GETTING THE DEAL THROUGH

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in 33 jurisdictions worldwide

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1 Types of private equity transactions

What different types of private equity transactions occur in your jurisdiction?

The Swedish private equity market is characterised as highly developed and attractive to investors even in comparison to other, more established private equity markets. It encompasses all existing types of private equity and venture capital transactions, ranging from buy-outs by private equity houses, seed and growth investments by venture capital houses to public-to-private transactions of large listed companies as well as venture capital houses specialised in purchasing whole portfolios of companies.

2 Corporate governance rules

What are the implications of corporate governance rules for private equity transactions? Are there any advantages to going private in leveraged buyout or similar transactions? What are the effects of corporate governance rules on companies that, following a private equity transaction, remain or become public companies?

As in most countries, Sweden has in recent years had a continuously growing debate regarding corporate governance and transparency in the private equity and venture capital industry. Although there are, as of yet, no statutory transparency or particular corporate governance rules in force for the private equity and venture capital industry, on 11 November 2010 the European Parliament voted on and approved a directive on alternative investment fund managers (the AIFM Directive). The final version of the AIFM Directive is expected to be published in the Official Journal of the European Union during the first quarter of 2011 and will enter into force at EU level on the twentieth day following the publication. The AIFM Directive shall thereafter be transposed into the EU member states' national law within two years after its entry into force (ie, the AIFM Directive is expected to be implemented in Sweden during the first quarter of 2013). The Commission, together with the European Securities and Markets Authority, will during the implementation phase shape and determine the practical application of the AIFM Directive by further clarifying and defining several of the provisions.

The alternative investment funds (AIF) that will fall under the AIFM Directive are defined as all funds that are not regulated under the UCITS Directive (2009/65/EC) and include hedge funds and private equity, as well as real estate funds, commodity funds, infrastructure funds and other types of institutional funds. The AIFM Directive applies to all AIF regardless of where an AIF itself is established, while it only applies to alternative investment fund managers (AIFM) established within the EU.

According to the AIFM Directive, it aims to establish a secure and harmonised EU framework for monitoring and supervising the risks that AIFM pose to their investors, counterparties, other financial market participants and to financial stability while permitting AIFM to provide services and market their funds across the internal market (only, however, to professional investors). In practice, the AIFM Directive imposes strict requirements on AIFM operating within the EU. For example, all AIFM will be required to obtain authorisation from the competent authority in their home member state to be allowed to operate within the EU. Further, the AIFM Directive stipulates certain rules regarding risk management, liquidity, minimum level of capital, fair valuation of assets and also, in relation to the competent authority, far-reaching disclosure obligations. From a private equity point of view, the AIFM Directive stipulates certain disclosure requirements to other shareholders and representatives of employees of a portfolio company in which the AIFM has acquired a controlling interest, and also annual announcements on investment strategy and fund strategies and objectives including disclosures regarding performance of portfolio companies post-acquisition.

The AIFM Directive has been subject to somewhat harsh criticism. The Swedish Venture Capital Association (SVCA) has, in its comment on the AIFM Directive, stated that although the private equity and venture capital industry supports regulation in general, the AIFM Directive assumes that all different types of alternative investments shall be subject to the same requirements and that the AIFM Directive with its current wording implies a 'one size fits all' regulation. SVCA deems the 'one size fits all' approach unfortunate since there are several big differences between the different types of AIF, especially between private equity funds and hedge funds. The 'one size fits all' regulation may also have disproportionate impact on smaller funds in terms of increased administration and may have negative effects on small and medium-sized enterprises' access to risk-willing capital for expansion.

In terms of corporate governance for publicly listed companies compared to privately held companies it may be noted that, since 1 July 2005, all Swedish limited liability companies whose shares are traded on regulated markets in Sweden shall apply the Swedish Code of Corporate Governance (the Code) in addition to requirements that stem from the Swedish Companies Act and other stock market regulations. At present, these markets are Nasdaq OMX Stockholm and NGM Equity. The Code currently applicable consists of the revised Code that came into effect on 1 July 2008, including all instructions that have thereafter been issued by the Swedish Corporate Governance Board. However, as from 1 February 2010 a new revised Code has come into effect.

As already mentioned, the Code applies to all Swedish limited liability companies whose shares are traded on regulated markets in Sweden. It is worth noting that the Code is based on the 'comply or explain' principle, which means that companies that are obliged to adhere to the Code under certain circumstances can choose not to comply with the Code in some respects. The company must clearly state that it hasn't complied with the Code, in which respects it hasn't complied and the reason for non-compliance, including a description of the alternative approach that the company has chosen.

According to the Swedish Corporate Governance Board, the revised Code aims at improvement of confidence in Swedish listed companies by promoting positive development of corporate

governance in these companies. However, compliance with the Code implies a higher administrative burden and thus higher costs for corporate governance in the companies listed on regulated markets compared to similar costs in non-listed companies. Going private in a leveraged buyout or similar transaction can therefore give the company in question a reduced amount of administration, not only in relation to the stricter reporting requirements, etc, that apply to listed companies, but also in relation to adherence to the Code. Some representatives of the private equity industry have therefore even stated that the Code provides a competitive advantage to the private equity industry compared to the stock markets. However, as stated above, the AIFM Directive may change that.

Further, in relation to an exit by a private equity or venture capital house through an IPO of its portfolio company, the company subject to the IPO will need to prepare for going public which, in addition to preparing for stricter regulations on reporting, etc, also means adapting to be in compliance with the corporate governance regulations of the Code before being listed on a regulated market.

3 Issues facing public company boards

What are the issues facing boards of directors of public companies considering entering into a going-private or private equity transaction? What is the role of a special committee in such a transaction where members of the board are participating or have an interest in the transaction?

The individual members of the board of directors of a public company considering entering into a going-private or private equity transaction must determine if and to what extent they can and shall assist in the transaction or if they have a conflict of interest. In general, the board of directors takes part and assists in the transaction, except for any potential board members of the target company that do have a conflict of interest. If a board member in a target company has an interest in the bidder or in a competitive bidder, for example, such director may not participate in the handling of an issue relating to the bid. The board of directors in these types of transactions is not required to appoint a special committee. However, if any of the board members is making or participating in a public offer, the target company must obtain and make public a valuation opinion from an independent expert regarding the company's shares. The expert commissioned to produce a statement of opinion of this nature must have an independent status in relation to the bidder. This means, for example, that the payment for the opinion may not involve a 'success fee'.

Since the board of directors normally has an in-depth knowledge of the business conducted by the company, it is of great importance when evaluating a bid as such. The new Swedish takeover rules that have been adopted by NASDAQ OMX and Nordic Growth Market NGM and entered into force on 1 October 2009 clarify that the board of directors in the target company must act in the interest of the shareholders in connection with a public offer. The board may not act in its own interest or allow itself to be steered by the interest of a single shareholder or certain shareholders. Similarly, if there is more than one bidder the board may not favour any particular bidder. If the bidder requests a due diligence investigation of the target company, the board of directors of the target company must decide whether the company can and should participate in such investigation, and if so, on what terms and to what extent. The board should endeavour to restrict the investigation to factors relevant to issuing and implementing the offer. Relevant legislation such as the Swedish Companies Act, the exchange rules and the insider trading rules must be taken into account when making such evaluation.

The board of directors must announce its opinion on an offer, stating the reasons for its attitude. According to the new takeover rules, such announcement must be made no later than two weeks prior to the expiry of the acceptance period.

In general, there are also confidentiality issues in relation to the potential bidders that need to be considered by the board of directors in any type of private equity transaction.

4 Disclosure issues

Are there heightened disclosure issues in connection with going-private transactions or other private equity transactions?

No, according to Swedish law there are no heightened disclosure issues in connection with private equity transactions in general. However, in relation to going-private transactions please see question 3 and the commentary on due diligence investigations. Furthermore, it should be noted that if the public company during such investigation supplies the bidder with information that has not been made public, and this information is likely to affect the valuation of the company's shares, the target company must ensure that this information is made public as soon as possible.

5 Timing considerations

What are the timing considerations for a going-private or other private equity transaction?

Typically, there are no timing considerations specific to a going-private or other private equity transaction except that, although not specific for private equity transactions, if a public bid (ie, an offer document) is published in a public-to-private transaction, there is a minimum acceptance period of at least three weeks or, if a member of the board of directors is making the bid, the minimum acceptance period is four weeks. In addition, a bidder has to complete an offer document to be registered with the Swedish FSA within four weeks after the offer is made public. Before a bid is made public, any potential bidder must provide a written statement to the stock exchange (there are two in Sweden: NASDAQ OMX and Nordic Growth Market NGM) that it will adhere to all legal requirements, as well as inform the FSA that the statement is made. Normally the FSA will register an offer document within 10 business days.

The timeline is thus:

- regarding filing with the stock exchange confirmation of adherence to all legal requirements by the offeror –
  - day 1, publication of the bid;
  - day 1 + maximum 4 weeks, filing of offer document with the FSA;
  - day 1 + 4 weeks + maximum 10 business days, review and approval of offer document by the FSA; and
  - day 1 + 4 weeks + 10 business days + minimum 3 or 4 weeks, acceptance period.

Finally, it can be mentioned that according to the new takeover rules, a bidder that fails and does not fulfil the offer is not allowed to return with a new bid on the same target company within one year.

6 Purchase agreements

What purchase agreement provisions are specific to private equity transactions?

As a result of the current financial turmoil, the private equity market and the M&A market in general have experienced a shift from a more seller-friendly market to a more purchaser-friendly market during 2009 and 2010. To some extent, this shift affected the terms of the private equity transaction agreements – that is, the private equity transaction agreements overall became more purchaser-friendly. Although several factors indicate an improvement in the M&A market during 2010, it is still too early to say if or when such market improvement will affect the terms and conditions of the private equity transaction agreements, thus affecting the balance between the seller and the purchaser.

In general and from a purchaser's perspective, it is typical to request that the purchase agreement contains a condition precedent to closing in relation to the purchaser's ability to finance the deal; namely that if the purchaser is not able to raise financing, it shall have the possibility to withdraw from the deal even though an agreement has been signed, without any obligation on behalf of the purchaser. However, a seller – whether a private equity house or a strategic seller – will try to limit the purchaser's possibility to withdraw from the transaction following signing. Since it is in the interest of both parties that financing is obtained, some sort of confirmation from the proposed debt provider is often sought prior to entering into a purchase agreement, although this is not always possible to get in a form binding to the debt provider. In recent times, with a more hesitant credit market, it is safe to say that a private equity buyer has not been able to sign a deal without a financing condition unless the financing package has already been in place at the time of signing.

A private equity buyer normally focuses heavily on the target's existing indebtedness, partly because it is often an important part of the purchase price calculation and partly because the existing indebtedness is typically refinanced in connection with closing. Therefore, the existing indebtedness is an important element in the private equity house's financing of the transaction. If the seller is a private equity house, the purchase agreement typically contains provisions regarding escrow of part of the purchase price to be used against any claims in relation to representations and warranties. Normally, the size of the escrow would equal the maximum cap on liability with certain exceptions, for example, in relation to warranties on due authorisation and ownership. The size of the maximum cap varies depending on market conditions and the negotiating strength of the parties involved. The agreement will also contain representations and warranties from the seller in relation to the target company and the business conducted. If the due diligence performed by the purchaser reveals any risks or exposures for the purchaser, the seller is likely to have to indemnify the purchaser in this regard by way of 'specific indemnities' in the share purchase agreement. In conclusion, given the current market situation with less competition for the investment objects, the purchaser is likely to be in a better position to negotiate favourable agreement terms at the expense of the seller. However, as the M&A and private equity market improves, resulting in more competition for assets to be sold, that may change.

Typically, purchase agreements do not contain any covenants related to financing since such covenants are normally part of the financing documentation (ie, as part of the credit facility arrangement between the debt provider and the purchaser). In respect of such covenants, however, it can be said that the financial turmoil has brought back focus to the covenants in credit facility agreements and the concept of 'covenants light' is no longer the market standard on the Swedish market.

7 Participation of target company management

How can management of the target company participate in a going-private transaction? What are the principal executive compensation issues?

The rule of conflict of interest described in question 3 also applies to the managing director of the target company. Hence, if the managing director has an interest in the matter owing to a common interest with the bidder that is in conflict with the interest of the shareholders, he or she may not participate in the handling of an issue related to the bid. It is not possible to clearly state in what situation a conflict of interest would occur but this has to be determined from the circumstances in each individual case. One example of such common interest would be if the managing director is also the owner of the company making the bid.

8 Tax issues

What are the basic tax issues involved in private equity transactions? Give details regarding the tax status of a target, deductibility of interest based on the form of financing and tax issues related to executive compensation. Can share acquisitions be classified as asset acquisitions for tax purposes?

Transfer of shares in a target company is the most widely used structure in private equity transactions in Sweden, as opposed to a transfer of the assets of the target company or companies. In such share transfers the seller divesting the shares may benefit from the participation exemption, making any capital gains on the divestment tax-exempt. This is the case if the seller is a qualifying entity such as:

- a Swedish limited liability company (AB) or a Swedish economic association that is not an investment company;
- a Swedish trust or a Swedish non-profit association that is subject to unlimited tax liability;
- a Swedish savings bank;
- a Swedish mutual insurance company; or
- a foreign company resident within the European Economic Area (EEA) that is the equivalent of a legal entity mentioned under the four categories above and is subject to corporate income tax in Sweden.

Further, although not expressly listed above, a *societas europaea* (SE) is also considered as a qualifying legal entity due to a general provision in the Income Tax Act stipulating that an SE is treated as a Swedish limited liability company.

As an alternative, shareholders who do not qualify for the participation exemption can obtain a tax deferral (this refers to individuals (eg, management owners) and to interests that are less than 10 per cent in a listed company). The Swedish participation exemption is applicable for 'business-related shares'. A share in an unlisted company is always regarded as a business-related share, irrespective of the size of the holding and the length of the holding period. By contrast, a share in a listed company is regarded as a business-related share only if the holding represents at least 10 per cent of the voting rights or if the holding is otherwise deemed necessary for the business conducted by the owner or any of its affiliates. Also, the holding in listed companies must fulfil two additional conditions: the shares must have been held for a period of one year, and the shares must have been regarded as business-related shares during this period.

As a result of the introduction of the participation exemption regime, capital losses realised on business-related shares are not tax-deductible. For other shares, to which the participation exemption does not apply, a tax deduction is available within certain limits.

When the participation exemption was introduced, the government specifically discussed the possibilities, under the legislation, to package valuable assets, businesses and real estate into an AB as a way to avoid tax. The government's standpoint was and still is not to introduce any legislation hindering packaging. 'Packaging' is based on the possibilities to move tangible and intangible assets from one company to another without triggering tax and has been used frequently since the participation exemption rules were introduced. An entire market has developed within this area, particularly for the packaging of real estate. A common structure is to push down real estate into a subsidiary, in the form of an AB, and then sell the shares of the subsidiary to the buyer. The pushdown is subject to certain limitations. The whole structure is based upon the possibility to transfer assets without any tax being imposed on the level of the transferor. In those cases, the assets are sold to a company within a company group for a price equal to the book value. Such a transfer can always be concluded if the companies involved qualify for intra-group contributions. In other cases, it is only possible to make a tax-exempt transfer if the entire business is transferred or if a specific division, which is conducted as a separate business and which can function as a stand-alone entity, is transferred. In many cases, real estate is allowed

to be spun off as a separate business and can therefore generally be transferred at book value without triggering taxation.

The lack of thin capitalisation rules, the unlimited deduction of interest payments, the lack of withholding tax on interest payments and the participation exemption all support highly effective cross-border financing structures using a Swedish company, both as a traditional holding company and as a group financing company. Interest payments may flow to any jurisdiction in the world without triggering withholding tax. The only limitation that applies for a full interest deduction is when the interest paid exceeds the market interest rate in the country from which the loan originates. The priority of the underlying debt does not affect interest deductibility per se, but from a transfer pricing perspective, a subordinated loan may motivate a higher interest rate than senior debt and the priority of the debt may therefore indirectly affect interest deductibility. From 1 January 2009 limitations regarding deductions of interest apply between related companies. The limitations apply if the interest-bearing debts originate from the acquisition of shares from a related company (or other ownership instruments). However, the limitation does not apply if the interest is paid to a related company in a country in which the interest would be subject to an income tax rate of at least 10 per cent or it can be proven that the main reason for the acquisition and the debt structure is based on business reasons. If the limitation applies the interest will not be tax-deductible.

A way of financing an acquisition of shares can be made in the form of profit participating loans. Until 1 January 2006 companies were not allowed to use profit participating loans under which the repayment of the loan was related to the profit of the company, to the distribution of dividends to the shareholders or to the financial position of the company. The only available form of such a loan was a loan with an interest rate being set in relation to the profit or the distribution of dividends of the company. A participating loan, as it now exists under Swedish law, is a debt instrument in which the underlying obligation to repay the capital amount of the loan, in whole or in part, is made dependent upon economic factors such as dividend distributions, the share price at a particular time, the issuer's profit level or its financial position taken as a whole.

This new opportunity to issue participating loans will enable Swedish companies to issue an instrument that, from a financial perspective, in all material aspects can be made to resemble an equity-related instrument (shares, etc). However, note the very significant exception that the participating loan will not allow its holder any administrative rights (eg, voting rights and other shareholder rights).

The tax treatment of the two forms of participation loans differs. With respect to loans with an interest set in relation to the profit of the company, the interest is fully tax-deductible for the borrower and treated as taxable interest income for the lender. However, there is a limitation with respect to the deduction of the interest if either of the following is the case: the loan has not been issued on the market, or the loan has been issued to shareholders, management or relatives of the shareholders or management in a closely held company.

Limitations also apply if the loan has been issued to a limited group of people who are shareholders in the company, to the management of a closely held company, to certain community-of-interests groups (such a group exists if a person, directly or indirectly, participates in the management or the supervision of another person's company or owns part of the equity in such a company; or the same group of people, directly or indirectly, participates in the management or supervision of both companies or owns part of the equity in any of these companies) or to individuals who are relatives of the first two groups. If limitations apply, the interest will not be tax-deductible.

Regarding a loan under which the repayment of the principal depends on the results of the borrowing company, any interest on the loan is treated in the same way as that on any other loan (ie, as a tax-deductible cost for the borrower and as taxable income for the lender). A profit or loss made in connection with the repayment of the loan itself is neither taxable income nor a tax-deductible cost for the borrower. For the lender, the profit is taxable and the loss is tax-deductible. A limitation also applies to losses if the loan is given to a company in community of interests (the term 'company in community of interests' refers to companies within the same group of companies or companies that are generally managed by the same management).

Interest received by a Swedish company is taxed at the normal corporate tax rate of 26.3 per cent. Interest income can be set off by interest payments or any other costs in the company.

If an acquisition is made through an acquisition vehicle, a 'BidCo', and is financed through loans, the BidCo can in practice deduct the interest payments made on such loans against group contributions made from the target companies to the BidCo.

The participation exemption is of vital importance for the private equity and venture capital investment business community. With few exceptions, the vehicle that has historically been used frequently in Sweden for fund structuring Swedish private equity funds is a limited partnership (KB). Under such a structure each partner accounts for the result of the KB based on the partners' agreement. This route has for a number of years been less suitable to a large number of investors, as the partnership has not qualified for the participation exemption. To benefit from the participation exemption, some of these investment structures have been structured through a Swedish company limited by shares (an AB). Using an AB fund structure, tax should in principle only be levied at the target level. The income flowing up through the Swedish AB to the investors may not be subject to tax at all under the participation exemption and the withholding tax legislation. Dividends from the target companies to the BidCo are normally tax-exempt. Further, the AB BidCo will not be levied capital gains tax upon a divestment of shares in a target company. However, from 1 January 2010 Sweden changed its tax legislation and now allows partnerships the same tax treatment as ABs with respect to the participations rules. The KB structures are now, from a Swedish tax perspective, therefore open again for investors.

The acquisition of a target company may be structured in different ways, and in most cases it will be advantageous to set up a special purpose vehicle as a BidCo for the acquisition, which may also be a requirement – or at least the preferred route – under the fund agreement in order not to have the fund itself as a party to the transaction documents.

In some instances it may be advantageous to acquire the business, namely the assets and not the shares, of the target company. The advantage, other than tax, of acquiring the business is that only identified assets and liabilities of the target company will be acquired, leaving behind primarily all hidden liabilities, which can be defined as liabilities not known by the parties at the time of the transaction but existing as such. On the other hand, from a seller's perspective, such a transaction will be a taxable event in the target company, which otherwise could have been avoided by selling the shares. If the target company has accumulated losses, the profit made in connection with the sale of the assets can be set off by the seller in whole or in part. From a tax perspective it is usually advantageous for the buyer to acquire the business of the target company, as there can be a step-up in tax basis of the acquired assets; any unallocated purchase price, namely the part of the purchase price that could not be allocated to specific assets, is identified as (depreciable) goodwill. The step-up enables the acquirer to depreciate the full value of the acquisition over a limited time – usually five years. It could be that the private equity fund may not, under its fund agreement, or may not wish to, acquire assets directly, in which case a 'pre-pack' by way of an asset transfer to a special purpose vehicle can be made by the seller, whereafter the shares in the special purpose vehicle are acquired.

The acquisition of a business can also be carried out as a transfer of assets in exchange for newly issued shares in the buyer. Provided some conditions are fulfilled, such a transaction does not lead to any immediate tax consequences for the seller. Hence, the assets transferred do not cause a step-up in tax basis for the purchaser.

The acquisition of shares may in some instances be less advantageous for the buyer, since a buyer cannot amortise the goodwill. Any goodwill paid for is not treated separately from the remaining part of the purchase price. Moreover, depreciation of business-related shares is not allowed. Nevertheless, acquisition of shares is the most common way to structure a private equity transaction in Sweden. Reclassification of a share acquisition as an asset acquisition for tax purposes is not possible under Swedish tax law.

In most private equity transactions the private equity fund will invite (and in fact require) that the management of the target company invests in the BidCo either by acquisition of shares or other securities, sometimes in connection with shareholder loans. Caution is required when preparing management participation agreements related to such securities as there are currently a number of ongoing disputes with the tax authorities on what type taxation will be triggered by provisions linked to the employment and transfer restrictions, etc. The Swedish tax authority's point of view is that provisions linking rights related to security instruments to employment render benefits related to the security taxable as employment income. In December 2009, the Supreme Administrative Court decided upon two cases regarding a linkage between shares received by a management and certain restrictions in the form of limitations to control the shares and to maintain the employment for a certain period of time. The main issue at hand was the timing of the taxable event. The Court ruled that the taxable event occurs at the time the shares are transferred to the management and not at the time of the restriction's expiry.

In the case of stock options or warrants, the taxation is triggered at the time the stock options are exercised (as opposed to at the time of granting or vesting). Employees are taxed on the benefit arising from the exercised options, calculated as the market value of the acquired shares less the exercise price and paid premiums, if any. The benefit is taxed as income from employment subject to 30 to 58 per cent tax to be withheld by the employer and paid to the Swedish Tax Agency on behalf of the employee. The employer, on the other hand, is required to pay social security contributions on the taxable benefit arising on the exercise of the stock option as well as report the benefit in the employee's annual statement of income. As there are currently ongoing disputes with the tax authorities in this respect, the terms and conditions of management participation agreements, warrants agreements and similar should be considered carefully, at least until such disputes have been finally settled by the Swedish courts.

Incentive schemes for management can also be structured as 'employee stock options', which is the commonly used term for options that have certain clear limitations related to employment and which are often structured as a mere contractual obligation in relation to the employee and are thus not necessarily actual securities from a corporate law point of view. To be able to deliver under such employee stock options, actual warrants are normally issued to a subsidiary of the issuing company, for example, the target if the employee stock options are issued by the BidCo. Such warrants can then be exercised to deliver shares to the employees upon exercise of the employee stock options. Benefits related to such employee stock options are clearly taxable as employment income under Swedish law and the above will apply.

9 Existing indebtedness

What issues are raised by existing indebtedness at a potential target of a private equity transaction? How can these issues be resolved?

Most private equity transactions are carried out on a cash-free and debt-free basis implying that the existing indebtedness has a direct effect on the purchase price. In addition, the purchaser would normally refinance any existing indebtedness in the target company in connection with the transaction. This means that the purchaser in many cases would replace existing indebtedness with new indebtedness, namely a premature repayment of the existing indebtedness. This can of course raise issues, such as break-up fees as a consequence of the premature payment of the existing indebtedness, in relation to the existing creditor, which will need to be assessed before signing and resolved before or upon completion of the transaction. Normally, these issues are solved when negotiating the new financing documentation. However, in some cases, issues relating to the purchaser's refinancing of the target company can be circumvented by refinancing the existing indebtedness with new indebtedness provided by the same debt provider (ie, by negotiating the refinancing with the same debt provider that provided the credit in the first place). This procedure may enable the purchaser to replace the indebtedness without having to pay any break-up fees since the debt provider in fact remains with the credit.

10 Debt financing structures

What types of debt are used to finance going-private or private equity transactions? Do margin loan restrictions affect the debt financing structure of these transactions? Are there any other restrictions in your jurisdiction on the use of debt financing for private equity transactions?

Private equity transactions include different types of debt instruments. Normally, the majority of the debt will be provided as senior bank loans, namely fixed-term loans for acquisition financing (usually divided into two or three tranches) in combination with a revolving facility (or an overdraft facility) for financing of the target's working capital needs. In addition hereto, mezzanine junior debt (with connected instruments, usually in the form of warrants) and shareholder loans are often used. Due to the turbulent situation on the credit market in recent years, many private equity investors have found it hard to obtain the bank financing needed to carry out a contemplated deal, at least in the debt-to-equity ratios that had been common on the market during 2005–2007. Thus, it is presently not uncommon for a private equity buyer to request that part of the financing be provided by way of a vendor note, and the use of vendor notes representing a larger part of the debt has thus increased. However, as the market is improving, debt-to-equity ratios are again increasing, but normally not to the highest ratios previously seen.

There are no margin loan restrictions in Swedish law that affect the debt-financing structure of going-private or private equity transactions, and there are no other restrictions for debt finance specific for private equity transactions in Sweden, although general restrictions on such rules on financial assistance do, of course, apply also to private equity.

11 Debt and equity financing provisions

What provisions relating to debt and equity financing are typically found in a going-private transaction? What other documents set out the expected financing?

In comparison with other private equity transactions, there are no significant differences, since potential purchasers will normally require similar prerequisites in relation to the target company's financial status before obtaining bank financing. Accordingly, the financing agreements used in going-private transactions are similar to those used in other private equity transactions.

In a public-to-private transaction it is, however, important to consider the requirement that the financing shall be in place before an offer is made to the shareholders in a public company.

12 Fraudulent conveyance and other bankruptcy issues

Do private equity transactions involving leverage raise 'fraudulent conveyance' or other bankruptcy issues? How are these issues typically handled in a going-private transaction?

Since most private equity transactions involving leverage are conducted with full transparency and under the supervision of legal and

Update and trends

Although not as active as initially hoped for, 2010 has certainly been a year of rebound from the financial crisis and a year of increased transaction activity in Sweden. We have seen a number of public-to-private transactions by private equity houses as well as private M&A transactions by both mid-size funds and larger private equity funds.

During the year we have started seeing a shift back from closing balance sheet price mechanisms and a return to fixed price and locked box mechanisms. Another interesting phenomenon is a rekindled interest in M&A insurance, which virtually disappeared from the M&A market in connection with the financial crisis.

Parties are continuously attentive to transaction risks and due diligence and transaction processes still tend to go 'on and off', thus still providing for a 'bumpy ride' to get to deal completion. Nevertheless, deal activity has increased and brings hope for intense transaction activity during 2011 (provided that such hope is not muffled by macroeconomics deteriorating further).

financial advisers representing the different parties involved, including the principal creditors, fraudulent conveyance issues are uncommon. The strict Swedish financial assistance regulations also contribute in minimising the risk for creditors being defrauded.

In respect of such financial assistance regulations, it should be noted that it is illegal to acquire a company by using the target company's assets to fund the transaction. However, once the transaction is completed, the offeror becomes the parent company and may use the assets or profits of its subsidiaries as it pleases. It is important to consider the absolute condition that an offer must be financed by the offeror not using the assets of the target. Unlike some other jurisdictions, there are no whitewash provisions.

As regards bankruptcy, private equity transactions involving leverage do not usually raise any specific issues in relation thereto other than, of course, in the evaluation by the buyer and the lending banks in relation to the commercial viability of the target, etc. However, a private equity buyer will normally require sufficient warranties from the seller in the purchase agreement that the target is not insolvent within the meaning of applicable laws, rules or regulations or similar requirements.

13 Shareholders' agreements

What are the key provisions in shareholders' agreements covering minority investments or investments made by two or more private equity firms?

Key provisions in Swedish shareholders' agreements covering minority investments basically cover corporate governance issues such as board representation, since the minority owner will usually require board representation in relation to the ownership. Decisions on certain important issues are not uncommonly subject to veto provisions. This implies that the majority owner will not have absolute control over corporate governance in the target company. Further, provisions regarding tag-along and drag-along rights and the right of first refusal are of importance in relation to transfer provisions and exit strategies of the private equity and venture capital funds. In relation to a transfer, restrictions in this regard can also be incorporated in the target company's articles of association. Other common provisions for a venture capital firm making a minority investment include anti-dilution and non-compete clauses.

14 Limitations on transaction size

Do private equity firms have limitations on the size of transactions they may engage in?

In general, limitations on the minimum or maximum size of transactions are set out by internal rules of the specific private equity fund. These limitations are set out in the investment or fund agreement (normally referred to as the limited partnership agreement (LPA)) of the private equity fund, and normally the investment criteria in terms of the minimum and maximum of equity instruments relate to the size of the fund. Other investment criteria that are often regulated in the fund agreement are geographical limitation and business areas of potential target companies.

It should be noted, however, that there are no statutory limitations on private equity investments.

15 Exit strategies and investment horizons

How do the exit strategies and investment horizons of private equity firms affect the structuring and negotiation of leveraged buyout transactions?

Normally exit strategies and investment horizons are treated and negotiated as any other item in a leveraged buyout transaction. Exit risks are covered by due diligence and the transaction documentation, such as a share purchase agreement and a shareholders' agreement, contain provisions regarding exit opportunities. The share purchase agreement may, for example, have specific indemnities on certain identified risks, such as environmental issues, in order not to become a burden upon exit. The shareholders' agreement usually defines what shall constitute an exit (for example, a trade sale or an IPO) and usually contains provisions relating to an exit as such (drag-along, tag-along and recapitalisation, etc).

16 Principal accounting considerations

What are some of the principal accounting considerations for private equity transactions?

Investigations to understand and assess key accounting policies and practices of the target company are important steps in the due diligence process in a private equity transaction. Lacking understanding of the material policies and practices could result in an unfavourable position in the closing negotiations of a transaction and could also potentially result in a lower return of investment as the target company is divested again.

For a private equity buyer applying US GAAP or IFRS in its portfolio companies looking to acquire a target using Swedish GAAP, it is important to understand the differences in reporting policies and practices and what the books of the target company will look like under US GAAP or IFRS. Items that may potentially affect revenue and profits and balance sheets significantly are, for example, principles for revenue recognition, provisions for restructuring and certain personnel-related liabilities (pensions and other employee-related obligations). For pension liabilities (which may or may not be a balance sheet item in Sweden depending on the structure of the pension liabilities) it is vital to understand what impact that may have on accounting and reporting and what the effects will be to ensure that they do not have a negative impact in completing the transaction as well as on the future exit value. Understanding and assessing accounting and reporting effects are not only important for the transaction in evaluating the target, but also in relation to how the private equity house shall present the deal to its limited partners, namely the investors in the private equity fund.

The same considerations apply for a Swedish private equity buyer acquiring a Swedish privately held company, which has a parent company using IFRS or US GAAP, thus forcing the target to report in the same manner. Also, if the intention is to acquire the Swedish subsidiary and thereafter make an exit, for example, by way of an IPO, it is important to assess how the accounting and reporting will be affected

by using another country's GAAP and also to consider requirements for IPO prospectus and other listing requirements on reporting for public companies. These are important considerations that may affect financial ratios and the overall exit or IPO process.

Potential upsides exist if different accounting policies could be used, which is sometimes contemplated in planning acquisition and exit strategies by private equity houses. Changing the accounting policies upfront in an IPO process could in some cases change the way analysts view and value the company and thereby potentially affect exit values positively. Strict requirements and assessments forego an IFRS or US GAAP implementation. Also, internal considerations of different effects and target company requirements to implement new accounting policies should be made and discussed thoroughly.

17 Target companies and industries

What types of companies or industries have typically been the targets of going-private transactions? Has there been any change in focus in recent years? Do industry-specific regulatory schemes limit the potential targets of private equity firms?

The Swedish market has not seen a significant number of going-private transactions in recent years. Therefore, typical targets are difficult to identify. However, as in most private equity acquisitions it is companies with stable cash flows that have been taken private.

Although acquisitions of target companies operating within certain industries, like the defence industry or other industries closely linked to government interests, might require specific approval by the relevant authorities, there are in general few regulatory schemes limiting the possibilities for private equity firms to invest in any potential target.

18 Cross-border transactions

What are the issues unique to structuring and financing a cross-border going-private or private equity transaction?

There is no unique structuring for cross-border transactions. The financial assistance restrictions that may apply are in all material respects the same as in a purely domestic transaction.

Although not particular to cross-border transactions, it should be noted that it is now permitted under Swedish law for the buyer to defer payments to the seller – that is, for the seller to grant a loan to the acquirer – without breaching financial assistance rules. Previously, such deferred payment was not permitted under Swedish law unless constructed as a strict earn-out mechanism where the outcome was uncertain. As a result, the concept of vendor notes has become increasingly popular for buyers to request, and in the current market vendor notes have also become a more frequent instrument as part of the acquisition finance. It must be kept in mind that a vendor note will need to be handled in the intercreditor agreements in terms of subordination provisions where the banks will normally require that the vendor note be subordinated to the bank debt, which is something the seller must keep in mind when discussing and potentially agreeing on the concept of a vendor note.

19 Club and group deals

What are the special considerations when more than one private equity firm (or one or more private equity firms and a strategic partner) is participating in a club or group deal?

There are no restrictions in Swedish law that prevent more than one private equity firm from participating in a club or a group deal. From a practical view the participants need to regulate their relationship in a shareholders' agreement or similar, setting out their respective rights and obligations as joint owners of the BidCo and the target. Of course, the bidders also need to respect any confidentiality undertakings with regards to the seller when forming the club.

20 Issues related to certainty of closing

What are the key issues that arise between a seller and a private equity buyer related to certainty of closing? How are these issues typically resolved?

Certainty of closing and issues related thereto often depends on the outcome of the due diligence conducted by the buyer and its advisers and the negotiation of the purchase agreement between the seller and the buyer. If signing and closing do not take place simultaneously, a buyer will often argue that closing shall be made subject to certain conditions having been fulfilled. The number and type of conditions required by the buyer differ and may comprise, inter alia:

- competition clearance;
- actions required to be taken by the seller in relation to issues identified by the buyer and its advisers during the due diligence; and
- a bring-down provision, meaning that the seller's warranties and representations are true and correct as of signing and will be true and correct as of closing, etc.

The consequence of one or more of the conditions not being fulfilled is normally that the buyer, in its sole discretion, is entitled to either waive the conditions not fulfilled or terminate the purchase agreement. If the purchase agreement is terminated as a result of conditions precedent not having been fulfilled, neither part is normally entitled to any termination fee.

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In conclusion, certainty of closing decreases the more conditions precedent the purchase agreement contains. From a seller's perspective, it is therefore normal to try to negotiate none or as few conditions precedent as possible while, from a buyer's perspective, sufficient conditions precedent may be an absolute requirement to enter into a purchase agreement when closing will occur at a later date. The inference that can further be drawn from the aforementioned is that simultaneous signing and closing is the best way to avoid uncertainty of closing, provided that there is no obligation to obtain competition clearance (eg, for smaller transactions).

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