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Corporate Acquisitions

The Acquisition Process and Legal Considerations from the Perspective of the Acquiring Party

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Contents

Summary

The amount of acquisitions has grown rapidly in Sweden during the past two decades and are today a very important strategic and financial decision for many companies. A corporate acquisition could also be a very big financial risk for the acquiring party. This thesis researches the process of corporate acquisitions from the perspective of the acquiring party with a focus on an economic analysis of law as well. To facilitate this research four research questions, that pinpoint specific areas of ensuring the interests of the acquiring party, have been used as a frame for both the research and this thesis.

The thesis starts off with an examination of how the common acquisition process is shaped and an investigation of applicable legislation to the process of corporate acquisitions. This thesis shows, the provisions that affect the acquisition process, and the parties of the transaction, are spread out in several acts and are not specifically designed to cover acquisitions. This can be a reason for the rapid growth among mergers and acquisitions in Sweden. Furthermore, this thesis also shows that more provisions on the branch would likely ensure secure transactions and facilitate economic efficiency in the Swedish society, seen to the business of corporate acquisitions.

For the interests of the acquiring party, and how to act to ensure these in the transaction process, it is first of all important to know, as early as possible, what these interests are and how important they are in relation to other imaginable points of negotiation and discussion between the parties. This thesis looks at ensuring the interests of the acquiring party through warranties and indemnities, through non-compete clauses, through price mechanisms and finally how to ensure the interests at the time of closing. Each instrument of ensuring the interests has its own traits and while they represent different parts of the share transfer agreement this thesis also shows that they are intertwined. Gaining security of the interests on one of the four instruments,

might likely lead to consequences on the other points of the agreement. However, an awareness of the detail that all risk reducing measures for the acquiring party likely is reflected on the purchase sum should be present throughout the transaction process. In general, important risk reducing means for the acquiring party are due diligence examinations and usage of warranties in the share transfer agreement. The warranties are a relatively unrestricted manner to ensure the priorities of the acquiring party.

A consequence of the scarce amount of regulation on mergers and acquisitions is that the legal field itself has few guidelines to lean back on when seeking legal advice on matters of the field.

Sammanfattning

Antalet företagsförvärv har vuxit snabbt i Sverige under de två senaste årtiondena och är idag en del av viktiga strategiska och ekonomiska beslut för många företag. Ett företagsförvärv kan dessutom vara en mycket stor ekonomisk risk för den förvärvande parten. Denna uppsats undersöker processen för ett företagsförvärv från den förvärvande partens perspektiv samt ur ett rättsekonomiskt perspektiv. För att underlätta forskningen har fyra frågeställningar, som preciserar olika områden för försäkrandet av förvärvarens intressen, använts som en ram för både forskningen och uppsatsen.

Uppsatsen inleds med en undersökning av hur den typiska processen för ett företagsförvärv ser ut och en undersökning av tillämplig lag för förvärvsprocessen. Som denna uppsats visar, så är de bestämmelser som påverkar förvärvsprocessen och parterna i transaktionen utspridda i flertalet olika lagar och inte specifikt utformade för just företagsförvärv. Detta kan vara en anledning för den snabba ökningen på förvärvsmarknanden i Sverige. Därutöver visar denna uppsats att om det hade funnits mer reglering på området så skulle detta sannolikt försäkra tryggare transaktioner och underlätta en ekonomisk effektivitet i Sverige, sett till marknaden för företagsförvärv.

Vad gäller intressena för den förvärvande parten och hur man ska agera för att försäkra dessa i transaktionsprocess är det framförallt av vikt att, så tidigt som möjligt, veta vilka dessa intressen är och hur viktiga de är i förhållande till andra tänkbara förhandlingspunkter och diskussioner parterna emellan. Denna uppsats tittar på hur man kan försäkra förvärvarens intressen genom garantier och skadeersättningar, genom konkurrensklausuler, genom prismekanismer och slutligen hur man försäkrar intressena vid tillträdestidpunkten. Samtliga instrument som finns tillgängliga för att försäkra intressen har sina egna karaktärsdrag och medan de representerar

olika delar av överlåtelseavtalet så visar denna uppsats att de är alla sammankopplade. Ökar man tillförsäkringen på den ena av de fyra instrumenten, så leder det sannolikt till konsekvenser för övriga delar i avtalet. Dock ska en medvetenhet finnas om att alla riskreducerande åtgärder för förvärarens försäkran sannolikt speglas på köpeskillingen. Generellt är viktiga riskreducerande verktyg due diligence-undersökningen och användandet av garantier i överlåtelseavtalet. Garantierna är ett relativt obehindrat sätt att tillförsäkra prioriteringarna som förvärvaren har.

En ytterligare konsekvens av den knapphändiga regleringen på marknaden för företagsförvärv är att man även inom juridikens fält har få riktlinjer att luta sig tillbaka på i sökandet efter rättsligt rådgivande inom branschen.

Abbreviations & Definitions

Closing	The final step of the transaction.
Delivery	The situation in which a buyer is given control of something they have acquired.
EBIT	Earnings before interest and taxes.
EBITDA	Earnings before interest, taxes, depreciation and amortization.
Escrow	A financial arrangement where a third party holds and controls payment for two parties in a given transaction.
EU	European Union
Indemnity	A contractual obligation for the indemnifier to compensate the loss of the indemnity holder.
M&A	Mergers and Acquisitions
NGM	Nordic Growth Market
Non-compete clause	An agreement not to enter into or start profession in competition against the other party.
Warranties	A term of contract, a promise that may be enforced if breached

1 Introduction

1.1 Background

Corporate acquisitions are steadily growing in number and have done so for the past two decades.[1] Today acquisitions are a common part of the business strategy in many companies, and for some companies acquisitions can even be the foundation of the business idea.[2] While they historically have been more common in USA, the number of acquisitions has grown quickly in Sweden as well. Today thousands of acquisitions are completed each year in Sweden and a lot of recourses are spent on these transactions. Sweden has sailed up to be the fourth most transaction intense country in the world, following USA, United Kingdom and the Netherlands.[3]

Reasons for the numerous transactions taking place in Sweden are, amongst other factors, the national legislation on the matter, the shareholder structure and the corporate structure in Sweden. Today transactions revolving acquisitions are common within the corporate world in Sweden and, in difference from what they once were, are not an option open only for the bigger actors within in the corporate scene.[4] With this increase in transactions, matters revolving acquisitions have become a growing question and topic for legal advice within the legal field.[5]

Furthermore, acquisitions are an important strategic decision for the future and can be very important for the growth and development of a company. The acquisitions have, to some extent, become necessary for renewal development and hold very different motives for the selling and the acquiring party.[6]

[1] Sevenius (2015), p. 40-41.
[2] Sevenius (2015), p. 29.
[3] Sevenius (2015), p. 40-41.
[4] Sevenius (2015), p. 41.
[5] Forssman (2016), p. 11.
[6] Johansson and Hult (2002), p.11.

Even though the number of acquisitions is increasing, the legal literature on the topic is very limited. There are a few books and articles on certain parts of the process but there are few writings that explain the entire process or that go into depth of the acquisition process, and there are no writings that can act as a guidebook for parties who are to go through the process of a merger or an acquisition.[7] Neither is there much regulation or cases applicable on the topic, and therefore one needs to look at legal literature in place (even though it is not extensive) to seek answers on the topic.

The different motives for the parties naturally also lead to different legal questions being of priority in the process of an acquisition. This thesis will therefore look at the acquisition process from the perspective of the acquiring party and some of the common questions that arise around the transaction.

1.2 Purpose

This thesis researches the process of corporate acquisitions from the perspective of the acquiring party. It examines some of the legal questions of priority to the acquiring party during the acquisition process when acquiring a company in Sweden. To ensure the relevance of such mentioned questions, conversations have been held with lawyers actively practicing law in Sweden. The identified questions of particular interest are presented in the following section, section 1.3.

1.3 Questions of Research

As mentioned earlier this thesis will focus on some of the common legal questions that an acquiring party might face in the acquisition process. To do so, and to ensure the fulfilling of the purpose of the thesis, this thesis will focus on the following research questions:

[7] Myrdal (2002/03), p. 452.

- How can warranties and indemnities be used to ensure the interests of the acquiring party?
- How can non-compete clauses be used to ensure the interests of the acquiring party?
- How can pricing mechanisms be applied to the benefit of the acquiring party?
- How can the acquiring party ensure its interests in the case of unwanted occurrences between signing and closing?

All questions are significant parts of the share transfer agreement, and, as will be noticed in the thesis, have an impact on each other. The outcome of the negotiation on one question, is likely to have an effect on the other questions of research.

1.4 Delimitations

While mergers and acquisitions often are discussed together this thesis will focus on acquisitions and not to any remarkable depth research the questions of the merger process. Furthermore, this thesis will not look into the acquisitions of publicly listed companies[8].

Acquisitions can be of both the shares of a company or the assets in the company. This thesis will only study the acquisition of the shares, and therefore also solely study limited companies (Swe. Aktiebolag), not companies with other partnership agreements. Neither will this thesis look into the case of share swaps (payment with the acquiring party's own shares).

While acquisitions are very financial in their nature and thereby bring up several questions in regard to tax consequences, tax rules will not be closer presented. That tax rules do apply will be briefly mentioned where they are

[8] Publicly listed companies have a share capital of at least 500 000 SEK, see chapter 1 § 14 of The Swedish Companies Act (Swe. Aktiebolagslagen SFS 2005:551).

of importance in considerations, but there will not be any closer examination of such rules. Neither will there be examinations regarding the questions surrounding filings to the Swedish Competition Authority. Lastly, the main focus will be on privately owned Swedish companies acquired in Sweden.

1.5 Perspective and Method

To answer the research questions above and to fulfil the purpose of this thesis a combination of methods and perspectives will be applied. This thesis will hold the perspective of the buyer as the main focus area. The thesis will be researching the legal framework concerning acquisitions, both the basic legal questions revolving the process of an acquisition, and the questions that are of greater interest to the acquiring party specifically.

The methodology used for this research is the legal dogmatic method. The legal dogmatic method is probably the most commonly used method for thesis' in the topic of law, however there are discussions as to what this method actually means. A common perception of the method is that the method is used in the analysis of the legal questions for the acquiring party in the process of the acquisition. Meaning a legal analytical method which systematizes and interprets existing law. Starting from the questions of research, legal material is examined in order to seek information and answers to the questions of research and also analyse the gathered information.[9] To examine existing law an analysis of legal sources is made, such as laws, preparatory work of laws, cases and academic writing within the legal field in the manner of methodological doctrinal study of law.[10]

[9] Korling and Zamboni (2014), p. 21 ff.
[10] According to the methodological doctrinal study of law the legal sources are of varying dignity and thereby have a varying hierarchy among the sources of law. According to an established division between the legal sources national law *must* be regarded, while preparatory work of laws and cases *should* be regarded and finally academic writing within the legal field *may* be regarded in a study of the legal situation. See Peczenik (1980), p. 49 f.; Peczenik (1995), p. 35 f,; Bernitz (2017), p.30 ff. and Kaldal & Sjöberg (2018), p. 13 f.

Another interpretation of the legal dogmatic method is seeing it as a reconstruction of the legal system. The reconstruction does not have to be restricted to established law, it can also be seen as a science which, like other sciences, tries to seek new answers and better solutions.[11] The legal dogmatic method here becomes an effort to determine existing rules (*de lege lata*) or rules that should exist (*de lege ferenda*) and determine their content.[12] This thesis will mainly consist of determining established law with the purpose of understanding its meaning, and thereafter use this knowledge in the discussion.

As corporate acquisitions naturally have a strong connection to financial matters and are driven by financial incentives it is motivated to also use an economic analysis of law to analyse the provisions in place. Because that is what an economic analysis of law is, using economic theory to analyse legal provisions and principles. The economics of law intends to also give answers to why legal provisions should be shaped a certain way that facilitates the economic efficiency. The national economy is often motivated to be a more important goal, compared to other goals in society, and the economics of law intends to justify these considerations.[13] Therefore, a discussion connected to financial considerations will be regarded as well and presented in the final parts of this thesis.

1.6 Materials

As the topic of mergers and acquisitions has become more common in Sweden during the past two decades, so have the writings on the topic. The amount of doctrine on mergers and acquisitions has therefore increased, while there still is a lot left to cover on the field. However, the writings are often of a general manner and broadly cover the process of mergers and acquisitions,

[11] Jareborg (2004), p. 4 ff. and Korling and Zamboni (2014) p. 21 ff.
[12] Lehrberg (2018), p. 207.
[13] Dahlman, Glader and Reidhav (2005), p. 21.

they do not look at the acquiring party in specific. Nonetheless, the materials that are accessible are of value and will be used in this research.

Furthermore, the processes around acquisitions have developed a lot in the past two decades. Therefore, the older literature in the field might only be partially regarded and newer sources are to be preferred in order to ensure a reliable result in this research. However, the newer writings on the field mostly reference back to the older literature on the topic of acquisitions, showing that they still are applicable and that their applicability has, indirectly, been confirmed by well-known authors in the field of M&A (Mergers & Acquisitions) in Sweden (such as Robert Sevenius). Nonetheless, the older sources, dating back more than two decades or so, will be regarded and studied with greater carefulness. Some American literature is also of value for this research as the field of M&A in Sweden is very inspired by the American M&A-market. Considering the fact that Swedish prominent sources in the field of acquisitions (such as Robert Sevenius) also have used American sources, the usage of these sources are considered validated.

As to specific legislation in Sweden regulating the process of mergers or acquisitions, they do not exist. Instead there are regulations that affect the acquisition process and thereby have an effect on it. Furthermore, the industry has designed its own rules for acquisitions, in regard to publicly listed companies, such as the Nasdaq takeover rules and the NGM (Nordic Growth Market) takeover rules. The industry itself creating rules, even though these are not applicable for the acquisitions that this thesis focuses on, shows a lack of provisions on the topic. The fact that there is a lack of laws that regulate the topic leaves anyone who is in search of answers to look at the legal literature, who in turn has not had a lot of laws to rest on either.

Lastly there are also a few legal cases that have discussed questions connecting the acquisition process. Relevant cases will be examined in this thesis. However, these are very limited and not much information can be derived from the cases.

1.7 Outline

Following this first chapter this thesis will present the process of a corporate acquisition in Sweden today, the potential background of an acquisition and the applicable legislation for corporate acquisitions. The following chapter, chapter number three, looks at the interests of the acquiring party at a corporate acquisition and some of the legal questions that are of particular interest for the acquiring party, describing different options and approaches, when negotiating the provisions of the share transfer agreement.

This will follow with a discussion on raised topics and a discussion on potential courses of actions to take as an acquiring party, in relation to the research questions of this thesis. Finally, the thesis will present a summarizing conclusion. As mentioned before, and as will be shown throughout the thesis, it is the acquiring party that is of main focus throughout the process, research and discussion.

2 Acquiring a Company

2.1 Acquisitions

Companies of today are constantly pressured to grow to remain a strong player on the market. One external mechanism, which offers organizations an option to grow, is corporate acquisitions.[14] However, compared to other resource allocations, acquisitions are characteristically nonroutinary. They are, for most managers, of sporadic nature and differ from the traditional experience of most managers, compared to routine investment decisions in the organization.[15] Acquisitions are often a strategical decision and an investment for the future. They are often an ambition to predict the future and are therefore based on assumptions and judgements of the future development of the target company and the world around it. Furthermore, they could be big financial risks and very important for the acquiring party.[16]

2.1.1 The Process of an Acquisition

The process of an acquisition is naturally started off with the acquiring party making a decision on having a desire to acquire a company or the selling party making a decision on wishing to sell a company. How this is initiated can vary, either an acquiring party is set on finding a company to acquire or the selling party is set on finding someone who wants to acquire the company in question.[17] Depending on how the acquisition process is initiated the strategy for the parties can vary. If the acquisition process is initiated by the acquiring party this same party often is prepared with their goals and limits for the transaction at an early stage in the process.[18]

[14] Bhagwan, Grobbelaar and Bam (2018), p. 217.
[15] Galavotti (2019), p. 92.
[16] Johansson and Hult (2002), p. 11.
[17] Forssman (2016), p. 12-13.
[18] Sevenius (2015), p. 129.

When both an acquiring and a selling party have met, and an understanding of mutual interests has been confirmed the next step of the process is introduced. The process can here take two paths, either there are direct negotiations with one acquiring party, or the selling party decides to organize an auction process. If direct negotiations are initiated it is common that a letter of intent, stating the basic conditions for the continued process, is signed. An auction process on the other hand is started off with the selling party inviting a number of possible acquiring parties to place initial offers, through so called bid letters, after a presentation of the target company in an information memorandum. When the bid letters have been handed in, these are evaluated and the selling party choses which of these to move on with for further negotiations.[19]

The bidders who have been chosen after the initial bid letters are then invited for a closer due diligence of the target company. Following this closer examination, the remaining bidders present revised bids which are evaluated. The selling party normally choses one bidder to initiate the final discussions regarding the acquisition of the target company. When the parties have reached this stage a letter of intent is commonly signed, and a full due diligence is done, if this has not been done earlier on in the process (the processes vary a lot from case to case).[20] The due diligence is important for the acquiring party as the acquiring party is forced to rely on information from external parties to examine the possibilities, minimise the risks and conduct the business agreement. Furthermore, the two parties of the acquisition can have complete opposite interests.[21] Therefore, the due diligence can be seen as one way for the parties to divide the risks between themselves.[22]

Along with the final parts of the due diligence examination the parties also often initiate the actual negotiations on the share transfer agreement. If the transaction does not contain any special components, such as reinvestments

[19] Forssman (2016), p. 13-14.
[20] Forssman (2016), p. 14.
[21] Sevenius (2013), p. 438-439.
[22] Sevenius (2007), p. 502.

from the selling party or the management, the share transfer agreement mainly consists of share transfer agreements itself and surrounding documentation.[23] Surrounding documentation, or agreements, can be escrow agreements, management service agreements, shareholders agreement, employment contracts etc.[24]

The negotiations on the agreements are commonly done by the legal representatives of both parties, along with corporate finance advisory capacity, if such has been involved in the process.[25] The share transfer agreement also often contains provisions on how future disputes between the parties should be handled.[26]

In the due diligence process the question of the risk that the selling party takes in the exposure of information is often raised. Various measures can here be taken to clarify such questions, involving precautions regarding the risks in question, agreements in the share transfer agreement or price adjustments. In some cases the acquiring party finds so called deal breakers in this stage of the process and decides to cancel the process.[27]

Once the share transfer agreement is finalized the deal is either finalized at one decided time, or signing is done at one time and the takeover and closing is done at a later time.[28] More on the closing procedure can be found in section 3.2.4 of this thesis.

While the anticipation is that the parties phrase the share transfer agreement to ensure the interests of the parties the share transfer agreements also have come to have a rather standardised form, except for the few provisions that are unique for the acquisition at hand.[29] However, discussions have been

[23] Forssman (2016), p. 14.
[24] Sevenius (2015), p. 288-289.
[25] Forssman (2016), p. 14.
[26] Forssman (2016), p. 90.
[27] Forssman (2016), p. 15.
[28] Forssman (2016), p. 15.
[29] Forssman (2016), p. 46-47.

raised in the field of acquisitions that in some cases parties can knowingly make sure that the agreement is strategically vague, as time and money spent on drafting an agreement that both parties agree upon can be higher than the cost of taking the issue to litigation at a later stage.[30]

It is also said that compared to other types of corporate contracts, agreements tied to the acquisition process, are in comparison very extensive. A custom has been created for the share transfer agreements and a common structure and standardised terms and conditions have emerged in the field of corporate acquisitions. The share transfer agreement itself commonly follows a structure with the following sections: parties, background, purchase sum, takeover, warranties, sanctions, periods of limitation, competition, confidentiality and finally governing law. As mentioned earlier in this section, several appendixes and other documents, can also be created as complements to the share transfer agreement. It is common that the parties try to limit the contractual content to the written contract through so called integration clauses and therefore the agreement is often seen to be exhaustive.[31]

2.1.2 Applicable Legislation

Acquisitions can be done to various extent. Either one acquires all shares of a company, or just a part of the shares.[32]

When it comes to acquisitions of just a few shares in a company there are mixed meanings on which law is applicable. However, doctrine seems to have agreed upon §9 Act on Instruments on Debt (Swe. Lag om Skuldebrev SFS 1936:81) being applicable for such transfers. This means that the selling party does not have a legal obligation for any flaws in the target company and its business. The alternative to using the Act on Instruments on Debt would be application of The Sale of Goods Act (Swe. Köplagen SFS 1990:931).[33]

[30] Choi and Triantis (2010), p. 848.
[31] Sevenius (2003), Balans nr 2003.
[32] Forssman (2016), p. 15.
[33] Forssman (2016), p. 15.

Legislation regarding acquisitions of all shares of a company or parts of the shares has earlier been a debated topic. However, a decision on using The Sale of Goods Act has been reached.[34] The Sale of Goods Act is applicable for purchases of loose items, examples being claims and rights, such as shares, intellectual property, including patents and trademarks.[35] The parts of the act that mainly come in to place in regards to corporate acquisitions are the regulations on liability and the sanctions regarding the obligation of investigation prior to the acquisition.[36] The applicability of The Sale of Goods Act in the case of acquisitions can also be confirmed by the ruling in NJA 1976 p. 341.[37] However, it should be mentioned though that according to §1 in The Sale of Goods Act it is mainly aimed to regulate sales of loose items and that according to §3 in The Sale of Goods Act the provisions of the law are optional, meaning that parties can decide that provisions in The Sale of Goods Act should not be applied in their specific acquisition.

As for the agreements made in the actual share transfer agreement these are regulated by The Contracts Act (Swe. Lag om avtal och andra rättshandlingar på förmögenhetsrättens område SFS 1915:218) and contractual principles of law.[38]

Furthermore, tax rules do come in to question after an acquisition[39] but as mentioned earlier, tax legislation will not be closer examined in this thesis.

2.2 Management of Limited Companies

While the main focus of this thesis is the acquiring party, the target company, is naturally a very important actor in the process as well, since the entire

[34] Forssman (2016), p. 15.
[35] Gorton (2002), p. 39.
[36] Forssman (2016), p. 15.
[37] NJA 1976 p. 341.
[38] Forssman (2016), p. 16.
[39] Johansson and Hult (2002), p. 56.

acquisition is about the target company, its assets and the future with the target company.

A significant part of the actual transaction process revolves around defining the target company in relation to its surroundings. Valuation, inspections and agreements require a clear delimitation of the target company from other business activities. It is not uncommon that the target company is a packaging of the business that is done specifically for the transaction at hand, this is then a so called carve-out. The identification of the target company should revolve around what the acquiring party wishes to acquire, and the selling party wishes to sell, not the object from the legal or economic standpoint. The definition of the target company is not dependent on the target company's own view of itself, its business or its organizational limits either.[40]

The target company is often also a part of the transaction process through the management of the target company. In some cases, other employees with functions within business or operations can be active in the transaction process as well. Whichever the role the management of the target company has in the transaction process, it is important to remember that the management of the target company has its own interests in the process as well.[41]

Limited companies that are managed by their owners are different, seen to company organization and decision-making processes, compared to publicly listed limited companies.[42] A majority of the limited companies managed by their owners are in fact family businesses and managed through family governance. Decisions are often made in less formal matters and decision-making processes are often very flexible and thereby also harder to track. However, the needs of decision-making processes can change as soon as the ownership and management no longer correlate fully, and external managers,

[40] Sevenius (2015), p. 70-71.
[41] Sevenius (2015), p. 70-71.
[42] Almlöf (2014), p. 13.

or advisory capacity, are brought into the company.[43] While limited companies are obliged to rule under The Swedish Companies Act (Swe. Aktiebolagslagen SFS 2005:551) many of its provisions are optional and shareholders can decide to disregard them through provisions in the articles of association of the company or with consent from all shareholders of the company.[44]

If the management of the target company holds a very free role and great trust in relation to the owners it is important for the acquiring party to identify what the interests and motives are of the management.[45]

[43] Almlöf (2014), p. 312-313.
[44] Almlöf (2014), p. 224.
[45] Sevenius (2015), p. 71.

3 Interests of the Acquiring Party

3.1 Parties of an Acquisition

Acquisitions naturally have two parties, and while both parties want to be satisfied with the outcome of the process, the parties often have different goals with the acquisition. Furthermore, each acquisition is unique and has its unique questions at heart. However, some of the more basic questions in the process are the establishment of the parties in the acquisition, the identification of the need of any supplementary contract, the purchase sum and transaction type, the company name and other intellectual property, the obligations and rights of the parties, how to act if demands are not met, the right to insight after the deal is completed, how disputes should be resolved, how to ensure quality and how to ensure that both parties understand the agreement.[46]

There are generally two different categories of acquiring parties, either parties who acquire for financial reasons or parties who acquire for industrial reasons. Those who acquire for financial reasons are often not too interested of the activities of the target company, they are more interested of the cash flow in the business and the financial risks with acquiring the target company. Those who acquire for industrial reasons commonly have run a business already, that is similar or has a relation to the activities of the target company. The acquiring party can here be either a supplier or a customer of the target company and the acquisition will therefore replace a cooperation between the two parties.[47] No matter the type of acquiring party, and the background of the wish to acquire, it is beneficial to understand the selling party as well. For instance, understanding whether the selling party is financially pressured or

[46] Dansell and Sen (2018), p. 253.
[47] Sevenius (2015), p. 63-65.

relaxed economically can have great impact on the negotiations in the process.[48]

3.2 Questions of Importance for the Aquiring Party

The negotiations on the share transfer agreement often revolve around similar questions and the outcome of the negotiations are often dependent on the case and target company at hand, in combination with the parties' willingness to sell and acquire.[49]

A share transfer agreement that is of advantage for the acquiring party does however have a few, by doctrine, identified characteristics:

- Extensive warranties.
- Escrow agreement that holds a part of the purchase sum.
- A purchase sum that is decided with regards to net cash, working capital or profit after takeover.
- An agreement where the acquiring party's knowledge does not affect the possibilities for the acquiring party to receive indemnity for any breaches in warranty.
- That there are few limitations of the seller's responsibilities.
- A wide definition for the compensatable damage in the case of breaches in warranty, and that it covers both the damages for the acquiring party and for the target company. In agreements that are very advantageous for the acquiring party the indirect damages are also compensated.
- Thresholds for warranty responsibilities are low and the maximum liability for the selling party is high.

[48] Sevenius (2015), p. 129.
[49] Forssman (2016), p. 46.

- The definition of liability according to The Sale of Goods Act is applicable to the agreement (which is not very common in agreements for corporate acquisitions).
- The transaction is conditional of events crucial to the selling party.
- Non-compete clauses are applied for the future activities of the selling party.
- In the case of several selling parties, they are equally responsible for any warranty breaches.[50]

While the entire share transfer agreement naturally is important to the acquiring party there are some topics that commonly are of greater weight and discussion during the process. After conversations with lawyers actively practicing law, these following questions, presented hereafter in this chapter, have been chosen as particularly interesting to the acquiring party.

3.2.1 Warranties and Indemnities

It is common that both parties have warranties they have chosen to include in the share transfer agreement and these are a way for the parties to ensure their interests, while they also are a big topic of negotiation.[51] The warranties are a way to clearly decide, beforehand, who will bear the financial risk for different occurrences after the takeover of the target company and any indemnity connected to the warranty.[52] However, the legal consequence of having warranties is widely discussed in doctrine and how the warranties affect the duty of examining the target company before the acquisition. Warranties can often have the purpose of establishing a standard of the target company and their impact in an acquisition has been discussed.[53] The government bill to The Sale of Goods Act states that statements from the

[50] Forssman (2016), p. 47.
[51] Forssman (2016), p. 100.
[52] Dansell and Sen (2018), p. 165.
[53] Gorton (2002), p.84.

selling party normally liberates the acquiring party of examining the item in question.[54]

In the case of an acquisition, the warranties that the seller leaves on the target company are a great part of the share transfer agreement and are the foundation of one of the central functions of the agreement, to identify and describe the purchase item.[55]

The extent of the warranties and what they cover varies. It is common that the warranties are tied to different posts in the balance sheet of the target company. The warranties are often limited to one year from the takeover, with an exception of warranties regarding tax related topics, which usually last a lot longer.[56] Despite the variety of warranties, a few common categories have been identified. There are substance warranties, revenue warranties (for the future revenue of the target company), license warranties (for licenses required for the business of the target company), warranties that ensure rightful ownership and operation warranties.[57] Warranties can be decided at different times of the negotiation process and can be initiated by both parties, depending on the goals of the parties.[58]

It is also common that the acquiring party adds a general warranty to be ensured in the case of any negative surprises due to circumstances that the selling party knew of but did not inform the acquiring party of. If the selling party does not meet the warranty the selling party is obliged to compensate for the established defects.[59]

The warranties that the seller provides are often reflected on the purchase sum as the seller takes a bigger risk when leaving any warranties. The seller should therefore not be encouraged to leave any warranties that the seller does not

[54] Prop 1988/89: 76, p. 94.
[55] Sevenius (2007), p. 505.
[56] Johansson and Hult (2002), p. 66-67.
[57] Sevenius (2003), Balans nr 2003.
[58] Sevenius (2007), p. 506.
[59] Johansson and Hult (2002), p. 67.

want to stand for. The same does not go for general commitments though, there can be reasons for the acquiring party to limit the warranties through a precise commitment.[60] The commitment can be seen as the seller guaranteeing the other qualities but that the acquiring party should specifically examine the qualities that the seller specifically has called upon. Thereby a warranty is neutralized as the acquiring party lacks reason to trust the warranty.[61] One can describe the warranties as a way for the parties to pinpoint the risks in a manner that makes it possible to complete the transaction.[62]

The functions of having warranties and conducting a due diligence are in some matters considered to overlap each other. Which has raised the discussion on whether one of them is unnecessary.[63]

Looking at the regulations and The Sale of Goods Act they show that there is a complete division of the risk between the parties, meaning that it is either the selling or the acquiring party that stands the risk if the acquiring party is not satisfied with the acquisition. The Sale of Goods Act § 17 states that the selling party stands the risk for errors which differ from the acquiring party's legitimate expectations. However, The Sale of Goods Act § 20 also states that the risk of the selling party is reduced with whatever information that the acquiring party knew before the transaction. This meaning that if an acquiring party has identified any flaws or errors prior to the transaction, these may not be raised as claims against the selling party. And as mentioned in the previous section, 3.2.1, statements from the selling party normally liberates the acquiring party of examining the item in question.

Furthermore, as explained in section 2.1.2 of this thesis, § 3 of The Sale of Goods Act states that the provisions of the law are optional. And the provisions of The Sale of Goods Act are only applicable when nothing else is

[60] Johansson (1990), p. 97.
[61] Gorton (2002), p. 85.
[62] Sevenius (2007), p. 506.
[63] Sevenius (2003), Balans nr 2003.

stated in the share transfer agreement. However, it is hardly possible to create an agreement that is entirely independent of the optional rules. Therefore, the provisions of The Sale of Goods Act are seen to, at least, have a complementing role.[64]

Given that the seller stands the risk for discrepancies from commitments through warranties or other descriptions of the target company and the acquiring party stands the risk for attributes which the acquiring party is aware of, the acquiring party should be careful with examining factors that the selling party clearly has guaranteed. However, there are several factors that should be taken into account when deciding whether the warranties should limit the due diligence or not. One of the main factors being the time of the activities. Generally, an acquiring party would not without close consideration trust the warranties of the selling party and refrain from conducting a due diligence. From this perspective the warranties are a foundation for the expected level of standard, but not something that completely compensates the acquiring party. The information that is derived from the warranties cannot be expected to correspond with the information that is derived from a due diligence.[65]

In practice, the warranties and due diligence do not compete with each other, they rather act as complementing parts seen to risk division at an acquisition. The due diligence is a proactive way of identifying and quantifying risks. It occurs before the binding agreement is in place and is used to raise issues that need to be regulated in the agreement, adjust the purchase sum or in any other way be taken into account during the transaction process. The warranties on the other hand are a reactive way of allocating risks, including risks that could not be identified during the due diligence or transaction process. The warranties create a predictable legal situation between the parties which can dismantle in a controlled manner. In the deliberation between warranties and due diligence it is actually often a matter of choosing both, rather than

[64] Sevenius (2003), Balans nr 2003.
[65] Sevenius (2003), Balans nr 2003.

choosing either or. It is reasonable for the acquiring party to use both instruments, considering the great risk that is taken with a corporate acquisition.[66]

3.2.2 Non-compete Clauses

The acquiring party always takes risks with an acquisition, one of them being the risk of the previous owner having very valuable information critical to the future management of the target company. This can be a risk both seen to the future management of the target company when the knowledge leaves the company and what the previous owners do with the knowledge when they leave the company.[67] Furthermore, if it is a company managed by its owners the target company is often very dependent of the owner, as the owner commonly has an important operations role in the company.[68] The former owners can also have a very strong position as to the customer relations and market connections, which are vital for the products of the target company.[69] Therefore, it is common that the parties add non-compete clauses to the agreements between the parties.[70] Non-compete clauses have the purpose of ensuring that the acquiring party can absorb the full worth of the customer basis, the know-how and the goodwill which the acquiring party is paying for and to ensure that the selling party does not start a new business which is directed to the old customer group just shortly after the acquisition.[71] For such clauses to be valid they must have both a time limit and a geographical limit.[72]

The question of the extent of the time limit for such non-compete clauses has been a topic of discussion within the legal field.[73] The Patent and Market Court of Appeal discussed the question in the case PMT 7498-16 when the

[66] Sevenius (2003), Balans nr 2003.
[67] Forssman (2016), p. 110-111.
[68] Dansell and Sen (2018), p. 27.
[69] Johansson and Hult (2002), p. 67.
[70] Forssman (2016), p. 110-111.
[71] Bernitz (2017/18), p. 666-667.
[72] Johansson and Hult (2002), p. 67.
[73] Bernitz (2017/18), p. 662.

Swedish Competition Authority brought action before the court and questioned three companies who had acquisitions with non-compete clauses stretching over more than three years.[74] The case can now be used as a guideline of how competition law regards non-compete clauses.[75] Another guideline is also the Commission notice on restrictions directly related and necessary to concentrations, which explains that non-compete clauses should be limited to up to three years when the transfer includes customer loyalty in the form of know-how and goodwill, and if only including the know-how be limited to up to two years.[76] This notice is a complement to the Council regulation No 139/2004 on the control of concentrations between undertakings[77] which presents EU rules for when two or more companies combine through merger or acquisition. The applicability of these rules is further confirmed by the Competition Act (Swe. Konkurrenslag SFS 2008:579). There are however, no cases where Court of Justice of the European Union or The General Court has tried the meaning or viability of the time periods given by the notice. This could be a sign that large companies who report their acquisitions to the commission are keen on getting the acquisition approved and therefore ensure that the agreements comply with the EU-regulations. In the case PMT 7498-16 The Patent and Market Court of Appeal reached the conclusion that a fixed time limit cannot be set. An individual assessment should be done in each case where the clause should be proportional to the interest in society of having efficient competition and the interest of the acquiring party to protect the investment in goodwill and know-how of the target company, while also having the freedom of the seller in mind.[78]

As presented above, a big part of the non-compete considerations is the goodwill. Goodwill is considered both as a reason for wanting a non-compete clause and is assessed in the proportionality of the time limit of the non-

[74] PMT 7498-16.
[75] Bernitz (2017/18), p. 662.
[76] EUT 2005/C 56/03, item 20.
[77] EUT 2005/C 56/03, item 1.
[78] Bernitz (2017/18), p. 668-672.

compete clause. Goodwill is a companies' exceeded value in shape of the unique competence that the employees hold, important customer relations, good geographical location etcetera. Goodwill is classified as an intangible asset.[79]

3.2.3 Price Mechanisms

As the risks for the acquiring party are very big when acquiring a company and the cost is high there are several different pricing mechanisms to choose from for an acquisition. Price mechanisms can be described as contractual clauses that describe that the full purchase price is not paid on the day of the takeover or is set to a certain purchase sum. The price is instead calculated and paid at a later date, usually in connection to an external circumstance in the future. Different options of pricing mechanisms to choose from could be purchase price adjustment, postponed fixed payment, escrow, bonus instrument or option instrument or, lastly, earn out. Price mechanisms usually add further complexity to the acquisition and should be chosen with great consideration with both advantages and disadvantages closely considered.[80] The structure of the acquisition can also have tax impacts, which in turn can influence the decision of the acquiring party.[81] The taxes have an impact on both the selling party and the acquiring party and is a financial load for both parties. For the acquiring party there are tax consequences as future owners of the target company and should therefore be calculated beforehand.[82]

One part of these calculations should be if the acquiring party is a company or is one or a group of individuals. If it is a company who is the acquiring party it can be valuable to transfer untaxed profits from the acquired company to the own company (the parent company) as a concern contribution. The purpose of this concern contribution is often to receive financial funds to facilitate the financing for the parent company or to receive funds for joint

[79] Törning and Drefeldt (2009), Goodwill.
[80] Sevenius (2015), p. 279.
[81] Henning, Shaw and Stok (2000), p. 1.
[82] Johansson and Hult (2002), p. 51.

investments in the concern. If the acquiring party is one or several individuals on the other hand it is beneficiary if the acquisition is done through a, often newly created, limited company. This limited company then becomes the parent company in a concern with the acquired company as a subsidiary. Between companies in a concern funds and assets often flow in business transactions. These transactions are called concern contributions and, according to corporate law, when dividends are payed between parent companies and subsidiaries they must fit under the limit for the distributions of profit. A group contribution that is too large could be an unpermitted distribution of profit. Furthermore, there are tax rules for concern contributions.[83]

3.2.3.1 Advantages of Using Price Mechanisms

Some of the advantages of using price mechanisms in an acquisition could be that the price mechanism handles a part of the risk with the transaction and the mechanism can then adjust the risks of the parties. Using price mechanisms can also be a security factor for the acquiring party as a part of the purchase sum can be kept and used to adjust flaws in warranties left by the selling party, indemnities or as a tool to ensure the implementation of certain parts of the agreement.[84]

Furthermore, price mechanisms can be used as a compromise in the price negotiations. They can act as a bridge between the parties' different perceptions of the value of the target company. The postponed payment can be an incentive for a selling, but remaining, management team to fulfill goals and forecasts that have been promised prior to the acquisition. Finally, price mechanisms can act as a non-compete clause, if the target company keeps the business and important staff members it would be disadvantageous for the selling party to compete with the target company after the acquisition.[85]

[83] Johansson and Hult (2002), p. 55-56.
[84] Sevenius (2015), p. 279.
[85] Sevenius (2015), p. 280.

3.2.3.2 Disasvantages of Using Price Mechanisms

Some of the disadvantages of using price mechanisms can be that these mechanisms create incentive effects that can be hard to predict. The thresholds and the measurements of achievements can have a negative impact on the future activities in the target company. Price mechanisms can also have a hindering effect on the integration and development after the acquisition in the time period where the price is still to be set. This as the selling party can demand that the financial results of the target company are to be held separated until the final payment, which can limit the integration, synergies and other means of company development.[86]

Furthermore, the price mechanisms can prolong and change the relationship between the selling and the acquiring party, which can have the consequence of a greater loyalty between the parties. This loyalty must be closely regulated in the agreement. The price mechanisms can also themselves lead to greater costs and risks, the mechanism is in itself never free of charge and must always be covered somehow in the process.[87] Even though price mechanisms can seem to be a very beneficial solution for the acquiring party, since this reallocates a part of the risk to the seller and also steers the management of the target company with incitements, the price mechanism often means a cost for the actual transaction taking place. This cost is however not a part of the valuation that takes place at the takeover, and therefore it is harder to balance in the decision of going through with the transaction.[88] Lastly the pricing mechanisms can lead to greater complications and need a greater awareness of compliance according to The Swedish Companies Act, even though it has become easier since 2006 (before 2006 many pricing mechanisms were in conflict with the prohibition in The Swedish Companies Act to grant advance,

[86] Sevenius (2015), p. 279.
[87] Sevenius (2015), p. 280.
[88] Sevenius (2004), Balans nr 6-7 2004.

provide loans or provide security for loans for a debtor to acquire shares in a company).[89]

3.2.3.3 Different Types of Price Mechanisms

There are several different types of price mechanisms to choose from when facing an acquisition, if the parties agree to not have a fixed price (also called "locked box"). No matter which mechanism is chosen they should be handled carefully as they are often technically advanced and require knowledge within both finance and law. The conditions can have a significant impact on both the division of risk between the parties and the incentives in the transaction [90] This chapter will present some of the common options.

3.2.3.3.1 Purchase Price Adjustment

It is common that the purchase sum is based on the bid from the acquiring party, these bids are often based on a few financial prerequisites, such as the target company not having any debts. If these prerequisites would differ from the actual situation the price must be adjusted.[91] A common price mechanism is that a part of the price sum will be paid once the acquiring party has had a chance to check some circumstances in the financial statements of the target company through an inspection at the point of takeover. This is usually called a purchase price adjustment and the adjustment is a calculation based on principles decided upon at the time of negotiations of the share transfer agreement. It does not have to be just a postponed payment, it can also be that the selling party pays back a certain amount of money to the acquiring party.[92]

This type of price mechanism is commonly used when the signing day is different from the day of takeover or when the purchase sum is dependent on the company value, and the net debt must be established. Such calculations

[89] Sevenius (2015), p. 280.
[90] Sevenius (2015), p. 283.
[91] Forssman (2016), p. 58.
[92] Sevenius (2015), p. 280.

can cause both practical and technical accounting consideration issues but can also be unavoidable as it is not possible for all acquisitions to occur in connection to ordinary closing of the books.[93]

3.2.3.3.2 Deferred Payment

A deferred payment is a payment option that is commonly convenient for the acquiring party. This option has both financial benefits and is viewed as a more secure option for the acquiring party. Choosing this option reduces or eliminates the need of using escrow (explained in the following chapter) if the acquiring party has been able to control a part of the purchase sum until having a chance to identify any warranty breaches.[94]

However, this deferred payment is also less appreciated by the selling party as this often has the impact of the acquiring party being more willing to reduce the purchase sum for warranty breaches if the acquiring party holds still holds the purchase. Rather than the contrary where the acquiring party often must seek judicial measures to demand a reduction of the purchase sum and regain the money. For the selling party to be covered for this, it is common that the seller requires a clause about the acquiring party needing to bring an action before court to raise any issue on a reduced purchase sum.[95]

3.2.3.3.3 Escrow

Another type of price mechanism has arisen from the issue of cash payments having the consequence of the acquiring party not being certain that the seller has the means to cover for future warranty breaches. Formally the seller can be a holding company that might be liquidated after the transaction or in other way stands without the means to compensate the acquiring party. Practically this could mean that the safety mechanisms in place for the acquiring party

[93] Sevenius (2015), p. 280.
[94] Forssman (2016), p. 53.
[95] Forssman (2016), p. 53.

become worthless as the seller is not able to fulfill them. To ensure the payed price the acquiring party places a part of the purchase sum with a bank or law firm. The deposit is regulated in an escrow agreement and the later payment is done through the agency of the depositary. Escrow agreements often hold a risk for the depositary and therefore often contain a clause stating that payments only are done with a binding court judgement or written consent from both parties of the transaction. The bank usually takes a fee for the service and the selling party often requests an interest on the money if no breaches in warranties have surfaced. The shares of the target company can also be placed as a deposit, as a safety for remaining payments to the seller. Letters of comfort can also be constructed for similar occurrences.[96]

3.2.3.3.4 Earn Out

Earn outs are commonly viewed upon as one of the most complicated pricing mechanisms. The earn out is a payment condition where a part of the purchase sum is dependent on the fall out of future accomplishments in the target company, often dependent on financial results at a certain level. The mechanism means that the purchase sum is dependent on a result, sometimes it is said that the purchase sum is payed with a reservation for the outcome.[97] While earn outs have, during many years, been viewed upon as a suitable option to resolve the issue of asymmetric information American studies have shown that earn outs do not help the acquiring party to categorize the quality of the selling party. Instead of the question of asymmetric information earn outs seem to resolve the issue of precontractual uncertainty by helping the parties reach a pricing agreement.[98]

The earn out is determined with several different parameters that are closely analyzed and negotiated when the price clause is phrased. The phrasing of the parameters decides whether the earn out can fulfill its purpose, being an

[96] Sevenius (2015), p. 280-281.
[97] Sevenius (2015), p. 281-282.
[98] Quinn (2012), p. 171-172.

allocation of risk, a structure of incentives or other effects that are reached. The four main parameters are the performance metrics, the threshold, the time period and the additional purchase sum.[99]

The performance metrics is the measurement that is measured to decide whether the payment should arise. This measurement is often decided as a level of result in the profit and loss statement or other type of financial measurement. It could be other circumstances connected to the business of the target company as well. Common measurements of performance are proceeds, earnings before interest and taxes (EBIT), or earnings before interest, taxes, depreciations amortization (EBITDA). Examples of a non-financial measurement are staff-turnover, result impact of a planned restructuring, defined milestones in research projects or sales revenues from sales of planned divestments. Which measurements that can be used can vary a lot and are often a topic of discussion during the negotiations. The leading principle for a good measurement is that it is based on value influential factors in the target company or is connected to the most important expectations of the acquiring party.[100]

The threshold is the defined level of which the chosen earn out must reach for the additional purchase sum to be payed. The threshold decides which incentive effect that is reached through the condition. A high threshold can be worthless if it is unlikely that it is reachable while a low threshold might not be motivating.[101]

The time period is the time when additional payments can be of question. This time period is commonly between three and five years and naturally prolongs the contractual time between the parties.[102]

[99] Sevenius (2015), p. 282.
[100] Sevenius (2015), p. 282.
[101] Sevenius (2015), p. 282.
[102] Sevenius (2015), p. 282.

The additional purchase sum is the amount that is to be payed if the threshold is reached. It can be connected to either the measurement of performance or to the threshold. The additional purchase sum can, for example, be the sum that reaches beyond the threshold or can be a percentage of the sum that reaches beyond the threshold. The additional purchase sum can also be completely independent of both the threshold and the measurement of performance and be a fixed, pre-decided, sum that is payed after performance.[103]

Sometimes the parties can also choose to have additional components to adjust the effects of the earn out:

- The parties can have a pre-decided cap and basket which are set to a certain percentage in development or as fixed sums.
- Another option is also to have the earn out dependent on the purchase sum that is paid by the acquiring party at takeover of the target company.
- Having several dates of additional payments (yearly, quarterly or monthly payments or a grouped sum at the end of a time period).
- A fourth option could be having multiple measurements of performance. These could, for example, be that the proceeds reach a certain level and that some valuable staff members remain in the organization. If multiple measurements of performance are used, the parties must decide whether all thresholds are to be reached, if it is sufficient that one is reached for the additional payment to be payed or if they have a certain priority.
- The impact that uncontrollable and unexpected events have on the price mechanism.
- Compensation (if landing just under the threshold could be rewarded with a smaller payment).
- Bonuses (for example extra payments if the threshold is passed significantly).

[103] Sevenius (2015), p. 282.

- Cumulative measurement (that the result, in relation to the threshold, can be added in the measurement of the following year).
- Specific demands on the measurements, such as only sales of certain products being included in the turnover, which should be monitored by the accountant of the selling party.
- Synergies (whether the synergies between the target company and the acquiring company can be allowed to have an impact on the measurements).
- Tax effects (whether tax thresholds and tax payments should be included in the measurements or not).[104]

Finally, it should be said that earn outs are based on an option not very unlike other financial derivatives and are not only a result of negotiations but also a cost that is hard to include in the expectations for the acquiring party.[105]

3.2.4 Closing

When reaching the closing this is when the pre-negotiated agreement actually occurs. It can either happen separate from the signing date or in direct connection to the moment of signing. The most important parts of the closing are the payment of the purchase sum (if nothing else has been decided in the share transfer agreement) and the transfer of the shares. The precise actions that are to be taken at the time of closing can vary to a great extent and are decided upon in the share transfer agreement.[106] At the most basic acquisitions, the closing can be as simple handing over the share certificates in return for the promissory note for the purchase sum. While other acquisitions are more complicated and require several signed documents and arrangements to be carried out.[107]

[104] Sevenius (2015), p. 283.
[105] Sevenius (2015), p. 284.
[106] Forssman (2016), p. 183.
[107] Svernlöv (2004), Balans nr 10 2004.

If either party does not meet the provisions in the share transfer agreement the other party is entitled to indemnities, and in cases of failing to meet, what is viewed as, essential conditions the transfer agreement can be revoked. Condition precedents can be revoked while closing deliverables are linked to essential breaches of contract. While it can seem complicated for the acquiring party to return the target company this does not limit the possibilities of revoking the acquisition. However, after the completion of the acquisition the acquiring party should not be admitted the possibility of revoking the acquisition. The difference between a revocation tied to a condition precedent is mainly that the right to revoke at the failure of meeting closing deliverables is tested against custom criteria of essentiality. According to general contractual principles the counter party has the right to revoke an agreement in the case of essential breach of conditions. These principles are also applicable to breaches in meeting closing deliverables. The reason for separate regulation of the right to revoke is that the general right to revoke can be an optional provision and the parties can agree to remove this general revocation right.[108]

The usage of conditions for the completion of the acquisition do raise the issue of the loyalty between the parties. The parties do commonly avoid conditions in the agreement where only one party can assess the fulfilling. Despite this ambition there can be cases where the counter party has a limited level of control of the fulfilling of the condition.[109] Such type of condition could be the financing of the acquisition, which has been discussed in Svea Court of Appeal. It was a case regarding a property takeover, which was conditioned with the acquiring party being able to receive financing. In this case the acquiring party had themselves made sure that the pre-approved loan was recalled. The judges here said that for the acquiring party to have the right to revoke the agreement, in regard to this condition, they should show that either the bank has changed their mind on the ability of the acquiring party to repay the loan, on their own initiative, that their financial situation has

[108] Forssman (2016), p. 183–184.
[109] Forssman (2016), p. 185.

changed dramatically and unforeseeable after the signing of the agreement or that the worth of the property, which secured the loan, has severely decreased after the signing.[110]

[110] T 362-09.

4 Discussion

All acquisitions are unique, and so are the acquisition processes. However much the acquiring party tries to plan, examine and prepare one cannot predict the future. As mentioned above, acquisitions are often a strategically very important decision and often of huge importance financially. Whichever the reason for the acquisition it is, as has been shown and will be demonstrated further, very important for the acquiring party to know what goals they have and what they prioritize in the transaction.

If the acquiring party is aware of, or identifies, some of the underlying reasons for the selling party to be willing to discuss the acquisition this can also be of benefit for the acquiring party in the negotiations. All in all, one could say that it is about tactics, knowledge of priorities and good negotiation skills (which of course must be backed up with knowledge and information).

The transaction process can vary a lot depending on the priorities of the parties and in Sweden the process of the acquisition is not very regulated, neither are the components of the acquisition. Meaning that there is no regulation that sets boundaries for the transaction process, apart from filings to the Swedish Competition Authority (but that is not examined in this thesis, as stated in the delimitations section 1.4). As also described in section 2.1.2 some of the legislation that is applicable to the field of corporate acquisitions in Sweden is not created or designed specifically for the applicability on acquisitions. It is therefore reasonable to believe that the regulations that are in place are not optimized to ensure safe and valuable acquisitions for the parties of an acquisitions, both the selling party and the acquiring party. And the parties themselves, especially the ones who have extensive experience from several acquisition situations (both as a seller and as an acquiring party), thereby have room to act more freely and as they find tactical. One example of this being the previously mentioned strategic vagueness that has been showed to be used purposefully in acquisitions. However, as explained in

section 2.1.1, a common structure for acquisitions has developed within the field of corporate acquisitions. It is likely that it is the lawyers and advisory functions that have set this structure, as they often hold strong role in the transaction process.

4.1 Ensurance Through Warranties and Indemnities

As presented above, in section 3.2.1, warranties are a way for the parties of the transaction to ensure their interests. Naturally though, in order to ensure the interests, one needs to know what interests are prioritized and what can one choose to disregard in benefit of receiving something else. Along with the interests, it is important to know what risks one is willing to take. Furthermore, warranties have the role of describing the purchase item and in this aspect hold an important role for the acquiring party, as to what can be expected of the target company.

No matter the priorities and the interests of the acquiring party, including a general warranty (as the one explained in section 3.2.1) which covers the case of any negative surprises due to circumstances that the selling party knew of but did not inform the acquiring party of, should be high priority for the acquiring party. Having such warranty in the share transfer agreement should not be anything that the selling party disagrees of, and if the selling party does try to refrain from leaving such a warranty, this should be a warning sign for the acquiring party.

While it is of interest for the acquiring party to have extensive warranties to reduce the risks that come with the acquisition, one must also be aware that any warranties that the seller provides is reflected on the purchase sum. So, as an acquiring party, one must balance the interest on reducing the risks against the purchase sum and the financial limitations one stands against. A discussion closely connected to the amount of warranties in relation to the purchase sum, is the discussion of the length of the warranties. It is reasonable

to believe that the selling party wishes to limit these to the greatest possible extent, while it is natural that the acquiring party wishes to reduce its risks by promoting warranties that last for longer periods.

As previously presented there has been discussions on whether both warranties and due diligence really are significant as they both serve the purpose of reducing the risks for the acquiring party. However, it is beneficial for the acquiring party to make sure to use both tools to ensure their interests. One aspect to have in mind here though, is that at the takeover of private companies there are not any regulations of the process, such as there are takeover rules for publicly listed companies given by the exchange markets. These takeover rules have provisions on how the target company has to assist in the due diligence-process[111], compared to private companies that do not have any similar regulations on the due diligence process. Furthermore, it is likely that a publicly listed company has more extensive internal rules and routine for how to report internal developments etcetera each year. Such documentation that is done regularly and at a high standard (assuming that they have a high standard as they have pressure from external shareholders who demand the information) would have given the due diligence examination very valuable information, that might not be accessible in an acquisition of a private company. Furthermore, a private company might have access to less information when entering the acquisition process as well, compared to a process where one is looking to acquiring a publicly listed company. Another probable circumstance when examining a private company, is that a private target company might have less formal decision-making processes and therefore decisions taken in the past can be harder to trace, analyze and understand.

[111] See provision II.20 Nasdaq Takeover-rules or II.20 NGM Takeover-rules.

4.2 Ensurance Through Non-compete Clauses

Naturally the more extensive non-compete clause, the better for the acquiring party. As soon as the non-compete clause expires, and the selling party starts a competing business, the target company will probably see one of its greatest competitors emerge. However, it can be hard to measure how valuable the non-compete clause is, and it is hard to measure whether you really absorb the full worth of the customer basis, the know-how and the goodwill during the time that the non-compete clause is in place. Especially if the acquiring party is new to the business and the industry and needs time to settle in to the business before being able to fully profit from the non-compete clause.

Furthermore, taking the issue of non-compete clauses, these can be of varying importance and require varying extent depending on the industry of the target company. Since the length of the non-compete clause should be proportional in relation to efficient competition in society, the investment in goodwill and know-how of the target company and the freedom of the seller, the proportional length in time can vary depending on the industry of the target company. Say that it is an industry where the development is rapid, such as the IT-industry, it might not be proportional to have a non-compete clause that is even three years long neither might it be very prioritized for the acquiring party as they will then be aware that the development is fast.

If the acquisition has been done for strategical reasons as for what the target company has in its possession, intangible assets, geographical location or goodwill that is hard to compete with, then the acquiring party might not even be very interested in negotiating for longer non-compete clauses and can give the length in time up for something more prioritized, in the negotiations of the share transfer agreement, as these negotiations are often a lot about giving on some points and taking on other matters.

4.3 Beneficial Usage of Pricing Mechanisms

When looking at the financial side of the acquisition and the technical side of the payment options, a first question to be faced with is whether the acquiring party wants to acquire as a company or as an individual. This can, as explained in section 3.2.3 have impacts on how the financing is done. From the information presented in section 3.2.3, it would also be beneficial for the acquiring party to acquire as a company, rather than an individual.

When taking the decision of using price mechanisms the advantages (presented in section 3.2.3.1) and disadvantages (presented in section 3.2.3.2) must be weighed against each other. Once again, it comes down to an awareness of the risk that one is willing to take and the priorities one has. In this discussion though, it is important to remember that price mechanisms bear with them a cost and this cost is often very hard to valuate. So, when taking the decision of using price mechanisms, one likely takes on a cost that is hard to predefine and the worth of it can often only be estimated after the entire transaction process and after any warranty time limits have passed.

However, the price mechanisms are very focused on results and deliveries of different types in order to establish the final purchase sum. It is therefore reasonable to believe that this creates a very short-term financial focus for the management, rather than having a long-term view on what is best for the company and the future development. It can therefore be of importance to consider the probable shift in focus for the management team when choosing which pricing mechanism to apply, and how this focus aligns with the corporate goals after the takeover. This is especially important if the selling management team remains as management team after the acquisition. If so, their loyalty and incentives might be hard to predict seeing to their willingness to fulfill goals and forecasts. This can also have a hindering effect on post-acquisition integration, which in turn can limit results and developments in the target company. If the target company previous was managed by the

former owners of the company (the selling party) the same issue will not arise, however, the acquiring party might not be able to run the business at the same level as the previous owners, from day one after the takeover and therefore the same results might not be expected.

In addition, pricing mechanisms do often prolong the relationship between the parties. While warranties also prolong the relationship, discussions in relation to warranties only occur if claims of flaws are made. Discussions on purchase sums will on the other hand be reoccurring throughout the time of the pricing mechanism being active (until the period time of which a final or additional payment etcetera should be payed). So, if the acquiring party prefers a clean cut at the closing, it would be beneficial to not have price mechanisms that prolong the relationship between the parties. If the acquiring party is more interested in a relationship where the transition between the parties is more protracted, and since the selling party is interested in high results for a high purchase sum, also being able to receive advice in the first period after the takeover, a price mechanism could likely assist the acquiring party in receiving this.

Furthermore, it is imaginable that the selling party does not want to let go of the target company completely, despite what the acquiring party wishes, if the final part of the purchase sum the selling party will receive is dependent on the results of the target company.

4.4 The Time Between Signing and Closing

For the time between the singing and closing, and for what one can expect, as an acquiring party, at the time of closing the content of the share transfer agreement is very important. If having any demands, requests or expectations as an acquiring party at the time of closing these all have to be pre-decided in the share transfer agreement, otherwise one does not have anything to demand

really. Because it is what is decided in the share transfer agreement that matters.

One important part of the share transfer agreement, that has great impact at the time of closing, is what is listed as closing deliverables since this is a list of requirements that the acquiring party sets up. They must of course be approved by the seller, and are a topic of negotiations, but generally this is where the seller has the opportunity to ensure its interest between signing and closing. As what is decided upon in the closing deliverables is what is supposed to be accomplished at the takeover. If these deliverables would not be met the acquiring party is entitled to indemnities, as explained in section 3.2.4. Having conditions listed in the closing deliverables, and the phrasing of these is also the way for the acquiring party to ensure avoidance of unwanted circumstances that decrease the worth of the target company or ensure the right to be compensated in such a case.

Further explained in 3.2.4 is the agreement on removing the general right to revoke, which is optional for the parties to agree upon whether it should be in place or not for the agreement. For the acquiring party though, it is beneficial to ensure that such a right is a part of the share transfer agreement, even though the selling party might be willing to push for such a removal from the agreement.

Not to forget though is that the right to revoke, no matter the foundation of the revocation, has by Svea Court of Appeal (in case T 362-09, closer explained in section 3.2.4) been established to not be allowed to be related to actions (or avoidance of actions) from or by the acquiring party.

5 Conclusion

This thesis has researched the process of corporate acquisitions from the perspective of the acquiring party and with the perspective of an economic analysis of law. It also looked into possible key interests for the acquiring party in an acquisition party. To facilitate this research four research questions were used as a frame for the research for the thesis. This chapter will sum up the findings of this research.

Firstly, as a consequence of the fact that the majority of the sources of law have not in detail treated the topics that this thesis researches, the specifics of ensuring the interests of the acquiring party, clear answers to the questions are hard to find. However, a list of general recommendations have been listed in section 3.2 and some common guidelines and conclusions to the research questions have been identified through this research.

As can be concluded from the discussion in the previous chapter many of the questions regarding the acquiring party being able to ensure its interests comes down to the acquiring party knowing what the key priorities and goals are as early as possible in the transaction process, and especially when negotiating the share transfer agreement, and surrounding agreements. It is also important to know what is less important to fight for, in order to be able to give something in return when striving for the key priorities. Nonetheless, some specific priorities have been identified in relation to the four research questions of this thesis.

Warranties and indemnities:
In regard to warranties it is very important for the acquiring party to know its key interests in order to ensure that these are covered by warranties, and also that the acquiring party should make sure to have a general warranty in the share transfer agreement. Despite discussions in the field of M&A and what the selling party might say in regard to risk reducing measures, the doctrine

has showed that using both warranties and conducting a due diligence prior to the agreement is reasonable for the acquiring party. Especially considering the large financial risk that the acquiring party is taking with the acquisition.

Non-compete clauses:

Looking at the non-compete clauses these are recommended if the acquiring party is worried about the selling party starting a competing business or moving to an already existing competitor. However, one should be aware that the proportionate length of such clauses is individually assessed along with also holding a geographical limit, and it is not useful if the acquiring party does not actually need it. If the non-compete clause is not necessary, it can be an unintentional price driver.

Price mechanisms:

Price mechanisms can also be used to ensure the interests of the acquiring party and several different price mechanism options have been presented in section 3.2.3. A common trait for the price mechanisms has been revealed to be that, however they are structured they lead to an increased cost for the acquisition, even though the precise cost for price mechanisms has been showed to be hard to trace. This cost can nonetheless be worth it in the case of the acquiring party being worried in regard to the delivery of the seller and the acquiring party being willing to take the cost to be slightly safer toward this worry, and also knowing that the selling party, through the price mechanism, has an incentive to meet the delivery.

Closing:

As has been explained in section 3.2.4 closing can occur separately from the signing of the share transfer agreement. Meeting the delivery conditions is closely connected to the closing time and the deliveries are often carried out during the time between the signing and closing if they are not already fulfilled before signing and the delivery is rather a remainder of the conditions. Concerning other deliveries that are of priority for the acquiring party these should be listed as closing deliverables, to ensure that the

acquiring party does not have to stand the risk for unwanted occurrences between signing and closing.

No matter how the acquiring party tries to ensure its interests and reduce its risk it is important to be aware that all attempts in doing so will also be reflected in the purchase sum, as the reduction of risk for the acquiring party naturally increases the responsibility for the selling party. This meaning that a higher purchase sum might unfortunately be a consequence of trying to reduce risks. However, looking at what has been presented in this thesis, a generally suitable way of ensuring the interests as an acquiring party could be to have the interests listed as warranties, as warranties can be quite free for the parties to phrase as they like.

In general, this research has shown that the field of corporate acquisitions is rather free from restricting regulations in Sweden. Maybe this could be one reason for the acquisition business being so popular in Sweden, in fact the fourth most transaction intense country in the world, in a comparison of M&A transactions worldwide. As it is now, the branch of M&A law is relatively young in Sweden and it is reasonable to believe that the business of M&A has developed more rapidly than the regulations within the field.

This study has further shown that the parties and the industry itself has created its own custom. Seeing this through the perspective of an economic analysis of law, it would be beneficial for the security of the parties in the M&A industry if there were more regulations (that are designed for M&A specifically) on the matter, which would also protect the parties of the transactions to greater extent, ensure secure transactions and facilitate economic efficiency in the Swedish society. Especially as the industry of M&A continues to grow. Whichever regulations that would be created for this purpose they could be optional for the parties. Despite being optional the new regulations could, just as The Sale of Goods Act is, be used as guidance even in the cases where the parties have decided that it should not be applicable. This would create reassurance for both the parties and the M&A-

market in Sweden. While more provisions also could facilitate the future development within the field, both for future transaction parties and for economic efficiency in Sweden.

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