Share Purchase Agreements in Sweden

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This paper has been prepared for purpose of describing the Swedish M&A market and in particular issues a foreign acquirer in Sweden should be aware of in negotiating the acquisition document in the environment of Swedish law, culture and traditions. Specific rules applicable to listed companies are not described herein. The paper is generally held and does not substitute the need for advice in any specific case.

1 GENERAL

The Swedish market is easily accessible to foreign investors for a number of reasons. Certain restrictions still customary in some other jurisdictions were in Sweden abolished a long time ago, such as foreign currency control, restrictions on foreign acquisition of Swedish real property, requirement of approval for foreign individuals' and entities' acquisition of shares in Swedish companies.

The Swedish market can also be said to be quite mature and sophisticated as a result of a large number of acquisitions and investments by foreign buyers and investors over the years, and also due to a number of large domestic private equity-players having shaped the market. Therefore a number of international customs and not least Anglo-Saxian features are widely accepted on the market, including of course extensive due diligence but also agreements in a format familiar to international investors. This being said, Swedish law is by far predominant as the governing law for acquisition agreements and an Anglo-Saxian investor will find it difficult to convince a Swedish party to accept an agreement with a pure Anglo-Saxian style of wording. There are also a number of features of more local character that a foreign party should be aware of and consider for a successful and smooth investment.

2 BUSINESS ENVIRONMENT AND CULTURE

The Swedish business environment is generally quite open and transparent; "open" meaning that Swedish businesses welcome international investment and take global interaction, as well as competition, for granted. Swedish business peoples are also quite accessible, though one shall be aware that there are old structures which it may be hard to pierce through.

Information held by the authorities, and any communication with them, are as a general rule publicly available and only as an exception subject to confidentiality. For example it

is easy to search company records held by the company registration authority and other public records. Another effect of the public records is that any correspondence with the authorities normally would be easily accessible to third parties.

Negotiations are typically on friendly terms with an aim to reach a common understanding as quickly as possible. The parties would normally not take extreme positions for purpose of later compromising on a common ground, but rather propose a more realistic approach - though not necessarily fully what the party may believe will be the finally agreed solution.

3 REGULATORY RESTRICTIONS

Generally, foreign parties are permitted to invest in Sweden without seeking permission from the Swedish government or any Swedish authority. It has not been considered necessary to restrict the access to Swedish assets for foreign investors, except in certain limited cases e.g. the manufacturing of war material.

There are also a couple of business sectors reserved for Swedish state controlled monopolies, e.g. sale of alcohol to consumers, and the management of the national power grid.

There are also certain business sectors that are regulated and for which reason acquisitions and investments may require permissions, concessions or the like. However, such regulations apply equally, and on a non-discriminatory basis, to Swedish and foreign investors. The regulated business sectors includes the banks, insurance companies, investment funds and other financial institutions, broadcasting and electronic communication including mobile phone network concessions.

4 DUE DILIGENCE

It is customary for the buyer to conduct a comprehensive due diligence but the reports are generally on a “red flag”-basis meaning that only matters deviating from what typically would be expected are mentioned in the report.

When the seller prepares for selling in the form of a controlled auction, it is also common that the seller undertakes a due diligence and makes the report from such vendor due diligence available to the bidders. Such report are typically more generally held than the report prepared on behalf of the buyer. I would also claim that it has become less common that the buyer is granted the right to rely on the vendor reports. The vendor report is rather serving as a background and introduction to the target company and its business in a manner similar to an information memorandum. It may still be relevant for the buyer to have the seller warrant that the reports to its knowledge are materially correct.

5 CONTRACTUAL ASPECTS

5.1 Calculation of purchase price and locked box

The calculation or adjustment of the purchase price is obviously a matter of particular interest for both parties. Typically one could say that it is the financial situation of the target at the time of closing that should be relevant for what price shall be paid. To the extent the booked values on assets and liabilities in the balance sheet are relevant it

would then be logical to determine the final purchase price based on the balance sheet, and then typically the items comprising the working capital, at the time of closing, and to provide for an adjustment of the purchase price after closing should the balance sheet deviate from the pro forma balance sheet used for the preliminary calculation of the purchase price. Over the years these adjustment to be made after closing have given rise to many complex and lengthy disputes.

In order to avoid complex adjustments, it has in the past decade been common to base the purchase price on the latest audited annual accounts, and for the period thereafter adjust the purchase price with an agreed interest rate, calculated from the date of the latest audited accounts, also referred to as the locked-box date, until closing. Such interest is intended to reflect the expected profit during said period. This locked-box arrangement would also include covenants by the seller not to take any dividend, make distributions or otherwise take actions outside the ordinary course of business, also referred to as leakage. This could be said to give rise to greater certainty for the seller, but also buyers tend to be agreeable to a locked box arrangement as a matter of simplification and greater foreseeability.

Earn-out transactions may in Sweden not be as common as in the U.S., but an earn-out is often introduced as a way to bridge the gap between the buyer's and the seller's expectations and valuation of the business.

5.2 Warranties

A Swedish share transfer agreement as well as a business transfer agreement would generally speaking have the form and content most international player would expect. This being said the civil law traditions tend to lean towards a shorter and more "compact" format than typically is the case in the anglosaxian world. A Swedish agreement would also in a format be closer to the U.S. style agreement than the UK style agreements. The scope of the warranties would typically be fairly comprehensive, but there may be more of a focus on generally worded warranties with broader coverage than a larger number of more specific and detailed warranties. Swedish contract law allows for a fairly extensive interpretation of the contract wording, because the wording of the contract serves only as evidence of the parties' intention. It is the parties' intention that constitutes the parties' agreement. Nevertheless, it would be difficult (not to say impossible) to successfully bring evidence to the effect that the parties' agreement deviates from clear and unambiguous terms set out in a written contract.

There are areas where the warranties in a Swedish agreement would appear insufficient for a buyer being used to a different regulatory environment. This would not least be the case when it comes to pension and certain employment matters such as social security. Pensions are with few exceptions fully funded and nowadays on a defined contribution basis, rather than a defined benefit basis. It is therefore fairly unusual with issues arising in this areas, though it is still important to have relevant warranties covering also pensions.

5.3 Other risk allocation under the warranties

It is most common that the buyer becomes liable for warranty claims only after a basket amount has been reached, and once such amount is reached the buyer is liable for the full amount of the claims. This is often called a tipping basket. A basked serving as a deductible making the seller liable only for the excess would be less common.

Liability caps is typically lower in a larger and more substantial transaction than in a small transaction, and would in any case typically range anywhere from 10% to 50%.

Limitation periods would normally be somewhere between 12 and 24 months with 18 month being the most often seen compromise.

5.4 Conditions precedent

There is a tendency in Sweden for the contract to reflect a great degree of deal certainty in that there are normally only few conditions allowing the parties not to proceed to closing. Typically, there are only conditions for mandatory regulatory approvals and merger filing. However, there are an increasing number of deals with more buyer friendly conditions, such as material adverse change in the business and no breach of warranties. A buyer should still expect a great deal push back from Swedish sellers faced with such conditions. Also financing conditions are not common.

In this context, it should be mentioned that break fees do exist and in principle are permissible under law, but they are not common.

5.5 Buyer's knowledge and anti-sandbagging

Another important aspect of negotiating warranties in a Swedish deal is that a Swedish party would not expect the buyer to be entitled to claim under the warranties with regard to any claim or discrepancy of which the buyer had knowledge at the time of signing. However, freedom of contract applies and, if the claim is based on a warranty or other contract wording, the effect of the knowledge would largely depend on how the warranty provisions, indemnities and other provisions have been worded. For this reason, it is customary to explicitly set out in the purchase agreement what effect the knowledge of the buyer shall have. As a result a substantial amount of time is often spent on negotiating the definition of "knowledge". It is fair to say that it is customary for "anti-sandbagging" provisions to be included in the purchase agreement, i.e. the buyer accepts that his actual knowledge of a circumstance, and that such circumstance gives rise to a claim, will prevent such buyer from effectively making a claim. It is not unusual to state in the contract that also "what the buyer should have known upon reasonable inquiries or after making a customary due diligence" will prevent the buyer from making a claim.

For known risks, the buyer would include a specific indemnity in the agreement, rather than relying on a warranty, which under law or due to anti-sandbagging provision may be ineffective due to the buyer's knowledge.

5.6 Restrictive covenants

The seller would typically be asked, and agree to, undertake not to compete with the target's business or to solicit its employees or customers for a period after closing. Such undertaking is permissible and enforceable under certain conditions. Generally speaking, a non-compete shall be limited to the scope of the business acquired and also to the geographical areas (countries or part of countries) where the business has been conducted. It should also normally be limited to 2 years but may be extended to 3 years if material know-how is included in the transaction.

5.7 Dispute resolution and choice of law

Agreements in an M&A transaction would normally refer to arbitration as dispute resolution. The reason is primarily confidentiality, speed, competence and arguably also costs. As an effect of traditionally more complex commercial disputes including share

and business transfers being resolved in arbitration, courts have limited experience from this kind of disputes. Furthermore, in arbitration the parties may ensure that experienced arbitrators are appointed. Even if arbitrators are costly, it may be more cost effective with a focused arbitration with no regular right to appeal, than a court proceeding which after judgment in lower court may be appealed.

If the target is a Swedish company, it is with few exceptions accepted that Swedish law would govern the agreement. The parties are however free to choose other governing laws and such choice would under Swedish choice of law rules be upheld at least between commercial parties.

5.8 Miscellaneous

There are no rules as to the form of a contract for sale of shares or most business assets (other than real estate). Specifically, it shall be noted that no notarisation is required, and no stamp duty or other levies are imposed sale of shares or assets (other than real estate).

6 REPRESENTATIONS & WARRANTIES INSURANCE

The use of representations & warranties insurance ("RWI") has increased over the years and the increase has further accelerated in the last couple of years. RWI became relevant on the Nordic markets earlier than on many other markets and then not least among financial investors. To the benefit of the insured the number of underwriters offering RWI is increasing and the rates have come down and are now normally around or below 1.5 per cent and sometimes as low as below or around 1 per cent of the insurance limit, of course always depending on factors such as the insurance limit, the enterprise value, amount of retention to be assumed by the insured as well as the breadth of warranties and disclosure.

The RWI was previously often a buy-side insurance introduced into the transaction at a late stage because the parties could not agree on the scope of the warranties, and in particular on the maximum amount of liability and the survival period for the warranties. However, it is now more common that it is arranged as a buy-side stapled insurance made available to bidders in an auction process.

The insurer's appetite for taking on risk has also increased with competition on the market. Certain risks not accepted by the insured to cover, e.g. some "known risks", or only under separate cover and/or at a higher price, are now more often covered by the regular RWI cover.

When considering an RWI it shall be noted that the process of pricing and documentation of insurance terms typically may require as little as ten days to two weeks, but in other cases it may take longer. The insurer will need to become comfortable with the risk. It is therefore crucial that the due diligence and disclosure exercise has been sufficiently thorough in relation to all risks warranted. The insurer would more easily become comfortable if the seller himself is at some risk, i.e. the insurance is not kicking in until the seller has indemnified part of the damage due to a warranty breach, because the warranties can then be assumed to have been carefully tailored to limit liability and the disclosure process to have been thorough.

7 MERGER FILING

Under the Swedish Competition Act, a mandatory advance notification to the Swedish Competition Authority (SCA) is required when certain turnover thresholds are met as set out below. In the past couple of years, the SCA has caused uncertainty in the processing of merger reviews by exercising its right to require a notification of a transaction also in cases where only the first turnover threshold below is met (and where particular grounds exist for doing so). The parties will therefore now be advised to more carefully consider whether to make a merger filing also when only the first turnover threshold is met (voluntary filing). Otherwise, the parties risk the transaction being challenged after closing and the authorities may eventually declare the transaction void and thereby causing it to be wound up. The SCA encourages pre-notification contacts with the authority.

The turnover thresholds for a mandatory filing to the SCA are as follows:

(1) the combined aggregate turnover in Sweden of all the undertakings concerned exceeds SEK 1 billion in the preceding financial year; and

(2) each of at least two of the undertakings concerned have a turnover in Sweden exceeding SEK 200 million in the preceding financial year.

The SCA has 25 working days (Phase 1) to issue a decision either to take no further action or to initiate a special (in-depth) investigation. During this 25-day period the parties are not allowed to take any actions to complete the transaction (the “stand still” period). The Phase 1 period is prolonged to 35 working days if the SCA receives a commitment that enables the SCA to leave the transaction without any further actions.

The SCA may also initiate a special investigation (Phase 2) and then the review period is extended with an additional three months (and may be further extended). At the end of the review period, the SCA must decide either to approve the transaction or to apply to the Patent and Market Court for a prohibition of the transaction. Both the time limits in Phase 1 and Phase 2 may temporarily be suspended, “stopping the clock”, if a party to the transaction has not complied with an order from the SCA on, for example, providing certain information.

A transaction may be prohibited if it would significantly impede effective competition within Sweden as a whole or a substantial part of the country, in particular as a result of the creation or strengthening of a dominant position. If a transaction is prohibited it becomes void. A third party cannot appeal an approval of a transaction.

Also, the competition law regime of the European Union (“EU”) applies in Sweden in accordance with applicable EU regulations.

8 EMPLOYMENT LAW

8.1 Employees right to transfer with the business

The sale of a company or its business often has an impact on the employees. If the transaction is structured as an asset deal, the rules on transfer of undertaking will apply and, if the transferred business retains its ‘economic identity’, the employees will normally have a right to transfer their employment to the buyer on unchanged terms. As provided under EU-law, the employees’ rights are mandatory. The rules on transfer of undertaking will also apply in other situations, such as outsourcing or transfer from one

service provider to another. Swedish law has, in this regard, fully implemented the EU-directive 2001/23/EC.

Except in very specific situations, the seller is not before the transfer permitted to carry out dismissals based on redundancies occurring as a result of the transfer. Consequently, the buyer must normally deal with any such redundancies subsequent to completion of the transaction.

Even if economic reasons in principle always constitute "just cause" for dismissal due to redundancy, the rules for determining which employees to become redundant are very strict. The basic principle is that the employee with the longest aggregate period of employment with the company should be the last to become redundant. This is also referred to as the principle of "first in, last out". Employees are also entitled to continued employment if they have "sufficient qualifications" for any other positions within the company.

If two undertakings have been merged, transferred employees are entitled to count their aggregated tenure in both companies. As a result of this rule, the transferee will face a situation where the newly transferred employees will be able to "compete" with the employees of the buyer employed already prior to the transfer. This will complicate the selection in subsequent redundancies in the buyer's business.

8.2 Consultation with unions

A transfer of any or all shares or otherwise of ownership of a company or legal entity will not give rise to a duty to negotiate or consult with the unions. However, in case of a transfer of business, the employer is obliged to carry out consultations with the unions that have a collective agreement with the company, or that has members at the company, and such consultations must take place already before a decision to transfer the business is taken. The same applies before a decision is taken to restructure a company or declare employees redundant. Such consultations are carried out with the unions, rather than with works councils. The duty to inform and consult with unions applies also if there is only one employee affected by the transfer or the redundancy. Thus, from this perspective the Swedish legislator has implemented EU-law more strictly than required. Since EU-law requires such consultations only if the number of affected employees is at least 50.

The unions have a right to be with consulted and informed, but are not required to approve of the transaction. Once the consultations have come to an end because the unions have received information and been given an opportunity to discuss, the employer has the power to make the ultimate decision and the unions have no further say or veto. If the employer fails to consult with the unions, it will not delay of affect the validity of the transaction, but might entitle the unions to damages.