This is a non-official translation of the Swedish original wording. In case of differences between the English translation and the Swedish original, the Swedish text shall prevail.

Johan Munck, Justice of the Supreme Court 9 April 2006

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Certain issues regarding the distribution of shares in a subsidiary

With regard to the company law equality principle *(Sw. likhetsprincipen)* and the company law general clause *(Sw. generalklausulen)*, you have requested a legal opinion on my part on how a limited liability company ought to act where this company, in which there are more than one series of shares with a different number of votes per share but with equal rights in the company's earnings and assets, wishes to distribute the shares in a wholly-owned subsidiary to its shareholders.

The issue concerns more precisely whether, when distributing shares in a wholly-owned subsidiary, a parent company with two series of shares, between which there is a difference in the number of votes per share but no other differences, should ensure that the holders of plural-vote shares in the parent company should receive shares with the corresponding number of votes per share in the subsidiary (alternative 1) or if the shares in the subsidiary should be of the same kind and be equally distributed to the shareholders in the parent company (alternative 2).

Alternative 1 entails that the power interrelations between the shareholders remain unchanged in the distributed company but that the shareholders will not receive identical assets in the distribution and alternative 2 entails that the power interrelations between the shareholders are shifted but that each shareholder receives exactly the same asset in the distribution.

I have previously had reason to consider this issue in another legal opinion when the question concerned the previous Companies Act (*Sw. aktiebolagslagen (1975:1385))*. I then established that, even though the question is of great practical importance and often has been discussed, there is no statement in the bill or in legal doctrine providing explicit guidance. However, the question has been considered in several legal opinions from exceptionally prominent company law experts, which however have come to partly differing results.

By and large, the situation is the same for the application of the current Companies Act. However, it should be noted that the question is briefly addressed in the white paper of the Company Law Committee, in which it is stated that, in the opinion of the Committee, alternative 1 is most consistent with the principle of equal treatment *(Sw. likabehandlingsprincipen)*(SOU 2001:1 p. 387). However, this statement is not repeated in the bill to the new Companies Act.

However, in the above-mentioned bill, a similar question is considered as regards the question of division of a limited liability company, a so-called fission, which previously has not been subject to specific regulation. Under Chapter 24 Section 1 of the Companies Act, this division is made through the take over of a limited liability company's assets and liabilities of one or more other limited liability companies for a consideration to the shareholders in the assigning company. Under Section 2 of the same chapter, the consideration to the shareholders in the assigning company (the consideration for the division) will consist of shares in the transferee company/companies or of cash. For cases where the consideration for the division consists of shares in the recipient companies, the following is stated in the bill (prop. 2004/05:85 p. 854):

It is inherent that the allocation must be made in such a way that no shareholders are favoured or treated unfairly. In that connection, the occurrence of different series of shares must be taken into consideration. Holders of shares with certain rights, for example a higher number of votes per share, will normally not have to accept that their shares are exchanged for shares which do not have the corresponding rights in the transferee company. Where a company is divided into two or more newly-formed companies, a solution may be that the transferee companies have the same series of shares as the transferor company and that holders of shares of a certain series in the transferor company are allocated shares of the corresponding series in the transferee companies.

The view forming the basis for this statement thus corresponds to alternative 1 above. The statement undoubtedly supports the view forming the basis of that alternative. But the statement has been made for division of a limited liability company, which is a special, regulated institution, and this statement may not straight off be considered binding for distribution.

I state the following on my part.

In itself, the provisions in the new Companies Act on dividend distribution will hardly provide guidance for the assessment of the question at hand. This is partly since those provisions primarily refer to distribution of cash, although there is no doubt that they also govern distributions in kind (*cf.* NJA 1995 p. 742, p. 759 in particular). As indicated in the question at hand, in this case it is rather the meaning of the company law equality principles *(Sw. likhets- och likställighetsprinciperna)* which are of interest. These principles are expressed mainly in Chapter 4 Section 1 and Chapter 7 Section 47 of the Companies Act.

Under *Chapter 4 Section 1 of the Companies Act*, it is stipulated that all shares have equal rights in the company, unless otherwise stated in the following Sections 2-5. Under Section 2, a company may stipulate in its articles of association that there will be plural series of shares in the company. If such a provision entails that the shares will entitle to different rights to the assets or profits of the company or that the shares will have different rights as regards number of votes per share, under Section 3 it should then also be stated which preferential right the shareholders will have in a new share issue. Such a provision may entail preferential right in relation to the share in the company's capital or preferential right to a new share of the same kind as the previously held share.

Under *Chapter 7 Section 47 of the Companies Act* – the company law general clause *(Sw. generalklausulen)* – the shareholders' meeting may not adopt a resolution which may provide an undue advantage to a shareholder or other person to the disadvantage of the company or another shareholder.

In my opinion, the provisions of Chapter 4 of the Companies Act do not provide any real guidance for the assessment of the problem at hand. In the cases discussed here, the difference between the series of shares are presumed to consist of a difference in the number of votes per share, while the shares have equal rights to the assets and profits in the company, which is a typical provision of the kind referred to in Chapter 4 Section 2. The question is how this provision should be interpreted when it does not – which in itself probably should be possible – explicitly stipulate how a company should act when distributing shares in a subsidiary.

If a holder of plural-vote shares in the parent company in such a case receives shares with the corresponding number of votes per share in the subsidiary and the other shareholders in the parent company receives shares with a lower number of votes per share but all distributed shares have equal rights in the profits and assets of the subsidiary, the subsequent shareholders will fully retain the pure financial rights in the part of the parent company which has been distributed. However, the problem is related to that a higher number of votes per share in the distributed subsidiary in itself may be looked upon as representing a financial value. Where listed shares are concerned, it is certainly not always the case that the market appraises the plural-vote shares at a value which is reflected in the price quoted. There have even been examples of plural-vote shares which due to lower liquidity have had a *lower* listed value than the shares with a lower number of votes per share. Typically, it may however be said that the greater influence involved in plural-vote shares has a certain financial value.

In the doctrine, the company law equality principle *(Sw. likhetsprincipen)* has been assumed to have the meaning as regards distribution in kind that for all shares with the same financial right in the company, an equally large distribution calculated by market value should be paid, unless all shareholders otherwise agree (Andersson – Johansson – Skog, Aktiebolagslagen, En kommentar, 12:14). That this principle must be presumed to apply seems to be uncontested. The shares in a wholly-owned subsidiary may however not fully be placed on the same level as other kinds of assets. In addition, no current market values of different series of shares are able to be established as long as all shares are held by the parent company. Since plural-vote shares not infrequently is given a higher value by the market than shares with a lower number of votes per share with equal financial rights, the difference in the market value between different shares which may arise after the distribution therefore has a quite special nature for many reasons.

If one proceeds to discuss the meaning of the company law general clause *(Sw. generalklausulen)*, it seems quite clear that one can imagine cases where an application of alternative 2 could be claimed to entail an undue advantage for some shareholders to the disadvantage of others, since the alternative entails that the power interrelations for the distributed business are shifted. The holders of plural-vote shares do not receive the same kind of asset as the one they have had in the parent company and lose the greater influence they previously had in the business comprised by the distribution. In many cases, this is certainly rather insignificant, but in other cases when dividing a company, the purpose of the measure itself could be to achieve this shifting in an undue manner.

In accordance with what has been stated above, an argument against this is that holders of shares with a lower number of votes per share but with equal right to the assets and the profit may claim that there is no support for them to receive a distribution of less value than the other shareholders.

Objections may thus be raised regardless of which method is being used. The conclusion may however hardly be that a distribution of shares in a wholly-owned subsidiary would be impossible to accomplish if the parent company has series of shares with a different number of votes per share but equal right to the assets and profit. These distributions are very common and have a large practical significance and must naturally be able to execute.

In accordance with information I have received in another matter some years ago and which I have not verified myself, the alternatives were previously equally common, whereas lately, alternative 2 is to have been more frequently used.

As regards a challenge of a resolution by the shareholders' meeting, if one wishes to attempt to assess the risks for rejection if any of the alternatives is tried by a court, it may be close at hand to remind of the Supreme Court's standpoint in the case NJA 1995 p. 742. This case concerned another issue connected to distribution in kind in which the law has not been regarded as providing any clear guidance, namely the choice between the so-called gross and net methods *(Sw. brutto- och nettometoderna)*. The Supreme Court stated, among other things, the following:

When comparing the two alternative assessments at hand, hardly any of them seems to be the clearly most consistent with the purpose of the legislation, as this may be understood from the wording of the provisions or the general systematic of the legislation or from case law or the bill to the Companies Act. The combined arguments for each of the alternatives seem to be regarded to be about as strong, even though by their nature they partly are so varying that a comparison is not easy. In consideration of these circumstances and since, which has already been mentioned, the practical legal life long seems to have conformed to one of the alternatives, even though possibly under the influence of tax assessments, it *would lead to many complications which would be difficult to grasp and also future disputes regarding transactions long ago if it is now established that the provisions effectively would be given a different meaning than the one assumed by so many.*

Even though the circumstances for the problem at hand are not fully comparable, the arguments by the Supreme Court in the case mentioned above indicate that unless there is a case of obvious misuse, there should be no risk that a resolution by a shareholders' meeting may be successfully challenged regardless of whether alternative 1 or 2 is applied.

When lacking clear guidance from law or bill, it is close at hand to conclude that alternative 1 is to be recommended and under all circumstances it must be possible to apply where the distribution has the purpose of a real division of the company, something which as a rule is the case when the shares of a operating subsidiary are being transferred to the shareholders in the parent company. The shareholders holding plural-vote shares will then retain the larger influence over the distributed business that they have had in their capacity as shareholders in the parent company and which they typically have paid for. From a practical standpoint, in this situation it seems to signify such an evident justice that the holders of plural-vote shares in the parent company retain their rights that the rules not reasonably could be interpreted in a way to make this impermissible. Further support is given to this conclusion by the statements cited above, which were made in the bill to the new Companies Act as regards fission.

On the other hand, alternative 2 may possibly appear to be more natural when the purpose is to transfer pure financial assets to the shareholders.

Even if such a distinction does not provide clear guidance for every case, it is hard to go further with guidance from the existing legal authorities. As is evident from the above, in my view, both alternatives may normally be regarded as permissible under the Companies Act.

[signed]
Johan Munck