SWEDISH
CORPORATE
GOVERNANCE BOARD

Finansdepartementet
Finansmarknadsavdelningen
Rättssakkunnig Rebecca Appelgren
103 33 Stockholm
fi.registrator@regeringskansliet.se

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Comments regarding Ministry of Finance Memorandum Ds 2013:16 on prospectus liability

The Swedish Corporate Governance Board (the Board) was invited to comment on the memorandum and the Board's opinions are summarised below.

1 Introduction

The Board welcomes the proposal to make companies liable for prospectuses and offer documents. The Board has particular opinions on some of the details of the proposal.

2 Directors' liability for prospectus documents

There is justification for a minor adjustment to the structure of the second paragraph of proposed Chapter 11Section 1 of the Swedish Companies Act (2005:551). The paragraph should contain the following underlined italicised text: "…or equity certificates *<u>issued by the company.</u>*" Otherwise, company executives and directors of, for example, Company A could be liable if Company A, as the seller of shares in Company B, is obliged to produce a prospectus as seller while the information on Company B is de facto issued by Company B itself. This, however, is not the stated purpose of the rule.

3 Directors' liability for certain offer documents

The proposed rules state that directors and executives are, together with the bidder, to have independent liability for damages for all offer documents. The reasons for this are not convincing.

On the issue of prospect liability for directors and executives, the Memorandum proposes limiting this to prospectuses issued for the sale or admission to trading of shares, convertible securities, warrants, subscription rights, profit participation or equity certificates. The justification offered for this limitation is that the liability is closely linked to corporate legal documents or the company itself, not its business. There is no reason to apply the same principle to offer documents. This would mean that directors are only liable if the offer comprises shares, convertible securities, warrants, subscription rights, profit participation or equity certificates in the bidding company since, in these cases, the connection to the company exists through the bidding company's issuing or transfer of these instruments. No legal connection exists in the case of cash offers or other types of payment. In cases where bids are submitted by a subsidiary of the company that is issuing the payment instruments, which is common, directors of the bidding company should also be liable.

Another argument proposed in the memorandum for limiting directors' prospectus liability without an equivalent limitation of liability for offer documents is that bond issues are so common that they are a normal part of a bank's business, whereas a public offer occurs rarely for a listed company, so director liability is always justified. The memorandum does not propose, however, that prospectus liability for the issue of equities other than shares etc be limited to just banks, but that this should be a general rule, and a bond issue is a very unusual event for a normal listed company. For some investment firms and other similar companies, however, public bids can be quite frequent occurrences. This argument therefore lacks any considerable force.

A further reason for allowing the liability for offer documents to also cover cash bids etc is that the directors' liability only applies to Swedish limited companies. Non-Swedish companies are not covered by the Swedish rules. There is no reason for treating Swedish and foreign bidders differently by making directors of Swedish bidding companies personally liable in purely corporate legal issues such as cash bids when there is no equivalent liability on the part of directors of non-Swedish bidding companies. The rules could also be avoided quite easily by bidders submitting cash bids through specially created foreign bidding companies.

It is therefore the opinion of the Board that there should be no directly regulated director liability in the case of cash offers or bids in the form of payment instruments other than shares, convertible bonds, warrants, subscription rights, profit participation or equity certificates issued by the bidding company or its parent company.

4 Profit participation certificates and equity certificates

The proposed text for Chapter 29 Section 1 of the Companies Act uses the terms profit participation certificate and equity certificate. As these are not legal definitions, the legislative text should refer instead to the types of loan covered by Chapter 11 Section 11 of the Act.

5 Subrogation from diligent sellers who make unjust profits

When an offer to purchase shares, convertible securities, warrants or subscription rights is made, the listed company that originally issued the instruments will be responsible, together with the seller, for the prospectus. If the seller has been diligent, but the company negligent in the preparation of the prospectus, the company may be liable for damages, despite the fact that it is the seller who actually benefited from the mistake by obtaining a higher price for the shares than would otherwise have been the case. If the seller has not been negligent, there is no possibility through reconciliation of ensuring that the seller bears the cost of damages relating to the price difference, and nor is subrogation an option for the company. Further, there is no possibility for the company to demand that this is regulated through contract, as the company is legally obliged to publish a prospectus. It is questionable whether general principles on unjust enrichment are sufficient, and particular regulation of this situation should therefore be considered.

6 Investor protection if there are financial intermediaries

In certain situations, it is unclear whether the proposed regulation may lead to investors being left without the protection that the rules aim to provide. This applies in cases where a financial intermediary resells securities and "uses" the prospectus issued by the company for the previous issue or sale by the company. Neither the legislative text nor the preamble offers any indication of how this use is linked to the proposed prospectus liability rules.

To give an example, a company conducts a public issue and draws up a prospectus. A securities firm helps to place the issue, but has also agreed to acquire the shares that cannot be placed for subsequent resale, or been granted the right to acquire some shares in order to sell them. When the securities firm then sells these shares, this sale is then to be considered a new offer with regard to the obligation to produce a prospectus and to the issue of prospectus liability. If the securities firm's sales offer is directed to the general public, a prospectus is to be published by the issuing company, and the firm, as seller, is then responsible for the prospectus together with the issuing company that drew up the original prospectus.

This situation is covered by the special rule found in the second paragraph of Chapter 2 Section 4 of the Swedish Financial Instruments Trading Act (1991:980). If the issuing company provides a concession to the financial intermediary allowing it to use the previous prospectus when reselling shares, the securities firm does not need to draw up a separate prospectus. The question of what applies with regard to prospectus liability, however, is left unanswered. If the regulation is considered an exception to the securities firm's prospectus obligation, that means that rules concerning demarcation of those entitled to compensation will result in shareholders who acquired shares from the securities firm on the basis of the prospectus not being able to bring damages claims against the issuing company or its directors according to this regulation, as they do not belong to the primary circle, since the original purchaser of the company's shares was the securities firm. As the securities firm did not issue a separate prospectus, due to the exception, there is no seller liability according to the proposed rules for securities firms.

The special explanation of the proposed Chapter 2 Section 42 of the Financial Instruments Trading Act states that if the company publishes a prospectus and issues all the shares to a financial intermediary for resale, the prospectus is to be regarded as being drawn up on the financial intermediary's behalf, as the intermediary has solely been used for reselling. Whether this principle can also be applied to the above case, when the prospectus has been drawn up primarily for the company's own offer of issue, is unclear. A particular liability rule linked to Chapter 2 Section 4 of the Financial Instruments Trading Act should therefore be introduced.

7 Participating securities firms

The discussion on the liability of participating securities firms is very brief. The conclusion is that the liability of these institutes is not to be dealt with in the new rules. Today, discussion on the liabilities of participating securities firms is based mainly on the events of the Kone case, which does not concern prospectus liability, but liability for valuation certificates. Even though the memorandum states that the proposed rules are not to be regarded as exclusive and that it will still be possible, on the basis of general principles of damages legislation, to make other participating actors, e.g. securities firms, liable, there is a danger that, in a purely practical sense, the proposed regulation leads to the particular liability of securities firms being neglected, as they are not identified as the subject of liability in the new rules. The firms will also disclaim all liability in their prospectuses.

We will therefore be faced with a highly unsatisfactory situation where protection for investors – the very thing that the memorandum strives to improve – has been neglected. If an error resulting from negligence on the part of a securities firm is found in a prospectus, the proposed rules only relate to the liability of the issuing company and its directors. It is not normally considered negligent to engage the services of a securities firm during a share issue. And as securities firms and their operations, board and management are strictly regulated and supervised by Finansinspektionen, the Swedish Financial Supervisory Authority, it cannot be considered negligent for an issuing company not to examine in detail how a securities firm has carried out its assignment. It would also not be socioeconomically defensible to require companies to supervise the work of securities firms and duplicate the role of the Financial Supervisory Authority.

This means that as long as no court rules that the liability for damages founded on the Kone principle, for example, also applies to a securities firms negligent behaviour, the issuing company is the sole subject of liability, and as outlined above, it would require very special circumstances for a company to be considered negligent if the securities firm is at fault. One possible solution would have been to create a special rule allowing the issuing company or the seller to be liable for the participating securities firm's negligence. This would be a reasonable solution, given that securities firms often have a crucial role and control over a share issue or offer.

8 Sanctions

The memorandum states that the introduction of the sanction nullity of share subscription requires further investigation, which is a view shared by the Board. However, the Board is of the opinion that this should be investigated as soon as possible, not least because this sanction is available on the basis of sales legislation in connection with the acquisition of shares, and there is no reason in principle for such a sanction not to be available in connection with a share issue if the company becomes liable for damages

9 Good faith requirements

The memorandum does not take up a position with regard to whether a good faith requirement, i.e. a requirement that the injured party must show that he or she has acquired securities based on the information contained in the prospectus, is to be drawn up or not. It is the opinion of the Board that the drawing up of a good faith requirement limits the protection of investors to too great an extent. Small investors would be particularly vulnerable, as they normally do not study the information contained in a prospectus, relying instead on the market to correctly set the price of the shares.

10 The scale of damages awards in takeover bids

There is a need for greater guidance on how a seller's damages are to be calculated in takeover bids. In cases where a payment is offered in the form of shares or other securities, and the damages can be in the form of the value of these instruments being lower than could be understood from the information about the issuer published in the prospectus, the calculation will be the equivalent of that which applies in the case of share issues and sales. If, however, it is a question of inaccurate information about the target company that means that the value of the target company should actually be higher, the calculation of damages becomes much more difficult. If the offer includes a premium of 30 per cent, but the information about the target company undervalues the company to the same extent, has the seller suffered any damages? Real damages ought to be the result of accepting a bid on false premises, and the scale of damages in such cases is very difficult to estimate.

11 Consent to the inclusion of documents in the prospectus

The special explanation of proposed Chapter 2 Section 41 of the Financial Instruments Trading Act states that if several individuals have been involved in the production of a document that is included in the prospectus with their permission, each of them must have given consent to liability for the prospectus. The wording can be interpreted as there being no liability for any of these individuals if one of them has not given consent, which would be unfortunate. In this case, the reasonable solution would be that only those who have given their consent are liable for the document.

Stockholm, 14 June 2013

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<table><tr><td>Hans Dalborg
Chair of the Board</td><td>Björn Kristiansson
Executive Director</td></tr></table>