

Corporate Finance/M&A - Switzerland

Federal Administrative Court rules on Quadrant public takeover

Contributed by [meyerlustenberger](#)

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Introduction

On January 1 2009 the regulatory framework governing public takeovers in Switzerland was amended. Together with the Financial Market Supervision Act, several changes relating to public offers and the applicable procedural rules were enacted in the Securities and Stock Exchange Act and its implementing ordinances, which resulted in, among other things:

- a strengthening of shareholder rights,
- a tightening of the disclosure obligations; and
- the amendment of the appeals process rules.

As a result of the changes, the Federal Supreme Court is no longer the court of last instance in public takeover matters; the Federal Administrative Court now has this role. This update analyses some of the main points to emerge from the first decision to be handed down by the Federal Administrative Court as the court of last instance.

Facts

In May 2009 SIX Swiss Exchange-listed Quadrant AG became the target of a friendly public takeover offer launched by Aquamit BV, an Amsterdam investment vehicle held by four board members and shareholders of Quadrant (ie, Quadrant Management) and Mitsubishi Plastics.⁽¹⁾ When preparing the public offer, Quadrant Management and Mitsubishi Plastics had entered into a framework agreement and a joint venture agreement. Under the terms of these agreements, Mitsubishi Plastics agreed to provide financing to Aquamit and to grant founders' rights and management options to Quadrant Management. Mitsubishi Plastics and Quadrant Management each held 50% of Aquamit. In order to implement the offer, the latter entered into a transaction agreement with Quadrant.

After Aquamit announced its public takeover offer for the shares of Quadrant at a price of Sfr86 a share, Sarasin Investmentfonds AG, a minority shareholder of Quadrant, challenged the decision of the Takeover Board regarding the approval of the offer and requested, primarily, an increase of the actual offer price. It claimed that, among other things, the valuation of the additional benefits granted by Mitsubishi Plastics to Quadrant Management in connection with the offer was not performed properly. Sarasin's claim was rejected both by the Takeover Board⁽²⁾ and the Financial Market Supervisory Authority (FINMA).⁽³⁾ Thereafter, Sarasin filed an appeal with the Federal Administrative Court.

Decision

Procedural questions

The Federal Administrative Court had to determine whether Sarasin was entitled to appeal against the FINMA decision, as Sarasin tendered most of its shares to Aquamit and thus no longer held 2% of the voting rights in Quadrant, as required under Article 33b(3) and Article 33c of the Securities and Stock Exchange Act, providing for a minimum shareholding of 2% to become and remain a party to the takeover proceeding before Takeover Board and FINMA. The court ruled that such provisions did not apply to the proceedings before it. According to the court, the Federal Administrative Procedure Act, which provides no 2% minimum shareholding requirement, is solely applicable to the proceedings. Furthermore, Article 29a of the Constitution provides a constitutionally

Authors

Alexander Vogel



[Debora Kern](#)



guaranteed right to access to courts. As a result, the prerequisites to appeal should not be interpreted narrowly; thus, the 2% minimum shareholding requirement did not apply to the proceedings before the court.

Scope of review body report

According to Article 25 of the Securities and Stock Exchange Act, before publication the offeror must submit the offer to an auditing company (or to a securities dealer or investment bank) accredited by FINMA for review, which must primarily examine whether the public takeover offer and its valuation complies with the provisions of the takeover regulations and the implementing rules. The Federal Administrative Court ruled that the review body fulfils a public task and must adopt a neutral position. The review body is an extended arm of the Takeover Board and may not protect the interests of the offeror.

Additionally, the court held that the review body should always examine which specific benefits are exchanged by the parties involved in a public offer or its related transactions. The contracts are not to be analysed as a whole to determine whether the performances are balanced. Instead, each material benefit to either party, and each component thereof, must be carefully assessed and valued. In the case at hand, the Federal Administrative Court found that the review body had assumed without good reasons that the performances were balanced, as it based its assessment of the "other material benefits" on false facts, incorrect legal assumptions or implausible or incomprehensible considerations.

The court confirmed that the Takeover Board and FINMA must not carry out an investigation to determine the facts themselves and may, in principle, rely on the facts established by the review body as well as on their assessment of the offers. However, the Takeover Board (and FINMA) must verify that the review body's assessment has been carried out thoroughly and comprehensively. They must, in particular, examine whether the review body's calculations and explanations with respect to the valuation of the "other material benefits" in the sense of Article 41(4) of the FINMA Stock Exchange Ordinance are "transparent, plausible and comprehensible".

As a result, the Federal Administrative Court revoked the FINMA decision and parts of the Takeover Board decisions. Thus, among other things, the Takeover Board must reassess certain "material benefits" and the adequacy of the offer price.

Effect of res judicata

Sarasin requested that the offer price be increased for all Quadrant shares. The court held that the decision of the prior instance could not be contested with force and effect for all shareholders. Thus, the decisions were revoked only to the extent that Sarasin was concerned. For all the other shareholders involved, the Takeover Board and FINMA decisions have come into full force and effect.

Comment

Under the new rules, which came into effect on January 1 2009, shareholders can request to participate in the proceedings before the Takeover Board and submit objections or requests. Additionally, shareholders have the option of appealing against a decree issued by the Takeover Board. In view of these new rights granted to qualified shareholders, since January 1 2009 the offeror has had to comply with a mandatory cooling-off period (usually 10 stock exchange days). Furthermore, due to the possibility of an appeal, the terms of the offer and the offer documents will be published with only a preliminary approval of the Takeover Board, since qualified shareholders may file an objection with the Takeover Board. This might cause the Takeover Board to reconsider its approval, or the approval decision may be appealed to FINMA. Thus, qualifying shareholders have the possibility to delay a friendly takeover transaction considerably, as the cooling-off period will be extended in most cases in which a qualified shareholder files an objection or an appeal. Therefore, the offer period does not start until the Takeover Board – or, in case of an appeal, FINMA – has issued its decision.

As a result of the delay, the transaction risks for both the offeror and the target company may increase considerably. The offeror, risks being bound to its offer – and thus be exposed to market risks – for a much longer period than anticipated. This in turn increases the offeror's costs and makes financing more difficult to obtain. It may be beneficial for the offeror to approach the appealing shareholder and try to offer better terms in exchange for a withdrawal of the legal challenges.

The *Quadrant* case illustrates these consequences very effectively. Two-and-half years after the offer was made public, a final decision is yet to be taken. In particular, according to the published decisions by the Takeover Board⁽⁴⁾ and FINMA,⁽⁵⁾ it seems to be a challenging task for the offeror to find a new review body which is willing to assess the issues raised by the Federal Administrative Court.

The *Quadrant* decision answered several elementary questions on Swiss public takeover law. However, some of the court's conclusions give rise to further questions.

The Federal Administrative Court raised the question of whether shareholders which

were not entitled to appeal before the Takeover Board and the FINMA due to the 2% shareholding requirement, would be entitled to appeal before the Federal Administrative Court nonetheless. However, the court concluded that this question did not need to be answered in relation to the case at hand. Thus, it is unclear whether shareholders which do not meet the 2% requirement would ever have access to a court. Considering that the *Quadrant* decision applies only to the appealing shareholders, it could be the case in future that all shareholders except those which hold less than 2% of the shares can benefit from the result of a contested decision. To compensate for the effect of this on shareholders that do not meet the 2% shareholding requirement, one solution could be to expand the definition of persons qualifying as shareholders which meet the 2% shareholding requirement.

According to the prevailing view among commentators, only single shareholders holding 2% or more of the shares are allowed to appeal; groups of shareholders holding an aggregate of 2% or more of the shares cannot appeal. Therefore, a solution could be to allow shareholders to act as a group. Nonetheless, it must not be forgotten that, generally speaking, the interests of the shareholders of the offeree company are protected by law and such protection is supposed to be ensured by the review body and the review by the Takeover Board. Thus, even where there is no possibility for the shareholders which do not meet the 2% threshold to file an appeal, their interests are still looked after.

However, as discussed above, according to *Quadrant*, the offeror need not pay the increased offer price resulting from an appeal to the non-appealing shareholders if the Federal Administrative Court comes to the conclusion that the offer price should be increased. This interpretation does not correspond to the aims of the legislation on stock exchanges and listed securities as, among other things, it fails to take the principle of equal treatment of all investors into account. Further, this might remove the incentive for an offeror to find an extra-procedural settlement with the appealing shareholder by offering better terms – thereby respecting the best price rule – to all shareholders in exchange for the withdrawal of the legal challenges.

Analysing the reasoning of the court regarding the review body (ie, the accredited audit firm or investment bank) reviewing and confirming compliance of the offer with the regulatory framework, it becomes clear that the requirements for the contents of the report by the review body have become more stringent. The conclusions must be thoroughly explained, thereby increasing the workload and level of detail regarding the review and assessment by the review body. As a result, in future review bodies and the Takeover Board may require more time for the analysis of complex cases resulting in higher costs. However, in the case at hand, it could well be that the Takeover Board arrives at the same conclusion as before, since the review body has been left with considerable leeway to apply its judgement regarding the assessment. If the review body abides to the increased demands, the Takeover Board can accept the assessment and evaluation.

In light of *Quadrant*, future offerors would be well advised to use the most simple transaction structures possible in order to avoid the increasingly costly and time-consuming processes involved with legal challenges from shareholders.

For further information on this topic please contact [Alexander Vogel](#) or [Debora Kern](#) at [meyerlustenberger](#) by telephone (+41 44 396 91 91), fax (+41 44 396 91 92) or email (a.vogel@meyerlustenberger.ch or d.kern@meyerlustenberger.ch).

Endnotes

- (1) Federal Administrative Court, Decision B-5272/2009, November 30 2009.
- (2) Takeover Board, Decision 410/02, June 16 2009.
- (3) FINMA decision, July 8 2009.
- (4) Takeover Board, Decision 410/03, July 5 2011.
- (5) FINMA decision, August 11 2011.

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