Sweden

Negotiated M&A Guide

Corporate and M&A Law Committee

Contacts

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1. Introduction

a. *Scope*

M&A transactions in Sweden are mostly made through an acquisition of all or part of the shares of the target company. Mergers under the Swedish Companies Act are a more complicated and the time frame required for a merger makes this procedure of less interest compared to an acquisition of the shares in a target company. This guide only addresses private acquisitions, i.e. transactions in which the shares of a private limited liability company are acquired.

Such transaction or transactions will hereinafter be referred to as “M&A”, “M&A Deal” or “Deal” in singular or plural. The guide does not address asset transfers or takeovers of public limited liability companies with shares listed on a stock exchange.

An acquisition of a Swedish private company is generally relatively straightforward and uncomplicated with very few applicable mandatory rules.

b. *Applicable Legislation*

The most important legislation to observe in a Swedish M&A Deal is:

1. The Swedish Companies Act, the provisions of which are, to some extent, mandatory, for example (i) how a transfer of title of shares should be made and how the transfer should be recorded into the target company’s share register (ii) requirements for shareholders meetings and appointment of board of directors and persons to be authorized to act on behalf of the target company and (iii) provisions related to financial assistance to a buyer and other transfer of funds to a shareholder etc.

2. Tax laws, especially in respect of structuring the Deal.

3. In the event the share purchase agreement is not exhaustive in certain aspects, the Swedish Sale of Goods Act is normally applicable. This means, for example, that if the warranty period is not covered by the share purchase agreement, said period is normally two years.

4. Other legislation, such as environmental laws or laws specifically applicable to the target company depending on its operations, also often come into play.

2. Initial Observations when considering a Transaction

a. *Types of limited companies*

Under the Swedish Companies Act there are two types of limited liability companies, private companies and public companies. The vast majority of Swedish companies are private companies. A private company (Sw. *privat aktiebolag*) must have a share capital of SEK 50,000 and the shares of such company cannot be offered to more than 200 investors. A public company (Sw. *publikt aktiebolag*) must have a share capital of SEK 500,000 and can offer shares to the general public and can have its shares listed on a stock exchange.

b. *Validity of a transfer of shares*

Under the Swedish Companies Act, a transfer of title to the shares in a Swedish limited liability company is valid when the share certificates representing the shares subject to the transfer (if such are issued, there is, however, no legal requirement to issue shares in a private company) are duly endorsed to the new owner. The seller will endorse the transfer on the certificate and deliver the certificate to the new owner. In addition, the new owner of the shares must be registered in the company's share register. The board of directors of a company is responsible for maintaining an updated share register.

There is no public register in Sweden of holdings of shares in private companies. However, according to new legislation effective as from 1 August 2017, Swedish private companies, associations and other legal entities (with some exceptions) must register their beneficial owners with the Swedish Companies Registration Office (Sw. *Bolagsverket*). For the purposes hereof, a beneficial owner is someone who ultimately owns or controls a company, association or other type of legal entity. The European Union Fourth Anti-Money Laundering Directive is the reason behind the new register. Registrations must be made before 1 February 2018.

c. Squeeze-out

In the event a buyer does not acquire 100% of the shares of the target company, the Swedish Companies Act enables a shareholder, holding more than 90% of the shares, to buy-out the remaining shares of the other shareholders on a compulsory basis (a so called squeeze-out). Correspondingly, a minority shareholder whose shares may become subject to squeeze-out is also entitled to demand that the majority shareholder purchase his shares on a compulsory basis.

d. Articles of Association – transfer of shares restrictions

If the buyer does not intend to acquire 100% of the shares of the target company, the buyer must verify whether or not the articles of association of the target company contains restrictions with regard to the transfer of shares. Normally, the articles of association of private companies contain pre-emption clauses (an obligation for the buyer to offer the purchased shares to the remaining shareholders) or offer of first refusal provisions (an obligation for the seller to first offer the shares to the remaining shareholders on the same conditions as the seller offered to the potential buyer). Articles of association can also contain a consent clause, whereas the consent of the board of directors in the target company or its shareholders is required for the transfer. The articles of association of all limited liability companies are publicly available.

e. Financial Assistance

Regarding financial assistance, it should be noted that according to the Swedish Companies Act a company may not grant an advance, provide loans or provide security for loans for which the debtor will acquire shares in the company or any parent company in the same group.

3. Structure of a Transaction

A transaction normally starts by either a bilateral discussion between two parties or with an invitation from the seller(s) to potential buyers followed by an auction procedure and final negotiations with one or several of the preferred bidders. However, final negotiations are normally only carried out with one preferred bidder.

A transaction is normally structured as an acquisition of all or a majority of the shares in the target company. This means that, in the event that there are several shareholders, the buyer has to negotiate the Deal with all of the relevant shareholders at the same time. If the sellers are parties to a shareholders agreement which contains a drag-along provision, a buyer will normally start negotiating with the majority shareholder or shareholders in order to reach a share purchase agreement. Shareholders agreements normally contain transfer restrictions, in addition to any such restrictions in the articles of association, and accordingly it is important that all shareholders waive such rights in connection with the Deal.

A transaction may contain cash consideration of 100% of the purchase price upon closing, with part of the purchase price paid in deferred payments, earn-out payments or other kinds of combinations of upfront payments, deferred payments and earn-out payments.

Payment of the purchase price (or part of it) may be made in cash and/or, for example, by shares in the buyer or its parent to a number that corresponds in value to the purchase price. Payment may also be made by a loan note issued by the buyer, often in combination with a cash payment.

4. Pre-Agreements

Pre-agreements are often used in Sweden in the form of non-disclosure agreements, letter of intents, term sheets or heads of agreements.

a. Non-Disclosure Agreement

A potential buyer normally has to enter into a non-disclosure agreement/confidentiality agreement in order to receive an information memorandum or any other information about the target company. A non-disclosure agreement (NDA) may contain provisions regarding:

1. Non-disclosure undertakings.
2. Non-solicitation undertakings in respect of employees, but sometimes also in respect of customers and suppliers.
3. Exemptions from non-disclosure undertakings.
4. Liability (normally damages, but sometimes liquidated damages).
5. Limitation of liability.
6. Term of undertakings/agreement.
7. Arbitration and applicable law provisions.

b. Letter of Intent

A letter of intent is frequently used in Sweden as a non-binding pre-agreement. Certain provisions of the letter of intent may, however, be legally binding upon the parties. Consequently, the agreement should explicitly state which sections that will be binding and which will remain non-binding. A letter of intent normally contains provisions regarding the following, with items 5-9 normally being binding:

1. Structure of the transaction.
2. Price indication or range – subject to due diligence and final share purchase agreement.
3. Procedure of due diligence.
4. Time frame for the transaction.
5. Confidentiality/reference to NDA
6. Non-solicitation.
7. Exclusivity.

8. The term of the letter of intent and the exclusivity.

9. Arbitration and applicable law provision.

c. *Term Sheet*

A term sheet is normally a non-binding (although of course morally persuasive), bullet point document containing the material commercial terms and conditions of a transaction agreement for the contemplated transaction. It is fairly common that a term sheet is made a schedule to the letter of intent.

d. *Heads of Agreement*

The parties may sometimes use a pre-agreement in the form of a heads of agreement which, in its substance, is rather similar to a letter of intent and a term sheet but has the form of an agreement and is more detailed in respect of the material terms and conditions to be inserted into the share purchase agreement.

5. The Transaction Process

An ordinary transaction process in an M&A Deal in Sweden can briefly be described as having the following steps:

1. Potential buyer (or multiple bidders) is provided with teaser material. This is more or less common practice in auction procedures.

2. Potential buyer (or multiple bidders) signs a non-disclosure agreement.

3. The seller provides the potential buyer (or multiple bidders) with the information memorandum.

4. The potential buyer (or multiple bidders) gives the seller a non-binding indicative bid.

5. In the event there is only one potential buyer (i.e. no auction procedure) the parties sometimes agree to enter into a letter of intent or similar pre-agreement. The potential buyer aims to obtain an exclusivity period.

6. In the event of an auction procedure, the seller selects a number of preferred potential buyers.

7. The potential buyer (or multiple bidders) is invited to a management presentation.

8. The potential buyer (or multiple bidders) carries out a due diligence. The data room is normally a virtual data room.

9. The potential buyer (or multiple bidders) is asked to provide the seller with a final bid.

10. The seller selects one or several preferred buyer(s).

11. Negotiations in order to reach a share purchase agreement starts.

12. Finalizing and signing of the share purchase agreement.

13. Press release to media (normally required when the buyer is a public listed company).

14. If required, filing with the relevant Competition Authority, and/or any other relevant authorities.

15. Closing of the transaction, payment of purchase price and actual transfer of the shares.

The above steps may of course not always take place in the sequence set forth above. For example, points 8-11 sometimes overlap and final negotiations are carried out with multiple bidders.

6. Due Diligence

A buyer is normally offered the opportunity by the seller to carry out, and normally carries out, a legal, financial and tax (and sometimes also commercial) due diligence of the target company prior to completing the Deal.

If the seller does not provide the potential buyer with access to a data room containing relevant information regarding the target company at the outset of the Deal, the potential buyer normally starts the due diligence with providing the seller with a request list setting out the documentation and information which the buyer would like receive access to. This is often the case in a proprietary transaction, i.e. one that starts through bilateral discussions. In an auction procedure, the seller usually prepares a data room and invites the bidders to begin the due diligence at a certain point in time.

In light of the increasing use of M&A insurance, especially in auction procedures, it is very important for the potential buyer to scope and conduct the due diligence in a manner sufficient for insurance purposes. If not, the buyer stands the risk to end up without sufficient contractual protection for the Deal. Hence, a limited investigation otherwise commonly used in auctions procedures with many potential bidders and high competition is normally not an alternative when the Deal is structured with an M&A insurance solution, unless the buyer is willing to accept limited insurance cover.

7. Transaction documents

a. Share Purchase Agreement

A Swedish share purchase agreement is normally shorter in length compared to UK or US style share purchase agreements. The reason is that Swedish law is a civil law system and consequently based on general legal principles including e contrario interpretation of the law as well as a “fall back” on legislation such as the Swedish Sale of Goods Act for issues not expressly covered by the agreement. This implies that a share purchase agreement, under Swedish law, does not need to specify in detail all possible circumstances and consequences.

A share purchase agreement in a Swedish transaction will normally contain the following types of provisions.

1. Date.

2. Parties.

3. Definitions.

4. Agreement to sell and purchase.

5. Purchase price, escrow and earn-out.

6. Conditions precedent to closing and closing related items.

7. Closing and closing actions.
8. Closing accounts (depending on purchase price model).
9. Warranties of the seller.
10. Warranties of the buyer.
11. Covenants between signing and closing.
12. Indemnifications and limitation of liability.
13. Specific indemnities.
14. Escrow release provisions.
15. Ancillary agreements (normally as schedules).
16. Transitional agreements (normally as schedules).
17. Escrow agreement (normally as schedule).
18. Financing agreements (e.g. loan notes and similar financing arrangement between the seller and the buyer; documents regarding buyer senior debt financing are, however, not made part of the share purchase agreement).
19. Non-competition and non-solicitation undertakings.
20. Announcements.
21. Confidentiality.
22. Entire agreement and amendments.
23. Notices.
24. Assignments.
25. Miscellaneous.
26. Governing law and disputes.

The following specific comments are made in respect of some of the provisions above.

b. Purchase Price and Escrow

Regarding the purchase price, a share purchase agreement very often stipulates a preliminary purchase price to be paid on the closing day, to be adjusted post completion based on the closing accounts as of the date of completion (closing). Once the closing accounts are agreed by the seller and the buyer, the preliminary purchase price will be adjusted establishing the final purchase price. The preliminary purchase price to be paid by the buyer on the closing day is however very often reduced by (i) an agreed amount to correspond to a potential negative adjustment amount and (ii) an escrow amount.

An alternative to a purchase price based on closing accounts is a fixed price mechanism with standard type locked-box provisions including warranties in relation to locked-box accounts.

As mentioned above, all or part of the purchase price may be paid by newly issued shares in the buyer or its parent. This is common practice in buyout deals as part of the management equity incentive plans (MIP) and when the buyer is a listed company.

The escrow amount (which is normally paid into an escrow account) is established in order to cover all or some of the indemnification claims to be paid by the seller in the event of a breach of a warranty, covenant or a specific indemnity. How the funds will be released from the escrow account is normally regulated by an escrow agreement between the parties to the share purchase agreement and the bank holding the escrow account.

c. Earn-out Models and Specific Considerations

An earn-out is frequently used as a compromise when the seller and the buyer cannot agree on the valuation. The earn-out serves as a risk sharing between the seller and the buyer, often related to the target company's future performance.

An earn-out can be described as a deferred portion of the purchase price which is conditional on the target company's achievement of certain predetermined operational or financial goals within a specified timeframe. Earn-outs can be structured according to various models in order to base these goals on different parameters. In most cases financial parameters such as net income, gross revenue, earnings before interest and taxes (EBIT) or earnings before interest, taxes, depreciation and amortization (EBITDA) are used. However, other parameters relating to new customers or other business-specific operating parameters may also be used.

Parameters which are easily measurable are used in order to ensure that earn-out models are simple and transparent. Even so, the buyer and the seller often struggle to agree on how the earn-out is to be calculated. For example, a buyer may argue that the earn-out should be based on EBITDA, while the seller may prefer it to be based on revenue. From the seller's perspective, using revenue as the basis for an earn-out is often seen as advantageous, since a company's revenue cannot be manipulated by the buyer. The EBITDA can be manipulated, for example, by incurring costs which are not in line with past practice. From the buyer's perspective, using EBITDA or net income is often preferable since these parameters say more about the company's performance.

To protect the interest of the seller, the buyer and the seller sometimes agree on a code of conduct during the earn-out period. According to such codes, the buyer, as the new legal owner of the target company, must adhere to certain provisions when operating the company. Irrespective of how the earn-out is structured, it requires the seller to be involved, to some extent, in the company's business during the earn-out period.

The seller and the buyer may agree that the seller's continued engagement in the target company is a requirement for the seller to receive an earn-out. Depending on the circumstances, this may lead to tax consequences for both the seller and the target company (and thus the buyer). This factor should be considered by the parties when negotiating an earn-out model. Further, and depending on the structure of the deal and the parties other operations, an excessively stringent code of conduct for the buyer (effectively a veto for the seller) may have competition law implications.

Earn-out provisions can be an effective tool for taking negotiations forward when a seller and a buyer have difficulties in agreeing on the valuation of a company. However, the parameters on which the financial or operational goals are based should be chosen carefully by both the seller and the buyer if the model is to spread the risk between the parties in a fair and effective manner.

d. *Conditions Precedent to Closing and Closing Related Items*

Typical conditions that closing may be subject to:

- Shareholder or Board approval (less common).
- Certain key employees not terminating their employment.
- Required filings with, and clearances from, relevant regulatory bodies, for example, Competition Authorities (Swedish Merger Rules in brief see below).
- Buyer having financing in place (less common).
- MAC clauses (Material Adverse Change).
- Bring down of warranties (although a lot less frequently used in Swedish agreements compared to UK or US agreements).
- Waivers from change of control provision that the target company may have in its agreements.

e. *The following rules apply under the Swedish Merger Control*:

As under EC law, the SIEC test is applicable for assessment of concentrations. This means that the question of whether a merger creates or strengthens a dominant position on the market is not the sole determining factor. Instead, concentrations which are intended to substantially impede the existence or development of efficient competition within the country as a whole, or a substantial part of it, are to be prohibited. Upon assessment, whether a dominant position will be created or strengthened will be considered.

It may be noted that in Sweden, the Competition Authority currently does not have the competence to prohibit a concentration. Instead it has to bring action in the Patent and Market Court. Any judgment may be appealed to the Patent and Market Court of Appeal as last instance. The parties to the concentration may make commitments in order to obtain concentration clearance. The commitments may be subject to penalty of a fine. Such decisions may be taken by the Patent and Market Court upon a claim by the Competition Authority. However, according to a pending legislative proposal it is suggested that the Competition Authority shall be entitled to prohibit concentrations.

The thresholds for when a merger is to be notified to the Competition Authority are that the undertakings concerned (typically the buyer group and the target company) must have a joint turnover to Swedish customers of SEK 1 billion and at least two of the undertakings concerned (typically the buyer group and the target company) must each have a turnover to Swedish customers of at least SEK 200 million.

In addition to the Swedish legislation, EU law applies and larger deals may need to be notified to the EU commission.

f. *Closing*

The actions to take place at the closing of the M&A Deal are described in the share purchase agreement. Actions that normally take place at closing are (among others):

- Confirmation of fulfilment of conditions precedent.

- Payment of the purchase price including transfer of escrow amount to the escrow account.

- Transfer of shares certificates (if issued) and registration of the buyer as new shareholder in the target company's share register.

- Signing of ancillary agreements.

- Other transaction specific items.

- Issue by the present board of directors of a general power of attorney in favour of the buyer's representatives enabling them to act for the target company until the new board of directors is registered with the Swedish Companies Registration Office.

- Holding of an extra shareholders meeting by the buyer as a new shareholder, at which a new board of directors is appointed as well as new auditor(s).

At closing a closing memorandum (or closing minutes) is prepared verifying that all actions set out in the share purchase agreement have been executed and that the closing has been carried through. Such closing memorandum is normally signed by the seller and the buyer.

g. Closing Accounts

The preparation of closing accounts is provided for in the share purchase agreement for several reasons. One reason may be that seller and buyer have agreed on a final adjustment of the purchase price to be based on the closing accounts. Another reason could be that the parties have agreed that the closing accounts should be a "first check" if there is a breach of the seller's warranties, especially if the seller has warranted a certain minimum financial result for the period from the date of the annual accounts through the date of the closing accounts. The share purchase agreement will describe how the closing accounts will be prepared and as of what date. The agreement will also describe (i) which party that will prepare the closing accounts; (ii) the procedure for establishing the closing accounts; and (iii) how disputes between the seller and the buyer concerning the closing accounts should be solved.

Closing accounts are not used when the purchase price is fixed and based on locked-box accounts.

h. Warranties

It should be noted that the expression "Representation and Warranties" often used in Anglo Saxon share purchase agreements is not an expression used or recognised under Swedish law, except as a collective expression for warranties or "guarantees". Also note that, under Swedish law, buyer's knowledge prior to signing of a warranty breach is considered to make the buyer unable to put forth a claim, which is also the way Swedish share purchase agreements are drafted. Thus, if a potential breach or a risk is disclosed to the buyer during due diligence and the buyer would like to reserve its right to claim compensation if the risk or breach materializes, it is important to negotiate a suitable specific indemnity for that particular issue. If a disclosed risk is taken into account during the negotiations, the seller normally will demand an exception from the seller's warranties in the share purchase agreement. Very often such exceptions are inserted in disclosure schedule(s) to the share purchase agreement as exceptions from the warranties.

Frequent seller's warranties are related to:

- Capacity and authority.

- Incorporation.
- Ownership (including absence of warrants, convertibles, options and other securities).
- Solvency.
- Accounts (including locked-box accounts, if applicable).
- Business agreements.
- Compliance with laws and material licences, permits and authorisations required to carry on its business.
- Environmental matters.
- Real property and leased premises.
- Disputes.
- Intellectual property rights.
- Information technology.
- Assets.
- Insurance.
- Employment matters including pensions.
- Taxes.
- Absence of certain events.
- Information.

i. Indemnification and Limitation of Liability

In the case of a breach of a warranty, it is usually stipulated that the seller will compensate the buyer for any loss suffered by the buyer or the target company due to such breach (either through damages or reduction of the purchase price). A topic that is often negotiated is whether the seller should compensate the buyer for direct and indirect losses, or merely for direct losses. A fairly common compromise is that the share purchase agreement stipulates that the seller will be liable to compensate the buyer for any loss suffered by the buyer or the target company that is reasonably foreseeable as a consequence of the seller's breach.

With regard to limitations of liability, share purchase agreements normally include provisions on de minimis (i.e. single claims threshold), a basket (i.e. multiple claims threshold) and a cap (i.e. maximum liability limitation). Both the de minimis level and the level of the basket are determined in relation to the purchase price. The cap is normally set to a percentage of the purchase price. Such percentage is mostly dependent on the type and size of the Deal as well as market conditions and the parties' relative negotiation strength.

Time limit for the seller´s warranties is often negotiated between the seller and the buyer. In Swedish share purchase agreements the warranty period normally vary from nine months to 24 months, but could be longer or shorter even though that would be uncommon. The aim for the buyer is often to extend the warranty period to a date after the end of the first (or of course preferably second) full financial year after the closing. It will also be provided that the buyer must file a complaint with the seller within 30 to 60 business days of discovery.

Other limitation of liability provisions include, inter alia, right for the seller to remedy a breach, obligation for the buyer to mitigate loss, no double recovery, tax benefit, conduct of third party claims etc.

The share purchase agreement normally includes provisions that the warranties are subject to disclosures with reference to all due diligence materials and other disclosures made within the frame of the share purchase agreement (e.g. through a disclosure letter). Accordingly, it is very difficult for a buyer to direct a claim against the seller based on circumstances that was actually known to the buyer when entering into the share purchase agreement (through disclosure or otherwise).

Special considerations must be made when negotiating and drafting share purchase agreements in Deals where M&A insurance is used since the mechanics of the insurance need to be interlinked with, and reflected in, the agreement in a correct manner.

j. Specific Indemnities

Specific indemnities often include any specific issues uncovered during due diligence, as well as tax indemnities and risk exposure that may be realized in the future, such as pending disputes or risk exposures in respect of environment.

k. Covenants

Under seller's covenants, the buyer will normally require that, during the period between signing of the share purchase agreement and closing, the target company will, for example:

- Conduct its business in the ordinary course consistent with past practice.
- Not pay any dividends.
- Not borrow any additional funds from banks or other external sources, except in the ordinary course of business and not enter into any agreements or purchase any assets with a value exceeding a specified amount.
- Not increase the rates of compensation (including bonuses) to any employee, independent contractor or consultant.
- Not terminate any material agreement.
- Not be dissolved or liquidated or merged into another company.
- Not change accounting principles or working capital policies or practices.

l. Escrow Release

The conditions for the release of the escrow amount are stipulated in the share purchase agreement. When the parties are in agreement that the conditions are fulfilled, the parties will sign a joint instruction to the bank in accordance with the escrow agreement. In the event of disagreement, the bank will only release the escrow amount upon receiving an arbitration award that indicates which party is entitled to the escrow amount.

m. Governing Law and Disputes

A Swedish share purchase agreement is usually governed by Swedish law, although the only mandatory requirement is that the agreement should not violate mandatory Swedish legislation such as mandatory provisions in the Swedish Companies Act (e.g. the rules on financial assistance).

However, in a cross-border transaction the International Sale of Goods Act (CISG), may be applicable and sometimes other choice of law principles may also come into play, unless otherwise agreed. Therefore, it is often stipulated that Swedish substantial law shall apply without reference to any choice of law principles.

Disputes are normally stipulated to be solved through arbitration and often with a reference to the rules of the Arbitration Institute of the Stockholm Chamber of Commerce (www.sccinstitute.se).

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