

# **Bankruptcy and a fresh start: stigma on failure and legal consequences of bankruptcy**

## **Sweden**

### **Title 1. Introduction**

The Swedish legislation on insolvency does not constitute a coherent body of legal rules. Provisions regarding insolvency are found in a number of laws that came into force in different periods of times and to serve different purposes. The main laws on insolvency are the Bankruptcy Act (1987:672) and the Company Reorganisation Act (1996:764), but the Preferential Rights of Creditors Act (1970:979), the Salary Guarantee Act (1992:497) and the Companies Act (1975:1385) are equally important.

The work of the Swedish legislator has been directed by specific needs risen at different times for different interests. The Swedish insolvency legislation therefore lacks an obvious systematic order. This is further elucidated by judgements by the Supreme Court which complete existing legislation, however there is in Sweden not much case law concerning insolvency. By tradition, the Swedish insolvency legislation is mainly focussed on the creditors' interests. This is especially obvious in the Bankruptcy Act, but can also be seen in the Reorganisation Act.

The bankruptcy proceeding was for a long time unregulated. Before 1921 ordinary civil law provisions were considered applicable since bankruptcy proceedings were conceived as civil law cases. By introducing a new law in 1921, the legislator wanted to emphasise on bankruptcies as liquidation proceedings. The current Bankruptcy Act was adopted in 1986. Some of the news introduced was the uniform procedure, the simplified dividend procedure and the receiver's possibilities to take into consideration not only the creditors' interests but also employment interests. The Company Reorganisation Act, enacted 1996, is relatively new compared to the bankruptcy legislation. Before 1996 there was however a law regulating compositions.

The two main Swedish insolvency procedures - bankruptcy and company reorganisation - have different purposes, different requirements and different legal consequences.

The Company Reorganisation Act expressly aims at the survival and the continued business of a company in financial difficulties. It is applicable on companies as well as on sole traders, however only on those companies/businesses with a potential to survive. The purpose of a reorganisation according to the Company Reorganisation Act is to make it possible for debtors with financial difficulties to take measures in order to reorganise themselves outside the scope of bankruptcy proceedings. There are two different ways of reorganisation, financial reorganisation and reorganisation of the business itself. A financial reorganisation is often effected through a judicial composition and provisions concerning such composition have been incorporated into the Company Reorganisation Act. Reorganisation proceedings will be discussed in chapter 4.1 and judicial composition in chapter 4.2 below.

The main purpose of a bankruptcy proceeding is to wind up the debtor's business, convert assets into cash and distribute the surplus among the creditors. If the debtor is a company, the bankruptcy proceeding normally results in a winding up of the company. Bankruptcy proceedings are applicable on all legal entities, as well as on natural persons. Only the state and municipalities etc. cannot go bankrupt. The procedure is uniform, i.e. the same proceeding apply for companies and for natural persons, whether trading or not. In principle a bankruptcy procedure has priority over a reorganisation procedure. However if a reorganisation procedure is started, an application for bankruptcy will be tabled. Although bankruptcy proceedings do not aim at reconstruction of companies, the procedure is often successfully used for this purpose. Bankruptcy proceedings are considered a good way to reorganise unprofitable businesses. The effect of bankruptcy proceedings on a company's possibilities to make a fresh start will be discussed in chapter 5 below.

Beside liquidation through bankruptcy, a company can also be liquidated according to the Swedish Companies Act (1975:1385). This is a diversified procedure and it does not only apply to insolvent companies. Some of the liquidation grounds have other purposes than winding up an insolvent company. Liquidation can for example be a form of sanction on companies that do not follow the provisions in the Company Act. Nevertheless, such liquidation often concerns insolvent companies and will therefore be discussed in chapter 4.3. Chapter 6 will contain a concluding comprehensive discussion.

## **Title 2. Definitions and terminology**

*Ackord* "Composition" - A financial settlement between a debtor and his/its creditors. It can be a voluntary composition (informal compromise), or a judicial composition within the scope of a reorganisation proceeding. In a judicial composition the majority of creditors can agree to an arrangement with the debtor that will be binding for the minority.

*Företagsrekonstruktion* "Company Reorganisation" - A legal proceeding aiming at reorganisation of the business of a company in financial distress by making various reforms and/or initiate a financial settlement with its creditors. The reorganisation proceeding is handled by the *Företagsrekonstruktör* "Administrator" who is appointed by the court and whose tasks are inter alia to establish a reorganisation plan and negotiate with the creditors.

*Konkurs* "Bankruptcy" – The legal process where all the debtors assets are taken in charge by the *Konkursförvaltare* "Receiver" for the purpose of winding up the company. The *Konkursbo* "Bankruptcy estate" is a legal entity in its own right and can as such enter into obligations during the process of realising the assets to facilitate that the creditors of the company receive as large a dividend as possible.

*Likvidation* "Liquidation" – An alternative way of winding up a company to bankruptcy. The assets are taken care of by the *Likvidator* "Liquidator" who will try to realise the assets, pay the creditors claims, the liquidation costs and give out the surplus proceeds to the shareholders. A fundamental requisite for liquidation is that all creditors receive full payment.

### **Title 3. Warning lights and prevention of insolvency**

There are several different ways to detect if a company is in financial difficulties. Some offer the possibility of early detection while others offer detection just prior to insolvency. These methods will be discussed below.

Swedish law requires that limited companies be registered at the Patent and Registration Office. The Register contains information on the objects of the company, the board, auditor(s), share capital and other matters but not including ownership. The Patent and Registration Office must be notified of any changes to this information. It is also possible to obtain information from the Patent and Registration Office on whether the company has registered any floating charges. Similar information regarding mortgages may be obtained from the land registration authorities in the appropriate district. Limited companies are under a duty to draw up for each financial year annual accounts, including a profit and loss account, balance sheet and management report. Copies of these must be filed with the Patent and Registration Office. Larger companies are also under a duty to file interim reports. The Patent and Registration Office on a regularly basis check on whether the limited companies are fulfilling their obligations above and if this is not the case they may be involuntarily wound up as a result.

The Companies Register is accessible to the public and for a small fee anyone may request a printout from the Register, showing the above-mentioned information. It is also possible to ask the Patent and Registration Office for copies of annual reports and other documents relating to limited companies, such as the articles of association. The information filed with the Register gives a good indication on whether companies are gradually entering into financial trouble but, depending on when the information was filed, it may not be accurate or recent enough to indicate when a company may become insolvent.

The state authority for execution of judgements in respect of financial obligations (the “enforcement service”) provides information relating to companies’ unpaid debts to the state. It is possible to receive information from the enforcement service about enforcements which have been started, such as a levied distress on a company’s goods.

There are also several private credit reference agencies that sell information on late payers and non-payers of debt. It is quite common that companies co-operate with these agencies and receive credit rating information directly via computer communication. However, banks and finance companies are not obliged to release such information about their customers without their customers’ consent.

Bankruptcies and public cancellations of payments are announced in the daily press and in the Official publication, the Swedish Official Gazette.

There are, as mentioned above, several ways of detecting whether a company is in financial difficulties. It is however up to the company through its own internal procedures to see to that it monitors any company that it does business with. A company that uses a combination of the above methods has the best chance of knowing when a debtor may be having financial difficulties which could impact on its own business.

## **Title 4. Legal possibilities to continue economic activities**

### **Chapter 4.1 Reorganisation**

#### *§ 1 Description of the regime*

The purpose of company reorganisation proceedings is to make it possible for companies with financial difficulties, but with the potential to survive, to take measures in order to reorganise themselves outside the scope of bankruptcy proceedings. The company is through reorganisation granted a respite, with respect to liquidity, which hopefully will enable it to perform various reforms and/or initiate a composition. Reorganisation proceedings ensure that the situation will be handled in a professional manner and that all creditors will be treated alike.

In 1996 Sweden adopted a new law regarding reorganisations, the Company Reorganisation Act. A new reorganisation procedure was needed as an alternative to bankruptcy in certain cases, where the business of the company could be considered viable and could continue its business in whole or in part, in some form. Under the company reorganisation procedure a debtor who is engaged in business will, with the assistance of an administrator appointed by the court, attempt to reorganise its activities and make an economic settlement with his creditors without bankruptcy.

During a reorganisation the company may not, without the consent of the administrator, pay any debts originated prior to the initiation of the reorganisation proceedings or offer collateral for any such debt. During the proceedings the company cannot, normally, enter into bankruptcy and creditors cannot rely on public execution to seize company property in order to secure payment of debts. The Company Reorganisation Act does not regulate how the debtor's property may be used or sold. The debtor retains control over its assets but must consult with the administrator. Only with the administrator's consent may the company assume new obligations or otherwise dispose of property that is of importance to its operation or business. If the debtor neglects its duties in this respect the court can decide to bring the proceedings to an end.

The agreements entered into by the debtor before the reorganisation remain in force during the reorganisation. However, the debtor is not obliged to perform his obligations during the reorganisation. Any contract entered into through the administrator, such as the ordering of goods or services, will be given priority over those entered into before the reorganisation proceedings began.

The Company Reorganisation Act is applicable equally to incorporated and unincorporated trading entities. Certain businesses fall outside the scope of the Company Reorganisation Act, such as banking companies, insurance companies, securities companies etc. Neither is the Company Reorganisation Act applicable to debtors over whose business the State has a controlling influence.

The Company Reorganisation Act also contains detailed provisions regarding judicial composition. The procedure of composition will be discussed in chapter 4.2.

### *§1.1 Criticism of the regime*

The Company Reorganisation Act has been in force for five years and public opinion is that it has not lived up to expectations. It has been criticised in different aspects. A study made in 2000 showed that the procedure has not been much used. Only 593 companies filed for reorganisation between 1996 and May 2000. This can be compared with the number of bankruptcies during 1997 - 1999, which was 25 879. A reason for this might be that companies run their business at a loss for too long. When they finally apply for reorganisation it is too late and bankruptcy is the only remaining solution. Also, bankruptcy is more favourable in certain respects. For example, a wage guarantee is payable in bankruptcy proceedings but not in reorganisation proceedings.

Another criticism of reorganisations is that they often only aim at a financial settlement, either through an informal compromise or through a composition. In many cases however, the company needs not only to make an arrangement with its creditors but also to reorganise its activities to be able to survive in the long run. While the former is common in reorganisation proceedings the latter is rare. If the reason for the financial difficulties of the company is the way the business has been carried on, a financial settlement with the creditors is not enough. If the company continues to carry on its business in the same way as before, a new application for reorganisation will soon be necessary.

Also the proceedings can merely be a way to postpone bankruptcy. In that case it has caused unnecessary costs and loss of time. According to the study mentioned above only 23,1 % of the reorganisations were successful in that the companies were able to continue business. In 299 cases, reorganisations ended with bankruptcy.

### *§ 2. The procedure*

The court of first instance in reorganisation proceedings is the district court. The decisions of the district court may be appealed to the Court of Appeal and eventually to the Supreme Court.

The procedure starts with an application from either the company/debtor or a creditor. If the court approves the application, the court appoints an administrator and sets up a date for a creditors' meeting before the court, which shall take place within three weeks following the order. At the meeting the creditors may express their opinion as to whether the reorganisation shall continue or not. As a basis upon which to formulate their opinion the administrator will normally present a preliminary reorganisation plan. The plan will contain information about the company's financial difficulties as well as suggestions of measures to be taken in order to achieve the purpose of the reorganisation. If any of the creditors so demands, the court shall appoint a creditors' committee. In that case the administrator must consult with the committee on all significant issues. The creditors' meeting is also an opportunity for the court, which initial decision normally is based on incomplete information about the company, to gain a more complete picture of the company and see if the necessary conditions for reorganisation are still at hand. After the meeting the administrator shall continue investigating the company in order to complete the reorganisation plan. The proceedings can result either in a successful reorganisation in which case the company continues business, or bankruptcy. The reorganisation procedure will normally end after

three months and may under no circumstances proceed for a period longer than a year following the order.

### *§ 3. Criteria to benefit from the regime*

In order to benefit from the regime, the court must establish that the debtor is unable to pay its debts as they fall due or that such inability will exist within short period of time. There is no need for proof of insolvency (cp. bankruptcy), only difficulties in paying debts. It must also be established that there is reasonable cause to assume that the purpose of the reorganisation can be achieved.

### *§ 4. Specification of the possible initiators of the procedure*

An application for reorganisation may be submitted by the debtor or by a creditor. The reason why both the debtor and a creditor may file for reorganisation is that it is important that the reorganisation proceedings begin at the earliest possible stage. This aim is facilitated if several actors can commence proceedings. If a creditor applies, the debtor must consent to the application. The reason for this is that the whole procedure is based on the debtor's participation. In practice it is usually the debtor who files for reorganisation.

An application from the debtor shall contain:

- a brief account of the debtors' finances and the reasons for the payment difficulties;
- a schedule of creditors;
- a statement regarding the manner in which the debtor believes the business should be operated and how an agreement could be reached with the creditors; and
- a nomination of an administrator.

An application from a creditor shall contain:

- information regarding the creditor's claim;
- information regarding the debtor's difficulties in fulfilling payment obligations; and
- a nomination of an administrator.

The application forms the basis of the court's decision. It can of course be difficult to present a complete picture of the company's affairs already in the application, especially if it is a creditor who applies. Consequently the court can only make a summary examination at this stage. As a consequence, in practice the court approves in practice most of the applications for a reorganisation.

### *§ 5. Administration of the procedure and the role of the different actors*

The role of the *administrator* is to investigate whether it is possible to continue the business and if so, in what manner this could be done and also whether there exists a possibility for the debtor to reach a financial agreement with the creditors. The result of his investigation shall be presented in a *reorganisation plan*, which shall be submitted to the court and the creditors. The plan shall set out the manner in which the reorganisation shall be achieved. The contents of the plan may vary according to the circumstances in each case. It can, for example, contain a suggestion of a composition arrangement or merely that the business should be wound up. Normally the plan will be presented to the creditors in a preliminary form at the first creditors' meeting. The

administrator can be regarded as the debtor's qualified adviser, notwithstanding that he also has to take the creditors' interest into consideration.

The *creditors* have an important role in reorganisation proceedings and several provisions of the Company Reorganisation Act relate to the creditors' position and their protection. First, they have the opportunity to express their opinion at the creditors' meeting. Since a successful reorganisation requires the co-operation between creditors, debtor and administrator, the creditors' opinion is crucial. The creditors can also request that a creditors' committee be appointed. Further, a creditor can make a request to the court that the reorganisation proceedings be terminated. Upon such request, the court shall terminate the reorganisation if its purpose cannot be determined to have been achieved. If there is special reason to believe that a debtor is taking or is failing to take a particular measure and thereby jeopardising a creditor's right, the court may, upon the request of a creditor, make appropriate orders to secure such rights.

The *debtor* has certain obligations during the proceedings. He is obliged to provide the administrator with financial information and he must comply with the administrator's instructions. If the debtor neglects his duties the court can, upon the request of a creditor, terminate the proceedings. Further the debtor must obtain the administrator's consent before he pays debts that arose prior to the order for the reorganisation and he may not incur new obligations without the administrator's consent. However, if the debtor fails to comply with this it does not affect the validity of such actions. Further, during the reorganisation the debtor is, with a few exceptions, protected against execution and other enforcement measures.

It is the *court* that initiates and terminates the reorganisation proceeding. However, its powers are considered restricted in these proceedings. The court is for example prevented from setting aside contracts and extending credit periods. On the whole the court does not play a very active role in the proceeding.

#### *§ 6. Termination of the procedure*

A reorganisation shall be terminated by the decision of the court in the following situations:

- the purpose of the reorganisation has been achieved;
- the debtor fails to appear at the creditors' meeting without legal cause;
- the debtor so requests and an order regarding composition proceedings has not been entered;
- the administrator or a creditor so requests and the purpose of the reorganisation cannot be said to have been achieved; or
- if there is another special reason.

Also, the reorganisation will terminate if the debtor enters into bankruptcy. If none of the above situations occur at an earlier stage, the court will decide to terminate the reorganisation after three months. That period can under certain circumstances be extended to a maximum of nine months.

### *§ 7. Degree of information towards creditors*

The administrator's obligation to establish and submit a reorganisation plan to the creditors guarantees access to essential information about the company. Moreover, as a result of the principle of public access to official documents, a creditor has normally access to all the documents submitted to the court.

### *§ 8. Costs related to the procedure*

The administrator is entitled to compensation from the debtor for work and expenditures necessitated by his appointment. The fee established must be a reasonable compensation for the assignment. The court shall, upon the request of the administrator or the debtor, adjudicate on the appropriate level of compensation. The debtor shall also bear the costs for the adjudication by the court.

The reorganisation proceedings have been criticised for being too long-drawn and being too expensive. The study mentioned in chapter 4.1 § 1.1. above has shown that the costs for the debtor for a reorganisation amount to between SEK 20,000 and 2,000,000.

## **Chapter 4.2 Composition**

### *§ 1. Description of the regime*

The legal definition of a composition is a financial arrangement between a debtor who is insolvent and his/its creditors. Three different forms of composition exist under Swedish law, namely: a composition within the scope of bankruptcy proceedings, a judicial composition within the scope of reorganisation proceedings ("offentligt ackord") and an informal compromise ("underhandsackord"). Since a composition within the scope of bankruptcy proceedings is highly unusual and the informal composition is rare, the following discussion is confined to judicial composition.

Before 1996 a judicial composition was an independent proceeding under The Compositions Act (1970:847). After being incorporated into the Company Reorganisation Act in 1996, it is now only available to those companies that fulfil the requirements for a reorganisation proceeding.

The purpose of a composition is to relieve the insolvent company of part of its aggregated debt and therefore ensure the continuation of the business. The debts written off as a result of the composition will no longer be enforceable and the debtor will no longer be regarded as insolvent.

A judicial composition arrangement only includes unsecured creditors and only debts incurred prior to the initiation of the reorganisation. As a rule all debts shall be treated *pari passu*, meaning that all creditors shall receive the same percentage of their original claim. There are, however, two exceptions to this rule. First, a creditor may voluntarily accept a lower percentage. Second, it is not logistically possible to handle a great number of small creditors in the arrangement procedure. It is therefore possible to state that all debts up to a certain limit will be immediately and fully paid. Moreover, a composition arrangement does not have to decrease the claims; it may also be used just

to create a moratorium with respect to the company's payments since the moratorium granted through the reorganisation proceeding itself normally only lasts for three months.

The arrangement is binding on all unsecured creditors. It does not matter how they voted, if they voted or even if they knew of the arrangement. Therefore, in order to ensure that all known creditors are included in the arrangement the officers of the company must swear an oath, if any creditor so demands, ensuring that the company has done its best to find all creditors and send them the arrangement proposal.

### *§ 2 The procedure*

In order to file for a judicial composition the company must prove that it has mailed the arrangement proposal to all its creditors and that 2/5 of the creditors representing 2/5 of the total debt of the company declare that they accept the arrangement. In order to facilitate the creditors' decision the proposal must include:

- a reorganisation report in which the reorganisation administrator shall describe the progress of the reorganisation, present the proposed arrangement in detail and state his opinion whether it will benefit the unsecured creditors;
- a recent inventory of the company's assets;
- the latest available balance sheet; and
- a reply form which the creditors may use to accept or reject the offer.

The court will then summon the unsecured creditors to a meeting during which they shall vote on the arrangement. The voting procedure is sometimes a mere formality since the administrator generally urges the creditors to grant him a mandate to vote in favour of the arrangement when he is rounding up the 2/5 of the creditors needed to apply. If the arrangement gives the creditors a dividend of at least fifty per cent of their claims 3/5 of the creditors representing 3/5 of the total debt must vote in favour of the arrangement. If the arrangement gives the creditors a smaller dividend 3/4 of the creditors representing 3/4 of the total debt must accept the arrangement.

The composition proposal must include the payment of at least 25 % of the claims made by the non-preferential creditors and payment in full to preferential creditors. If the percentage of repayment is any lower, all known creditors who would be affected must either agree the proposal for the composition or there must be specific reasons for accepting a lower figure.

The law does not elaborate on what these specific reasons might be but leaves this matter to the discretion of the court. If a composition with a lower percentage is the only viable solution for the company, then the court may regard this as a sufficient reason for accepting a lower figure.

If the conditions are met the court will ratify the arrangement. Ratification may be appealed to the Court of Appeal. Payment should normally be made within a year from the day the court approved the composition.

### *§ 3. Criteria to benefit for the regime*

The initial criteria to benefit from the regime of judicial composition are the same as for a reorganisation. It is not possible to apply for a composition outside the scope of the reorganisation proceedings. When the judicial composition was incorporated into the Company Reorganisation Act, critics considered it unfortunate that compositions would be available only for companies who fulfilled the requirements for a reorganisation. The legislator, however, considered it unlikely that many debtors in need of a judicial composition would not fulfil the requirements for a reorganisation. If the company's purpose for a composition would be to wind itself up, bankruptcy proceedings would be a natural alternative.

### *§ 4 Specification of the possible initiators of the procedure*

The administrator generally drafts the documents needed for an application for composition proceedings, but the company must formally apply for the arrangement itself.

### *§ 5 Administration of the procedure and the role of the different actors*

The function of the *administrator* is to investigate and negotiate with the creditors in order to conclude a composition.

*Creditors* may be divided into two categories:

- creditors whose rights will be affected by the composition (and who are entitled to vote at the creditors' meeting); and
- creditors who are not entitled to vote, since their rights are not prejudiced by the composition. This category includes preferential and secured creditors and creditors who will be paid by reason of being able to set off their claims against payments due by them to the company. Where only a partial set-off applies, such creditors may vote to the extent that their claims are not covered by payments due to the debtor.

Participation in the proceedings is limited to those creditors whose claims arose prior to the decision to institute the proceedings. Those creditors whose claims arise after such a decision have an automatic priority over all "pre-decision" creditors and must be paid in cash. A creditor is entitled to participate in the proceedings even though his claim has not yet fallen due. Accepting the composition does not bar the creditors from claiming payment in full from any third party that guaranteed payment.

The existence of such "divided" creditors' collective has been criticised and debated. Creditors with security might be unwilling to take part in a reorganisation of the company while unsecured creditors have more reason to do so. For preferential creditors execution measures or bankruptcy can be as good an alternative to reorganisation. Non-preferential creditors on the other hand, will most probably receive more from a reorganisation than from a bankruptcy. The regime would probably work better and its purpose would more easily be achieved if all the creditors had the same aim and interests.

Since a composition proceeding is an integral part of the reorganisation proceeding, the *debtor's* obligations are the same as mentioned in chapter 4.1 (§ 5).

### *§ 6 Termination of the procedure*

Commonly, the composition proceedings are terminated because the financial situation of the company makes it impossible to continue, leaving a petition for bankruptcy as the only alternative. Sometimes, however, the composition is successful and the company returns to financial health. The composition is regarded as terminated in any of the following circumstances:

- the composition proposal has been accepted, ratified by the court and the distribution has been completed in accordance with the proposal;
- the proposal is rejected by the court; or
- the debtor has been allowed to withdraw the proposed composition or the proposed composition has never been accepted.

Also, the court may, upon request by an affected creditor, order that a composition be forfeited if the debtor has:

- committed fraud against the creditors or surreptitiously favoured one creditor against another;
- failed to fulfil its obligation to provide a supervisor with information and comply with the supervisors instructions; or
- in some other manner manifestly failed to perform its obligations pursuant to the composition.

In the study mentioned in chapter 4.1, only 78 out of the 593 applications for reorganisation proceedings resulted in a composition.

### *§ 7 Costs related to the procedure*

The debtor must, in the demand for a composition, append payment of the court costs for the administration of the composition as well as security approved by the court for such amounts as are not covered by the advance.

### *§ 8 Publicity conditions*

Following a demand for composition proceedings, the court shall publish an order regarding composition proceedings in the Swedish Official Gazette.

## **Chapter 4.3 Liquidation**

### *§ 1. Description of the regime*

The aim of a liquidation is not a continuation of a company's business, but to facilitate for the owners and creditors to come out of a bad investment or a bad financial engagement. The purpose of liquidation proceedings is to terminate the activities of the company in such a way that all the company's creditors receive full payment of their claims and the assets of the company are distributed so that the shareholders get back as much as possible of the capital they have invested.

Limited liability companies may be wound up through liquidation for a number of different reasons. A limited company may go into liquidation purely voluntarily if the shareholders no longer wish to continue the business, a so-called voluntary liquidation. There may also be an obligation to go into liquidation whether or not the shareholders wish to do so, a so-called compulsory liquidation. In a liquidation a liquidator is appointed by the court or the Patent and Registration Office to carry out the liquidation process and the winding up of the company.

The liquidation process is a civil law procedure. Depending on the grounds for liquidation, the Patent and Registration Office or the district court in the district where the company has its registered place of residence, will decide on whether the company should go into liquidation.

### *§ 2. Criteria to benefit from the regime*

A company can according to the Companies Act be liquidated on several different grounds. A limited company may go into liquidation purely voluntarily or may be obliged to go into liquidation.

In the case of a *voluntary liquidation*, a balance sheet for liquidation purposes should be drawn up before an application is made for the company to go into liquidation. If the balance sheet shows that the assets are sufficient to cover all of the company's liabilities, including the cost of the liquidation proceedings, a resolution that the company shall submit a petition to go into liquidation may be passed. When such a resolution has been passed an application must be submitted to the Patent and Registration Office, which will then declare the company in liquidation. However, if it is concluded that the company's assets are insufficient to cover all its liabilities, a petition in bankruptcy should be lodged.

As mentioned above there may also be an obligation to go into *compulsory liquidation* whether or not the shareholders wish the company to do so.

One reason for a compulsory liquidation is that the company's financial situation has become too troubled. The board of directors must draw up a balance sheet for liquidation purposes without delay as soon as there is reason to believe either that the company's equity has fallen below half of the registered share capital or if the company under an enforcement action has been considered to lack sufficient assets upon which distress can be levied on.

When calculating the equity of the company, the assets side must include an item showing the estimated sale value of the assets minus estimated costs of sale, if the sale value of the assets exceeds their book value. The reason for this is to avoid compulsory liquidation of companies which have hidden assets in their books which are worth more than the equity. If the balance sheet for liquidation purposes confirms that the company's equity has fallen below half of its registered share capital, the company must lodge an application for liquidation unless the entire registered capital can be restored within a certain period of time.

Another ground for compulsory liquidation is if the majority of the shareholders abuse their position. The court may, on motion of at least one-tenth of the shareholders, order the company to go into liquidation. This is the case if a shareholder by virtue of his influence in the company has deliberately been a party to a breach of the Companies Act, the law on annual accounts or the articles of association and there is special reason due to the duration of the abuse that the company be put into liquidation.

The court will also order that the company be put into liquidation if:

- there is an obligation pursuant to the articles of association for the company to go into liquidation;
- if the company is subject to bankruptcy proceedings and as a result of which a surplus proceeds is achieved; or
- if the company has been subject to bankruptcy proceedings which have been terminated without a surplus of proceeds and there are assets not included in the bankruptcy.

There are also some cases where it is not the court but the Patent and Registration Office that will make the decision to put the company into liquidation. This is the case for example if:

- according to the company's register at the Patent and Registration Office, the company has no auditor, board of directors or managing director, contrary to the provisions of the Companies Act; or
- the company has not submitted an annual report to the Patent and Registration Office within 11 months from the expiry of the financial year.

In the above mentioned cases the Patent and Registration Office has a discretion on whether to decide to put the company into liquidation. Such a decision shall not be made if the reason for liquidation has ceased and the eventual penalty fees levied by the Patent and Registration Office have been paid. This rule is clearly beneficial for the company since unnecessary liquidations can be stopped.

There are several grounds for compulsory liquidation that do not take notice of the actual financial situation of the company. This can in theory mean that a financially sound company will be put into liquidation. In practice this is however not likely, since most companies put into liquidation by the Patent and Registration Office are non-trading dormant companies.

### *§ 3. Specification of the possible initiators of the procedure*

Depending on what grounds the company is put into liquidation for there can be different initiators of the procedure. In the case of a voluntary liquidation the meeting of the shareholders may pass a resolution to the effect that the company be put into liquidation on a motion of the board or a shareholder.

If the court decides on whether the company should go into liquidation the possible initiators of the process are different depending on the grounds for liquidation. The company officers and the shareholders can initiate the liquidation, but also the company's auditor, the court or any affected person.

When the Patent and Registration Office decides the question of liquidation the process can be initiated by the Office on its own motion, the board of directors, a board member, the managing director, a shareholder, a creditor, or in some cases any other affected person.

In practice the most common initiators of the liquidation process are the board of directors and the Patent and Registration Office.

#### *§ 4. Administration of the procedure and the roles of the different actors*

When a meeting of the shareholders have decided to put the company into liquidation, the Patent and Registration Office or the court shall appoint one or several liquidators. The liquidator will then assume the powers and duties of the board of directors and managing director and will assume the task of carrying out the liquidation.

When the company has gone into liquidation the board and managing director must immediately submit a report on their management of the company's affairs, annual report and auditor's report for the company to the shareholders.

The liquidator or liquidators are under a duty to commence a special procedure, whereby the district court publishes an announcement notifying all the creditors. This is designed to ensure notification of the liquidation to those creditors who do not appear as such in the company's books and records. These creditors have six months within which to notify the district court of any claims they may have. When the six-month period has elapsed and all known liabilities have been paid, the liquidator distributes the remaining assets of the company. If any liability is disputed or has not fallen due for payment or for any other reason cannot be paid, necessary funds are to be retained but the remainder of funds may be distributed.

The liquidator must submit an annual report for each financial year, to be put before the annual general meeting for approval. As soon as possible after the liquidator has completed his assignment he must submit a final report on his administration of the liquidation. This report must include details of the distribution of the company's assets, detailed accounts covering the whole period of the liquidation. The report and accounts must be submitted to auditors for examination. After the auditors' report has been sent to the liquidator he must immediately convene a meeting of the shareholders so that the final accounts may be examined.

It is clear from the above that the principal character in the liquidation process is the liquidator. The liquidator, together with the board and the management of the company carries out the main part of the work. The participation of the shareholders depends on whether it is a voluntary or compulsory liquidation, but generally the shareholders, creditors and the court play a less active role.

#### *§ 5. The degree of protection of the actors*

In a liquidation there are two groups of stakeholders that are in need of special protection: the shareholders and the creditors of the company.

Some rules are designed to protect the shareholders' right of information in case of a voluntary liquidation. It is very important that all shareholders receive correct information before the decision to put the company into liquidation can be taken. The proposed resolution to go into liquidation therefore for example states the reasons for the decision, the different alternatives to liquidation and the estimated time for distribution of the company's assets. The shareholders shall also receive a copy of the annual report and the auditor's report. These information requirements are intended to make it easier to avoid unnecessary liquidations and in situations where the company may have a better alternative, make it more likely for the shareholders to choose this alternative.

After the liquidation process has started there are several general rules that apply to protect the shareholders, irrespective of whether it is a voluntary or a compulsory liquidation.

The shareholders can challenge the distribution of the funds made by the liquidator. A shareholder wishing to challenge the distribution must institute legal proceedings against the company no later than three months after the final accounts for the company have been put before a meeting of the shareholders.

In the case of a compulsory liquidation on the grounds that the majority shareholders have abused their majority, there is a special rule that gives the court the power to appoint one or more trustees to take over the board of directors' and the managing director's duties to manage the company while the court's decision is gaining legal force. It is also possible for the company to request that the court instead of putting it into liquidation may order the company to redeem the applicants' shares within a certain time.

Except for the special rules above, both shareholders and creditors are protected by the fact that there is a liquidator that manages the liquidation process and not the ordinary management of the company. This fact together with the different rules above gives shareholders and creditors good protection and makes liquidation a reliable process. This might encourage creditors and shareholders to support voluntary liquidations if this is thought to be for the company's best interests.

#### *§ 6. Termination of the procedure*

When the liquidator has presented his final report the company is regarded as having been wound up. The Patent and Registration Office must immediately be notified of this for de-registration purposes. If the liquidator finds that the company is insolvent and is unable to pay the costs of liquidation, he must apply for the company to be declared bankrupt.

#### *§ 7. Degree of information towards creditors*

The creditors have access to all the documents that the liquidator submits to the court as they are normally open for public display. The creditors normally receive copies of documents such as annual reports and the final report from the liquidator, but if this is not the case the public display of court files gives the creditors a chance to contact the court and ask the court to give them a copy of the documents.

### *§ 8. Costs related to the procedure*

In the case of a voluntary liquidation the liquidator will be paid out of surplus proceeds received from the sale of the company's assets after that the creditors have been paid. The fee is based on inter alia time spent, complexity of the case etc. so it is not possible to provide a general estimate. The actual cost also depends on the amount of work done and the liquidator's hourly billing rate.

If the liquidation is compulsory the liquidator receives a fixed fee. Currently this fee is SEK 6,726. Due to the low amount received the liquidator does not normally spend much time investigating the company's financial situation. It is therefore common that the liquidator, after a smaller investigation, will make a petition for bankruptcy for the company on the assumption that the assets are not usually sufficient to cover all its debts.

### *§ 9. Publicity conditions*

Where there is a requirement for publication in the liquidation process the court or the Patent and Registration Office must give notice in a special Official Swedish Gazette called "Post- och Inrikes Tidningar". The aim of this is to make known to creditors, especially those who do not obtain the information directly, in order for them to protect their interest. However, in practice it is probably the case that not many creditors read the Official Gazette, so there is a significant risk that some creditors will not claim their legal rights in the liquidation.

## **Title 5. Legal consequences of bankruptcy and possibilities for a fresh start**

### **Chapter 5.1. Bankruptcy procedure**

Unlike liquidation proceedings, bankruptcy proceedings take place because the company is unable to pay all its debts and must therefore be declared bankrupt. In this case a "konkursförvaltare" (receiver) is appointed for the purpose of realising and settling the assets of the company. The purpose of bankruptcy proceedings is to wind up the company in such a way that the company's creditors receive as great a proportion of their claims as possible.

A company must be declared bankrupt if it is insolvent. If a company is unable to pay its debts as they fall due and such inability is not merely temporary, the company is deemed to be insolvent. In this situation it is not permitted for the company's board to continue trading. If the board of the company realises that the company is insolvent, the company must itself lodge a petition in bankruptcy with the court. As a rule, such a petition will mean that the company is declared bankrupt the same day.

A creditor may also lodge a petition in bankruptcy. He must be able to show that the company is insolvent and this burden of proof can be onerous. The Bankruptcy Act stipulates a number of situations in which a debtor is regarded as insolvent:

- where distress has been attempted at any time during the six months prior to the lodging of the petition in bankruptcy and the debtor has been found to lack assets capable of being distrained upon;
- where a debtor carrying on business subject to a requirement that books of accounts be kept has received a demand for payment accompanied by a threat on the part of the creditor to lodge a petition in bankruptcy and payment has not been made within a week of receipt of such demand; and
- where the company has suspended payments and informed a substantial number of creditors of such suspension, for example, by means of a circular letter.

When the court has declared the company bankrupt it will appoint a receiver whose main task will be to realise the assets of the company and pay the debts of the estate in bankruptcy in accordance with specific priorities regarding claims.

The receiver must immediately take charge of the affairs of the bankruptcy estate, including the books and other documentation concerning such estate. The receiver is under a duty to ensure without delay that money received by the estate in bankruptcy earns interest. He must book payments made and received. He must draw up a statement of affairs specifying the assets and liabilities of the estate as at the date the company was declared bankrupt. This statement must be submitted to the district court and the supervisory authority as soon as possible and at the latest one week before the swearing of oaths at the district court.

The board of directors of the bankrupt company must swear an oath at the district court to the effect that the statement of affairs is an accurate reflection of the company's position.

The receiver then sells the assets of the estate in bankruptcy in an appropriate manner and collects the estate's debts. If the bankrupt company has been trading, the receiver may continue trading on behalf of the estate if it is expedient to do so. For instance a receiver can decide to continue the trade if he has reason to believe he can obtain a better price for the assets if they are sold as a "going concern" than in a piece by piece auction. However, the main rule is that trading may not continue more than one year after the swearing of oaths.

The receiver is also under a duty to draw up a receiver's report. This should contain information on the reasons for the company's insolvency, a summary of the company's assets and liabilities, particulars on any transactions regarding assets which may be recoverable, the date when the company became insolvent, the date when the board became liable to draw up a balance sheet for liquidation purposes, information regarding whether or not there is reason to suspect that any of the directors or shareholders may be liable to repay sums of money to the company, details of the company's accounting system and the manner in which the books have been kept, and finally, whether the receiver has reported any criminal actions to the prosecution service. The report of the receiver must be submitted no later than six months after the company has been declared bankrupt.

In addition, every six months the receiver must report to the court and the supervisory authority on the steps which have been taken to terminate the bankruptcy. This report is to be accompanied by a statement of the estate's current accounts.

When the receiver has realised the assets of the estate in bankruptcy he must draw up a dividend proposal including details of the creditors entitled to receive a dividend. He must then follow the provisions of the Preferential Rights of Creditors Act. In short the Preferential Rights of Creditors Act state the order in which the creditors have a right to be paid. As a general principle in bankruptcy proceedings competing claims have equal right to payment, in relation to the size of the amount claimed, from the debtor's assets. However, some creditors – preferential and secured creditors – have the benefit of payment before other creditors.

There are two types of preferential rights: specific and general preferential rights. Specific preferential rights apply to certain specific property and give the creditor right to payment out of this property. General preferential rights cover all property belonging to the insolvent corporation's estate in bankruptcy, which is not covered by specific preferential rights, and give the creditor a right to payment out of all this property.

The most important specific preferential rights rank in priority as follows: mortgage in ships and aircraft, pledge and repairer's lien, rent, floating charges, mortgage in real property and execution. The most important general preferential rights rank in priority as follows: cost of having the insolvent corporation declared bankrupt, auditor's and accountants' claims, taxes and general charges and claims of the employees. Claims which do not carry any of the above mentioned preferential rights are non-preferential and are of equal standing as against each other.

If the receiver believes that there is a likelihood that non-preferential creditors will receive a dividend, he must inform the district court that creditors are to be given notice that proofs of debt should be lodged. As a rule, the district court will then announce in the Swedish Official Gazette that all creditors in the bankruptcy must lodge proof of debt with the district court within a certain time limit in order to qualify for a dividend in the bankruptcy. When the time limit has expired the district court sends all proofs of debt to the receiver for scrutiny. If he finds reason to object to any of the proofs, he must do so within a certain time limit. The court then arranges a meeting between the creditors with the contested claim and the receiver at which the two sides endeavour to reach a settlement. If no such settlement is reached, the court will decide the matter. The usual state of affairs in Sweden is, however, that non-preferential creditors do not receive any dividend in the bankruptcy of the insolvent corporation.

Unless the court announces that creditors must lodge a proof of debt as described above, they do not have to act in a special way to qualify for a dividend. To be on the safe side however, they often write to the receiver and inform him of their claims. They may also obtain particulars from the receiver about the estate and its administration. The receiver is under a duty to contact creditors whose claims have been particularly affected by specific actions or omissions of the trustee.

Finally, the receiver must submit a final report on his trusteeship to the court and the supervisory authority. A bankruptcy is terminated when the receiver submits his final report and his dividend proposal to the district court and the supervisory authority. A bankruptcy in which there are no assets is terminated when the bankruptcy is removed from the court's cause list on application of the receiver. The court must inform the Patent and Registration Office which then de-registers the company.

## **Chapter 5.2. Legal effects of the initiation of bankruptcy procedures**

In the Swedish legal system there are few legal consequences of the petition in bankruptcy. However, an important one is that the day of registration in court of the petition in bankruptcy is the starting point for the different time limits for recovery after the declaration of bankruptcy. Accordingly, the time limit for recovery can be prolonged between the date of petition and the declaration of bankruptcy if the petition should take a long time.

The administration of a petition in bankruptcy sometimes may take a considerable time. The debtor might use this time to damage the result of a bankruptcy through disposal of property. It is therefore possible to take enforcement actions against the debtor which will limit the debtor's freedom of action during the initiation of a bankruptcy process.

The requirements for an enforcement action are generally that it should be plausible that the petition in bankruptcy will be approved and that there should be reason to believe that the debtor will dispose of property, travel abroad or in other ways evade his duties in the bankruptcy process. Enforcement actions can be made up of sequestration on property, prohibition on the debtor to travel abroad or even detention in custody.

As is seen above the petition in bankruptcy does not result in so many legal effects in Sweden. Except for the enforcement cases mentioned above, which constitute legal obstacles to the company's business, the petition in bankruptcy does not create legal consequences which constitute obstacles to the company's business. However, it is probably fair to say that the petition in bankruptcy in itself is an obstacle to new investments and entering into new business relations. This is because the petition shows that the company is in such financial difficulties that the company's officers will soon lose powers to dispose of the company's assets and it is therefore a big risk to do business with the company. Investors that might be interested in the company making a new start are probably waiting for the actual bankruptcy to occur so that they can deal with the receiver.

## **Chapter 5.3. Legal effects of bankruptcy as such**

Unlike the situation with the petition in bankruptcy there are several legal consequences that flow from the company being declared bankrupt.

Probably the most important legal consequence is that the receiver takes over the company's right to dispose of its property. The officers of the company are no longer entitled to run the company. They have instead a duty to provide the receiver with all the information required by him. The officers of the company are also under a duty to swear an oath at the district court as to the truthfulness of the statement of affairs, if so required by the receiver. Directors of a company which has been declared bankrupt may not without the court's permission travel abroad before having sworn the oath at the district court. If officers of the company do not provide the receiver with the information he requires or fail to swear an oath at the district court, they may be forcibly brought to account with the help of the police or remanded in custody by order of the district court.

The fact that the company officers lose their right of disposition can constitute both an obstacle and an incentive for a fresh start for the company. If the officer was close to solving the company's financial difficulties it may be an obstacle that he no longer can represent the company and that he now owes his duties to the receiver. However this is not normally the case, usually the officers have failed to turn the company's fortunes around.

On the other hand the take-over of the receiver can also constitute a legal incentive for a new start for the company's business as he has no emotional ties to the company and therefore can more easily reach better deals with the creditors and new investors. He might also give the company a new credibility which a company in financial trouble earlier lacked.

Another important legal consequence is that since a bankruptcy has occurred there is no longer the possibility of parallel ways of receiving payment out of the debtor's assets. It is in principle no longer possible for a creditor to apply for an enforcement action against the bankrupt company. A levied distress on the company's property is not valid if the creditor did not already have security over the property. Enforcement actions which were commenced before the bankruptcy declaration may continue. However, this does not mean that a creditor who has started an enforcement action will get paid, while the security received through the enforcement action may be recovered.

The bankruptcy usually brings to an end different creditors trying to receive a piece of the company's assets. It is probably easier for a receiver to find a new investor who will take over the business since the receiver is not hindered in the same way as the former management could have been by different enforcement actions. The prohibiting of fresh enforcement actions could therefore mark a new dawn for the company.

When the court has declared the company bankrupt it is no longer possible to revoke the petition in bankruptcy. It is necessary to appeal against the declaration to a higher court to reverse the decision. This rule could constitute a legal obstacle to a fresh start since it hinders an applicant from reversing the petition in bankruptcy if the company has solved its financial problems. The company instead has to appeal against the decision in bankruptcy, which is a slower process. However, in practice this is normally not a problem.

There are also several legal consequences flowing from the fact that the system regarding bankruptcies in general is applicable.

One such effect is that no new claims against the company can arise after the decision in bankruptcy. However the receiver can assume obligations on behalf of the estate in bankruptcy. Creditors shall receive payments according to the special rules applicable in a bankruptcy proceeding. This means that the standing between creditors may change due to the rules in the Preferential Rights of Creditors Act. Some creditors may be very positive to a fresh start since they know they will get paid and others who will not get paid will be more reluctant. The special preferential order and the fact that no new claims can arise may make it easier to make a fresh start.

The receiver may for example have a competitive advantage when continuing the business of the company due to the state guarantee of debts of employees up to three

months salary and the landlords preferential right for three months rent. A sale of a running business is normally much easier and fetch a much higher price than selling the different assets separately. The bankruptcy regime is accordingly in this part a clear incentive for a fresh start of the company's business. However, sometimes the bankruptcy regime is criticised for facilitating "bankruptcies of convenience". A bankruptcy of convenience is a bankruptcy where the entrepreneurs behind the company receive a chance of buying back the assets of the company at a low price. It is then possible to resume the business, since the bankruptcy resulted in a good debt rescheduling, and then revive the value of the company as a "going concern".

Furthermore since the principle - little money is better than no money at all - applies in a bankruptcy it may be easier to find new investors for a bankrupt business than for a not yet bankrupt, but financially troubled business. This is also an effect of the bankruptcy regime which constitute an incentive for a fresh start for the business.

There are also other things that do not follow as legal consequences from the declaration of bankruptcy but may function better after such a decision from a practical point of view. One example is the collection of debts. Debts may be collected smoother due to the extra pressure it might be to receive a letter of demands from a receiver instead of the company. On the other hand this also might work the other way around, because the receiver due to scarce time and cost efficiency can not chase assets for an extended period of time, especially if the amount of money is small.

In summary it is fair to say that the Swedish bankruptcy legislation works well to facilitate a fresh start of a bankrupt business.

#### **Chapter 5.4. 'Excusability' following bankruptcy**

There are a few rules in Swedish law which deal with the "excusability" for persons in bankruptcy. Firstly, the Bankruptcy Act states that physical persons who have been declared bankrupt automatically are prohibited from carrying on a business, with a requirement of keeping books, during the bankruptcy process. The Bankruptcy Act has no similar rules for the officers or owners of a bankrupt company. However there are other rules in the Trading Prohibition Act which apply to officers of a company and may by way of injunction prohibit them from trading.

These rules apply to a number of people. Both a sole trader, officers and any other person who has been able to control the business of a company or appeared to be the responsible person for the business may be prohibited from trading. The requirements for prohibition are that it is necessitated in the public interest and that the person either has grossly neglected his duties in the business, omitted to pay taxes or in the case of bankruptcy grossly neglected the interests of the creditors. In the assessment of "public interest" the court considers if there has been a repeated wrongdoing by the company, if the aim of the act was to receive considerable profit, if considerable damage has been inflicted or if the person earlier has committed crimes in the course of carrying on a business.

These strict rules might give the impression that the “excusability” for the persons involved in a bankruptcy is rather low but this is not the case in practice. It is rare that persons will be prohibited from trading. Some public commentators have suggested that the rules should prohibit a person who has been involved in several bankruptcies from trading. This might imply that it is “excusable” to be involved in one bankruptcy but less so as the bankruptcies add up.

### **Chapter 5.5. Responsibility of the Company’s management**

There are several ways in which the company’s management can be held liable in the case of a bankruptcy. Both the criminal law regime and the civil law regime provide remedies for unlawful behaviour by the company’s management.

The company’s management might before or during the bankruptcy process commit several criminal acts. The company’s management is, if the company already has or soon will become insolvent, not allowed to deprive the creditors of property of considerable value or continue to spend considerable amounts of the company’s resources without the company receiving corresponding value. When the company already has become insolvent the management are not allowed to distribute the company’s assets to certain creditors if this will damage other creditors’ rights. Furthermore, the company’s officers have the duty to see to that the company’s books are properly kept. If the company’s management does not follow the above-mentioned rules the managers might be sentenced to prison.

There are several different civil law remedies which can affect the management of the company which will be discussed below.

In *chapter 15* of the Swedish Companies Act provisions concerning the liability of various officers of a limited liability company to pay damages are found. Directors and the managing director who in the course of their duties deliberately or negligently cause loss or damage to the company are liable to pay damages. Such liability may also arise if loss or damage is caused to shareholders or other parties. “Other parties” here means the company’s creditors, among others. Liability to pay damages may be moderated in accordance with what is reasonable in light of the nature of the act, the size of the loss or the damage and other circumstances.

The Companies Act contains several time limits. An absolute time limit for actions for damages against officers of the company is normally five years, although the date on which the period starts to run varies. Where a company is declared bankrupt as a result of a petition lodged before the period has expired, the receiver is allowed time to bring an action notwithstanding the fact that some time periods expired before the company was actually declared bankrupt.

*Chapter 12* of the Companies Act governs the distribution of dividends to shareholders. Generally speaking, dividends may only be distributed from net profit and certain unrestricted reserves minus losses, compulsory allocations and other statutory deductions. If a distribution is made contrary to the provisions of the Companies Act, the recipient is liable to repay what he has received, irrespective of whether or not he is a shareholder, provided that he did not have reasonable cause to assume that the

payment constituted a lawful distribution of profit. The company, as a prerequisite to the establishment of liability, is required to prove that the recipient understood or should have understood that the particular distribution was made in breach of the Companies Act. If the recipient is not able to repay the sum unlawfully received as a profit distribution, certain officers of the company may be liable to make good the shortfall if they were involved in the decision to make the distribution or in the distribution itself.

These provisions have to some extent been used to deal with asset stripping of companies. The regulatory system has taken shape as a result of a number of Supreme Court rulings in recent decades. These cases have frequently concerned so-called “hidden dividends”; where, for example, assets have been taken out of a company without being booked as dividends. According to the Companies Act, hidden dividends need not be unlawful. They are only unlawful to the extent that the value of the property distributed exceeds the funds properly available for distribution. The rules are particularly complicated and controversial. They are also very far-reaching, since it is suggested that it is not only the recipient who may be liable to repay sums unlawfully received, but also banks involved in the transfer of the shares of limited liability companies.

The directors and the managing director can according to the rules in *Chapter 13* of the Companies Act be held liable in case of a compulsory winding up. The rules place a duty on the board of a limited liability company to draw up a balance sheet for liquidation purposes, to refer the question of the company going into liquidation to the shareholders’ meeting and eventually lodge a petition to the court for liquidation as discussed in chapter 4.3 above. If the directors fail to carry out these duties, they will be jointly and severally liable with other persons who knew of their failure to carry out their duties. A director may avoid liability if he is able to show that the failure was not due to negligence on his part. These rules are very rigidly framed and it is essential that the officers of the company observe them.

A limited company is obliged to file a copy of its annual report and audit report with the Patent and Registration Office within one month after it has been adopted by the annual shareholders’ meeting. If a company does not comply with this obligation and filing has not been made within 15 months of the end of the fiscal year in question, the members of the board of directors and the managing director will be jointly and severally liable for any debts falling on the company after that time. A director can escape liability by showing that he was not himself negligent. Once the documents are filed, the directors’ liability ceases from the date of filing.

Non-compliance with the above rules may result in officers being sent to prison, paying damages, making good any shortfall for wrongful profit distributions or personally liable for debts. Therefore, this may give the impression that the company’s officers will be keener to seek bankruptcy rather than look for ways to create a fresh start for the business of the company. This is however not the case in practice. It is instead often a fact that company officers will continue in business for too long in the hope of finding new investors that can turn around the business and even improve the profits of the company.

## **Title 6. Prospects and recommendations**

The focus of this report has been to determine whether the insolvency system in Sweden, in particulars and as a whole, constitutes an incentive or an obstacle to a fresh start for a company in financial trouble. Crossborder bankruptcies have accordingly not been included in the scope of this article. The different regimes' influence in particulars on this question has already been discussed above. In this final chapter it will be discussed how well the regimes work together and how well the insolvency system generally fulfils this goal.

As has been evident from above the Swedish insolvency legislation is found in several different acts and the first impression one might get is that reorganisation including composition would be the best instrument to make a fresh start for a company's business. This is however not so. The procedure is not much used and the regime contains several weaknesses. If the legislator wants this to change, it is *inter alia* probably necessary to reconsider the fact that the wage guarantee is not payable in reorganisation proceedings. A new mechanism must be sought in order to guarantee that the proceedings are commenced earlier, when there is still value to rescue.

The Swedish bankruptcy legislation has however proved to be a good instrument often used to reorganise companies. It might even have proved to be too effective, given that there are not so many reorganisations compared to the number of bankruptcies.

The bankruptcy legislation has on the other hand been criticised for unnecessary destruction of asset value and for contributing to so-called bankruptcies of convenience. This might need a short explanation. Bankruptcy proceedings destroy value in that the company's total assets are sold as is in a prompt way piece by piece instead of as a "going concern" in a longer time perspective. A bankruptcy of convenience is a bankruptcy where the entrepreneurs behind the company get a chance of buying back the assets of the company at a low price. It is then possible to resume the business, since the bankruptcy resulted in a good debt rescheduling, and then revive the value of the company as a "going concern".

The question is if those problems can be solved with legislation more aimed at reorganisation or legislation that do not make such a distinctive choice between reorganisation and liquidation. This is probably so, but it is not an easy task to make the necessary changes.

It has within the jurisprudential debate been advocated that a better way of regulating the field of insolvency is within one single insolvency code. A single insolvency code has obvious advantages such as greater transparency and a more systematic approach. But such a code can also easily become incredibly complex and filled with intrinsic oppositions due to the fact that it has to bring the different interests of the debtor, the creditor and the society in line with each other. Furthermore, it is not an easy task to adjust the different regimes of reorganisation. On the one hand aiming at a continuance of business and on the other hand bankruptcy that aims to a winding up of the company to mention the two extremes.

Even if one simplifies the insolvency process into having only one aim, which is valid for both these regimes, being that the creditors shall be paid this is not easy to achieve. The creditors cannot usually be seen only as a group with joint interests, but instead as a group of individual creditors. It is very common that the creditors have internal disputes regarding the possibilities to be paid out of the debtor's assets. The society also has interests in that the insolvency process is designed in a way that is reliable and takes account of the legal rights of the individual. Moreover the society has an interest in that viable companies have a possibility to overcome temporary financial difficulties and continue business.

A single insolvency code is probably still in some remote future. But let us finally look at what future legislation work in the field of insolvency is in the pipeline.

The Swedish legislator is at present preparing changes to *the Preferential Rights of Creditors Act*. The proposed changes are primarily the abolition of the right of priority of rental claims and tax claims. There are also some proposed changes to the rules regarding floating charges: a reduction of the value to fifty per cent of the value of the assets and a somewhat enlarged scope. The changes are planned to come into force at the earliest on 1 January 2003. Recent public debate implies that the legislator has listened to the criticism of the proposed changes and it seems at the moment as if the proposal will not be put forward for parliament to vote on.

The proposed changes would quite radically change the conditions for the work of the receiver. The abolition of the priority for rental claims would probably force the receiver to empty business premises much faster. He could be forced to sell the assets to prices much lower than their value just to speedily get rid of them. The continuation of the company's business by the receiver would also be impaired by the new rules while it will be harder to sell a company as a going concern to a new investor. The changes regarding floating charges make the receiver's distribution of dividends more complicated and time consuming. It might also lessen the value of a floating charge as a commonly used security in the future.

It is difficult to predict the effect of the abolition of the priority for tax claims. It might make the state less keen on putting companies into bankruptcy while it will only have a non-preferential claim which normally do not receive a dividend. On the other hand it is also possible that the state, when it discovers that a company has problems paying the taxes, in time more promptly makes a petition in bankruptcy before the tax claims have increased too much.

In relation with the work on the proposed changes to the Preferential Rights of Creditors Act, complementary issues arose which lead to a new report concerning the *Company Reorganisation Act*. The principal aim of the report was to investigate whether, during a reorganisation, a debtor should be entitled to terminate agreements prematurely. As mentioned above in chapter 4.1 the debtor's agreements remain in force during a company reorganisation. However, with the limitation that he is not obliged to perform during the reorganisation.

The fact that the debtor is bound by onerous agreements can in itself constitute an obstacle to a successful reorganisation. Therefore it is now proposed that, in order to prevent termination from the other party, the debtor will not be forced to demand full

performance of an agreement. Instead, the debtor may for example demand performance only with respect to a specific term or quantity. This might seem highly favourable to the debtor at the sacrifice of the creditors. The creditors will however also be protected in different ways.

The debtor will be obliged to notify the other contracting party of his intention to demand performance only for a limited time or quantity. Furthermore, and probably most important, the consideration that the other contracting party receives from the partial performance of the agreement will not be included in the composition. It is also independent of whether a composition later on actually is achieved. However, the other claims stemming from the non-performed parts of the agreement will be included in the composition. The overall purpose of the proposed changes is to encourage companies to commence a reorganisation proceeding at an earlier stage.

The report also proposes some amendments to the *Bankruptcy Act*. It needs to be clarified to what extent a bankruptcy estate has a right of accession in unregulated contractual relationships and also whether such right is mandatory. These questions are at present unregulated in the Bankruptcy Act. In the perspective of a bankruptcy being a way to reorganise a company's business, it is important that agreements remain in force until the business can be transferred to a new owner.

In summary it looks at the present time as if the changes in the Preferential Rights of Creditors Act probably will make it more disadvantageous to put a company into bankruptcy in the future. Bankruptcies are already criticised for generally losing too much of the assets value and this will probably increase. However, this might somewhat be compensated by the proposed changes in the Bankruptcy Act regarding bankruptcy estates' right of accession in unregulated contracts which will facilitate a transfer of the business of the company. A consequence of the reduced advantages of bankruptcy proceedings might be an increasing number of reorganisations within the Company Reorganisation Act.

As to the proposal regarding the Company Reorganisation Act it remains to be seen if the proposed changes will favour reorganisation proceedings as a way to continue business. It is clear that the Swedish insolvency system as a whole still lacks a good systematic order and an overall mechanism for how the different regimes should work together. Even if a single insolvency code can be difficult to realise, it would probably be beneficial if the different insolvency regimes somehow could be merged.

## **Title 7. State of knowlegde**

### **Legislative preparatory works**

Proposition 1970:142 Kungl. Maj:ts proposition till riksdagen med förslag till förmånsrättslag.

Proposition 1975:103 Aktiebolagslag m.m.

Proposition 1986/87:90 Ny konkurslag.

Proposition 1991/92:139 Om statlig lönegaranti vid konkurs.

Proposition 1995/96:5 Lag om företagsrekonstruktion.

SOU 1969:5 Utsökningsrätt IX Förmånsrättsordningen m.m.

SOU 1971:15 Förslag till aktiebolagslag m.m.

SOU 1983:24 Ny Konkurslag.

SOU 1986:9 Ny lönegarantilag.

SOU 1992:113 Lagen om företagsrekonstruktion.

SOU 1999:1 Nya förmånsrättsregler.

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