International Venture Capital Terms

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Although requirements for the board of directors and management apply to First North and Spotlight as well, they are not as strict as with the regulated markets, where the rules focus on requiring that the companies' management is organized in a manner that allows the company to comply to the rules for providing information to the market. Companies listed on First North are required to engage a Certified Advisor to assist with giving information, and companies on Spotlight are required to engage a mentor for the first two years after listing to assist the company in fulfilling the listing requirements. 27

Usually, the first step to an IPO is to employ a law firm to perform a **pre-IPO due diligence** of the company, to assess whether the company is 'market ready'. The due diligence process will be based on the respective market rules for issuers/members, and some of the topics needed to be addressed are a description of the legal and tax risks in the prospectus, the issuers material agreements, the issuers tax situation, corporate matters and records with relevance for the admission and an assessment of the issuers board members and executive managers' honesty and integrity. The law firm must be objective in relation to the issuer and may not have held any previous or ongoing engagements with the company itself. The due diligence report is then passed on to the exchange auditor, appointed by the marketplace, for review and approval. 28

Prospectus requirements differ between the marketplaces. For Nasdaq OMX Stockholm and NGM Equity, a prospectus must be produced prior to listing in accordance with the Financial Instruments Trading Act (SFS 1991:980) and the Prospectus Regulation. 29

The Swedish Financial Supervisory Authority *Finansinspektionen* (FI) is the financial regulator in Sweden, authorized to supervise and monitor all financial markets, including companies that operate under a permit required under law. Prior to an IPO taking place at one of the two regulated markets, FI must approve the prospectus regarding the IPO before any securities may be offered to the public or listed on a stock exchange. As in many other countries, FI does not take a position on the correctness of the information provided in the prospectus or the quality of the investment proposition, but merely reviews the prospectus for completeness, comprehensibility and consistency. The obligation of a member of a MTF to publish an approved prospectus is subject to certain limited exemptions, the most notable of which is that a company that offers securities to the public for a total value of less than EUR 2,500,000 during a total period of twelve months are exempt from the obligation to publish an approved prospectus, which is a substantial deviation from the Prospectus Regulation which sets the exemption threshold at EUR 8,000,000. 30

Prior to the public listing of an issuer, the issuer must take measures through decision of the general meeting to amend the articles of association and convert the company from a private to public company. This requires 2/3 of the votes both present and given at the general meeting. Further, a listing must consist of all shares of the same type. The articles of association may not, at listing, contain any restrictive terms such as consent clauses, rights of first refusal or post-purchase pre-emptive rights, all which serve to limit the transferability of shares. 31

Finally, the company must amend the articles of association in order for the company's shares to be registered in a central securities depository (CSD) register pursuant to the Central Securities Depositories Instruments (Accounts) Act (SFS:1479). A company aiming to list its shares on a marketplace applies with Euroclear Sweden AB for administration of the share register. 32

3. Winding up procedures/liquidation

33 When a legal entity is subject to winding-up procedures in Sweden, there are several options to consider. Bankruptcy, although not often the chosen method, is quite often the chosen when a company fails to generate income or profit, and the investors are unwilling to capitalize the company. The company can either voluntarily choose by long bankruptcy, or the proceedings can be brought to court by a creditor. In the event of a bankruptcy, a bankrupt estate manager is appointed to manage and disburse of the assets of the bankrupt estate, with the main objective to secure funds for the creditors.

34 An alternative to bankruptcy is that the company applies for liquidation proceedings. Liquidation proceedings are regulated under the Swedish Companies Act, and can in some instances be forced by the Swedish Companies Registration Office (e.g. due to the company not having a registered board of directors, not filing their annual accounts on time, or an accountant not being appointed) or by an order of a civil court of first instance (due to depleted share capital during a consecutive period or where conditions in the articles of associations that formally require liquidation are fulfilled).

35 A company can also enter into liquidation procedures by following a formal process, whereby the general meeting passes a decision to enter into liquidation. The board of directors or a shareholder may draft a proposal on liquidation, which needs to follow certain procedures and include information on the reasons for the proposed liquidation and what other options are available, from which day liquidation shall be enforced, the suggested date for disbursement of any assets to the shareholders and the expected amount of disbursements to be made.

36 As a result of this, an investor will seek protective measures in a SHA, typically requesting veto rights on decisions of winding-up procedures. Further, it has become more common for VC investors in later stages to request subscription for shares with liquidation preference, not only to position itself for an exit but also in order to secure priority to any assets disbursed (or the monetary equivalent of said assets).

37 According to Swedish bankruptcy legislation, the shareholders hold the lowest priority in the distribution of dividends during a liquidation or bankruptcy proceeding. Further, holders of preferred shares have priority to holders of common shares, especially if the preferred shares carry priority rights to assets in the case of a liquidation. Preferred shares are quite often requested by VC due to uncertainties of an early-stage investment. As such, holders of other securities such as common shares, convertible debt instruments and warrants will most likely not receive any dividends in a liquidation proceeding.

III. Legal regulations of the various 'players' of the VC market

1. Target

38 **a) Usual legal form. aa) Private company limited by shares.** Portfolio companies are almost exclusively formed as a private company limited by shares, in Sweden referred to as an *aktiebolag*, regulated under ABL. A private company limited by shares needs to have at least SEK 25,000 in share capital. The governance of a private company limited by shares is dictated by its articles of association, which must contain the following:

- company's business name
- the objects of the company
- the share capital, stated as a number or a minimum and maximum number (in a span with ratio of 1:4)

- the number of shares, stated as a number or as a minimum and maximum (in a span with ratio of 1:4)
- the number (or minimum and maximum number) of members (and alternates) of the board of directors
- the number of auditors, where an auditor shall be appointed
- the procedure for convening general meetings, including the obligatory decisions to be made
- the period to be covered by the financial year (usually January 1 to December 31).

The articles of association is a public document, and any terms set out therein cannot be held confidential by the shareholders – a person being offered shares in the company needs to be able to assess the rights and limitations of the shares. Further, the articles of association are legally binding not only upon the company but also upon a third party wishing to acquire shares. A **SHA**, on the other hand, does not need to be registered to be legally binding and is not a document in the public domain. A SHA in general does not bind the company itself (or its representatives, merely regulating obligations between the shareholders. The SHA therefore typically goes further in imposing terms and restrictions over its shareholders, than what is usually imposed through the articles of association. As a result, articles of association in Sweden tend to be a document limited in information, and many of the terms that companies in other jurisdictions are required to include in by-laws or articles of associations will in Sweden be regulated in a SHA or in other formal documents. **39**

There are certain restrictions relating to private companies concerning the amount of people shares can be offered to in the form of a ban of dissemination of shares and other instruments to the general public, why a private company is not a suitable company form for a company that wants to direct subscription rights in securities to a general public. **40**

A private company limited by shares can be converted into a public company through a resolution by the general meeting by a 2/3 vote and a subsequent amendment to the articles of association. **41**

bb) Public company limited by shares. A public company limited by shares is in general subject to the same legislation as a private company. Most often, a limited liability company will be established as a private company and **convert** to a public company later on. It is possible that a company will choose to be registered as a public company limited by shares from the beginning, most likely due to a wish to offer shares to the public, e.g., under a crowd funding scenario. A public company requires an issued minimum share capital of SEK 500,000. The administrative requirements for a public company are quite burdensome in comparison to a private company. The benefits are that only public companies are entitled to market its shares, subscription rights, warrants and debt instruments to the general public. Further, a company must be classified as public in order to register its shares or securities for trade on a regulated market or MTF. **42**

Certain statutory requirements apply to public companies under the ABL. For example, specific rules apply to convening the general meeting through public channels such as newspapers and public registers, the number of board of directors required is higher, a public company must always have a registered managing director and is further required to provide certain information to all shareholders on a regular basis. The latter results in the increased administrative burden. **43**

b) Capitalization. A Swedish private company limited by shares is as of 2020 required to have a registered share capital of at least SEK 25,000. A share cannot be **44**

issued at a price below its nominal value, but that price does not need to be paid on issue, or in cash. Although it is not common, in Sweden it is allowed for the share capital to be paid for by a non-cash contribution, but any such assets used must be conveyed to the company and the contribution must be of benefit for the company's operations.

45 As stated above, the minimum share capital of a public company limited by shares is SEK 500,000.

46 A Swedish company limited by shares may in general be capitalized in several ways, subject to the provisions of the ABL. The main formats are:

- Issuance of new shares
- Issuance of warrants
- Issuance of convertible instruments
- Issuance of instruments regarding equity loans.

47 In general, in connection to all issues of securities from a limited company in Sweden, the shareholders shall hold pre-emption rights to the new shares pro rata to the number of shares they own. This provision can only be deviated from where the shares are to be paid for with non-cash consideration, or if the articles of association provide for another order, the terms and conditions which have been issued in conjunction with an earlier issue of warrants or in conjunction with an earlier issue of convertible instruments, or if provisions of the issue resolution provide otherwise. A resolution on a directed issue with deviation to the pre-emptive rights requires a vote of 2/3 by the general meeting, a protective statutory measure provided to protect the existing shareholders from dilution.

48 The board of directors are not entitled to pass resolutions on issuance of shares or other securities other than subject to approval of the general meeting or pursuant to authorization by the general meeting.

49 Special provisions regarding resolutions on issuance of securities apply to public companies, primarily in relation to additional information afforded the existing shareholders prior to a decision by the general meeting.

50 **aa) Issuance of new shares.** Under Swedish law, the general rule regarding shares in limited companies is that all shares are equal. This may only be deviated from by the content of the articles of association, and any such amendments can only be made within the limitations set out in ABL. Shares are generally issued through a shareholders' resolution at a general assembly. If the issue is made within the limits of the articles of association, the articles do not need to be amended. No notarisation is required.

51 A company may issue different classes of shares, primarily of two sorts: common shares and preferred shares. All shares can be given different voting rights, but no share class may carry a lower vote than 1/10 of the strongest share. In early stages of VC in Sweden, it is common to issue common shares of differentiating voting rights, in order to secure the entrepreneur control of the company and at the same timing giving an early-stage VC investor a larger portion of the dividends of the company. This applies in particular to business angels and other early round investors and applies when the entrepreneur has a strong bargaining position. By contrast, a VC may also request shares with a higher vote in order to create a majority situation in votes despite only controlling a minority of the shares.

52 A **preferred share** typically provides preferential rights over the assets of the company, in the case of a liquidation or bankruptcy and/or distribution of proceeds. In general, preferred shares are not commonly used in Sweden. At later stages in a company's VC cycle, preferential shares of these sorts become more relevant and are

more often issued by a company receiving VC investment, with the most common form giving liquidation preferential rights to the company's dividends, especially in relation to institutional investors. If liquidation preference is requested, it is primarily in three formats: full-participation preference, non-participating preference, or capped-participating preference, with the latter being least common in Sweden today. The three types of preference shares carry with them different rights to distribution of dividends. Since most companies at a VC stage do not give dividends to its investors, these types of preferred shares will in most cases only have a practical effect in a sale of the company or the assets. The conditions for the preference shares are regulated in both the articles of association and the SHA, where the articles of association as stated above becoming legally binding on the company and any third parties (such as later stage investors) and the SHA being applicable towards the shareholders and providing a means to calculating the payment streams among the shareholders in a share transfer.

Most VC investments take the form of a directed issue, with deviation from the shareholders' pre-emptive rights. The issue is made at a premium in relation to the shares' quotient value, calculated on the basis of the company's value pre-issue (often referred to as a 'pre-money valuation'). The premium becomes part of the company's equity after the completion of subscription. A subscription must formally be registered with the Swedish Companies Registration Office within six months of its completion, and the board of directors is responsible for updating the share register upon subscription. **53**

bb) Issuance of warrants. A company may issue warrants, which entitle a holder to subscription of new shares in the future. A warrant can be issued for free or at a subscription price. The holder of a warrant may then during a fixed subscription period, with or without a preceding qualification period, subscribe to shares at a set price decided in connection to the issue terms (calculated as a figure or set by a formula for a market valuation). Normally, the company will issue a warrant certificate, representing the subscription right. A warrant may be subject to certain terms for conversion of the subscription price and/or amount of shares a warrant entitles to subscribe to, in order to account for amendments to the share capital and the outstanding number of shares that may occur during the period between issuance of the warrant and subscription period for new shares. The usual time period for a warrant can be between one to three years, and at a stage when VC funding is common, warrants may have its most important purpose in giving incentive schemes for employees or advisors, see under section V.1.f) for more information on VC incentive schemes. **54**

cc) Issuance of convertible debt instruments. As an option to issuing new shares or warrants, a company may issue convertible debt instruments, where the loan granted to the company under the issue may be used as payment for subscription of new shares in the future. This is quite a common bridge financing for companies in a VC stage, primarily where an early investor wants to assess the company's business plan and feasibility for later investments. The instrument is also useful if the parties have difficulties agreeing on a market valuation and need additional time for assessment on both sides. **55**

Often, a convertible debt instrument will allow the creditor to subscribe for shares at a **discounted** price in relation to the new investors that may subscribe to shares directly at a later stage. Further, a convertible debt instrument carries lower risk for the investor since they can choose to be repaid the loan rather than convert the loan to new shares. A creditor may also request that the convertible debt instrument is interest bearing. The **56**

convertible instrument carries some risk for the company , since the convertible amount is not in general treated as equity.

57 **dd) Issuance of instruments for equity loans.** Equity loans, a form of financing that has been common in the USA for a long time, used to be prohibited in Sweden. However, the legislator provided an opportunity for a company to pass resolutions on taking up equity loans in the adaption of the new ABL in 2006, if such resolution is adopted by the general meeting or by the board of directors following authorization by the general meeting. An equity loan has the characterization of a loan where the amount of interest which shall accrue on the loan or the capital amount which shall be repaid increases if the company's profits, market value or dividends to the shareholders' increase. An equity loan is in relation to the company's equity treated as a form of hybrid, registering as both principal debt and equity in the company's accounts. In Sweden, equity loans are not commonly used for companies seeking investment from VC.

58 **ee) Later investment rounds.** A shareholder is, in general, entitled to pre-emptive subscription rights in later rounds in relation to the shares it holds. A note on this should, however, be given to the investor. This relates to common shares, but in the event that common shares have different voting rights, or the articles of association limit the number of shares of each class that may be issued, an investor holding preferred shares may not be entitled to activate pre-emptive rights to subscribe for new common shares, and vice versa.

59 It is therefore important when a company has issued shares of different classes to regulate **pre-emptive rights** in both the articles of association of the company, a shareholders' or investment agreement in order to secure anti-dilution rights of a shareholder, and to regulate the pre-emptive rights for the different categories of shares.

60 **c) Shareholders' rights and duties.** As in many other jurisdictions, a shareholder in a private or public company has no statutory positive obligations other than paying the price of the shares when they founded the company or, at a later stage, subscribed to new securities. There is no general, express or implied obligation for a shareholder to provide further funding or to even act in the best interests of the company. Should the company become insolvent, leading to liquidation or bankruptcy proceedings, the shareholders' liability is limited to the amount they have agreed to pay for the shares at the time of the initial investment.

61 The governance of a company limited by shares is dictated by its articles of association, to which each shareholder is legally bound to. The articles of association can in certain instances be legally binding towards third parties, as is the case where a post-sale purchase right clause is included. The articles of association can, in addition to the mandatory conditions set out under section III.1. a) aa) above, contain optional clauses that restrict the shares. These include clauses that restrict the transfer of shares from a shareholder to a third party, and are categorized in the following way:

- consent clauses, whereby a share transfer is made subject to shareholders' consents;
- right of first refusal, whereby a shareholder shall be invited to purchase a share prior to a transfer to a new owner; and
- post-sale purchase rights, whereby a shareholder (or another person) may be entitled to purchase a share which has been transferred to a new owner.

62 The board of directors manages the business of and acts on behalf of the company. The general meeting is the forum whereby the shareholder can invoke his rights over the company, by electing the board of directors and casting votes on resolutions to which the general meeting has absolute authority over. Certain matters will always

require a formal decision by the shareholders during a general meeting. These resolutions include, but are not limited to:

- any amendments to the company's articles of association,
- changing the company's name or object of the business
- election of board of directors
- approving subscription issue of shares, convertible debt instruments, warrants or stock options or other financial instruments
- approving a reduction of capital or share buy-back out of capital,
- adoption of the annual accounts
- resolutions on payments of dividends.

Most resolutions require a simple majority of over 50 %. Certain resolutions require an absolute majority of 2/3 or 9/10 of the votes both cast and present at the general meeting. A passive shareholder who decides not to cast a vote can thus not affect the outcome of the vote itself. **63**

A private company limited by shares is required to hold an **annual general meeting**, in order to adopt the annual accounts. The general meeting must be held 'where the company is registered'. Although the COVID-19 pandemic has called for resolution to allow for digital general meetings, the Swedish Companies Act has not been adopted to take this into account, although some amendments were put in place to make participation on a digital platform easier. A meeting doesn't need to take place in person if all shareholders agree on the resolutions to be made, in which case minutes can be circulated to representatives of all shareholders for execution and the general meeting is then considered to have been held *per capsulam*. **64**

Shareholders have few rights under the Swedish Companies Act. First and foremost, a general rule is that all shares hold the same rights unless otherwise provided by law or under the articles of association. This is derived from the Swedish Companies Act, where it is set out that the general meeting may not adopt any resolution which is likely to provide an undue advantage to a shareholder or another person to the disadvantage of the company or another shareholder.[5] **65**

A shareholder is entitled to participate at a general meeting, to receive any documents that the company must provide under law and may initiate proceedings against resolutions of a general meeting that have not been adopted in due order. If a company has less than ten shareholders, the right to information to a shareholder is extended vastly, giving a shareholder a right to review accounts and other documents which relate to a company's operation. It is common practice for a VC to require at least the same level of information in a SHA, in order to make sure that the same level of transparency can be upheld after the company has increased its shareholdings. More commonly, a company receiving VC funding will have to provide information in excess of what is required under law, in order to align the information flow with the VC's internal reporting process. **66**

There are further some statutory minority shareholder control instruments in the ABL worth pointing out, namely the following: **67**

- A holder/holders of at least 10 % or more of the votes may:
  - neglect a Director discharge from liability;
  - require the general meeting to allocate company profits of at least 1/10 of the profits set out in the company's profit and loss account, subject to certain restrictions;
  - elect a minority shareholders' auditor (at the cost of the company);

[5] Chapter 7 § 47 of the Swedish Companies Act.

- propose and support the appointment of a special examiner (at the cost of the company), in order to review transactions on a general scope or specific transactions;
- prevent the conversion of a public company into a private company (or vice versa).

– Holder(s) of 1/3 or more of the votes may prevent a conversion from a private to a public company.

68 Due to the legislative boundaries of control above, it is common for founders of a company seeking VC funding to afford minority shareholders' rights in excess of the rights granted under the articles of association or law, including veto rights, right to information and entitlement to elect board representatives under a shareholders' agreement.

69 **d) Management/board of directors.** Both private and public limited companies are legally required to elect and be managed by a **board of directors**. The board of directors have a fiduciary duty to act in the best interest of the company and is responsible for the organization of and management of the company's affairs and shall regularly assess the company's financial position. The board of directors must consist of at least one regular member and one deputy. In Sweden, over half of the members of the board of directors must be residents of the EU/EEA. If no director is domiciled in Sweden, a deputy of service must be appointed in Sweden.

70 In particular if the portfolio company becomes insolvent a director can become personally liable for the company's debts if the company is guilty of wrongful trading or fraudulent trading (in short, continuing to enter into obligations with third parties and incurring debt once it is clear the company is insolvent).

71 A VC most often requests the opportunity to be represented by at least one member of the board of directors. It is also common for VCs to request the ability to appoint an observer to the board of the portfolio company, with the right to attend and speak (but not vote) at meetings of the board of directors of the portfolio company. This provides the VC with visibility, without any of the liabilities of the board of directors being laid upon the VC representative.

72 For companies with at least 25 employees, employees are entitled to representation on the board of directors.[6] This often results in even small companies carrying a large board of directors, in order to keep the employee representatives in minority.

73 Lately, there has been an increase in the use of 'sweat equity' funded **advisory board** with VC funded companies, most likely influenced by the US VC scene. Also, advisory boards without equity occur, but in that case, they are paid a fee. An advisor to the founder will receive a small portion of the shares (around 1 %) for providing in kind time towards the company's management. The advisory board does not in itself hold any authority over or legal obligation or liability towards the operations of the company. The application of advisory boards also carries a tax element, since directors by law are required to pay income tax on any reimbursement earned. An advisor can provide its services as an independent contractor, keeping the tax burden low for both the advisor and the company.

74 **e) Incentive programs.** For some VC-owned companies, an incentive program will seek to incentivize management and other key employees by offering them to invest through an instrument that qualifies as a security (such as shares, warrants and convertible debt instruments). Incentive schemes in Sweden in companies in a VC phase are usually set up in one of four different ways:

[6] Rules on procedure and requirement can be found in the Private Sector Employees (Board Representation) Act (SFS 1987:1245) and the Cross-Border Merger (Employee Participation) Act (SFS 2008:9)