

## Corporate Finance/M&A - Switzerland

### Relevance of Minder Initiative to M&A transactions

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#### Introduction

On March 3 2013 the Swiss voting population approved the fiercely debated 'Rip-off Initiative', launched originally in 2008 by Thomas Minder. This led to the amendment of the Federal Constitution (Article 95). On November 20 2013, based on the constitutional amendment, the Federal Council issued the Ordinance Against Excessive Compensation in Listed Companies (the draft ordinance was entitled the Ordinance Against Fat Cat Salaries), which entered into effect on January 1 2014. The Ordinance Against Excessive Compensation in Listed Companies will apply until Parliament incorporates the new constitutional provisions of the Minder Initiative into a formal amendment of the respective Swiss laws – primarily the Code of Obligations, which also contains the provisions relating to stock corporations. Recently, the Federal Council published draft amendments to the code together with ancillary amendments to other laws (eg, implementation of the penal provisions of the ordinance in the Penal Code), which will replace the ordinance. However, in view of the controversial subject matter contained in the ordinance and the proposed provisions, it is to be expected that discussions in Parliament will take some time, particularly in view of the fact that the amendments will be subject to the possibility of a referendum (ie, a petition signed by at least 100,000 Swiss citizens). This update outlines the implications that the Minder Initiative has for M&A transactions involving public listed corporations.

#### Scope of application

The ordinance applies, in principle, to all public stock companies registered in Switzerland whose shares are listed on a domestic or foreign stock exchange. Issuers that do not have their registered office in Switzerland are outside the ordinance's scope, even if their shares are listed in Switzerland (eg, on the SIX Swiss Exchange). Further, in accordance with Articles 620 and following of the Code of Obligations, corporations with securities other than shares listed (eg, participation certificates) do not fall under the ordinance's scope.

Even though the ordinance is, in principle, applicable only to public corporations, consideration paid to members of the board of directors, executive board and advisory board by a subsidiary, is treated in the same way as if it were paid directly by the listed parent. Consideration paid to board members and executive management of non-listed subsidiaries is outside the ordinance's scope.

#### Compensation

Besides numerous provisions increasing the transparency and giving shareholders a say on pay, the ordinance seeks to prevent abusive payments prejudicing the interests of shareholders – including, for example, extraordinary severance payments (golden parachutes) and advance payments (eg, sign-on bonuses in excess of forfeited claims against the previous employer).

Article 20 of the ordinance is of great significance in M&A transactions, as it prohibits "commissions for the acquisition or transfer of enterprises or parts thereof by the company or by enterprises, which are controlled directly or indirectly by the company" paid to members of the board of directors, executive board or advisory board (ie, such payments will result in penal sanctions and inadmissible consideration may have to be refunded). 'Acquisition and transfer of companies' means any transaction according to the Merger Act (including quasi-mergers) and includes share and asset deals. The literal interpretation of Article 20(3) of the ordinance merely prohibits compensation paid to members of the board of directors, executive board and advisory board for divestments by a public corporation. However, consideration paid in connection with a change of control in the public corporation itself would remain outside the scope of Article 20(3). Nevertheless, provided that such payments are linked to a subsequent change of management, they may still be considered inadmissible severance payments (ie, golden parachutes) and may thus still be prohibited. The draft

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amendments to the Code of Obligations provide for a prohibition of any "commissions for the acquisition or transfer of enterprises or parts thereof". By omitting the second part of the phrase, the provision would clarify (presumably in line with the intention of the Minder Initiative) that an extraordinary premium paid to an executive employee, a member of the board of directors or the advisory board in the course of a takeover is inadmissible in any event. However, until the code's amendments enter into force, it is thought that the wording of Article 20(3) is not a legal foundation solid enough to prohibit (and trigger criminal liability for) premiums to, for example, executive employees granted on a change of control in the public corporation itself, if the executive employee thereafter remains an employee of the company.

The explanatory report on the draft code published by the Federal Council clarifies further cryptic terms in the ordinance with regard to inadmissible considerations.

Compensation payments for post-contractual non-compete clauses are still permitted to the extent they are agreed on at arm's-length terms. On the other hand, the proposed amendments to the code state explicitly that such compensation payments are prohibited to the extent that they are not market based, as they must be considered as prohibited severance payments (golden parachutes). Further, the Federal Council proposes that no contractual non-compensation clause for a period exceeding 12 months may be agreed. By the same token, notice periods for termination of an indefinite employment contract (and fixed-term employment contracts) may not exceed one year.

It is clear that any payments which may be classified as a termination payment (eg, a golden parachute or special compensation due to the termination after change of control) are not permitted. Permitted payments include (subject to abusive use of these instruments):

- compensation made as part of the variable remuneration;
- incentive payments which are paid even if the transaction does not take place; and
- bonus payments made in connection with the achievement of set goals.

Even though not contained in the catalogue of prohibited payments, the following instruments containing considerations to executive employees, a member of the board of directors or the advisory board will be subject to close examination under the new regime:

- accelerated vesting provisions in executive participation schemes;
- compensation payments in termination agreements; and
- advisory agreements entered into on termination of the mandate as an organ.

While, for instance, accelerated vesting periods and termination agreements providing for a (reasonable) amount payable to the employee to settle a legal dispute are thought to be permissible, re-pricing of options for the benefit of the employee on termination of employment (eg, due to a change in management following a change of control) must be regarded as critical.

The ordinance contains penal provisions with far-reaching consequences. With regard to the arrangement or payment of prohibited elements of compensations, for instance, members of the board of directors or executive board expose themselves to criminal liability.

## **Comment**

Even though the ordinance came into force on January 1 2014, it remains open how it will affect public M&A transactions involving Swiss corporations whose shares are publicly listed. One aspect that seems clear is that amendments to the compensation packages of the management board used as a defence measure will qualify as being an ineligible defensive measure, based on the argument that such an extension is not in the interests of the public corporation, but rather in the interests of the group's management (eg, supplements to employment contracts of of Saia-Burgess group management; extension of notice period from 12 months to 24 months). However, this remains highly controversial under the provisions of the takeover regulators (see the recommendation issued by the Takeover Board on August 23 2005). In addition, the blacklisting of forbidden defence measures in the Takeover Ordinance now requires shareholder approval of such defence measures, making such instruments even more difficult to use if – as usually is the case in such transactions – time is of the essence. Conversely, due to the new requirement to prepare a compensation report and its increased transparency requirements, the ordinance facilitates the evaluation of a particular target by a potential bidder. When planning a takeover of a public corporation, a bidder must consider the target's obligations under the ordinance, if and until there is a squeeze-out – either immediately following the offer after having reached the required 98% threshold under the takeover legislation or the lower 90% threshold required for a squeeze-out merger under the Merger Act – or delisting of the target.

Should a public corporation wish to make payments to the members of the board of directors, executive board or advisory board, it is important to assess whether such payments (eg, consideration paid in order to retain employees during the acquisition process, time vesting or performance vesting with regard to executive participation schemes) are in line with the ordinance. It will also be interesting to see whether the judiciary expands the transactions which fall under Article 20 of the ordinance when having to assess such payments.

In general, the ordinance has extensive consequences and the board of directors of a public corporation is recommended to deal actively with the implications evident at this stage. In particular,

in parallel to the amendments of the articles of association and regulations, and the voting procedure of remuneration (prospective, retrospective or combination) which must be implemented during 2015, the board of directors should re-evaluate its remuneration scheme and consider the preferences of its shareholder base. Further, it is also recommended that the board review and re-evaluate employment agreements and compensation schemes, and that the management and all members of the board of directors are informed about the compensation and penal provisions.

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