
S W E D E N

Warranties, Representations and Due Diligence in Swedish Law

BY JON KIHLMAN | GÄRDE WESSLAU ADVOKATBYRÅ

There are only two kinds of property in Swedish law: movable and immovable property. Immovable property is primarily land, buildings (if the building is owned by the owner of the land on which it stands) and accessories to the land or building. All other property, including intellectual property rights and other immaterial assets, is by definition movable. Thus, companies – even companies with the sole purpose to own immovable property – are movable property.

The Swedish Sale of Goods Act (Köplagen (1990:931), hereafter referred to as “SGA”) applies to all inter-Nordic sales of movable property. It also applies to barter transactions and – by analogy – to a greater or lesser extent to other transactions, e.g., licence agreements and service agreements. Almost all M&A transactions are for the sale of either a company or its movable assets. SGA applies to all such transactions.

When at least one party is from a non-Nordic country, the UN Convention on Contracts for the International Sale of Goods (“CISG”) will apply to sales of most movable property. However, CISG does not apply to sales of *inter alia* stocks and shares. Therefore, SGA will also apply to sales of companies in international transactions. Consequently, when Swedish law governs the contract, SGA will apply to most M&A transactions.

Warranties, Representations, Etc.

Sections 17-21 SGA define the breach of contract that in CISG is referred to as “non-conformity” or “lack of conformity”. Section 17 (1 and 2) SGA are not much more than translations of art. 35 (1 and 2) CISG. One effect of the close resemblance is that the distinction between warranties and representations (and for that matter conditions) is as foreign to Swedish law as it is to CISG. A breach of either of them will – short of application of such foreign distinctions by way of interpretation of the contract – constitute a *breach of contract* which will give the aggrieved party – i.e., the buyer – the right to remedies as stipulated in SGA. Just as in CISG (and for that matter other modern sets of rules such as the Unidroit Principles of International Commercial Contracts) obligations can be either express or implied. And just as in these sets of rules, it is wholly immaterial whether the obligation that was not fulfilled was expressed or implied; in both cases there will be a breach of contract and it will be treated in exactly the same way regardless of whether the obligation that was not fulfilled was expressed or only implied.

The Buyer’s Knowledge

While section 17 (1 and 2) SGA are mere copies of the corresponding sub-paragraphs in CISG, there seems to

be a difference between section 17 (3) SGA and art. 35 (3) CISG. While art. 35 (3) CISG deals with the buyer's knowledge or assumed awareness in relation to art. 35 (2), section 17 (3) SGA states that goods must conform with Section 17 (1 and 2) *and in all other matters conform with what the Buyer could reasonably expect*. Section 20 (1) SGA adds to this by stating that a buyer cannot claim that a good was non-conforming if the buyer must have been aware of the "non-conformity" (the brackets are used to mark that the "non-conformity" does not constitute a breach of contract) when the contract was concluded. Section 20 (2) SGA goes even further: If the buyer has examined the goods before the conclusion of the contract, or if the buyer has not adhered to the seller's suggestion that it should examine them, the buyer cannot claim that the goods lacked in conformity if the buyer ought to have discovered the "non-conformity", i.e., if the buyer would have discovered the "lack of conformity" if it had adhered to the seller's invitation. More than anything else, Section 20 SGA clarifies what already follows from section 17 (3): A buyer cannot reasonably expect the goods to be any different than what the buyer knows to be the case. And the buyer cannot *reasonably* expect them to be any different than what the buyer ought to have known to be the case.

A Due Diligence Can Kill a Warranty

Since SGA applies to most – if not all – M&A transactions, parties to such transactions must realise that a due diligence process *kills* all warranties, representations, guarantees, or whatever they are called in the specific contract, to the extent that they deal with a matter that ought to have been discovered in the due diligence process. All such warranties, etc., are simply no longer relevant parts of the contract!

Exceptions and Alterations

It is – of course – not always true that a due diligence will kill a warranty. One obvious exception is when it follows from the contract – either expressly or through interpretation – that warranties, etc., shall apply even when the buyer knows them to be untrue. Although SGA is wholly non-mandatory, the exception has the obvious drawback that it directly contradicts the non-mandatory rule in section 17 (3) and section 20. Therefore, interpretation of the contract with this effect is unlikely, unless the indications are very strong that the parties indeed intended to include the exception in their contract.

Another exception is the relationship in time between the warranties, etc., and the due diligence process. Primarily, the rules are based on the assumption that the warranties, etc., are given before the due diligence process. It is a completely different matter if it is the other way around, since it then is relatively easy to assume that the warranties, etc., are given as a result of the buyer's discoveries and – consequently – that it follows from the contract that those "non-conformities" shall be remedied before delivery (i.e., closing). However, most contracts do not deal with the relationship in time and do not specify if the warranties, etc., are given as a result of the buyer's discoveries. Most probably, such warranties, etc., will be assumed to have been given before the due diligence process, since that is the assumption on which the relevant part of SGA is based.

An alternative, rather than an exception, is to wholly steer clear of the concept of breach of contract and, by doing so, manoeuvre around the discussed rules. To achieve this, it is recommended that the parties clearly state that the warranties, etc., are not descriptions of the contract's object and that, therefore, any "non-conformity" shall not constitute a breach of contract. The purpose of the warranties, etc., shall instead expressly only be to provide a base for the final calculation of the price. The construction corresponds well with the usual sole remedy

for breaches of warranties, etc., in M&A transactions, i.e., a reduction of the price (calculated in accordance with section 38 SGA (cf. art. 50 CISG)). A use of this alternative requires diligence in the construction of the contract, since it is foreign to “usual” contracts, where warranties and similar terms are the positive side of breaches of contract, and where the breach of a warranty is regarded as a lack of conformity.

Exclusion of SGA or Other Non-mandatory Law

It is not uncommon that contracts – both in M&A transaction and otherwise – altogether exclude the application of SGA (or for that matter other non-mandatory law). Such choices are most unwise. They create uncertainty regarding legal structure and terminology. They also create “legal black holes” for situations that are not covered by the contract. Even when a contract is meticulously drafted, situations are bound to occur once in a while that were not contemplated by the drafters, and then what? Most probably, an arbitrator or a judge will revert to general principles of (Swedish) law. For sales contracts, such principles are found in SGA. So even with a clause that excludes SGA, the content of SGA is likely to come back dressed up as general principles of law. And the rule expressed in Section 17 (3) SGA and clarified in Section 20 is most certainly such a general principle.

Conclusion

There is nothing wrong with Swedish sales law. SGA is a good base for an M&A transaction. If one chooses Swedish law to govern any such transaction, one must, however, be aware of the possibly unwanted effects of the choice, and of course, deal with them. More than anything else, the described relationship between the buyer’s assumed knowledge after a due diligence and the seller’s warranties, etc., may come as a nasty surprise to buyers who have relied to heavily on such statements by the seller.

Jon Kihlman is a Partner at Gärde Wesslau Advokatbyrå.



[Click here to view COMPANY profile](#)