

Corporate Finance/M&A - Switzerland

Overview (May 2012)

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Introduction

Private M&A transactions are governed by the Swiss Code of Obligations – primarily the section on purchase agreements. If acquisition structures – either pre-sale or within the framework of the transaction – provide for a merger, demerger or spin-off by way of asset transfer or bulk sales transaction, the Merger Act, which contains detailed rules for each of these procedures, applies.

The acquisition of interests in listed companies, on the other hand, is governed by the Stock Exchanges and Securities Trading Act and its implementing ordinances, which set out rules that apply to both friendly and hostile public offers. These rules have been significantly amended in recent years and are subject to further proposed amendments on crucial points.

In addition, the Federal Act on Cartels and Other Restraints of Competition - and similar antitrust regulations of any other jurisdiction in which the parties to the merger are active - must be considered, particularly if the parties' consolidated turnover is significant.

If an acquisition is financed by the issuance of securities or the transaction structure provides for the issue of additional securities, the relevant provisions of Swiss corporate law dealing with the obligation to prepare a prospectus and the technicalities of a capital increase (provided for in the Code of Obligations) must be observed. If the issuer is listed on a Swiss stock exchange, the listing rules of that stock exchange – either the SIX Swiss Exchange or the BX Berne eXchange – also apply.

Significant M&A transactions over the past year

M&A transactions saw a recovery in 2010, which continued into the first half of 2011. The number of transactions increased significantly in the first quarter, although deal volumes remained flat. In a strong second quarter, however, deal volumes increased, as several large transactions were recorded. The third and fourth quarters showed further signs of improvement, even though market confidence was negatively impacted by an uncertain outlook and visibility in different industries.⁽¹⁾

Overall, the number of Swiss M&A transactions increased during 2011, with total volume declining, notwithstanding several high-profile transactions which drove up the total considerably. In particular, during the second half of 2011 the number of larger transactions declined, while the number of smaller transactions increased.

With regard to cross-border takeovers or sales by Swiss companies, significant deals in 2011 included:

- Transocean's \$3.4 billion acquisition of offshore drilling contractor Aker Drilling in the third quarter;
- German Süd-Chemie's acquisition by Clariant, a Swiss speciality chemical company, for \$2.5 billion;
- Nestlé's acquisition of a 60% equity stake in Chinese confectionery producer Hsu Fu

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Chi for \$1.75 billion;

- Meyer Burger's \$400 million public offer for German solar equipment producer Roth & Rau; and
- Roche Venture Fund's sale of pharmaceutical company Pharmasset to Gilead Sciences for approximately \$11 billion.

Large inbound transactions included:

- the acquisition of Swiss-based pharmaceutical company Nycomed by Japanese Takeda Pharmaceutical for approximately \$13.7 billion;
- Johnson & Johnson's acquisition of Synthes for \$21 billion;
- Group Bruxelles' acquisition of an equity interest in Imerys, a leader in the extraction and processing of industrial minerals, valued at \$1.6 billion;
- the Safra Group's acquisition of Rabobank's 46% shareholding in Bank Sarasin & Cie for \$1.1 billion;
- Swiss Allied World Assurance Company Holdings' acquisition of Transatlantic Holdings, a leader in the reinsurance sector, for \$4.2 billion; and
- the acquisition of mobile operator Orange Switzerland by Apax Partners for \$2.1 billion.

As in 2010, cross-border transactions were influenced by the strength of the Swiss franc, which made Swiss acquisitions expensive for foreign acquirers. Nevertheless, Swiss-based companies seem to remain attractive targets for foreign acquirers due to their healthy financials, global footprint, market position, innovations and technologies.

Conversely, the high Swiss outbound M&A deal flow was clearly influenced by the weakness of the euro and the US dollar, as well as the importance of securing high-growth opportunities in emerging markets. Furthermore, Swiss-based companies dependent on exports, and therefore exposed to the strong Swiss franc, continue to expand their sourcing and/or production bases to countries in the Eurozone or US dollar-dominated areas in Asia, in order partially to hedge their currency exposure.

The few transactions relating to Swiss acquirers of Swiss listed target companies included:

- ABB's acquisition of Newave Energy Holding, a producer of uninterruptible power supply, for Sfr170 million (\$186.6 million);
- Artemis Beteiligungen III's offer for equipment producer Feintool International Holding;
- MRSI Medical Research, Services & Investments' offer for the shares of Genolier Swiss Medical Network, a network of private hospitals;
- the public offer of Axpo Holding for energy trading company EGL; and
- the public offer of Highlight Communication for Escor.

Public takeovers

Public tender offers for issuers listed on a Swiss exchange are governed by the Stock Exchanges and Securities Trading Act. In certain circumstances - mainly in the case of a listed issuer spin-off of a non-listed company - an offer for the latter's shares is still subject to the act.⁽²⁾ Conversely, pure merger transactions are subject not to the Stock Exchanges and Securities Trading Act, but rather to the Merger Act. An exception applies if, before the effective date of the merger, one of the merging companies acquires a controlling stake in the other merging company, thereby triggering the obligation to submit a public offer under the Stock Exchanges and Securities Trading Act.

In such circumstances the Takeover Board, while requiring that the merger documentation and terms comply with the act and the Ordinance on Public Takeovers, can allow the acquirer to postpone the offer. The acquirer can thus complete the merger, with the consequence that the obligation to submit a public offer lapses due to the absorption of (usually) the target.⁽³⁾ However, if the merger fails, the acquirer will be obliged by the Takeover Board to follow through with its public offer.

The act specifies when a purchaser is required to make a mandatory offer for all outstanding equity securities of a target. This is the case if an acquirer directly or indirectly controls more than 33.3% of the company's voting rights, whether exercisable or not. Exceptions apply if the target had increased this threshold in its articles of association to up to 49% (opting up) or if the articles contain an opt-out clause.

Further, once a public offer has been pre-announced, the target's board is no longer permitted to take any defensive measures that could significantly alter the target's assets or liabilities; instead, the board must submit such measures to the shareholders' meeting for approval.

Compliance with the act is supervised by the Takeover Board, which issues compulsory administrative orders in the form of binding decrees. Any decision of the Takeover Board can be brought to the Financial Market Supervisory Authority (FINMA) for review. Any party can appeal a FINMA decisions to the Federal Administrative Court, whose decision is final.

Recent legislative changes

Since the Financial Market Supervision Act, which introduced an amended regulatory framework, entered into force on January 1 2009, shareholders holding 2% or more of the voting rights of a target can request the status of a party in Takeover Board proceedings. In addition, shareholders can also request to participate in Takeover Board proceedings, submit objections or requests to the board and appeal against a decree issued by the board.

This right of participation is enjoyed by shareholders holding in aggregate 2% or more of the voting rights of the target, whether exercisable or not (so-called 'qualified shareholders'). To qualify for admission to the proceedings, qualified shareholders must already hold their qualifying stake at the time that the pre-announcement (if any) or the offer itself is published and must retain at least 2% of the voting securities throughout the offer period in order not to lose their standing.

However, it is unclear under the new legislation whether a qualified shareholder will lose its standing if it retains its shares during the offer period, but accepts the offer during the extended offer period (which allows shareholders that have not accepted the offer during the offer period to accept it, once it is clear that a previously conditional offer has become unconditional).

Such delays may also have considerable disadvantages for the target, as it will not be known for an extended period whether the intended transaction will go ahead as planned or whether an uninvited third party will launch a competing (hostile) offer in an attempt to profit from the target's decision to put itself in play.

This question was addressed by the Federal Administrative Court – the highest court in takeover matters since the introduction of the amended regulatory framework – in a recent landmark decision.

Facts

In May 2009 SIX Swiss exchange-listed Quadrant became the target of a friendly public takeover offer launched by Aquamit, an Amsterdam investment vehicle held by four members of the board and/or management (and, at the same time, shareholders) of Quadrant and Mitsubishi Plastics.

When preparing the public offer, Quadrant's management group and Mitsubishi Plastics had entered into framework and joint venture agreements. Under the terms of these agreements, Mitsubishi Plastics agreed to provide financing to Aquamit and to grant founders' rights and management options to Quadrant's management group. Mitsubishi Plastics and the members of the management each held 50% of Aquamit. In order to implement the offer, the latter entered into a transaction agreement with Quadrant.

After Aquamit had announced its public takeover offer for Quadrant's shares at Sfr86 per share, Sarasin Investmentfonds, a minority shareholder of Quadrant, challenged the Takeover Board's decision to approve the offer and requested an increase in the actual offer price. It claimed that the valuation of the additional benefits granted by Mitsubishi Plastics to Quadrant's management in connection with the offer had not been conducted adequately. Sarasin's claim was rejected by both the Takeover Board and FINMA. Sarasin appealed to the Federal Administrative Court.

Decision

First, the court had to determine whether Sarasin was entitled to appeal FINMA's decision. Sarasin had tendered most of its shares to Aquamit and thus no longer held 2% of the voting rights in Quadrant, as required under the Stock Exchanges and Securities Trading Act in order for the right of participation to apply. The court ruled that such provisions are governed by the Federal Administrative Procedure Act, which imposes no 2% minimum shareholding requirement. Furthermore, Article 29a of the Constitution provides for a constitutionally guaranteed right of access to the courts. Consequently, the court held that the prerequisites to appeal should not be interpreted narrowly and therefore the 2% minimum shareholding requirement did not apply.

Scope of review body report

According to the Stock Exchanges and Securities Trading Act, before publication an offeror must submit its offer to an auditing company, securities dealer or investment bank accredited by FINMA for review. FINMA must primarily examine whether the public takeover offer and its valuation comply with the takeover regulations and their 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 agreements between the offeror and other parties to the transaction should not be analysed only as a whole in order to determine whether the parties' obligations and benefits are balanced or whether there is additional value for a party that is also a shareholder. Instead, each material benefit to each 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 reason – that the interests between the parties were balanced, as it had based its assessment of 'other material benefits' on false facts, incorrect legal assumptions or implausible or incomprehensible considerations.

The court confirmed that the Takeover Board and FINMA need not conduct an investigation to determine the facts themselves, but can rely on the facts established by the review body, as well as on their assessment of the offer. However, the Takeover Board and FINMA must verify that the review body's assessment was conducted 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' under the FINMA Stock Exchange Ordinance are "transparent, plausible and comprehensible".

The Federal Administrative Court revoked FINMA's decision and certain components of the Takeover Board's decisions. The Takeover Board was forced to reassess certain material benefits and the adequacy of the offer price. Sarasin requested that the offer price be increased for all Quadrant shares. The court held that FINMA's decision at prior instance could not be contested with force and effect for all shareholders. Thus, the decisions were revoked only as far as Sarasin was concerned. For all other shareholders involved, the Takeover Board and FINMA decisions had come into full force and effect.

Impact on transaction planning

Under the new rules, shareholders can not only participate in the proceedings before the Takeover Board and submit objections or requests, but can also appeal decisions of the Takeover Board.

In view of these new rights granted to qualified shareholders, an offeror must comply with a mandatory cooling-off period (usually 10 stock exchange days).

Further, due to the possibility of an appeal, the terms of the offer and the offer documents will be published with only a preliminary approval by the Takeover Board, since qualified shareholders may file an objection with the board. This might cause the Takeover Board to reconsider its approval; or the approval decision may be appealed to FINMA.

Thus, qualifying shareholders can considerably delay a friendly takeover transaction, as the cooling-off period during which a qualified shareholder can file an objection or an appeal will be extended in most cases. Therefore, the offer period will not start until the Takeover Board – or, in case of appeal, FINMA – has issued its decision. As a result of the delay, the transaction risks for both the offeror and the target may increase considerably.

The offeror risks being bound to its offer – and thus being 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 withdrawal of the legal challenges.

The *Quadrant* case illustrates these consequences effectively. Almost three years after the offer was launched, a final decision is yet to be taken. In particular, according to the latest published decisions of the Takeover Board and FINMA, it seems to be a challenge 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 fundamental questions on Swiss public takeover law, but some of the court's conclusions gave 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 FINMA due to the 2% shareholding requirement would be entitled to appeal before the Federal Administrative Court. The court concluded that this question did not need to be answered in relation to the case at hand. Therefore, it is unclear whether shareholders that 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 holding 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 parties that qualify as meeting this requirement. According to the prevailing view among commentators, only single shareholders holding 2% or more of the shares can appeal; groups of shareholders holding an aggregate of 2% or more of the shares cannot. One solution could be to allow shareholders to act as a group. Generally speaking, the interests of the offeree company's shareholders are protected by law and such protection is supposed to be ensured by the review body and the Takeover Board's review. Thus, even where there is no possibility for shareholders that do not meet the 2% threshold to file an appeal, their interests are still protected.

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 concludes that the offer price should be increased. This interpretation does not correspond to the aims of the laws on stock exchanges and listed securities, as it fails to take the principle of equal treatment of all investors into account. Further, it 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 a legal challenge.

Analysing the court's reasoning 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 review body's report have become more stringent. Conclusions must be thoroughly explained, thereby increasing the review body's workload and the level of detail needed in the review.

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 judgment regarding the assessment. If the review body abides with 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 simplest possible transaction structures in order to avoid the increasingly costly and time-consuming processes involved with legal challenges from shareholders.

Opting out

The Stock Exchanges and Securities Trading Act provides for a mandatory offer obligation in the event that a shareholder or a group of shareholders acting in concert exceeds a threshold of 33.3% of the voting rights in a listed company. All EU member states have also introduced such an obligation based on the EU Takeovers Directive⁽⁴⁾ (which also provides for a mandatory bid threshold of 33.3%), although many provide for a mandatory bid threshold of 30%. Switzerland is the only country which provides for an opt-out mechanism (whereby the shareholders of a listed company can choose to opt out from the mandatory offer obligation).

This is possible when an opt-out clause has been included in the articles of association. The Stock Exchanges and Securities Trading Act distinguishes between the introduction of an opt-out clause before and after listing. A company may at any time – even after listing – adopt such a clause in its articles of association, provided that this does not prejudice the interests of the shareholders within the relevant provisions of the Code of Obligations. Once such a clause has been validly introduced, any acquirer is generally exempt from the mandatory offer obligation for an unlimited period – irrespective of the reasons for exceeding the threshold. The Takeover Board's latest decision on this matter regarding LEM Holding highlights the board's recent interpretation of the rules when such an opt-out provision is introduced after the company has already been listed on the stock exchange. This further expands the board's practice, which had already been relaxed in two 2010 cases. In *LEM*, two shareholders (one of which was simultaneously a board member) announced their intention to increase their participation in the company, thereby (likely) exceeding the 33.3% threshold. Therefore, the shareholders requested the introduction of an opt-out clause into the articles of association.

On June 2010 the LEM shareholders' meeting approved the introduction of the opt-out clause by 71% of the voting rights represented (the shareholders requesting the opt out held 39.84% of the votes represented). The board of directors recommended that the motion be rejected, as it was not in the shareholders' interests, and informed the shareholders of the implications and consequences of introducing an opt-out clause. One year later, the two shareholders that had requested the opt-out announced that they held 32.3% of the voting rights in the company; they filed a request to confirm the

validity of the opt-out clause adopted in the shareholders' meeting with the Takeover Board, as they wanted exemption from the mandatory offer obligation when increasing their participation in LEM above the 33.3% threshold.

The Takeover Board confirmed that the introduction of an opt-out clause was valid as long as it did not prejudice the shareholders' interests within the meaning of applicable Swiss corporate law. Such a clause is, in particular, considered to be invalid if it is selective either in a formal sense (ie, the party that is to benefit from the opt-out clause is specifically mentioned in the clause) or in a material sense (ie, the opt-out clause has been introduced in view of an upcoming transaction or for the benefit of a specific party). However, if an opt-out clause is introduced five years ahead of a transaction that will benefit from the opt-out clause, it is assumed that the insertion of the opt-out clause is not selective in a material sense.

Additionally, an opt-out clause which is selective in a formal or material sense is not invalid if the opt-out does not prejudice the shareholders' interests. In the case at hand, the opt-out clause was selective in a material sense, as it was clearly introduced for the benefit of the significant shareholders. In addition, less than five years had passed since its introduction. The significant shareholders were about to exceed the threshold that triggered the mandatory offer obligation due to the planned increase of their participation in the company, and would thus have benefited from the opt-out clause as they would have been exempt from the mandatory offer obligation.

When the Takeover Board analysed the validity of the introduction of the opt-out clause, it did not rely on applicable corporate law as a basis for its analysis and thus did not review whether the introduction of the opt-out clause prejudiced the other shareholders' interests. Instead, the Takeover Board argued that the shareholders were fully aware of the consequences of the introduction of such an opt-out clause, as they were fully informed by the board of directors that they should reject its introduction.

Nonetheless, a majority of the shareholders approved the insertion of the opt-out clause. Since the minority shareholders had not contested the majority shareholders' decision before the civil courts within two months of passing the resolution, the Takeover Board concluded that the shareholders had approved the introduction of the opt-out clause, even though they were fully aware of its implications and consequences.

Therefore, the resolution was said to have been validly passed and the opt-out clause was deemed to have been validly introduced into the articles of association. The Takeover Board ordered the board of directors to issue a statement on the introduction of the opt-out clause. Although the board of directors had initially recommended that the shareholders reject the introduction of the opt-out clause, it reversed its position after the shareholders' vote. Thereafter, it was of the opinion that the introduction of the opt-out clause was valid, since the shareholders had been sufficiently informed of the implications and consequences of the clause. Further, a majority of the shareholders approved its introduction and LEM had benefited from a stable shareholder base in previous years, which led to the successful development of the company. Therefore, the opt-out clause had been validly introduced and the significant shareholders were not subject to the mandatory offer obligation.

Further proposed changes

On August 31 2011 the Federal Council adopted a proposal to amend the Stock Exchanges and Securities Trading Act. The amendments contain an expanded and tightened criminal offence of insider trading. The bill would also introduce certain alterations with regards to the disclosure of holdings in companies listed in Switzerland and public takeovers, and the abolition of the so-called 'control premium' in the case of public offers.

Where a justified suspicion of a breach of the disclosure obligation exists, FINMA will have the authority to suspend voting rights and ban additional purchases for affected market participants until the disclosure obligation is fulfilled or it is established that no disclosure obligation exists. If a breach of the disclosure obligation is detected, FINMA can confiscate the profits derived from any violating transactions.

The Takeover Board will also have the authority to suspend voting rights and ban additional purchases as precautionary measures where it discovers a failure to observe the obligation to make an offer; it will also raise the threshold from 2% to 3% for shareholders to participate in the proceedings before the Takeover Board and appeal its decisions.

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Endnotes

(1) See, for detailed statistical figures, Menz/Eschenmoser, *M&A Review 2011*, pp554-559, and Ernst & Young, *Mergers & Acquisitions Quarterly Switzerland*, Third and Fourth Quarter 2011.

(2) See, for example, the Hammer Retex transaction in 2009 or the earlier Eichhof/Heineken or Mövenpick/Clair Finanz Holding transactions.

(3) See the Hiestand transaction, for example.

(4) 2004/25/EC.

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