

## Governance and Steering of MOCs – Legal Perspective

JANNE RUOHONEN, LASSI SALMINEN & VEIKKO VAHTERA

**Abstract** Local governments often use corporations for public service output. In Finland, limited liability companies can be used as a means to produce functions that a municipality is required to engage in by law or those functions that are optional for a municipality. This paper explains the current state, regulative background and reasons for corporatisation in Finnish municipalities. We then present a legal analysis of the legal strategies provided in the legislation that a municipality can use to govern and steer its external corporate bodies. Understanding the legal boundaries and possibilities is imperative for extending local self-governance to MOCs, and to align their goals with those of the municipality.

**Keywords:** • MOC • municipally owned corporation • limited liability company • ownership policy • corporate governance

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## 1 Introduction

### 1.1 Municipally owned corporations

Municipally owned corporations<sup>1</sup> (MOCs) are part of the diverse institutional landscape that provides public services. MOCs are utilised in many European countries as a means to organise and provide public services. Increased usage of MOCs has led to municipalities no longer being administrative bureaucratic bodies, but more like conglomerates of corporations (Grossi & Reichard, 2008: 597-600). MOCs are increasingly being used for service provision in Europe and in the United States (Voorn, van Genugten & van Thiel, 2017: 820). The problems of governing and steering MOCs seem to be quite similar across Europe (see for example Ruohonen, Vahtera & Penttilä, 2021; Voorn et al., 2017; Torstein, 2019).

Municipalities as local governments are responsible for providing a myriad of central tasks that make up the welfare society in Finland (Haveri, 2015: 139). In the Finnish setting, limited liability companies can be used as a means to produce functions that a municipality is required to engage in by law or those functions that are optional. There are over 2000 of these corporate entities in Finland where a *municipality or municipalities exercise control through owning the majority of shares* (Official Statistics of Finland, 2021). The number of such corporations has increased over the past years as a result of the competitive neutrality regulation that is included in the EU's state aid rules (see Ruohonen et al., 2021: 22), and new public management (NPM) reform -related corporatisation in pursuit of better performance (see Christensen & Læg Reid, 2003; Hakari, 2013), which is undertaken by municipalities in Finland in preference to other local government units.

MOCs in Finland operate in numerous industries: energy, property maintenance, catering and public services. The majority of MOCs in Finland are *subsidiary companies* in their respective municipal corporate groups (MCGs). In addition, municipalities often have ownership in *associate companies*, which typically have multiple municipality shareholders that house a municipality's optional and statutory functions. It is also not uncommon for these MOCs to have private shareholders alongside their municipal owners. As a rule, MOCs' institutional form is that of a limited liability company (Ruohonen et al., 2021: 1-2). A limited liability company is characterised by its separate legal personality. These legal entities, companies, operate in the institutional setting provided in the national legislation through company organs; each according to the competence allocated to them in that legislation (see Davies & Worthington, 2016: 149-151).

The nature of a limited liability company effectively creates a principal-agent relationship between a municipality as a shareholder (principal) and the municipally owned corporation and the management (agent) it exercises power over. This creates agency problems, as the agent might have better information on relevant

facts and can use this advantage for its own cause, resulting in loss of performance and skimping on quality. These agency problems can be overcome or mitigated with different legal strategies offered in legislation (Armour et al., 2017: 29).

According to our *hypothesis* municipalities need to steer and govern their MOCs through legal tools provided in the laws regulating them. In the Finnish local government setting, this task is bestowed upon the municipal council, the local executive and the chief executive. In addition to private law regulating limited liability companies, also public law has provisions directed at companies with a semi-public nature like MOCs (Penttilä, Ruohonen, Uoti & Vahtera, 2015: 85-86). This also makes the steering process even more complex and layered. Municipalities also use MOCs for joint-service delivery; meaning that the governance process is undertaken by multiple principles, which further complicates the steering and governing of MOCs by adding more principals to the mix (Voorn et al., 2017: 834).

## 1.2 Purpose, method and structure

*The purpose* of this paper is to study the institutional and legal nature, usage and governing of MOCs in Finland by focusing on their legal nature, instruments of steering and corporate governance. In doing so, we show how local governments are able to steer and govern their external bodies. In our article we contribute to the existing, yet quite scarce, literature and its findings on MOCs by presenting a Finnish perspective on the subject matter and offer insight on how the key questions around the usage of MOCs identified in the literature have been and can be answered in a certain European jurisdiction. Simultaneously, the Finnish MOC literature is given a larger awareness (for knowledge deficit on MOCs see Voorn, 2019, and on how MOC literature is limited by the language barrier see Torstein, 2019: 6). Multidisciplinary research around MOC governance is especially crucial in the Nordic countries, where the public services making up the welfare state are largely provided by local governments (Torstein, 2019: 6). Thus, we first aim to present an overview of municipally owned limited liability companies as part of the public services and their governance in Finland.

*The research method* in this paper is legal dogmatic analysis. We aim to analyse and assess the legal regulation regarding municipally owned companies. We present an overview of the Finnish institutional setting which defines the legal nature and framework of using and steering MOCs. Treading between public and private law, we explain in what volumes, industries and why MOCs are utilised in Finland as part of municipalities' operations in fulfilling their legal obligations and other ambitions as service providers. We explain how a local municipal government and the governance of a municipality's corporations are meshed through ownership policy and together conduct a regulation analysis of the key points of the said entities' governance. Self-governance of these structures through practicing

ownership policy and ownership steering in MOCs requires a full comprehension of the governance instruments at hand. Therefore, we examine and present these central tools of governing MOCs that are given in the legislation – corporate governance system of MOCs. These instruments include modifying a company's articles of association and aligning the company purpose with the municipality's strategy by utilising the corporate governance principles that apply to a local authority corporation and its subsidiaries and by using the shareholders' agreement as a contractual unifier between multiple cooperating municipal owners in associate companies. Additionally, we look at how things operate in the *general meeting* through an appointed proxy. One of the key decisions conducted in the general meeting is making the municipally owned corporation's board nominations. We examine the municipally owned corporation's legal requirements for board composition in regard to collective financial and business expertise and the gender diversity of board members. All previous themes are discussed alongside the state of the current trending corporate governance practices for the benefit of the local self-government. Our scope is mostly limited to corporate and municipal law, and we do not for instance focus on details of competition law. We do not address outsourcing related contractual means of steering MOCs.

This paper is *organised* as follows. First, we illustrate the current situation of MOC usage and structures in Finland. We also present the causes and trends behind the recent corporatisation in Finland. In section 2 we review the literature concerning the challenges of MOC governance and steering. In Section 3, we start with examining the legal form, key definitions and the regulative landscape of MOCs in Finland. Section 4 further discusses the legal strategies, focusing on presenting the instruments of ownership policy that localities can use to steer their MOCs, as well as their best practice and limitations. In section 5 we draw conclusions and briefly discuss the future of MOCs as local public service providers.

### 1.3 Finnish MOC landscape

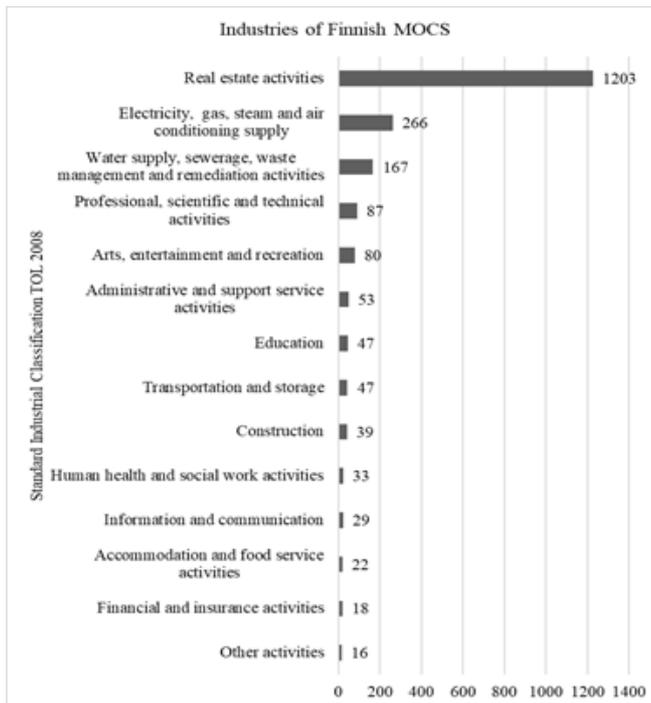
*MOC as a term* is not only reserved for those corporations where a single municipality owns the majority of the shares. If the shares of a corporation are owned by multiple municipalities, and this combined municipal ownership threshold of 50 % is surpassed, the corporation is a MOC by legal definition where certain provisions of the Local Government Act (410/2015) also apply. A MOC can therefore also be an associate company in the local authority corporation.

In 2019, the year of the latest available official statistical data, there were over 2 000 MOCs in Finland, with a combined turnover of 11,8 billion euros. There has been a steady increase in both turnover and the number of MOCs in the past decade (Official Statistics of Finland, 2021). Finland's local government sector is made up of 310 municipalities (Association of Finnish Municipalities, 2019). This means that on average there are approximately seven corporations per municipality. The

largest cities have local authority corporations that consist of dozens of MOCs (Ruohonen, Vahtera & Salminen, 2019a: 745).

In Finland, local governments are responsible for delivering a myriad of services as part of the welfare society like education, city planning and social and healthcare services (Jäntti, Vakkala & Sinervo, 2019: 26). MOCs generally deliver market-oriented services and healthcare and social and cultural related services (Grossi & Reichard, 2008: 603). This is also the case in Finland, where MOCs operate in a variety of industries. In addition, municipalities may provide services voluntarily as well, for instance recreation and accommodation services. By statute, municipalities in Finland have the liberty of choosing the means of production of their mandatory public service delivery in most of their services, and municipalities are increasingly and voluntarily choosing MOCs as the vehicle of service delivery. Real estate activities are the most prominent industry where Finnish MOCs operate. Most of these companies offer business premises or housing. Finnish housing companies are a unique limited liability corporate form for residential apartments, but holding and renting operations are not uncommon. Typically, the small municipalities are minority shareholders of, for instance, local energy or water supply companies.

**Figure 1:** Industries of all Finnish MOCs (Official Statistics of Finland 2021).



MOCs are used for public service delivery in a single municipality or joint service delivery across multiple municipalities. Ownership structures in Finnish MOCs vary greatly as per dataset from a comprehensive survey conducted in 2018,<sup>2</sup> directed at 200 Finnish MOCs, which is approximately one-tenth of all MOCs in Finland. According to our study, MOCs in Finland are mostly owned by one controlling municipality shareholder; only one municipal shareholder owns 100 % of the MOC's shares. Half of MOCs in Finland are solely owned by one municipal shareholder. MOCs can also be public-public collaborations with multiple municipal shareholders, which are service providers that operate in multiple municipal areas or whole regions. These joint-owned MOCs usually have over 10 shareholders in total. There is also a significant amount – nearly one-fifth of all MOCs – of mixed public-private owned MOCs in Finland, where a MOC is owned by both municipalities and private shareholders (see also Ruohonen et al., 2019a: 745-747).

The company purpose in MOCs varies from profit-making to non-profit and benefit corporations. According to a study in 2017, where 200 MOC articles of association were reviewed and analysed, most Finnish MOCs operate under the profit-making principle (Ruohonen et. al., 2021, 162). This means that in addition to providing a public service, MOCs also replenish local governments' dwindling funds through *yearly dividends* that they are able to distribute after making a profit. Our analysis from 2017 shows that the 10 largest cities in Finland received dividends paid by MOCs of approximately 170 M€ (Ruohonen et. al., 2021: 52). The rest of the MOCs' purpose has been altered in their articles of association, making them effectively non-profit organisations, where possible profit is directed at developing the service as defined by their industry.

Why are MOCs used in such numbers and different ways in the Finnish public service landscape? We have identified two different – one reform based and one regulative based – causes as drivers for the increase of MOCs in Finland.

*EU-state aid rules* on the national level are laid out in the Competition Act (948/2011) and Local Government Act. The interpretation of the said legislation left municipalities with LG units that operate in markets with two options: Either running down and discontinuing the part of the service in a LG unit that disturbs markets, or incorporating the operation into a limited liability company. Finnish municipalities have chosen to do both. Some operations have been discontinued (privatisation), and some have been transformed into limited liability company MOCs (incorporation) (Ruohonen et al., 2021: 24-26).

Finland has seen the same restructuring of the public sector that is evident in most OECD countries. The NPM doctrine has influenced the public sector – most evidently at the local level – to be molded following principles drawn from the business models and contemporary management of the private sector in search of

more efficient and effective public administration (Grossi & Reichard, 2008: 599; Christensen & Læg Reid, 2003). MOCs have been seen as a means to produce and deliver local public services *more effectively* than traditional means of providing services like bureaucracies (Voorn et al., 2017: 831), although evidence from a study conducted by Voorn, Borst and Rutger suggests that it is not the autonomous nature of MOCs but the business techniques intrinsic to the corporate form that are the cause for more efficient public service production (Voorn et al., 2020).

The pursuit of effectivity in service production has also been noted by the legislator in the government proposal for the new Local Government Act in which corporatisation is stated to have effectiveness related gains in public service production (Proposal for Local Government Act 268/2014: 174). We assume that a limited liability company, its managerial autonomy and implied business-like techniques are more efficient and streamlined than in-house delivery in the bureaucratic structure of municipality. This is because the independent LGs in Finland increasingly continue to corporatise their functions. This gain in efficiency also benefits municipalities and their weak economy through dividends paid by profit-making MOCs each year, thus making it a tempting reason to corporatise certain public service functions.

To summarise, the institutional choice made by self-governing localities to use MOCs as public service deliverers and corporatisation in Finland has therefore been either 1) forced by competition neutrality regulation or 2) chosen in order to pursue effectivity related gains in service production.

## **2 Literature overview – Features of MOCs and the importance of successful corporate governance**

Where municipalities in general are regulated by public law, MOCs are subject to private laws and have an independent corporate status (Voorn et al., 2017: 821-822). Corporatisation is transforming local governments into multiple-entity institutions. The country-specific institutional form of MOCs varies in different economies. This is further complicated by the fact that despite being the same corporate form, the regulation of these seemingly similar entities varies greatly even in Europe (Torstein, 2019: 6-7). This is due to structure and rule driven path dependency, which shapes and dictates corporate and ownership structures in an economy (see Bebchuk & Roe, 1999). The legal form of MOC used in a certain country is therefore dictated by the country's own legal framework, be it a limited liability company or some other type of private law organisation. The nationally prevalent legal form of a MOC tends to also be the most flexible of the institution options provided in a certain economy (see Grossi & Reichard, 2008: 306).

MOCs often operate in a multiple market setting where they have to fulfil multiple expectations which stem from their semi-public nature and are laid out in legislation

and defined through market practices (see Corvellec & Bramryd, 2012: 1724-1727). One of the key questions of MOCs is how LGs are able to govern their affiliated corporations and the MCG as a cohesive whole. Lack of integrative steering can effectively decentralise and alienate the concern's affiliate entities from their parent municipality and its purpose and strategy (Grossi & Reichard, 2008: 608, 611-612). Certain points have to be met for MOCs to reach their capability as more efficient deliverers and producers of local public services than bureaucracies. For the efficiency related aims to be achieved, it is essential that the MOC's goals, expectations, incentives and responsibilities are considered (Voorn et al., 2017: 831). Municipalities also need to ensure that their corporations' risk management and compliance functions are secured and in place to avoid reparations or other legal repercussions (Perovič & Tomažič, 2021).

Municipalities need to steer and control their corporations to *ensure their performance* related goals are attained and maintained. Properly considered corporate governance structures and operational and strategic steering instruments are imperative for municipal groups if they want to survive in the market-oriented corporation landscape and retain their focus on public interest. The process is a complex one, and it includes balancing between various interests and coordinating the municipality's own activities and that of its corporations that possess their own managerial authority.

Hence, the steering and controlling of MOCs demands that municipalities have the skills and resources to perform them (Grossi & Reichard, 2008: 598, 613). In this paper, we refer to this steering as ownership policy or governance, a holistic process of measures with which the municipality as the owner or as a member of the municipality contributes to the administration and operation of corporations. Balancing between independent board decision-making and the setting of ownership policy might be challenging. However, the roles of the board of directors and owners should not be mixed. Hence, this is why we need a clear set of rules for steering the MOCs.

Small municipalities often need to exploit scale economies and cooperate with other municipalities to reduce the costs of providing public services. Dispersed production of services *between multiple municipalities* also makes supervising the service quality more difficult (Bel, Fageda & Mur, 2013: 445-446). Having more than one municipal shareholder or additional private shareholder creates both another level and additional challenges for the governance and steering of MOCs as well as a multiple principal problem. Joint ownership of a MOC therefore results in a need for intermunicipal cooperation and cooperation with private shareholders to overcome problems (see Voorn et al., 2018: 671-682).

MOCs that have multiple municipal shareholders and dispersed ownership can bring large efficiency gains if their governing related problems can be overcome.

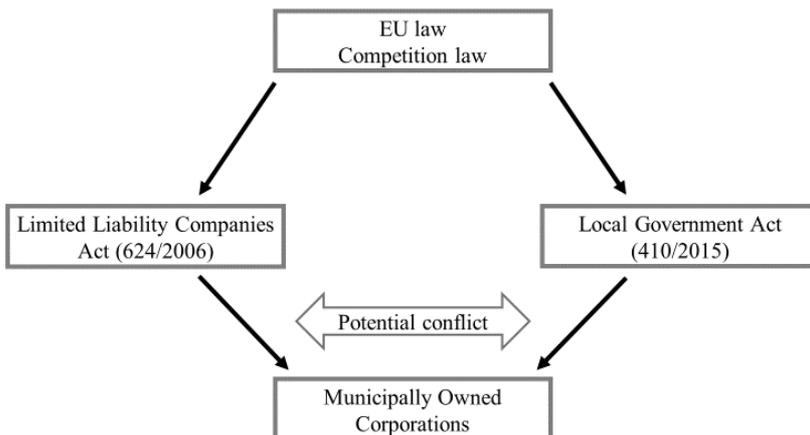
MOCs with public and private owners have an even higher potential gain in effectiveness than publicly owned joint MOCs, albeit their higher efficiency potential goes hand in hand with their challenging governance (Voorn et al., 2017: 834). Likewise, incoherent steering undertaken by multiple municipalities can cause reduced effectiveness, quality and efficiency in an MOC's output and performance (Voorn et al., 2018: 14). In other words, cooperation between municipalities and private owners can be highly beneficial for an MOC's capacity to perform its set task if the cooperation is duly managed, or it can seriously hamper the MOC's output if not. Intermunicipal cooperation can be legislatively regulated, or the decision to cooperate can be left to the municipalities (Grešová & Fuka, 2018: 444).

### 3 Research

#### 3.1 Legal perspective to solving problems arising from governing MOCs

In Finland, public laws have special provisions directed at MOCs (Ruohonen, Vahtera & Salminen, 2019b: 44). In addition, certain European Union laws have provisions that affect MOCs through legal praxis (Penttilä, Ruohonen & Vahtera, 2015), or have been implemented into the existing law (see Mähönen & Villa 2015: 22-28; Jäntti, Vakkala & Sinervo, 2019: 24-25). Therefore, the regulatory field of MOCs in Finland encompasses public and private law and is affected by EU law as well.

**Figure 2:** Legal Institutional Framework of MOCs in Finland.



In Finland, the sole dominant legal form of MOC is a *limited liability company* ('osakeyhtiö'). Limited liability companies are the reigning corporate form in all business conducted in Finland (Finnish Patent and Registration Office, 2020), so adopting the same institution for MOC was a natural choice. Limited liability

companies are regulated in the Finnish Limited Liability Companies Act, also known as Finnish Companies Act (624/2006, hereinafter the FCA). MOCs are, as a rule, private limited liability companies and their shares cannot be traded publicly. Co-operatives and partnerships also have a significant role in Finland (see Finnish Patent and Registrations Office, 2021; Pönkä, 2019), but co-operatives have not been adopted as a vehicle for MOC-like activities. The Competition Act (948/2011) ensures fair competition in business conducted by MOCs and private actors.

In the legislation the parent municipality and its subsidiary companies together constitute a local authority corporation. The closest synonym for local authority corporation in literature is indeed a municipal corporate group (MCG) (Grossi & Reichard, 2008: 308). Local authority corporation can include corporations, unincorporated business entities, partnerships and cooperatives.

First and foremost, due to a limited liability company being regulated in the FCA, the municipality controls its MOCs as a *shareholder*. The Finnish limited liability company form has historically followed the same regulation-evolutive path as other Nordic countries' corporate law (Toiviainen, 2008: 261-265). However, in 2006 when the current act was implemented, the company law in Finland took a turn towards being more modern and liberal. The current legislation is considered to be flexible and liberal, and due to these traits it is considered to have a high level of shareholder autonomy (Limited Liability Companies Act Proposal 109/2005: 1-20). The Finnish corporate governance system as a whole can be described as shareholder friendly, with an emphasis on strong shareholders' rights (for a full summary see Mähönen, 2013). To this date, only minor legislative changes have been made to the act.

Company law lays down the basis of corporate governance in MOCs. One of the main principles in the FCA is freedom of contract, which means that shareholders have discretion to freely contract the terms for which no mandatory legislation exists (see Savela, 1999: 249-256). For example, according to the Finnish Companies Act the purpose of a limited liability company is to generate profits for the shareholders unless otherwise provided in the articles of association. Thus, the modern corporate form can be molded for purposes other than profit, like not-for-profit organisations (Davies & Worthington, 2016: 10-12), or to provide certain services without accumulating distributable profit (see European Parliament, 2010).

Owing to the autonomy and freedom of delivering public services in Finnish municipalities, intermunicipal cooperation through jointly owned MOCs is often indeed left to a municipality's own decision-making. Due to the institutional setting of MOCs in Finland, the multiple principal problem of steering joint MOCs needs to be overcome *as a shareholder cooperation related problem* (Ruohonen et al., 2021: 280-282). The dispersed ownership of shares also disperses the shareholder power. Therefore, the problem is very similar to shareholder cooperation in private

corporations like publicly listed companies. Where the majority principle ensures that shareholders with the majority of shares have the authority, special minority protection clauses in the FCA shields shareholders in the minority from exploitation and abuse (see Mähönen, 2013; Toiviainen, 1998: 128-136).

The Competition Act (948/2011) ensures fair competition between business conducted by public and private actors. The Finnish Local Government Act and other legal sources include provisions directed especially at ownership policy of municipally owned corporations. The Constitution of Finland (731/1999) also states that in all public activity the law shall be strictly observed, which highlights the importance of the legal compliance of MOCs. Recent municipal and other legislation adds to the institutional setting provided in company law, with requirements and legal instruments aimed at MOCs specifically. Due to this trend, public law increasingly affects the governance of MOCs, which *effectively narrows some elements of shareholder autonomy*. These include additional requirements for an MOC's board of directors, the introduction of guidelines for local authority corporation and other means of governing the group of companies under the municipality. The dispersal of ownership and heterogeneity of shareholders with differing objectives in these companies further complicates a municipality's operations and the governing of its corporations. Finland is an EU member country, so new EU regulation can affect directly or indirectly the governance and nature of MOCs.

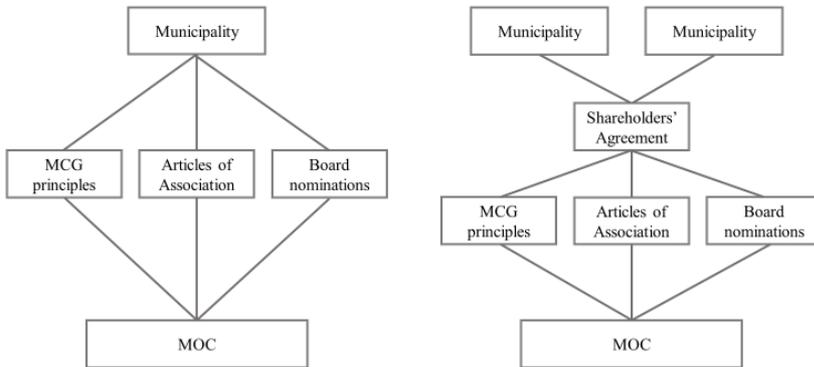
### 3.2 Legal strategies as a governing toolkit

Possible conflicts in interpretation can arise when the additional instruments of steering provided in the Local Government Act clash with those provided in the FCA. Also, problems arise when the municipal owner enforces certain goals and steering through means that are not legal according to the FCA but which are regularly used and established in the traditional sense of governing local government and municipal, in-house functions which do not have a separate autonomous nature.

Where is this *governing toolkit*, i.e. the legal strategies to minimise agency costs, refined? Since the legal form of MOCs in Finland are solely limited liability companies, the legally sound instruments of steering them can be found in the Limited Liability Companies Act. Company law provides principals with certain legal steering tools to mitigate their vulnerability to the opportunism of their agents. In addition, the Local Government Act provides additional legal strategies and tools that bridge the gap between a local authority and its corporations. When multiple shareholders, public and private alike, need to agree on a MOC's steering, the control mechanisms are tailored through contractual means and cooperation as dispersed ownership dilutes the shareholders' controlling power. Therefore, also contract law provides legal strategies in the form of contracting to control the agent's

performance. In the next chapters, we will further highlight these tools and legal strategies as illustrated below.

**Figure 3:** Legal strategies of governing MOCs.



Local governments can use these instruments to steer their external corporate bodies. The steering toolkit including MCG principles, articles of association, board nominations and a shareholders' agreement *offers a means to achieve the financial or other goals of the MOCs*. It is important that public owners realise how to utilise these legal tools proactively when choosing the most appropriate instruments of steering MOCs. From a legal point of view it is essential to realise the differences between these instruments.

## 4 Discussion – Steering instruments of governing MOCs de lege lata

### 4.1 Articles of association

The *articles of association* can be considered the single most important instrument of steering a MOC. The articles of association is a compulsory company's rule book (French, Mayson & Ryan, 2016: 75). According to the FCA the articles of association shall always contain the following information on the company (minimum contents): trade name, the municipality in Finland where it has its registered office and field of operation. All other stipulations are voluntary. The articles of association might contain stipulations on basically any matter concerning the MOC, unless the stipulations are against the law or contrary to the rules of appropriate conduct (Toiviainen, 2008: 425). According to recent research, typical stipulations in Finnish MOCs concern the composition of the board, decision-making, purpose of the company, distribution of assets and transfer restrictions of

the shares (Ruohonen et al., 2021: 200-224). An MOC's articles are firstly a contract between the company and its shareholders and secondly a contract between shareholders themselves (Mayson et al., 2016: 75, 82-93).

There are no explicit stipulations on the purpose of the MOCs in Finland. However, for example in Sweden, the municipality has to ensure that the established municipal purpose and the municipal powers that form the framework for the activities of a MOC are stated in the articles of association according to the Swedish Local Government Act (2017: 725). According to the FCA, the purpose of a limited liability company is to generate profits for the shareholders *unless* otherwise provided in the articles of association. The profit-maximising purpose of the company is understood through enlightened value-maximisation, profit-making in the long-run, in the Finnish setting (see the Limited Liability Companies Act Proposal 109/2005: 38-39; for enlightened value maximisation see Jensen, 2010). According to our research one-fifth of the MOCs have actually changed the purpose of the MOC. It is essential that municipal shareholders recognise the situations which are important in achieving the set goals (purpose of the company) and which commonly cause collision between shareholders. For example, according to the FCA it may be provided in the articles of association that the general meeting decides matters that normally fall within the general competence of the board of directors, such as major investments. There might also be stipulations requiring the unanimity of the decision-makers.

In Finland the articles of association shall always contain the *MOC's field of operation*. This is a risk management tool for municipal shareholders as the directors of the company must obey the stipulation and operate only in the fields stipulated in the articles of association. Field of operation might be specific, for example healthcare services, or general, for example all fields of business. The shareholders of the MOC must accept the changes concerning the field of operation in the articles of association. If the field of operation is rather narrow, the shareholders can strictly restrict the operation of directors.

Only the qualified majority of the votes and shareholders (2/3) are able to amend the articles of association. As a result, the articles of association is also a powerful way to control for instance the decision-making of the board of directors. In the UK a company's articles of association vest in the board of directors wide management powers (Keya, 2016: 32; Bruce, 2016: 27-28). In Finland, however, the default is that broad general management powers are vested in the board of directors in the stipulations of the FCA, but it may be provided in the articles of association that the general meeting decides matters that fall within the general competence of the the board of directors. This means that the shareholders have the possibility to decide that not all the typical decision-making in an MOC belongs to the board of directors, but instead to the general meeting.

The articles of association are an essential tool of risk management as all organs of an MOC *must comply with the articles of association*: general meeting, board of directors and CEO. A shareholder may object to a decision by the general meeting by bringing an action against the company if the articles of association have been breached, where the breach may have had an effect on the contents of the decision or otherwise on the rights of a shareholder. According to the companies act the director or shareholder shall be liable in damages for the loss that he or she, in violation of the articles of association, has in office deliberately or negligently caused to the company, a shareholder or a third party.

In this way, *company law offers an adaptive and versatile mode*, a contract model, which municipalities can tailor to fit their needs. Using articles of association is a robust way of setting the MOC's scope to support the activities of the LG. However, municipalities seldom utilise this opportunity (Ruohonen, Vahtera & Salminen, 2019a: 742; Proposal for Local Government Act 268/2014: 72). This can be due to two possible reasons. Firstly, we suggest that municipalities simply do not have the human resources or the legal know-how to modify the articles of association of their companies, or they are lacking in the strategic assessment, which is the very purpose of their MCG. Secondly, most MOCs are often solely owned by a single municipality, which results in much more straightforward governance, and as such the municipalities have not seen private ordering as necessary. Thirdly, in joint-owned MOCs, a shareholders' agreement is used over the articles of association.

## 4.2 MCG principles

The Finnish Local Government Act provides a tool which is called *corporate governance principles applying to the local authority corporation* in the legislation. In this paper we have opted to call this tool the MCG principles. The MCG principles is a combination of ruleset and principles and corporate governance code that the municipality's local council needs to draft and ratify. According to the law, the MCG principles are required to include at least clauses regarding the planning and control of the local authority corporation's finances and investments, the arrangement of oversight of the local authority corporation and of reporting and risk management.

The principles also need to include a provision of information and the securing of the right to information of elected officials of the municipality and the *obligation to obtain the views of the municipality in certain important matters prior to decision-making in MOCs*. In this way, the municipal council may take a position on certain decisions of a fundamental nature or of otherwise great importance before they are taken. This gives a forewarning to the municipality so it can consider voicing its thoughts on the subject matter, or the undertaking of other legal strategies if the decision in the making is not aligned with its interests. The board is still accountable

and culpable for its own decisions, even when heeding the municipal owner's views (see Keya, 2016: 507-545).

The principles also have to include provisions considering the internal services of the MCG. These provisions give a roadmap for all the MOCs inside the MCG on what services, like financial management services or property maintenance, they need to rely on from in-house delivery. The composition and designation of the MOCs' boards of directors and good administrative and management practices need to be in the principles too. In this way, the municipal shareholder is able to produce external guidelines for corporate governance that direct the board nominations. In addition, the municipality can include self-imposed guidelines in the MCG principles to further steer its external corporations. For example, municipalities which aim to foster innovation across their organisation between different units (see e.g. Kurkela, Virtanen, Tuurnas & Stenvall, 2019: 255-260) can implement these processes into their MCG principles.

To draft such guidelines is a task in itself and requires that the municipality commits some resources to it. The guidelines also need to be updated regularly to uphold the best practices of governance. There is not an official nationwide corporate governance code for MOCs to follow. Instead, municipalities need to draft one of their own. The Association of Finnish Municipalities has provided the municipalities with model practices, and the legislator has encouraged municipalities to follow the Finnish Corporate Governance Code for listed companies when compiling their own guidelines (Proposal for Local Government Act 268/2014: 177).

Corporate governance principles applying to the local authority corporation are directed at subsidiaries but are applicable to associated corporations as well. As the MCG principles need to be ratified by the MOC's board, this becomes increasingly difficult when there are multiple municipal shareholders with MCG principles of their own. Also, with mixed private-public ownership, private owners do not necessarily feel like accepting the principles laid out by the municipalities. Mainly due to this, the governing principles in joint venture MOCs between multiple owners are laid out in a *shareholders' agreement*. This document is drafted in unison between the shareholders, be they municipal or private owners (see Ruohonen et al., 2021).

### **4.3 Role of the general meeting – board nominations**

The MOC's decisions shall be made at the ordinary general meeting on the appointment of the members of the board of directors, unless it is otherwise provided in the FCA or in the articles of association about their appointment. The board of directors has the overall duty of overseeing business strategy. The nomination of the MOC's chief executive officer (CEO) is the board of director's

task according to the FCA, which cannot be amended. The CEO is responsible for running the daily activities that fall into his or her remit. Therefore, *board nominations* are a critical part of governing MOCs.

The powers of the board derive from provisions in the FCA, and the general meeting can not interfere in the operational actions taken by the directors (Keya, 2016: 31-32). According to Local Government Act, the composition of the board of directors of a local authority subsidiary must take into consideration the financial and business expertise required for the sector in which the corporate entity is operating. This expertise requirement was introduced in the 2015 Local Government Act to ensure that MOCs are duly managed (Proposal for Local Government Act 268/2014: 114). According to a recent survey among chairs of the board in 2018, only 63 % of MOC board members have expertise that is sufficient enough to act as board members. It is worth noting that the expertise requirement statute only applies to subsidiary MOCs. However, in our survey, the associate companies were no different from subsidiaries when comparing the amount of competent board members. The average number of board members in the surveyed set was 6,6 (Ruohonen, Vahtera & Salminen, 2019a). The question is: If say four members of the board are competent enough, what are the rest there for?

The answer is *political representation*. According to our studies, approximately 60 % of all board member in MOCs are elected due to political representation, as confirmed by our 2018 survey and another similar research conducted in 2015 where public board member information was compared with the names of the elected municipal representatives. However, political representation is a *double-edged sword*. It can be useful due to bringing its shareholder local government's interests into the day-to-day management conducted by the board, but at the same time it can seriously hamper the effectiveness of a MOC if the politically – that is, not based on her or his expertise – chosen board member is not capable of addressing the strategic or industry-related problems that inevitably occur (for board expertise and strategic competence relating to performance see Harris & Raviv, 2008; Hendry & Kiel, 2004).

However, this problem can be alleviated by making sure that the expertise requirement is fulfilled by introducing hybrid boards where expertise and political representation based members are elected in equal numbers. One also needs to be aware that a person can be nominated for political reasons and have suitable expertise at the same time (Penttilä et al., 2015: 94-96). However, according to arm's length principal-agent theory, political representation in MOCs can cause potential conflicts of interest when a politician may pursue the interests of the voters or her or his private interests, while ultimately being obligated to promote the MOC's interests (Bergh, Erlingsson, Gustafsson & Wittberg, 2018: 324-327).

Corporate board composition and diversity are one of the most researched items in modern corporate governance (Licht, 2018: 153; Linck, Netter & Yang 2008: 308-309), and diversity requirements are one of the defining clauses directly affecting board composition in corporate governance codes (see UK Corporate Governance Code 2018 principle J; Finnish Corporate Governance Code 2020 recommendation 9). Various studies have shown that diverse representation of gender improves a board's ability to address and cope with various problems for the benefit of the corporation, but the true relation between gender diversity and firm performance is complex (see Adams & Ferreira, 2009: 292-293, 307-308). Gender diversity is also an important factor in MOC boards as well (see Papenfuß, van Genugten, de Kruijf & van Thiel, 2018: 87-90).

In Finland, the Act on Equality between Women and Men (609/1986) has provisions directed at composition of public administration bodies and bodies exercising public authority. The act states that the proportion of both women and men on government committees, advisory boards and other corresponding bodies, and in municipal bodies and bodies established for the purpose of intermunicipal cooperation, but excluding municipal councils, must be at least 40 %, unless there are special reasons to the contrary. Legal praxis has confirmed that the provisions in the section regarding gender diversity also apply to MOCs in Finland (see Finnish Supreme Administrative Court ECLI:FI:KHO:2017:2; Ruohonen, Vahtera and Salminen, 2019b: 54-55). Research from 2018 showed that the gender balance of Finnish MOCs is unbalanced, since only 35 % of MOC board members are female. Additionally, 10 % of the surveyed MOCs were *male only*, making them illegitimate unless the special reasons to the contrary provisions should apply (Ruohonen et al., 2019b: 53-54).

In addition to all of the above, also other good board composition related corporate governance practices should be taken into account. Board remuneration should promote healthy long-term operations and service quality to further budge the management to align their modus operandi towards the municipality's benefit (for executive remuneration and corporate governance see Ferrarini & Ungureanu, 2018). Also, to ensure that expertise remains at suitable levels, the municipal shareholders should regularly evaluate and, if needed, replace board members accordingly (for board turnover and performance relation see e.g. Bates, Becher & Wilson, 2017).

#### 4.4 Shareholders' agreement

It is most common that the shareholders of MOCs commit themselves to the shareholders' agreement. There are *several differences* between the shareholders' agreement and the articles of association. Firstly, the shareholders' agreement is a voluntary tool for multiple owners of the MOC, whereas the articles of association is a compulsory tool for all MOCs. Secondly, not all the shareholders are obliged to

bind themselves to the shareholders' agreement, but all the shareholders must obey the articles of association. This means that the agreement is binding only on the parties to it, and the agreement does not involve those parties that have not bound to it. Thirdly, the shareholders' agreement cannot be altered by a majority of the contractual parties (see Hannigan, 2016: 116-117). This is a major advantage, especially from the MOC's minority shareholders' point of view, in comparison to the articles of association (see e.g. Kershaw, 2009: 582-587). The juridical relevance of the shareholders' agreement derives from the binding contract, and if the contract parties fail to comply with the terms of the agreement, they are obliged to pay for the damages or contractual penalty. Unlike breaching the articles of association, breaching a shareholders' agreement does not constitute enforcing decisions as void (see Finnish Supreme Court ECLI:FI:KKO:2020:34; Mock, Csach & Havel, 2018).

The shareholders' agreement is a contractual unifier between multiple cooperating municipal owners in MOCs. In European countries shareholders' agreements are normally not subject to a specific legislation, which leads to a certain amount of flexibility compared to the articles of association (Mock, Csach & Havel, 2018: 8-9). The shareholders' agreement is a contract between the company's shareholders, who dictate how the company should be managed, and what the rights and obligations are of the contracting parties (Černá, 2018: 59-60). As a contract, it legally binds its parties according to the *pacta sunt servanda*, the universal principle of contract law (Charman, 2007: 3-4; Jansen, 2011: 632). The very nature of a contract therefore characterises it as a powerful tool for joint-steering MOCs. Clauses found in these shareholders' agreements between MOC shareholders encompass everything from voting guidelines at the annual general meeting, to financing and contingencies (Ruohonen et al., 2021: 235-238).

The shareholders' agreement is typically made even if there is a majority shareholder. Typical stipulations deal with the composition of the board of directors, board nomination and decision-making. There are typically stipulations that ensure the position of minority shareholders. For instance, the minority shareholder(s) might withhold a right to appoint at least one member of the board.

The MOC's owners can set the guidelines of their own actions as a shareholder collective to reflect the purpose of the company in a way that sets a foundation for long-lasting strategic partnership. The shareholders' agreements are effectively business contracts. Business contracts require understanding how long-lasting and proactive contracts are drafted (Kujala, Nystén-Haarala & Nuottila, 2015: 94-96, 100-101) to serve their purpose and to create the best value possible; meaning that municipalities need to have in-house legal competence or procure legal services in order to fully realise the steering potential of said contracts.

## 5 Conclusions

In this paper we have presented an overview of MOC usage on the Finnish local government level and how to address the legal challenges of using MOCs in public service delivery. There has been a significant increase in the amount of MOCs in the 2010s. Business-like techniques and the managerial autonomy of MOCs are seen as more efficient producers of local public services than bureaucracies. In Finland, MOCs are almost solely private limited liability companies. As we presumed in our hypothesis, the municipalities must understand and holistically utilise and apply different legal steering and governing mechanisms to guarantee their external corporate bodies' success in their set tasks.

Our legal dogmatic analysis of the regulation of MOCs shows that municipalities have a high level of autonomy to modify and to steer the MOCs to best fulfil their duties in local governments tasked with providing services to numerous industries. Company law offers a variety of different options for a MOC's management model in which competencies are clearly distributed between the corporate organs. Municipalities steer their limited liability companies through the decision-making process in a general meeting of the company as shareholders. Municipalities are also able to partake in contractual activities as shareholders when cooperating with other private or public entity shareholders in join-operation MOCs. Municipalities must exercise this mode of control fully to guarantee their MOCs' performance and to survive in the market-oriented corporation landscape.

There are several legal strategies for governing MOCs. Firstly, and most importantly, company law offers the instruments to steer MOCs. Shareholders may tailor the articles of association to fit their needs. The articles of association is a key instrument for steering MOCs as all the organs must comply with it. Secondly, contract law offers a shareholder a useful control mechanism through the shareholders' agreement, which is a contractual unifier between multiple cooperating municipal shareholders. Thirdly, the Local Government Act includes a list of tools for steering MOCs. For example, municipal corporate group principles (MCG principles) are required to include clauses on the obligation to obtain the views of the municipality in regard to important matters in MOC decision-making, the composition of MOCs' board of directors and good administrative and management practices. Board nominations are crucial in MOC governance. Expert nominees are required in different industries to ensure that MOCs are duly managed. It is worth noting that ultimately the shareholders exercise their decision-making powers in a general meeting of the company even if the steering principles derive from the Local Government Act or contract law.

We have presented the legal strategies of steering and ownership policy that LGs can use to govern their MOCs and the MCG as a whole. But is this toolkit provided in the company, contract and local government regulation adequate? Our analysis

of the legal instruments at hand shows that robust governance of a municipality's external corporate bodies is possible. Company law and municipal legislation provide municipalities as shareholders and localities a formidable arsenal that they can use to form a cohesive grip on their MOCs. However, municipal shareholders do not utilise these instruments as widely as they should. Municipal shareholders also seem to lack the expertise to diversely utilise these legal governing tools. The success of an MCG's governance also depends on how well the municipality is resourced to govern and steer its corporate entities.

The number and economical volume of MOCs have increased significantly in the past years. In the future, the municipalities should invest in developing and enhancing ownership policies, instruments of steering and corporate governance codes to strengthen their position as shareholders. The steering toolkit offers a means to achieve the financial goals of the MOCs. The municipalities as shareholders should especially make sure that the expertise requirement of the board is fulfilled through board nominations. Also, other corporate governance practices relating to board composition should be actively implemented to enhance their companies' financial performance.

## Notes

- 1 For a comprehensive list of other terms for MOCs appearing in research, see Voorn (2019).
- 2 This survey was conducted in 2018 and was carried out at 200 municipally owned corporations in the 21 largest cities in Finland: Helsinki, Espoo, Tampere, Vantaa, Oulu, Turku, Jyväskylä, Lahti, Kuopio, Kouvola, Pori, Joensuu, Lappeenranta, Hämeenlinna, Vaasa, Rovaniemi, Seinäjoki, Mikkeli, Kotka, Salo, Porvoo. The survey was directed at and completed by the MOCs' chair of the board. The survey was commissioned by Tampere University and carried out by Taloustutkimus Oy. The data gathered was subjected to qualitative and quantitative analysis. For the results and further information see Ruohonen et al., 2019a: 745–752; Ruohonen et al., 2019b: 45–61.

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