

Corporate Finance/M&A - Switzerland

Control premium

Contributed by [Meyerlustenberger Lachenal](#)

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Introduction

In the context of a larger overhaul of the regulatory framework with regard to insider trading, market abuse and similar practices, the Swiss legislature has recently passed an amendment to the rules of the Stock Exchange Act governing the disclosure of shareholdings and the minimum price rules applicable in a public tender offer. In particular, the new rules will:

- extend the reach of the act to shares of companies with registered offices outside Switzerland;
- expand the supervisory instruments of the Swiss Financial Supervisory Authority regarding compliance with disclosure obligations of market participants;
- change some important procedural provisions; and
- abolish the possibility for an offerer to pay a control premium to the controlling shareholders of a target company shortly before the launch of a public tender offer - the most significant and controversial change.

Existing minimum price rules

Under the existing provisions of the act, any shareholder whose holding exceeds a threshold of 33.3% of the voting rights of a listed company must make a public offer to purchase all other listed equities - unless such listed company has adopted an opt-up or opt-out clause (for further details please see "[Takeover Board becomes more lenient regarding opt-out clause](#)"). Such mandatory offers - and voluntary offers extending to more than one-third of the voting rights of a listed company (or, in case of an opt-up, to the respective higher number of shares) - must provide for an offer price that corresponds to a two-tier minimum price rule. Under the first tier of the test, the offer must at least equal the current stock exchange price (ie, the volume-weighted average price of the last 60 trading days preceding the pre-announcement, if any, or the announcement of the offer), and may not be below 75% of the highest price that the bidder - and any persons acting in concert with the bidder - paid for equities of the listed company in the last 12 months. As a consequence of the second tier of the test, the bidder may, to a limited extent, pay the selling major shareholders a higher price for their shares prior to publication of the public offer than is offered under the public offer to the minority shareholders. The current rules therefore accept, to an extent, a differentiation between shareholders whose shares are acquired in a first step at a higher price - almost always shareholders holding significant interests in the target which together have relative or absolute control over the target - and other shareholders, bigger and smaller, whose shares are acquired only in a second step at a lower price. The shareholders in the first group can profit from the control premium, while the shareholders in the second group must accept a minority discount. The maximum premium allowed by the existing takeover regime is 33.3% of the price offered in the subsequent public offer, provided that the acquisition of such a controlling block is entered into before and independently of the launch or success of the public offer. The limitation on the amount of the control premium applies to a 12-month period before the (pre-)announcement of the public offer. Once the offer has been officially announced, the best price rule becomes applicable, forcing a bidder that acquires any shares at a higher price than the offer price to pay such price to all shareholders of the target. The best price rule also remains applicable after the end of the (additional) acceptance period of the offer for a further six months.

Authors

[Alexander Vogel](#)



[Debora Kern](#)



The current rules therefore allow for a structure that resembles a two-tiered tender offer in other jurisdictions, where the acquirer is allowed under the first tier - which is designed to give the acquirer control over the target - to offer a better price for a limited number of shares of the target, while it offers a reduced price for an additional number or the remainder of the shares under the second tier that has a later completion date. Both approaches have significant benefits from the acquirer's perspective. Most importantly, the overall cost of the tender offer using a two-step approach is reduced, in comparison to a tender offer at the same price extending to all outstanding shares. Further, the shareholders of the target company in a two-tiered tender offer will likely tender their shares more quickly, in order to avoid being placed in the second tier and receiving a lower offer price. In case the bidder has already acquired a controlling interest in the target, there is no risk of a competing offer and the remaining shareholders are essentially forced into accepting the offer in order not to be at risk of holding illiquid shares and receiving - similar to the shareholders in a two-tiered tender offer - a lower pay out at a later date.

As a result, bidders launching a public offer with a significant interest in the target - even if short of a controlling interest - are more likely to succeed with their takeover attempts, since they can discourage or fend off potential third-party bidders and stifle potential resistance, if any, from the target itself. Further, the possibility to pay a control premium to certain shareholders, but not to others, when a controlling stake in a target is acquired (ie, more than 33.3% of the voting rights), puts minority shareholders in a worse position by having to accept a price that is up to 25% below that offered to the significant shareholders before the public offer.

While bidders have in the past been reluctant to pay selective premiums to significant shareholders - even though the provisions allowing this have been in force since 1997 - it has become more usual to employ selective control premiums in the context of public offers, despite the fact that Swiss media has in several cases heavily criticised the payment of a premium to majority shareholders. Recent cases involving significant control premiums ranging from 20% to 33.3% include the takeovers of Hiestand Holding AG, sia Abrasives Holding AG, Quadrant AG and Bank Sarasin & Cie AG.

Abolition of control premiums

The abolition of the possibility to pay a control premium to certain shareholders before the launch of the offer was brought forward by the federal government based on a proposal by the Takeover Board. The proposal was also supported by the SIX Swiss Exchange - the larger of the two official stock exchanges in Switzerland. The proponents' main argument for this change is that the payment of a control premium significantly violates the principle of equal treatment and transparency, and therefore violates the legitimate interests of minority shareholders in a public takeover. It can be assumed that this change has also been triggered by the growing use of significant premiums in the recent past and the apparently increased willingness of both acquirers and sellers of substantial blocks to share the advantages of an unequal treatment of shareholders, while simultaneously taking the public blame for such perceived unfairness. In a broader view - the opinion of the SIX Swiss Exchange - the possibility to pay a control premium to one or several significant shareholders is considered a significant disadvantage to the Swiss financial market in terms of international competitiveness. A further argument is that such an option has been abolished in most European countries, since pursuant to the EU takeover offer guidelines, EU member states may not allow for any control premiums under their national laws.

Conversely, the opponents of an abolition of control premiums argued mainly that such an abolition is an unjustified infringement of the principle of freedom of contract, since the ability to sell a controlling block represents an economic value which should justify being compensated by a control premium to be paid to the holder of such a controlling block. Further, the defender of the current statutory regime argued that an abolition would necessarily lead to an increase of the overall costs for a takeover, and thus would be likely to prevent a takeover in many cases. These arguments were the subject of heated debate, both in the legislative consultation procedure and in both chambers of Parliament. Finally, the latter decided - after protracted controversial debate with a narrow margin - to abolish the control premium as proposed by the Federal Council and the Takeover Board.

Comment

As a result, the revised version of Article 32(4) of the Stock Exchange Act provides that the price of an offer must at least equal both the current stock exchange price and the highest price paid by the bidder for shares (or other equity securities of the target company) in the 12 months preceding the announcement of the offer. These revised provisions will effectively prevent a bidder from acquiring a block from a significant shareholder pre-offer at a price exceeding the offer price offered to the minority shareholders. A bidder that wishes to acquire - or a significant shareholder willing to sell - a significant block of shares at a higher price than offered to the public must do so at least 12 months before the announcement of the offer. The acquired interest must be - together with any shares already held by such bidder or any parties acting in concert

with it - below 33.3% of the voting rights in order not to trigger a mandatory public offer, unless the articles of association of the target increase the relevant threshold for a mandatory public offer (opt-up) or waive the applicability of the mandatory tender offer rules, including the minimum price rules - altogether (opt-out). As a result, an increase in the introduction of opt-out clauses to avoid mandatory offer obligations, and thus the minimum price rules, may be seen. However, the Takeover Board has already taken the immanent limitations applicable to the use of control premiums into consideration in a recent decision, whereby the Takeover Board applied a more stringent practice with regard to the introduction of an opt-out clause, requiring the affirmative votes of a majority of the disinterested shareholders present at the meeting. Besides opt-out situations, a selective premium also remains possible - to the extent agreed prior to and independent of the public offer - if the bidder already holds shares in an amount exceeding the threshold for a mandatory offer.

The new rules relating to limiting the payment of control premiums are expected to come into force in April 2013. Bidders and sellers that are considering employing a control premium when structuring the sale of a target listed in Switzerland would therefore be well advised to speed up their preparations in view of the fact that such structures will be impossible in the near future.

For further information on this topic please contact [Alexander Vogel](#) or [Debora Kern](#) at Meyerlustenberger Lachenal by telephone (+41 44 396 91 91), fax (+41 44 396 91 92) or email (alexander.vogel@mll-legal.com or debora.kern@mll-legal.com).

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