

Corporate Finance/M&A - Switzerland

New regulatory framework: impact on public offers

Contributed by [meyerlustenberger](#)

November 30 2011

[Market trends](#)

[Public offers](#)

Market trends

Private M&A transactions are primarily governed by the Code of Obligations, and, to the extent that acquisition structures include mergers, demergers, asset transfers or bulk sales transactions, by the Merger Act, which provides detailed rules for each of these procedures. Acquisitions of interests in listed companies are further governed by the Act on Stock Exchanges and Securities Trading, which contains the applicable rules for both friendly and hostile public offers.

In addition, the Antitrust Statute must be taken into consideration if the turnover of each of the parties involved in the transaction is significant – that is, if:

- at least two of the involved parties had a turnover of more than SFr100 million (\$110 million) in the preceding business year on a standalone basis; or
- the parties had a combined turnover in Switzerland of more than SFr500 million (or exceeding SFr2 billion globally).

The statute establishes a preventative merger control procedure led by the Merger Control Commission for transactions which exceed certain minimal thresholds.

To the extent that an acquisition is financed by the issuance of securities or the transaction structure otherwise provides for additional securities to be issued, the relevant provisions of the code must be complied with. If the issuer is listed on a Swiss stock exchange, the listing rules of the stock exchange also apply.

The sharp decline in M&A transactions experienced in 2008 and 2009 was arrested in the first two quarters of 2010, although deal volumes still dropped considerably. The third and fourth quarters brightened up the picture significantly and showed clear signs of an improvement in market confidence. This trend was underpinned by a relatively strong fourth quarter.

The reversal of the negative trend which characterised the two previous years can be interpreted as a sign of a slow recovery of the markets and reflects, on the one side, the increased confidence among industrial buyers in their own projections and those of their targets as well as in the stability of the economy as a whole, while on the other side, the (perceived) improved availability of financing even for large acquisitions. This factor has also prompted financial buyers to play a more active role in the marketplace.

With regard to cross-border transactions, the further strengthening of the Swiss franc continues to make acquisitions expensive for foreign entities, while Switzerland-based companies that are heavily dependent on exports and thus more exposed to a strong Swiss franc are increasingly looking to expand their sourcing and/or production bases to countries in the Eurozone or to US dollar-dominated areas in Asia. Even though the strong Swiss franc is likely to take a toll on the export-oriented segments of the Swiss economy, the solid domestic demand is expected to mitigate such negative impact and thus sustain the positive trend in M&A activity within Switzerland, although the levels experienced before the crisis still seem to be far out of reach.

Public takeovers

Specific regulations

Public tender offers on issuers listed on an exchange in Switzerland are governed by the Act on Stock Exchanges and Securities Trading. In certain instances – mainly in the case of a listed issuer spin-off of a non-listed company – an offer on the latter's shares

Authors

Alexander Vogel



Christoph Heiz



Andrea Sieber



is nevertheless subject to the provisions of that act (eg, the Hammer Retex transaction in 2009 or the earlier Eichhof or Mövenpick/Clair Finanz Holding transactions).

Conversely, pure merger transactions are subject not to the Act on Stock Exchanges and Securities Trading, 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 according to the Act on Stock Exchanges and Securities Trading.

However, in that case the Takeover Board – while requesting compliance of the merger documentation and to the extent applicable, the terms of the merger, with the requirements provided for in the Act on Stock Exchanges and Securities Trading and the Ordinance on Public Takeovers – allows the acquirer to postpone the offer and instead complete the merger, with the consequence that the obligation to submit a public offer lapses due to the absorption of (usually) the target (provided that if the merger fails, the acquirer will be obliged by the Takeover Board to follow through with its public offer).

The Act on Stock Exchanges and Securities Trading defines when a purchaser is required to make a mandatory offer for all outstanding equity securities of a target, which is the case if an acquirer directly or indirectly controls more than 33.3% of the target's voting rights, whether exercisable or not. Exceptions apply if the target had increased this threshold in its articles of incorporation to up to 49% (opting up), or if the articles of incorporation contain an opting out clause.

Furthermore, once a public offer has been pre-announced, the Takeover Board of the target is no longer permitted to take defensive measures that could have the effect of significantly altering the assets or liabilities of the target, but must submit such measures to the shareholders' meeting for approval.

Compliance with the rules provided for in the Act on Stock Exchanges and Securities Trading is supervised by the Takeover Board, which issues binding 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. FINMA decisions can be appealed to the Federal Administrative Court, whose decisions are final.

Impact of recent legislative changes

The Swiss legislature enacted the Financial Market Supervision Act providing for a new regulatory framework, and the act entered into force on January 1 2009. The regulatory framework is supervised by FINMA. Together with the new act, several changes to the Act on Stock Exchanges and Securities Trading relating to public offers and the applicable procedural rules were enacted, which took effect on the same date.

In view of these changes in the legislation, FINMA and the Takeover Board undertook a general overhaul of the FINMA Stock Exchange Ordinance and the Ordinance on Public Takeovers. The amendments to the act and the two ordinances introduced some important changes to the applicable rules for public takeovers and codified, to a certain extent, the Takeover Board's decision practice since the enactment of the act in 1997.

The rules strengthen the position of the Takeover Board. While in the past the Takeover Board could issue only recommendations which could be accepted or rejected by the parties involved, as of 2011 its decisions are handed down in the form of a decree.

Further, the procedure in front of the Takeover Board is – with a few exceptions – governed by the applicable procedural rules for administrative procedures.

The exceptions take into account that a takeover procedure must be speedy. Today, shareholders holding 2% or more of the voting rights of the target, have the possibility, whether exercisable or not, to request the status of a party in the proceedings before the Takeover Board. This innovation changes the practical steps considerably, particularly in a friendly transaction.

In the past, the offeror and the target could agree on the terms and conditions of a public offer and have those terms – as well as all relevant documents relating to the offer – approved by the Takeover Board before publication of the pre-announcement of the offer or the offer itself. The Takeover Board then issued the publication and its recommendation simultaneously. The recommendation could not be appealed by the shareholders. Here, the only potential threat to the success of a friendly offer was a competing offer by a third-party offeror. In such case the original offeror had the option either to increase its original offer or to withdraw its offer.

Under the revised rules, certain shareholders can request to participate in the proceedings before the Takeover Board and submit objections or requests to the latter and/or appeal against a decree issued by the Takeover Board. In view of these rights granted to qualified shareholders, the offeror must comply with a mandatory cooling-off

period of usually 10 stock exchange days. Further, due to the possibility of an appeal, the terms of the offer and the offer documents – even though reviewed by the Takeover Board – will be published with only preliminary approval from the Takeover Board.

By making use of their procedural rights, qualifying shareholders have the possibility to delay a friendly takeover. Such delays may significantly increase the transaction risks of both the offeror and the target. The threat of extended litigation with a minority shareholder may well force the offeror to the negotiation table, trading better offer terms in exchange for the withdrawal of legal challenges.

On the other hand, such delays may have considerable disadvantages for the target, since its management, workforce, customers and suppliers are left in limbo for an extended period, unsure as to whether the intended transaction will be completed as planned or whether an uninvited third party will enter the scene and launch a competing (hostile) offer in an attempt to profit from the fact that the target has put itself in play.

'Put up or shut up' rule

In order to prevent potential offerors from publicly communicating that they are considering launching a public offer on a specific target without publishing a pre-announcement in compliance with the Act on Stock Exchanges and Securities Trading rules, the Takeover Board can now force such potential offerors either to submit a public offer within a certain deadline or to declare publicly that they will not launch an offer in the following six months (although in the case of a third-party offer such a temporary ban can be lifted by the Takeover Board).

Competing offers

A competing bid can be launched until the last day of the preceding (initial) offer by publishing an offer prospectus or at least a pre-announcement. In the latter case, the offer prospectus must be published within five exchange business days.

In addition, due to the now mandatory cooling-off period, a potential competing offeror will in most cases have at least 10 more exchange business days available to prepare a competing offer.

A competing offer also affects the offer period of the previously published (initial) offer: the offer period of the initial offer is extended so that it expires on the same date as the competing offer. Further, contrary to the former rules, the offeror of the initial offer cannot withdraw its offer in case a competing offer is launched. However, the initial offeror can amend its offer up to the fifth exchange business day before the expiration of the adjusted offer period.

Changes relating to defensive measures

As indicated above, once a public offer has been pre-announced (or announced), the Takeover Board of the target may no longer take defensive measures which have a significant impact on the target, although it can submit such measures to the shareholders for approval.

The Ordinance on Public Takeovers provides for a detailed blacklist containing such disallowed defensive measures. The ordinance provides, among other things, that assets generating more than 10% of the target's consolidated earning power may not be sold or acquired, and that the target cannot purchase or sell its own shares, shares offered in exchange or related financial instruments, or write or grant any rights to acquire its equity securities, in particular conversion or option rights.

Rules relating to the offered consideration

Pursuant to the rules regarding the consideration offered, the offer price may be paid in the form of a cash consideration or by offering securities in exchange. However, according to the applicable rules of the ordinance, in case of a mandatory offer, the offeror must offer cash consideration as an alternative in addition to the shares offered in exchange to the remaining shareholders of the target.

Until the Takeover Board published its Communication 4/2009, the consequences of this article were unclear and heavily criticised. The criticism focused on the fact that the obligation to offer cash consideration as a mandatory alternative – if necessary at all – was not limited to an offer of illiquid equity securities (ie, to securities that have not been traded on at least 30 out of 60 exchange business days before publication of the offer or pre-announcement).

If the offered equity securities are illiquid, the cash alternative to be provided enables the remaining shareholders of a target effectively to exit the target at a fair price. On the other hand, a mere offer of equity securities that are illiquid would leave the shareholders with the option either to:

- remain a shareholder of the target with a minority stake and therefore enjoy limited shareholders' rights; or
- become the owner of equity securities that are illiquid and therefore not easily marketable.

However, from a potential offeror's perspective, this rule has a significant financial impact. The offeror must provide evidence of its ability to finance the public tender offer. In the past, in case of an exchange offer, the offeror had to prove the availability of the securities to be exchanged at the time the offer was scheduled to settle. As a consequence of the revised rule, the potential offeror now must not only prove the latter, but also make arrangements for the cash consideration to be offered alternatively to the remaining shareholders. The offeror must also prove the availability of such funds.

Communication 4/2009 states that the obligation to offer cash consideration as a mandatory alternative to an exchange offer does not apply to voluntary tender offers, even though as a general rule the minimum price rules for mandatory offers are also applicable for voluntary offers aimed at more than 33.3% (or such applicable higher threshold in case of an opting-up) of the shares of a target. However, according to the amended language of the ordinance, the rule in any case applies to mandatory offers, regardless of whether the offered equity securities are liquid.

In other words, an offeror whose holding in the target exceeds the relevant threshold of voting rights and thus triggers the duty to submit a mandatory offer will not have a choice as to how to fulfil such obligation and is not only bound by the minimum price rule and best price rule. To the contrary, even if the offeror wishes to offer securities that are liquid – and therefore can easily be sold by the offeree – it will be obliged to offer cash consideration as an alternative and must prove the availability of such (additional) financing.

However, the Takeover Board stated in its Communication 4/2009 that the value of the offered securities and the value of the cash consideration need not be equal. Therefore, the offeror may offer a premium on the offered security consideration compared to the cash consideration, and can thus provide an incentive to accept the exchange offer. However, both the value of the offered securities and the cash consideration must fulfil and comply with the minimum price rule.

The last revision to the Act on Stock Exchanges and Securities Trading has not changed the possibility to pay a so-called 'control premium' in the case of a public offer: the price offered to the minority shareholders may be lower than the share price agreed before the offer with the principal shareholders. However, the Takeover Board recently proposed to abolish such possibility in the course of the next revision of the Act on Stock Exchanges and Securities Trading which is now under way, as it is contrary to the principle of equal treatment of shareholders and is unusual in the European context.

Voluntary offers

As mentioned, in Communication 4/2009 the Takeover Board further confirmed its interpretation that the obligation to offer a cash consideration as a mandatory alternative to an exchange offer does not apply to voluntary tender offers. This is true particularly in relation to voluntary tender offers made for a number of equity securities, the acquisition of which would reach the applicable threshold triggering a mandatory offer. Further, the Takeover Board confirmed that a successful offeror (where the offeror holds a majority stake in the target exceeding the triggering threshold after the public tender offer is completed) has no obligation to submit an additional public tender offer (against cash consideration) to the remaining shareholders.

Nevertheless, the exemption for voluntary offers does not apply if the offeror acquires equity securities of the target against cash consideration after the exchange offer is launched. Under such circumstances, the Takeover Board requires that the terms and conditions of the exchange offer be modified to ensure equal treatment of all shareholders of the target.

In particular, the recipients of the offer must be able to choose whether to accept the initially offered securities or cash consideration – as paid after the exchange offer was launched. Furthermore, shareholders that have already tendered their shares can change their choice and request to receive the cash consideration rather than the previously accepted securities. However, a shareholder cannot withdraw its tender (ie, decide to accept neither the offered securities nor the cash consideration) if it has already accepted the (initial) exchange offer.

On the other hand, the duty of equal treatment does not prevent the offeror from acquiring securities of the target against cash consideration, where the purchase has been effected before the pre-announcement or publication of the offer. However, such consideration must be taken into account when determining the minimum price of the offer.

Furthermore, in the case of a voluntary tender offer, the offeror is free to offer equity securities for which no liquid market exists or which are not listed. In such case the offeror will be required to provide a valuation by an accredited audit firm or investment bank.

The Takeover Board argued that in such case the shareholders of the target may, simply by refusing the tender offer, avoid the negative consequences of having to

choose between becoming a minority stakeholder (thus limiting the shareholder's rights), and becoming the owner of equity securities that are not liquid and consequently not easily marketable. This is because, unlike in the case of a mandatory offer, the recipients receiving a voluntary offer have the option to reject the offer and thus prevent the offeror from acquiring a controlling stake.

For further information on this topic please contact [Alexander Vogel](#), [Christoph Heiz](#) or [Andrea Sieber](#) at meyerlustenberger by telephone (+41 44 396 91 91), fax (+41 44 396 91 92) or email (a.vogel@meyerlustenberger.ch, c.heiz@meyerlustenberger.ch or a.sieber@meyerlustenberger.ch).

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