Private Companies,* 1(3) ECFR 347–349 (2004).

§11.04 REGULATION ON CONFLICTS

[A] Introducing Regulatory Techniques for Minority Protection

Minority protection provisions comes in many forms, for example as mandatory or defaults, rules or standards and with aim to function *ex ante* or *ex post*. This subsection provides a general overview of some alternative regulatory techniques used for minority protection in company law.[27] In the subsequent subsections, I discuss how these regulatory techniques are used to prevent, counteract, or solve shareholders' conflicts in SMEs.

As a first alternative, the legislature can protect minority shareholders by procedural safeguards. In first-hand, such safeguards come in form or requirements of special majority or supermajority approval at the general meeting. The strictest regime will require consensus among shareholders. This is very seldom demanded by the companies act but could be stipulated in a shareholders' agreement or in the articles of association. An alternative could be approval by all shareholders who are negatively affected by the decision. A procedural safeguard discussed in the context of related party transactions is majority-of-the-minority approvals. This means that a transaction between the company and, e.g., a controlling shareholder is allowed if the majority of the disinterested shareholders approve.[28] Another safeguard to allow such transaction would be upon approval by independent directors or by an external evaluator guaranteeing that the terms of the transaction are made on arms-length, e.g., by a so-called fairness opinion.[29] The advantage of procedural safeguards is that they are clear rules with high level of predictability. Since the assessment is on formalities, it does not necessitate advanced *ex post* review. The downside of the regulatory technique is that its efficiency is highly dependent on the access to information.

A second regulatory technique to protect minority shareholders is therefore to counteract information asymmetry. Disclosure provisions, most intensively regulated by the financial reporting standards, are frequently used to protect creditors, investors, and shareholders. However, information is also provided though the general meeting and enforced by shareholders' right to pose questions. In some legislations, a minority shareholder also has the right to information outside the general meeting. One such opportunity is discussed *infra*. Information can also be upheld by other means. Two examples are by appointing a separate (minority) auditor to participate in the audit or by applying for an examiner to perform a special examination of the company's management and accounts during a specific period. Commonly, these measures to access information are granted to a minority of certain size, for example holding at least 10% of the shares in the company. The function of disclosure provisions is primarily to make sure that minority shareholders have the opportunity to make informed decisions

27. One example of a regulatory techniques not regarded in this chapter is the usage of independent directors as it mainly targets other companies than SMEs.
28. *See, e.g.*, Luca Enriques, *Related Party Transactions: Policy Options and Real-World Challenges (with a Critique of the European Commission Proposal)*, 16 (1) EBOR 15–18 (2015).
29. *Ibid.*, at 22–23.

and have enough information to utilize any other rights given to them. They can also have some deterrent effect. However, any disclosure rule is subject to a cost-benefit analysis, as the cost of collecting, systematising, and providing the information is often borne by the company no matter if the information is used or needed in the individual case.

A third regulatory alternative is to prohibit actions which typically will harm minority shareholders. An example of such mandatory regulation is found in the Swedish Companies Act[30] which prohibit companies to provide loans or offer security for loans to a related party. This kind of regulation is nowadays rather rare from a European perspective to tackle related party transaction.[31] The prohibition is however not explicitly motivated as a minority protection rule but mainly for tax reasons.[32] For this purpose, unlawful loans provided by the company are not only void but any person who intentionally or through gross negligence violates these rules also faces the risk of fines or a term of imprisonment of a maximum of one year. Thus, the prohibition is supplemented with a criminal sanction. Mandatory prohibitions would normally carry the benefit of clear rules that are easy to grasp and apply.[33] When combined with efficient sanctions, such rules can have strong deterrent effect. However, the scope of a clear rule is always with limits, carrying the risk of other harmful actions falling outside the scope, underinclusion, and that parties tries to circumvent the rule.[34] Further, a mandatory provision leaves no room to assess if a particular action in a given situation is not harmful for the minority shareholder, or indeed beneficial for the company at large. Thus, mandatory prohibitions also bear risk of overinclusion.

As a fourth alternative, the legislature can protect minority shareholders by standard based review provisions. Equal treatment of shares, and of shareholders, is a predominant norm in most companies acts. In alignment with the directors general duty of loyalty to act in the interest of the company, avoiding conflict of interest, principles of reasonableness or fairness, etc. they form standards which allows shareholders to request for *ex post* review of resolutions, decisions, and transactions. Standards are utmost important in a legal system as their open endings compensate for humans bounded rationality and consequently for the legislature's limitation to foresee all contingencies.[35] Disadvantages of such catch-all standards include lack of predictability, risk of inconsistencies in interpretation and application, and that *ex post* review risk to be time consuming and thereby costly.[36]

Fifth and finally, any minority protection provision, but particularly *ex post* reviews, are dependent on shareholders' right to bring suit. This includes the right to

30. Aktiebolagslag (2005:551).
31. For example, the EU Shareholders rights directive (Directive (EU) 2017/828) rely on disclosure in combination with a procedural safeguard, in some members states with demand of a so-called fairness opinion by an external examiner.
32. *See* Government bill Prop. 1973:93, at 90–95 and Government bill Prop. 2004/05:85, at 426–428.
33. *See, e.g.*, Cheffins, *supra* n. 1, at 277–278.
34. *See, e.g.*, Louis Kaplow, *Rules versus Standards: An Economic Analysis*, 42 Duke Law J. 588–596 (1992); Isaac Ehrlich & Richard Allen Posner, *An Economic Analysis of Legal Rulemaking*, 3 (1) J. Leg. Stud. 267–269 (1974).
35. *See* Herbert Lionel Adolphus Hart, *The Concept of Law* 125 (Clarendon, 1961).
36. *See* Cheffins, *supra* n. 1, at 282–285.

bring proceedings against a resolution adopted at general meetings and the right to suit for damages. An important aspect of these rights is if the minority shareholder can take actions in the company's name against board members, managers, auditors, or other parties against whom the company may have cause of action. Another important aspect is if this right can be exercised individually or requires shareholdings above a certain size, e.g., one-tenth of all shares or votes.

Against this general background, let us look at contractual and legislative tools which aim to prevent, counteract, or solve conflicts in SMEs. The discussion is divided into three phases; upon the entry of a minority shareholder, during the co-ownership, and when the collaboration has collapsed.

[B] Phase 1: Entry

Easterbrook and Fischel have argued that potential investors are in little need of legal protection as they enter as shareholders freely, and that the price mechanism on the market will constitute accurate protection.[37] Professional actors on the market will evaluate companies and provide an adequate price of the shares. Non-professional investors act on the same market and will benefit from the analysis. The mechanism is supported by disclosure rules, including the prospectus regulation which aim to provide investors with necessary information in a harmonized format.[38] The purpose of prospectus is to enable investors to make an informed assessment of the company and the transferable securities that are being offered or admitted to trading.

Noteworthy, these arguments are aimed at public and listed firms. In contrast, shares in closely held SMEs lack open market and for this reason, there is no functional price mechanism. However, other argument can be forwarded supporting that potential shareholders, also in SMEs, are able to assess their investment and make informative decisions. As a starting point, joining a company as a shareholder is based on free will. For this reason, individuals ought to be able to negotiate essential terms of the co-ownership before joining. We also know that the relationship among shareholders in SMEs are based on close connections in form of, e.g., family ties or friendship. Therefore, it can also be assumed that the average shareholder entering a business has a good dialogue with current owners. Further, when current owners have interest in expanding the owner group, for example to attract new capital, it is also in their interest to offer shares on transparent and reasonable terms. Hence, it must be presumed that an entering shareholder has good chances to assess the benefits and risks of becoming a co-owner in an SME, and that the parties can use contractual regulation to balance their interests.

37. *See* Frank H. Easterbrook & Daniel R. Fischel, *The Corporate Contract*, 89 (7) Columbia Law Rev. 1430–1431 (1989). The same argument is found among other scholars. *See, e.g.*, Macey, *supra* n. 11, at 189. Cf. the distinction between *informed* and *uninformed investors* by Jeffrey N. Gordon, *The Mandatory Structure of Corporate Law*, 89 (7) Colum. L. Rev. 1557–1562 (1989).
38. Harmonized in the EU by Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC.

However, the following examples can illustrate situations when the free and informed choice of an entering shareholder can be questioned. When a partner, colleague, or employee is offered shares in a business, it can be a sign of trust and appreciation. The person offered a minority position might feel gratitude, be honoured, and flattered. To question the terms of the co-ownership can be perceived as ungrateful, and an employee who says no to become a co-owner might feel unwelcome to stay on his/her position. Current owner(s) have the ultimate power to accept the new owner, creating the possibility for a take-it-or-leave-it deal. Hence, in some situations, the future minority shareholder lacks bargaining power. The opposite situation can also be the case. In the event of a venture capitalist or business angel entering the company, the investor might dictate the terms of the investment leaving no space for negotiation for the current owner(s). Research also indicates that parties in many situations fail to align expectation,[39] which could be a sign of no negotiations at the entry phase. A second situation when a future minority shareholder experience low bargaining power is when the shares are given to him/her, through a gift, will, or inheritance. A significant number of closely held companies are family firms, and among family members shares are not always sold on market price. Even if a beneficiary has the right to say no to an asset, feelings of letting the family down or of being ungrateful might be a hinder.

Two examples from interviews with owner-managers that we have met in the Ownership Dynamics project[40] can illustrate the problem. In one case, the founder of a consultancy firm regularly hired two external consultants. At one point in time, the business needed to move from a rented facility to a new building. The move was costly as it included purchase of new equipment. The two external consultants were offered shares in the company, but the founder left no room for negotiation. This was most evident when the founder unilaterally changed the terms of the investment several times during process. The parties failed to align expectations, which became apparent rather soon after the co-ownership started. The new owners, who worked fulltime in the company, sought to develop the business, but the founder who used the business as a part time job had no such interest. The disagreement was not solved at the time for the interview.

In the second case, an employee was offered to buy shares in the company by the three current owners. All three of them were closing in on retirement, but the new co-owner was roughly ten years younger. The entry took place after almost no negotiation. Soon after the entry, the new co-owner started to feel trapped as a minority shareholder. The old owners saw no need to invest time or the yearly profit to develop the business. Being close to retirement, they instead aimed to cash out. The conflict arose quickly, and hard words were exchanged. After the interview, the minority shareholder told me that the majority owners finally agreed to repurchase his shares, and he left the business both as owner and employee.

39. *See* Marina Bitsch Madsen, Mette Neville, Hanna Almlöf, & Kajsa Haag, *Ejerskabsdynamik i SMV'er – Et svensk/dansk projekt om problemer og løsninger ved ændringer i ejerkredsen*, Nordisk Tidsskrift for Selskabsret 79 (2019:4).
40. This research project, started in 2018, is a Danish-Swedish collaboration. *See also, ibid*.

In sum, upon an entry of a new co-owner, i.e., in the first phase, both statutory and contractual instruments are used to prevent the upcoming of future disagreements and conflicts. Two instruments seem relevant. The first is to enable entering shareholders to make an informed decision. The regulatory technique with disclosure provisions is important in this aspect, but the close connection between co-owners of closely held SMEs work in the same direction. Second, the interests of the parties need to be aligned, but in this aspect the legislature falls short. Instead, communication is essential to construct a joint vision and common goals, but imbalance in bargaining power complicates this process which calls for other mechanisms.

[C] Phase 2: During

Once the co-ownership has been established, the shareholders need to stay on good foot with each other for a fruitful cooperation. A disagreement or conflict could jeopardize the collaboration, or even the company. In this second phase, all rules protecting minority shareholders together set the playing field of the joint ownership. Hence, the different regulatory techniques presented *supra* in §11.04[A] are combined to hopefully form an effective minority protection. However, two strategies are particularly important to counteract escalation of disagreements and conflicts and both of them relate to access to information.

First, as mentioned in §11.03, the shareholders in SMEs are often active in the everyday business and function as key employees as well as managers. Sometimes this is regulated in a shareholders' agreement, both the expectation to work fulltime in the company, and the right to be a member of the board. Such agreement deviates from the typical majority rule that otherwise dominate company law.[41] Hence, instead of allowing the controlling(s) to appoint all board members, the contract allows the minority to be represented, either in person or by electing one or several members. Corresponding rules can be included in the article of association. In the Danish report from 2015, it was noticed that *anpartsselskap* with more than one shareholder often choose to have a board, which is a voluntary company organ, and the researchers conclude that this indicates that in practise the board is, among other things, utilized to give minority shareholders voice against controlling owners.[42] The foundation of these contractual strategies must be assumed to be that the collaboration is based on personal relations and mutual trust. Trust in its turn is dependent on transparency, and a position in the board is a main channel for information. Enriques et al. hold: 'Even if they select a fraction of the board, a minority can benefit from access to information, and, in some cases, the opportunity to form coalitions with independent directors'.[43]

41. Occasionally, company law stipulates the default right to appoint minority directors.
42. *See* Bennedsen & Nielsen, *supra* n. 4, at 27.
43. *See* Luca Enriques, Henry Hansmann, Reinier H. Kraakman, & Mariana Pargendler, *The Basic Governance Structure: Minority Shareholders and Non-Shareholder Constituencies*, in *The Anatomy of Corporate Law: a comparative and functional approach* 80 (Reinier H. Kraakman, et al. eds, Oxford University Press, 2017).

Second, the legislature also recognizes that access to information is a key aspect in the relationship among shareholders. Disclosure provisions come in many forms. One interesting example is found in the Swedish Companies Act. In Chapter 7, Section 36, we find a special right to information for shareholder in companies with no more than ten shareholders.[44] This rule is an add-on to the individual right to pose questions at the general meeting. The Swedish legislature has found that shareholders in closely held companies are in particular need of information to be able to exercise any other minority rights that are given to them.[45] Posing questions at the general meeting is simply not enough. Therefore, the rule in Chapter 7, Section 36 entitles the minority to review accounts and other documents which relate to the company's operations, to the extent necessary for the shareholder to be able to assess (1) the company's financial position and results at any time of the year, or (2) a particular matter which is to be addressed at the general meeting. The information should be provided by the board,[46] making it impossible for potential non-shareholding board members to stay out of the disagreement. The purpose of the rule is to strengthen the individual shareholder's position and bargaining power by counteracting information asymmetry.[47] In literature, it is argued that such information can prevent or resolve conflicts, but it is otherwise essential for being able to put forward any critique of the management and in the long run to equip the minority with evidence needed to bring actions against board members, managers, or the company.[48]

In a recent study, I have conducted in-depth interviews with legal advisors and used this data in combination with the scarce case law from the lower courts of Sweden to investigate how this rule is used.[49] My conclusion is that the rule is beautiful in theory but hopeless in practice for a minority shareholder in need. The information is often accessed too late to be of any practical use. The company, and the majority shareholder(s), may delay the process, and the sanctions are too vague and too slow to help the situation. Even more cumbersome, the right to information is often used as a weapon in an already ongoing conflict between majority and minority shareholders. In this fight, both parties play rough: the majority stonewall, and delay while the minority shareholders use different minority rights to defend themselves such as calling for extra general meetings or special examination. Sometimes, these minority rights are used

44. The rule was introduced in the companies act early 1980s by Government bill Prop. 1979/80:143, at 103, 106, and 179, but it was originally presented in a suggested but never adopted act for a new corporate form for SMEs in Swedish Government Official Reports SOU 1978:66.
45. *See* Swedish Government Official Reports SOU 1978:66, at 128–129.
46. After a questionable ruling in a court of appeal in 2009, it appears uncertain if the respondent in such litigation should be the company or the individual board members. *See* Urban Båvestam, *Några frågor kring den särskilda insynsrätten enligt 7 kap. 36 § aktiebolagslagen*, in *Vänbok till Anders Lagerstedt – Studier i associationsrätt och förmögenhetsrätt* 49–52 (Jan Andersson, et al. eds, Jure 2020).
47. Cf. Stattin, *supra* n. 14, at 49.
48. *See* Torsten Sandström, *Svensk aktiebolagsrätt* 209–210 (7th ed. Wolters Kluwer, 2020); Sten Andersson, Svante Johansson, & Rolf Skog, *Aktiebolagslagen: en kommentar*, (JUNO version 16, Norstedts Juridik 2021).
49. *See* Hanna Almlöf, *Insynsrätt i ägarledda aktiebolag*, in *Festskrift Rolf Dotevall* 12–36 (Marie Karlsson-Tuula, et al. eds, Juristförlaget i Lund 2021).

solely to put pressure on the controlling shareholder(s) to place a bid on the minority shares. Some advisors use the notion of abuse of minority rights in this context. Hence, my study provides some evidence that the right to information sometimes backfires and nurture the conflict, instead of resolving it.[50]

To summarize the second phase, we see that both contractual and legislative corporate governance instruments are used to ensure the minority a right to insight and information. Transparency is essential to nurture trust between parties. One evidence of this is that parties often include consensus clauses in shareholders' agreements, i.e., a list of decisions which requires unanimity by all shareholders.[51] Such clauses bear risk of deadlocks but are often motivated by the business owners as the only realistic path for a successful collaboration. If one shareholder holding majority vote would exclude other co-owners from important decisions and use his/her voting power to overrule them, it would itself be the source of conflict. Similarly, as indicated in this section, once a minority shareholder puts a statutory right to information to proper use, it is a sign of an already ongoing conflict which hardly can be solved with additional information. Hence, in the second phase minority rights to insight and information works poorly to counteract escalation of disagreements and could in fact even aggregate an already ongoing conflict. The need to end the collaboration then becomes inevitable. This also means that rights to insight and information, as well as contracted veto rights and other provisions protecting the minority, such as the norm of equal treatment, mainly function to prevent the upcoming of disagreements or conflicts during the second phase,[52] just as aligning interests as discussed in the first phase but is of no help if their preventative function fails.

[D] Phase 3: Exit

If disagreements or conflicts occur, the parties might find a way to mediate without the interference of legal advisors or litigation. However, as has been shown *supra* in §11.04[C] with the in-depth interview study with legal advisors, once a minority shareholder starts putting his/her contractual or statutory rights to use, transparency and trust has most likely already been lost leaving very little room for a functional collaboration. The only realistic solution would then be to end the co-ownership.[53] However, the minority often finds it difficult or even impossible to sell the shares to anyone beside the controlling shareholder(s) leading to unwanted lock-in effects, *see supra* §11.03. This can create a conflict or aggravate an ongoing conflict between the owners.[54] Consequently, the third and final phase addressed in this chapter includes shareholder exits to solve the disagreement or conflict.

50. Cf. Mathias Dahlerup Krarup, *Interessekonflikter i små og mellemstore selskaber* 101–102 (Djøf Forlag 2019), who makes a similar conclusion concerning the right for special examination.
51. *See, e.g.*, Neville, *supra* n. 24, at 215–216.
52. Cf. Krarup, *supra* n. 50, at 37–38.
53. *See* Almlöf, *supra* n. 49, at 34–36.
54. *See, e.g.*, Klaus Ulrich Schmolke, *Expulsion and Valuation Clauses – Freedom of Contract vs. Legal Paternalism in German Partnership and Close Corporation Law,* 9 (3) ECFR 388 (2012).

Countries seem to deal with the question of shareholder exits very differently in their companies acts. The Swedish legislature, for example, provides a very narrow application of exit alternatives, mainly focusing on situations of clear and long-termed abuse of power by the controlling shareholder, also requiring a breach of law or the articles of associations, and that the situation bears a risk of continuous oppression.[55] With this regulatory technique, the parties are strongly encouraged to regulate exits in shareholders agreements, as the legislation is of very little help in conflict situations. An analysis of the Swedish regulation of exits is presented in a separate study.[56] A slightly less strict regulation is found in Norway, which since the end of 1990s includes severe and long-termed disagreement between the shareholders on the running of the business as a ground for requesting exit or to buy out a shareholder.[57] The rules are, however, not meant to be used lightly, but they are considered as a safety valve in the most severe cases when a continuous collaboration appear as unthinkable.[58]

Another regulatory strategy is represented by the German legislature. Shareholders in a Gesellschaft mit beschränkter Haftung (GmbH) may request an exit of the company on so-called important grounds – 'aus wichtigem Grund'.[59] This is an un-codified mandatory rule, which work both ways, i.e., it can both give the company the right to exclude a shareholder (a buy-out right) and a shareholder the right to exit (a right to withdrawal).[60] When assessing if an important ground is present, all circumstances must be taken into consideration, and decisive factors can either be with the exiting shareholder, the company or any co-owner, particularly controlling shareholders. Examples of important grounds include situations in which a shareholder makes the achievement of the company purpose impossible or acts in a way that makes his/her remaining in the company appear intolerable and hence the trust between shareholders have been lost.[61] Examples also include serious or repeated violation of shareholder obligations and reputation-damaging effects on the company.[62] Exit on important ground is only permissible as a last resort, but it is always seen as a less dramatic solution compared to an action for dissolution.[63]

In the Netherlands, we find another legal strategy to shareholder exits. Similar to the German regulation, specific reasons for the exit are set up, but in this case, the rules are codified. The Dutch Companies Act both grants shareholders the right to withdraw from the company in cases of minority oppression, and the right for co-owners to buy

55. Similar regulation is found in Denmark, *see, e.g.*, Krarup, *supra* n. 50, at 46.
56. *See* Hanna Almlöf, *Regulation of Shareholder Exits in Closely Held Companies – Reflections from Sweden*, 19 (2) ECFR 175–202 (2022).
57. Norwegian Companies Act, Ch. 4, ss 24 and 25; Norwegian Government Official Reports NOU 1996:3, at 109–111.
58. *See* Tore Bråthen, *Selskapsrett* 129–132 (6th ed. Gyldendal, Focus Forlag, 2019).
59. *See* Hartmut Wicke, *Gesetz betreffend die Gesellschaften mit beschränkter Haftung (GmbHG)*, Anh. § 34: Austritt und Ausschließung eines Gesellschafters, Rn. 10 (C.H. Beck, 4. Auflage 2020).
60. *See, e.g.*, BGH NJW 1999, 3779; OLG Köln, NZG 1999, 1222.
61. *See* Holger Altmeppen & Günter H. Roth, *Gesetz betreffend die Gesellschaften mit beschränkter Haftung – GmbHG* § 60 Rn. 80 (C.H. Beck, 10. Auflage 2021).
62. *Ibid.*, § 60 Rn. 82.
63. *See* Wicke *supra* n. 59, Anh. § 34: Austritt und Ausschließung eines Gesellschafters, Rn. 12.

out an individual shareholder based on that person's harmful conduct towards the company or other shareholders.[64] In both situations, the same value principle to set the price for the shares is used, and upon a decision by the court, the shares shall be transferred and the compensation paid within two weeks.[65]

The exit regulations of Germany and the Netherlands provide examples on important grounds for dissolving a harmful or dysfunctional collaboration among shareholders. In German company law, the shareholders have the possibility to include additional grounds for exits in their articles of association, but they may not limit the scope of the general standard.[66] For example, the shareholders may include an ordinary right of termination without particular reason. Such general exit right without cause, familiar to partnership law, is also chosen by the Italian legislature. According to Article 2473, Section 2 of the Italian Civil Code any member of a Società a Responsabilità Limitata (S.r.l.) is entitled to exit at any moment, with a notice of at least 180 days or another time period stipulated in the articles of association, not exceeding one year.[67] Further, any member has the right to exit in a number of given situations stipulated in the Article 2473, Section 1; i.e., when the member did not agree (1) with the decision to change the company's object or type, (2) on a merger or division, (3) on the revocation of a decision for the company's winding-up, (4) on the transfer of seat abroad, and (5) on the execution of operations involving a significant modification of the company's object or a significant modification of the administrative or financial rights belonging to single members.[68] In addition, members can add any other exit ground in the articles of association, and if any such ground is removed from the articles, then it itself constitute a ground for exit.

As shown, the regulatory strategy to enable shareholder exits varies from country to country. Sweden, as well as Denmark, represents a strict regime, which has been criticized. Neville argues that an exit at will could be a key corporate governance mechanism for promoting effective management, as it allows the minority to put pressure on the management, and if not respected, the minority shareholder can choose to leave.[69] Andersson concludes that only with a proper exit right, minority shareholders are placed in a bargaining position where they can achieve either renewed grounds for trust, loyalty, and long-term commitment between the parties or an exit on fair terms.[70] Both authors stress the importance of carefully drafting such

64. The Dutch Civil Code, Art. 2:343 and Art. 2:336. For an in-depth analysis, *see* Paul de Vries, *Exit rights of minority shareholders in a private limited company*, Ch. 6 in particular (Kluwer 2010).
65. *See* Samantha Renssen, *Extra ordinary corporate transactions. Liquidation and winding up*, in *Company laws of the EU: a handbook* 1438–1440 (Andrea Vicari & Alexander Schall eds, C.H. Beck 2020).
66. *See* Wicke, *supra* n. 59, Anh. § 34: Austritt und Ausschließung eines Gesellschafters, Rn. 10.
67. According to de Vries, *supra* n. 64, at 14, most of the Italian private limited companies are set up for a fixed term, for which this exit right at will does not apply.
68. Cf. Danish Companies Act, ss 110, 286, 306, and 318k which entitle a down voted minority to request redemption of shares in specific situations. *See* Krarup, *supra* n. 50, at 42–43.
69. *See* Neville, *supra* n. 15, at 289.
70. *See* Jan Andersson, *Minority shareholder protection in SMEs: a question of information ex post and bargaining power ex ante?*, in *Company law and SMEs* 204 (Mette Neville & Karsten Engsig Sørensen eds, Thomson Reuters 2010).

right to minimize the risk of opportunistic behaviour by minority shareholders and avoid financial instability and possible obstruction of the company. In sum, exit rights are essential in SMEs as an important corporate governance instrument to empower minority shareholders.

§11.05 NEW INSTRUMENTS TO TACKLE SHAREHOLDER CONFLICTS

[A] Beyond Current Regulation

In closely held companies, disagreements or conflict will inevitably affect the business. For example, it might be impossible to separate an ownership conflict from the board work, as the two are intertwined due to the overlap of roles. Shareholder conflicts, thus, pose a corporate governance problem. After reviewing the three phases in §11.04, it is now possible to deepen the discussion and identify new, or at least less recognized, instruments to prevent, counteract, or solve disagreements or conflicts in SMEs. In this section, I discuss instruments to align shareholders' interests, to entitle a minority shareholder a position on the board, and to enable shareholder exits. To enrich the discussion with new elements, these mechanisms are viewed outside the described phases and with reflection on possible changes in the companies act.

[B] New Instrument to Promote Aligned Interests

A key element to prevent disagreements or conflicts is to properly align interests of the parties upon entry on a minority shareholder. Legal advisors I have interviewed in research projects often stress that the process before signing a shareholders' agreement is utterly important, and often more important than the final document. The process includes communication on topics such as the aim of undertaking business together, future plans, expectations, and assumptions for the collaboration. The research performed by Mustakallio et al., *see* §11.03, adds a dimension to this. They argue that companies need corporate governance structures throughout the joint ownership that promote cohesion and shared vision among owners. This can include arenas that promote social interaction with the aim to form a shared vision, which could reduce harmful conflict.

In management literature, arenas for shareholders' interaction outside the company organs are discussed and often put forward as important governance tools. Such arenas include shareholders' meeting; or for family-controlled firms, family assembly, family council, or family office.[71] The choice of arena depends on, e.g., the size of the business, the number of owners, whether the business is a family firm, and the degree of involvement of family members. Arenas can both be formal, informal and of hybrid

71. *See, e.g.*, Miguel Angel Gallo & Denise Kenyon-Rouvinez, *The Importance of Family and Business Governance*, in *Family Business: Key Issues* 45–57 (Denise Kenyon-Rouvinez & John L. Ward eds, Palgrave Macmillan 2005); EcoDa, the European Confederation of Directors' Associations, *Corporate Governance Guidance and Principles for Unlisted Companies in Europe* (2010).

character, with complementary purposes.[72] One main purpose could be to separate business issues, which normally should be dealt with in the boardroom, from ownership issues, which requires a separate forum. The discussions can and are often encouraged to lead to documents, in which the parties put their agreements in wording. Such documents can be legally binding contracts but are often indented as non-binding arrangements.

Alternative shareholders' arenas are seldom discussed in legal literature, and to my knowledge never acknowledged by the legislatures. However, a legal analysis of so-called family constitutions, as a possible output from a family council or alike, has been provided by Fleischer. He concludes that these documents are 'chameleon-like regulatory instruments' with various purposes and levels of obligation, which makes it impossible to collectively classify them as legally binding or not.[73] Fleischer suggest that a family constitution can be seen as a linked contract to other documents such as the articles of association and shareholders' agreement, allowing for the creation of duties of care, loyalty, and cooperation among individuals that are not bound by a single contractual agreement, but are part of the same contractual group.[74] Hence, the process of creating a family constitution not only assist the shareholders to align their interests but a family constitution can also be used as aid to interpret the article of association and other agreements between shareholders with the purpose to counteract any escalation of potential disagreements or conflicts.

Against this background, it is possible to discuss the role of the board relating to formal and informal shareholders' arenas. The board is often seen as the company organ that takes strategic decisions about the future of the business, e.g., by formulating the company's vision and mission.[75] As a subordinate decision-taking body to the general meeting, which is the starting point in the Nordic Corporate governance model, such strategic work must take directions from the owners into account. In cases where shareholders in SMEs fail to provide a joint vision of the business, it could be argued that the board should assist the owners in this matter and promote a process where the owners meet and discuss.[76] As soon as the board is composed by other individuals than solely shareholders, this function is both feasible in theory and desirable in practice.

In sum, aligning the interest of shareholders is crucial not only at the beginning but also throughout the co-ownership, i.e., both in phase 1 and phase 2. A seldom regarded corporate governance instrument to achieve this is found in formal or informal arenas outside the traditional company organs. The challenge for business

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72. *See* Mattias Nordqvist, *Understanding Strategy Processes in Family Firms: Exploring the Roles of Actors and Arenas*, 30 (1) Int. Small Bus. J. 36 (2012) who argue that too strong reliance on formal arenas may have a negative impact on the flexibility and speed of decision-making, while too much strategic work channelled to informal arenas can lead to the exclusion of individuals from being allowed to influence the strategy process.
73. *See* Holger Fleischer, *Family Firms and Family Constitutions: A Legal Primer*, 15 (1) Eur. Comp. L. 16 (2018).
74. *Ibid.*, at 18.
75. For a recent discussion on the boards strategic work, *see* Neville, *supra* n. 19, at 969–974 and 976–977.
76. This is, e.g., argued by Carsten Fode & Mette Neville, *SMV-bestyrelsen – hele vejen rundt: Bestyrelsesarbejde i små og mellemstore virksomheder* 168–170 (Karnov Group 2018).

owners and their advisors is to identify a relevant and appropriate arena in each specific case and define its function as a corporate governance, a family governance, and/or an ownership governance tool. The board can be active in this process and take on a guiding and supporting role. Consequently, the instrument discussed in this section consists of both the arena itself and the board's role to support its function. The challenge for legal scholars is to recognize the importance of such arenas and assess the legal bindingness of any imperative document coming out of it. Fleischer provide an excellent example of this and could be an inspiration for others. Comparative analysis in these matters would be particularly beneficial.

[C] New Instrument to Ensure Minority Insight

A main legislative tool to counteract disagreements or conflicts is shareholders' right to information and insight. This tool is based on the logic that information equals transparency, which in turn is essential to promote trust. And reversed, lack of transparency can lead to mistrust. Therefore, companies acts include provisions which entitle current or entering shareholders the right to information and the responsibility to provide such information is placed on the board. However, as has been shown and argued *supra* in §11.04[C], this legal strategy does not always fulfil the function to counteract escalation of conflicts.

A common contractual regulation to promote trust is to give minority shareholders the right to be a member of the board or appoint one. When such regulation is included in shareholders' agreements, a disagreement or conflict can result in the controlling shareholder(s) not honouring the contract. The advantage of such action by the controlling shareholder(s) is that the conflict formally can be placed outside the boardroom as the minority no longer holds a seat. The problem for the minority might be that that is it! The sanctions of the contract are not strong enough to avoid these situations and as illustrated in §11.04[C], a statutory extensive right to information does not help either.

A relevant question could therefore be what if the right to a chair in the boardroom was stipulated in the companies act or the articles of association?[77] Initially, it should be recognized that such statutory rule should never be mandatory, as it for sure does not fit all SMEs. It should not even be a default rule without the empirical evidence that this is the preferred rule for most SMEs and therefore correspond to the hypothetical bargaining model that can be employed to select default provisions.[78] It could however be an opt-in alternative that the shareholders enact by inserting a provision in their articles of association. Such opt-in possibility could have a signalling

77. In the discussion here, I am using Nordic company law as my starting point, as this is the legal framework that I am most familiar with.
78. *See, e.g.*, Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 Yale Law J. 91–95 (1989); David Charny, *Hypothetical Bargains: The Normative Structure of Contract Interpretation*, 89 (7) Mich. Law Rev. 1821 (1991).

effect, encouraging more parties to choose this alternative.[79] Even in absence of such a provision in the articles, a proactive court might, based on the behaviour of the shareholders, argue that this opt-in rule in fact is applicable in the relationship between shareholders. Hence, if the parties since the beginning of the co-ownership or during a significant period of time have acted in accordance with the opt-in rule, it could be regarded as applicable without formally being inserted in the articles of associations.

Regulating a minority shareholder's right to be a member of the board in the article of associations carries significant risk because it makes it impossible to isolate a shareholder conflict, so it does not affect the governance of the company. For this reason, I imagine that many legal scholar and advisors would dissuade such solution. However, on the topic of regulation shareholder conflicts, I see one major positive effect from this kind of regulation. As argued *supra* in §11.03, a consequence of a disagreement among shareholders could be that the minority shareholder is not re-elected as a member of the board. Hence, this could be a clear sign of a collapsed co-ownership. However, from the analysis in §11.04[D] of different exit regulations, losing one's seat in the boardroom does not normally constitute an exit ground, while breach of the article of associations may.[80] Therefore, in situations where the mutual trust between shareholders have been manifested by a joint right to be part of the board, and this trust is lost, the legislature could consider including this as a potential ground for minority shareholders to withdraw from the company. If such statutory exit right would be the only remedy to this opt-in rule, controlling shareholder(s) can still banish the minority shareholder from the board but this would trigger the minority's right to withdraw. This constitutes a new instrument to save the company from harmful conflicts for legislatures to consider. Another possible consequence of empowering a minority shareholder with a statutory exit right is that it increases his or her bargaining power in the boardroom. This allows the minority shareholder to put pressure on the controlling owner(s) to promote good governance.[81] For example, it might make the board focus more on the strategic issues, business opportunities, growth potential, development of products or services to stay relevant on the market, etc.

[D] New Instrument to Enable Shareholder Exits

Regulatory strategies to enable shareholder exits varies across countries, which has been shown *supra* in §11.04[D]. As been pointed out by others before me, a too strict regime is not in the interest of SMEs.[82] Arguments for an exit right at will, similar to the

79. Cf. Henry Hansmann, *Corporation and Contract*, 8 (1) Am. Law Econ. Rev. 12 (2006); Ian Ayres, *Regulating Opt-Out: An Economic Theory of Altering Rules*, 121 Yale Law J. 4–5 (2012).
80. As seen in §11.04[D], e.g., both Germany and Italy allow shareholders to include additional grounds for shareholder exits in the articles.
81. *See* Neville, *supra* n. 15, at 289.
82. *See, e.g.*, Andersson, *supra* n. 70, at 204–206; Neville, *supra* n. 15, at 289–293.

Italian regime, has been put forward[83] but also rejected,[84] and in literature, suggestions on how to regulate for exits in shareholders' agreements to compensate for the lack of legislative solutions have been presented.[85]

A less highlighted difference between the national exit regulations, which I wish to address in this section, is how the exit is executed. Two main alternatives exist; either someone must acquire the shares from the exiting shareholder or the shares must be redeemed by the company. The question is which of these two alternatives is preferable from a corporate governance perspective.

From the exiting shareholder's point of view, it might be irrelevant from whom the compensation is paid. For the other shareholders, it might be both a question of how to finance the withdrawal or buy out and a question of whether the balance of power among remaining owners can be kept. If the shares from the exiting shareholder are acquired by only one out of several shareholders, the exit will be followed by a redistribution of power. One reason for such result could be that some shareholders lack the resources needed. By using the company's resources, unwanted redistributions of power could be avoided. Capital that otherwise can be used for dividend may be utilized for redemption of shares. In legal regimes with minimum capital requirement in the companies act, or if stipulated in the articles of association, the compensation might deem a reduction of share capital, perhaps with a necessary restoration of the same, to prevent it falling below the stipulated threshold. For the given reasons, redemption of shares may be the first-hand alternative to enable a shareholder exit, but this requires that the company has the financial resources needed. When drafting exit rights, either in the companies act, in articles of associations, or in shareholders' agreements, one must therefore consider which alternative should come in first hand, or if there is a choice to be made between the alternatives.

In the Dutch regulation, it is the co-owners who on the courts order must acquire the shares of a shareholder who ask for his/her withdrawal. The same applies when a shareholder is bought out.[86] However, a shareholder may start exit proceedings against the company in certain situation, when the reprehensible action was taken by a company organ, but this appears less common.[87] The Italian regulation stipulates that the compensation to the exiting shareholder should in first hand come from the remaining shareholders, who should acquire the shares proportionally to their current holdings.[88] Alternatively, if unanimously agreed by the shareholders, a third party may acquire the shares. As a second-hand alternative, the compensation should be paid by the company using free reserves or, if no free reserve is present, by reducing the share capital. Lastly, if compensation is not possible based on these two alternatives, the company must be dissolved. In both Germany and Norway, a shareholder who wish to exit target his/her request towards the company. In Germany, the GmbH may then

83. *See* Harm-Jan de Kluiver, *Private Ordering and Buy-Out Remedies Within Private Company Law: Towards a New Balance Between Fairness and Welfare?*, 8 (1) EBOR 103 (2007).
84. *See* de Vries, *supra* n. 64, at 18.
85. *See* Krarup, *supra n. 50*, ch. 7.
86. *See* Renssen, *supra* n. 65 at 1438–1440.
87. *See* de Vries, *supra* n. 64, at 295–298.
88. The Italian Civil Code Art. 2473, s. 4.

choose either to redeem the shares using free reserves,[89] to acquire the shares, or to let other co-owners or a third party acquire the sharers.[90] If the company lacks necessary free reserves to compensate the exiting shareholder, and if no other buyer accepts to acquire the shares, the only solution left is to wind up the company.[91] In Norway, the rules on share buyback or on reduction of share capital must be considered, but if the company appoints someone else who is willing to acquire the shares, the exiting shareholder must accept this and cannot demand that the companies reserves are used instead.[92]

The difference in regulatory solutions presented here gives us reason to analyse the decisions needed to enable the exit from a corporate governance perspective. On the one hand, the decision to reduce the share capital or to redeem shares to give compensation to an individual shareholder are fundamental for the company and normally requires a resolution by the general meeting. For example, in the Netherlands, such solution must both be supported in the article of association and requires a resolution by the general meeting.[93] On the other hand, the board is given the main responsibility to provide financial oversight and to protect the company's assets. The board must therefore approve and execute any usage of the company resources for this purpose. Problem arises, of course, when most assets are tied and the company face liquidity problems. At the same time, a destructive relationship may have negative spill-over effects on the company and in worst case scenario jeopardize the business as such. Therefore, it might be in the company's interest, and arguably part of the duty of the board to enable the exit.[94] Consequently, if the company face a destructive conflict among co-owners, company law could impose a duty on the board to use the company's assets to end the harmful relationship.

Notably, in closely held companies, the board might be composed of, or dominated by, the controlling shareholder(s) who are part in the conflict. Knowing that the minority shareholder has few alternatives to exit the business by other means, the board members might argue that the company lack the resources needed for the compensation. One alternative could be to entitle a shareholder, who requests exit on important grounds, to demand that capital that otherwise could be used for dividend is used as exit compensation without the approval by the general meeting or a decision by the board. This would mean that a minority shareholder, based on his/her right to withdrawal may seize free reserves without the interference of co-owners. So far, I have neither noticed this solution in national exit regulation nor discussed in the literature that I have studied.

In sum, exit solutions for minority shareholders are an essential tool to solve disagreements or conflicts in SMEs. There are many reasons for a default statutory redemption clause in the companies act, making the parties less dependent on costly

89. *See* Wicke, *supra* n. 59, Anh. § 34: Austritt und Ausschließung eines Gesellschafters, Rn. 13.
90. *See* Christian Kersting (Ulrich Noack, et al. eds, Gesetz betreffend die Gesellschaften mit beschränkter Haftung: GmbHG, C.H.Beck 2022), Anhang nach § 34 Rn 24.
91. *Ibid.*, Anhang nach § 34 Rn 25.
92. *See* Bråthen, *supra* n. 58, at 130.
93. *See* de Vries, *supra* n. 64, at 297.
94. *See* Fode & Neville, *supra* n. 76, at 179.

contractual solutions in shareholders' agreements. When drafting such rule, many arguments can be forwarded why redemption of shares should be the first-hand alternative and consequently why the company should be the counterparty in such process or litigation. However, if the company lacks the financial resources needed, the duty to acquire the shares must be placed on the remaining shareholders. Alternatively, upon the request to exit, the company can choose how to execute the exit.

§11.06 CONCLUDING REMARKS

In this chapter, I have argued that conflicts cause corporate governance problems in SMEs, and that they often origin from diverse interests and a combination of financial and non-financial goals among shareholders. The chapter have explored three possible new instruments and their functions to enhance good governance in owner-managed SMEs in situation where there is a disagreement or a conflict between controlling and minority shareholders. These instruments aim to either prevent or solve shareholders' conflicts. First, the usage of formal and informal areas outside the company's decision-taking organs should be considered. This is not a task for the legislature, but the board can be active in the process and guide and support the shareholders to find appropriate arenas to align their interests with the purpose to prevent conflicts. Second, the legislature should consider an opt-in rule in the companies act on minority shareholder's right to insight and information by being a member of the board. The purpose is twofold. Insight and information aim to prevent conflicts, but when this function fails, it instead allows the minority shareholder to withdraw from the company. Such exit right can put pressure on the controlling shareholder(s) to enhance good governance. Lastly, the minority shareholder's right to exit the collaboration have been discussed, and arguments for why redemption of shares should be the first-hand solution to finance the exit have been forwarded. Redemption of shares will put financial restraints on the business but can avoid deadlocks and other harmful effect that will hinder the company to be run properly.

As always, a study comes with limitations. While this study has touched upon comparative elements, more could be done. Suggestions for future research avenues therefore include more comparative studies on shareholder exits and the role of the board in shareholders conflicts. If possible, such study should benefit from an empirical approach such as an interview or case study. Also, conflicts in mutual co-ownerships, i.e., companies owned to equal share by two parties (50:50) have not been considered in this study. Another related topic not considered in this chapter is the range from destructive to productive (value-creating) shareholder conflicts.