

# Due diligence requirements regarding share ownership and related compliance in M&A transactions

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## Introduction

### New and existing bearer shares

### Reporting obligations

### New organisational deficiencies

### Criminal penalties

### Consequences for M&A transactions on the buy side

## Introduction

In Swiss M&A practice, share deals remain the most common method of acquiring a business from a third party for several reasons. Due to strict Federal Supreme Court precedents, legal due diligence regarding share ownership and related compliance has always been a fundamental component of legal due diligence in Swiss share deals. Recent legislative changes have further increased the importance of thorough due diligence in this regard.

From 1 November 2019 companies and their advisors will face the following new regulations in Switzerland:

- New bearer shares will be permitted only if a company has listed equity securities on a stock exchange or if the bearer shares are structured as intermediated securities and deposited with a custodian designated by the company in Switzerland.
- Existing bearer shares of companies not in liquidation will be automatically converted into registered shares on 1 May 2021 if the company:
  - listed no equity securities on a stock exchange and their bearer shares are not structured as intermediated securities; and
  - listed no entries according to Article 622(2)*bis* of the Code of Obligations.
- Bearer shareholders will face new penalties for breaching reporting obligations.
- The reporting obligations of beneficial owners are expected to be partially clarified.
- Organisational deficiencies will be remedied with regard to:
  - the improper maintenance of the share register or list of beneficial owners reported to a company; and
  - bearer shares without an exemption.
- New criminal penalties will be introduced for the violation of:
  - reporting obligations relating to beneficial owners; and
  - maintenance obligations relating to directories.

On 21 June 2019 the Federal Assembly passed the new Federal Act implementing the recommendations of the Global Forum on Transparency and Exchange of Information for Tax Purposes. During its meeting on 27 September 2019, the Federal Council decided that the new act would enter into force on 1 November 2019. The new provisions will directly apply to existing companies. Further, the Federal Administration will publish guidance on implementing the act when it comes into force.

This article examines these legislative changes in the context of share ownership and related compliance in M&A transactions.

## New and existing bearer shares

Bearer shares will be partially abolished under the new law. New issues of bearer shares will be prohibited from the date on which the new law enters into force and existing bearer shares must be converted into registered shares within 18 months of 1 May 2021; otherwise, they will automatically

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(ie, legally) be converted into registered shares. Exemptions will apply to public companies, companies with bearer shares in the form of intermediated securities and companies undergoing liquidation. Such companies must register with the competent commercial register within 18 months of the entry into force (ie, by 1 May 2021), confirming that they qualify for an exemption.

The automatic conversion will apply irrespective of:

- article of association provisions or commercial register entries to the contrary; and
- whether shares have been issued.

The commercial register will make such entry changes *ex officio*. It will also enter a comment indicating that the documentation contains information that deviates from the entry in the commercial register. Converted shares will retain their nominal value, payment quota and characteristics with regard to voting rights and claims under property law. The transferability of such shares will not be limited.

In the case of automatic conversion, the company will have to adapt its articles of association to the new circumstances when the articles of association are next amended. If this adjustment is not made, applications to register another amendment to the articles of association in the commercial register will be rejected by the latter. After the conversion of bearer shares into registered shares, the company will enter in the share register only those shareholders that have fulfilled their notification obligations under Article 697i of the Code of Obligations.

### **Reporting obligations**

If any bearer shareholders have not fulfilled their notification obligation under Article 697i of the Code of Obligation at the time that the new law enters into force, the relevant board of directors will request compliance from shareholders – namely, through:

- a special notification if the shareholders, persons or companies are known; and
- a notification of the form set out in the articles of association and via a public announcement in the *Official Gazette of Commerce* if the shareholders, persons or companies are unknown.

Compliance invitations must document the number of shares concerned and indicate that shareholders that fail to fulfil their reporting obligations will permanently lose their rights and economic benefits and their shares will be transferred to the company.

The membership rights of shareholders that fail to comply with the reporting obligation will be suspended and their property rights forfeited. Boards of directors must:

- ensure that no shareholders exercise their rights in violation of Article 697i; and
- record in the share register that these shareholders failed to comply with the reporting obligation and that the rights attached to the shares cannot be exercised.

The share register will also contain the dates of special notifications and public announcements in the *Official Gazette of Commerce*. Shareholders that fail to comply with their notification obligation under Article 697i of the Code of Obligations and whose bearer shares have been automatically converted into registered shares may apply to the court to be registered in the company's share register, with the company's prior consent, within five years of the entry into force of the new law (ie, by 1 November 2024). The court will approve the application in summary proceedings if the shareholder can prove their shareholder status. Affected shareholders will bear the costs of such court procedures. If the court approves an application, the company will need to register the relevant shareholder.

Shareholders can assert property rights stemming from shares arising only from this point in time. Where shareholders have neither complied with the board of directors' request for notification nor applied to the court to register in the company's share register within the specified period, the company must apply to the court to cancel the affected shares. The courts will decide in summary proceedings.

After a decision to cancel affected shares has been finalised, the affected shareholders will lose their legal rights irreversibly and definitively and any economic benefits or contributions will be transferred irrevocably to the company. Instead of the cancelled shares, the board of directors will issue new treasury shares.

Bearer shareholders that fail to comply with the reporting obligations under Article 697i of the Code of Obligations and in due time after the conversion into registered shares therefore risk the irrevocable loss of their legal and economic rights relating to the affected shares.

The new law also clarifies the following issues relating to the existing obligation to report the

beneficial owners of shares to a company:

- If the shareholder is a legal entity or partnership, the beneficial owner to be indicated must be a natural person who controls the shareholder in accordance with Article 963(2) of the Code of Obligations. Where no such person exists, the shareholder must notify the company accordingly.
- If the shareholder is a corporation whose participation rights are listed on a stock exchange or if it is controlled by such a corporation within the meaning of Article 963(2) or controls such a corporation within the meaning of Article 963(2), it need only report this fact and the name and registered office of the corporation.
- Shareholders must notify companies within one month of any changes to a beneficial owner's name or address. Until now, it was unclear whether and to what extent a deadline existed.

### **New organisational deficiencies**

The commercial register and any shareholder or creditor of an affected company will be entitled to request the court to take the necessary measures (eg, liquidation) in the following circumstances:

- The company fails to maintain the share register and/or the list of beneficial owners notified to it in accordance with the regulations.
- The company fails to consider any legal exceptions when issuing bearer shares (ie, without its equity securities being listed on a stock exchange or set up as intermediated securities).

### **Criminal penalties**

#### ***Beneficial owners***

Shareholders of a corporation or members of a limited liability company that intentionally fail to comply with the reporting obligations under Articles 697j(1-4) or 790a(1-4) of the Code of Obligations and to report the company's beneficial owners of shares will face fines.

#### ***Directories***

Company boards of directors, managing directors in limited liability companies and administration members in cooperatives that deliberately fail to maintain the share register, register of cooperative's members or register of the beneficial owners of shares or units in a company in accordance with the regulations or violate the associated company law obligations will face fines.

### **Consequences for M&A transactions on the buy side**

In Switzerland, the vast majority of M&A transactions are structured as share deals for several reasons – an important one being the taxation of proceeds on the sell side, in particular in case of individuals acting as sellers. According to Federal Supreme Court case law, legal due diligence regarding the ownership of shares and an uninterrupted chain of title of the shares to be acquired has always been a fundamental component of legal due diligence in Swiss share deals. The abovementioned legislative changes have further increased the importance of such due diligence.

Buyers of shares in a target must ensure that the target is and has always been fully compliant with the reporting obligations of its shareholders and the documentation obligations of its board of directors or managing directors, so as to avoid criminal and civil penalties.

From 1 November 2019 potential buyers of bearer shares in a company that does not qualify for an exemption should either require the seller to arrange that the bearer shares are converted into registered shares pre-acquisition or pro-actively require the company to do so as soon as possible post-acquisition.

If the seller of the shares to be acquired or any other shareholder of the target fails to comply with their obligations to notify the company of their shareholding and/or of beneficial ownership, the membership rights conferred by the respective shares will be suspended.

Given the Federal Supreme Court's strict stance on unauthorised persons' exercise of company rights, any resolution of a shareholders' meeting in which a shareholder participated in the past may be considered null and void, depending on the circumstances (eg, the percentage of the shares affected compared with the total number of shares present at the relevant shareholders' meeting). Such qualification might have far-reaching consequences. Board of directors' elections (and decisions and actions thereof), decisions relating to structural changes such as capital increases, capital decreases and mergers/demergers and resolutions regarding dividend payments will be affected and as a result might also qualify as null and void. Therefore, buyers should thoroughly investigate such issues and follow up any related red flags in the due diligence report.

Further, buyers acquiring shares must ensure compliance with their own reporting obligations in order to avail themselves of the legal and economic rights to the acquired shares and avoid criminal

and civil penalties. It is in share buyers' best interests to enable the target's board of directors to maintain its share register and beneficial owners list in accordance with the applicable legal provisions. The board of directors will thereby avoid criminal and civil penalties which may result in the company losing its executive body and facing an *ex officio* request for liquidation.

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