

Insolvency – Sweden

Insolvency Law Trends and Reforms

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October 31 2003

Swedish insolvency law provides three main alternative procedures for tackling insolvency in Swedish companies:

- composition by voluntary arrangements with the creditors;
- business reorganization; and
- bankruptcy/liquidation.

Voluntary arrangements can provide a quick and flexible way of alleviating financial strain. This procedure is often used when an insolvent company only has minor payment problems and the number of creditors is limited. No statutory law applies to this procedure. In most cases the debtor declares a suspension of payments and uses the time to negotiate a voluntary composition. As this is a voluntary solution, each creditor must agree to it, whether actively or passively (ie, by not filing for bankruptcy).

A company which is likely to pay its debts in the future, but which needs to solve immediate financial problems, can file (at the local district court) for business reorganization under the Business Reorganization Act. If the court approves the application, an administrator is appointed. The administrator's assignment includes evaluating whether the company could continue to operate either fully or partially, and determining how either goal could be achieved. The administrator also evaluates the prospects of settlement with creditors. The Business Reorganization Act states the conditions under which a debtor or administrator can order the fulfilment of old contracts.

A successful formal business reorganization, which normally includes an injection of additional funding, concludes in a mandatory composition, with the major creditors imposing the composition settlement on minority creditors.

The two alternatives mentioned above are both reorganizations of the debtor with the aim of enabling the legal entity to survive. This opens possibilities for flexible solutions, such as swapping debt for shares, as an extra incentive for the creditors to participate in future growth.

However, the third procedure - bankruptcy/liquidation - eventually leads to the dissolution of the company. Swedish law distinguishes between liquidation of solvent companies and liquidation of insolvent companies, here referred to as bankruptcy/liquidation.

A reorganization of a business in bankruptcy presupposes a transfer of the business from the estate. Under the procedure, the court appoints an official receiver in bankruptcy/liquidation that liquidates the company and sells its assets, either as a going concern or in parts to pay off the creditors. Bankruptcy/liquidation is by far the most commonly used insolvency procedure, both for businesses being reorganized and for those being dissolved.

The latest important reform of Swedish insolvency law was the introduction in September 1996 of the Business Reorganization Act. The intention was to enable early reorganizations that maximize flexibility and minimize the destruction of asset value, which often occurs in bankruptcy/liquidation procedures. It was soon acknowledged that the reform did not meet these high expectations. The number of business reorganizations was low from the beginning and has decreased since. The number of successful formal business reorganizations is limited to just a few.

Many believe that the most significant reason for this failure is the strong position that banks enjoy in a bankruptcy/liquidation situation because of their security by a floating charge (described in more detail below). As a result, the banks had little or no incentive to participate actively in the reorganization.

In June 2003 the Swedish Parliament adopted reasonably radical amendments to insolvency legislation in order to remedy this situation, among other aims. The new legislation will enter into force on January 1 2004, with a transition period of one year.

Current Order of Priority

The order of priority is regulated by the Priority Rights of Creditors Act (1970:979). A distinction is made between general preferential rights and preferential rights with respect to specific property. General preferential rights apply to all property that is part of the bankruptcy/liquidation estate. The preferential rights with respect to specific property are:

- particular liens;
- three months' rent and leasehold rent in a company's floating charge assets;
- a floating charge certificate secured by the floating charge assets;
- mortgages on real property;
- mortgages on site-leasehold rights; and
- seizures.

The floating charge gives a priority pledge in movable and intangible assets in the debtor's business. Receivables are included, but cash and shares are exempt from the floating charge security. The floating charge is perfected by the transfer of the floating charge certificate. Claims for rent have a first-priority preferential right in the floating charge assets in a sum

equivalent to three months of rent, and claims for leasehold rent in a sum equivalent to rent for one year before the floating charge certificate security interest.

The general preferential rights are, in order of priority:

- costs for bankruptcy petitions by creditors and company reorganization costs;
- costs for accounting and mandatory yearly audit, taxes and fees; and
- claims for salaries and pensions.

The preferential right for accounting and auditing costs is limited to costs for work that was performed in the six months prior to the petition for bankruptcy. For salary claims, the preferential right exists only with respect to salary that fell due at most three months prior to the declaration of bankruptcy.

Preferential rights with respect to specific property have preference over general preferential rights. The exception to this rule is that costs for petitions by creditors and costs for reorganization and accounting and auditing fees may, if necessary, have priority over floating charges, rents, leasehold rents and seizure claims. Claims without preferential right are paid after all claims with preferential right have been paid. General preferential rights only apply in bankruptcy/liquidation, whereas preferential rights regarding specific property can also be enforced as a result of financial distress.

New Order of Priority

One of the more significant effects of the new rules is that the concept of a floating charge changes from a preferential right over specific property to a general business mortgage carrying only a general preferential right. Business mortgages will give security in 55% of all the debtor's remaining assets after all claims with superior preferential rights have been paid. This new security will also apply to cash, shares and real property, which are excluded from a floating charge.

As a consequence, the preferential right for rent and leasehold rent is abolished in terms of the floating charge. Instead, the bankruptcy/liquidation administration will be liable for rent from the day of bankruptcy until the premises are returned to the landlord, if the landlord's possession is not restored within one month of the landlord so requesting. This rule will better balance conditions for competition between bankruptcy/liquidation estates and their solvent competitors.

The new general preferential right for business mortgages ranks behind costs for petitions by creditors, the costs of reorganization, and costs for accounting and yearly audit of the debtor. The new business mortgage can be enforced only in bankruptcy and not in the case of distress.

In regard to other general preferential rights, a number of changes are being introduced. One major change is the abolishment of the preferential right for taxes and fees. The rules regarding salary and pension claims will also change. Salary that has been earned during the

three months prior to the declaration of bankruptcy will have a preferential right. A cap on the amount of salary that has a preferential right is introduced and the amount covered by salary guarantee is raised. The estate's liability for salaries will increase and will commence after the first month if the debtor's business is continued by the official receiver. This rule corresponds to the new liability for rent and aims at ensuring competition equality between insolvent and solvent companies. The government has also indicated that the new rules for state salary guarantee will also apply to business reorganizations from January 1 2005.

Transition Period

The changes described will be implemented as of January 1 2004. However, there will be a transition period of one year for the new rules on floating charge security. During this period both the old floating charges and the new business mortgages will be in use, to give creditors a chance to re-evaluate and adjust their old security. If an existing security is impaired because of the new rules and the debtor, upon request of the creditor, does not supply supplementary security, the creditor will have the right to demand ongoing credits, even if the creditor does not have such a right in the current loan agreement. Once the transition period has ended, floating charges granted before January 1 2004 will be treated as business mortgages.

International lenders with a security interest in a Swedish floating charge are advised to review their security packages by July 2004 at the latest to be able to restructure them before the end of 2004.

Consequences

The government's own calculations estimate that the dividend on floating charge security in Sweden will generally decrease from 45% to just over 33%. However, creditors will therefore be more likely to file a petition for bankruptcy at an early stage, when the indebted company's assets are worth more. This may compensate for the lower preferential right of the business mortgage as compared to the floating charge. This will also lead to an increase in the total amount of money available for distribution among the creditors.

In regard to the rules on floating charges during the transition period (which allow the creditors to call in credits for re-negotiation of terms), the effects are difficult to foresee. What loans will the creditors call in? How will creditors change the terms in order to secure their future rights? A likely effect of both the new rules and the rules during the transition period is that the price of credits secured by floating charges/business mortgages will go up due to the lower preferential right. Another likely effect is that the banks will use other types of security, with factoring, leasing and security assignment through registered purchase of movable property all becoming increasingly popular.

Premises in top market areas are likely to be available more quickly than today, with landlords of such properties benefiting from a shorter period of insecurity in the case of an insolvent tenant. However, many landlords with premises in less attractive areas will potentially suffer from the loss of their preferential right. As bankruptcy administrations usually avoid liability for rent unless this is impossible, the result is likely to be faster administrations where leased premises are involved.

It is generally understood that official receivers will be much more cautious about continuing a business knowing they are liable for rent and salaries after the first month. This might lead to an increased number of pre-packaged bankruptcies/liquidations, where the business is sold for cash prior to the bankruptcy.

Non-preferential creditors may get a slightly higher dividend when the preferential right for taxes and fees is abolished. Once the state's preferential right for taxes and fees is abolished and securities in floating charges are worth less, companies may find it more difficult to gain a respite from payment. This may lead to closer individual follow-up from the creditors (who will have lost their advantageous position) and bankruptcies that are sought quickly in order to safeguard the value of the assets. However, it might also lead to creditors being overcautious and thus denying respite from payments unreasonably. This would be particularly troublesome for smaller companies with only limited funds.

New Reforms

Discussions on a new insolvency reform have begun alongside the implementation of these radical changes. The intention is to have a new and coherent legislation, with one starting point and no pre-determined outcome. During the procedure, it will be determined whether it is possible to make agreements with creditors or to reorganize the company, or whether a bankruptcy/liquidation with an eventual dissolution of the company is the best solution. It is also being discussed whether a company should be under a duty to try to raise more funds, for example through issuing new shares, to try to save the company and protect its creditors. The investigation of how such a law would be drawn up and how it would work is still at a preliminary stage, and it is too early to predict the outcome in any greater detail. The reform will be prepared by a committee in the autumn and will then be revised by the government. New legislation would be introduced in 2006 at the earliest.

Summary

OLD ORDER	NEW ORDER
<i>Preferential rights in respect of specific property</i>	
Particular liens	Particular liens
Floating charge property: <ol style="list-style-type: none"> 1. Rent (three months) and leasehold rent (one year); and 2. Floating charge deeds 	Abolished
Mortgages on real property	Mortgages on real property
Mortgages on site-leasehold right	Mortgages on site-leasehold right
Seizures	Seizures
<i>General preferential rights</i>	
Costs for petitions by creditors and company reorganization	Costs for petitions by creditors and company reorganization
Costs for accounting and yearly mandatory audit	Costs for accounting and yearly mandatory audit
Taxes and fees	Business mortgage with a right to 55% in all remaining assets after creditors with superior rights have received dividend
Salary and pension claims	Salary and pension claims (only minor changes)