

Corporate Finance/M&A - Switzerland

Takeover Board confirms opting out practice

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Introduction

The Securities and Stock Exchange Act provides for a mandatory offer obligation where a shareholder or a group of shareholders acting in concert exceeds a threshold of 33.3% (or 49% when a company has introduced an opt-up clause) of the voting rights in a listed company listed. According to Article 22 of the act, the shareholders of a listed company can choose to opt out from the mandatory offer obligation by including an opt-out clause in the articles of association, regardless of whether this clause is included before or after listing. However, if the opt-out clause is adopted after listing, its validity is subject to more stringent requirements.

The Takeover Board previously expanded its practice with regard to the evaluation of the validity of opt-out clauses. Pursuant to the act, the introduction of an opt-out clause after listing is valid, provided that it does not prejudice the interests of the shareholders within the meaning of Article 706 of the Code of Obligations. Such a clause is considered to be invalid if it is selective either:

- in a formal sense (ie, the party which is to benefit from the opt-out clause is specifically mentioned in the clause); or
- in a material sense (ie, the opt-out clause had been introduced in view of an upcoming transaction or for the benefit of a specific party, and is thus in its consequence selective).

However, if an opt-out clause was introduced five years ahead of a transaction benefiting from such a clause, it is assumed that its introduction was not selective in a material sense. Additionally, an opt-out clause which is selective in a formal or material sense is valid if opting out does not prejudice the interests of the shareholders according to Article 706 of the Code of Obligations.

In two recent cases, the board had to decide whether opt-out clauses introduced after listing were valid. The board also took this opportunity to reflect on its own practice.

BT&T Timelife

In 2008 the shareholders' meeting of BT&T Timelife AG - a company listed on the SIX Swiss Exchange - approved the introduction of an opt-out clause in the articles of association. The majority shareholder, Dr Walter Meier, indirectly held 48% of the voting rights. Meier also held 100% of Aceps Holding AG, which in turn held a majority of the voting rights in Alpha PetroVision Holding AG. Alpha's articles of association also contained an opt-out clause, which was introduced at its incorporation.

BT&T Timelife planned a strategic realignment, whereby it intended to shift its business development focus onto Rock Well Petroleum Inc, a Canadian-US petroleum company. BT&T Timelife and Aceps held in aggregate approximately two-thirds of Rock Well's shares, while the rest were held by minority shareholders.

Alpha planned on submitting a voluntary exchange offer to Rock Well's minority shareholders, whereby they could tender their shares in exchange for Alpha shares. Simultaneously, Aceps intended to contribute its shares in Rock Well to Alpha as a contribution in kind and receive shares of Alpha as consideration. BT&T Timelife intended to merge with Alpha, whereby Alpha would be the absorbing company.

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Therefore, the shareholders of BT&T Timelife would become shareholders of Alpha by operation of law. As a result of the implementation of the envisaged transaction, there was a change of control in BT&T Timelife: BT&T Timelife's public shareholders (which held in aggregate 51% of its shares) became minority shareholders of Alpha; and the former minority shareholder of BT&T Timelife (Meier, who held 48% of the shares) became indirectly (ie, through his holdings in Aceps) the majority shareholder of Alpha. Further, Rock Well would – assuming that all of its minority shareholders accepted Alpha's exchange offer - become a 100% subsidiary of Alpha. Thereafter, Alpha intended to list its shares on the SIX Swiss Exchange.

According to the board,⁽¹⁾ the envisaged transaction would trigger a mandatory offer obligation, since Meier would hold in excess of 50% of the shares in Alpha after the transaction was implemented, even though the increase in his shareholding would be the result of a merger. In the past, according to board practice, a merger did not trigger a mandatory offer obligation.⁽²⁾ However, the merger was not discussed in the *BT&T Timelife* decision at all. As a result, a request was filed with the board to release the shareholders of BT&T Timelife and Alpha from the mandatory offer obligation with regard to the planned transaction.

BT&T Timelife had introduced an opt-out clause after its shares were listed. It was planned that BT&T Timelife would get absorbed as a result of the merger and its shares would be delisted, while Alpha's shares would be listed. Thus, the board had to decide whether the prerequisites which apply to the validity of an opt-out clause that has been introduced after listing would also apply to Alpha. However, the board stated that this would not have to be decided if it deemed the introduction of the opt-out clause by BT&T Timelife's shareholders to be valid.

The board first summarised its previous practice. It concluded that the previous practice resulted in significant legal uncertainty, as the parties could never be certain during the five-year observation period whether the introduction of the opt-out clause was valid. In addition, the legal protection for minority shareholders was duplicated; on one hand, the civil or commercial courts in charge of adjudicating corporate law matters could have reviewed the introduction of the opt-out clause due to Article 706 of the Code of Obligations, based on a shareholder suit against the resolution of the shareholders' meeting; and on the other hand, the board could have reviewed such introduction under the Securities and Stock Exchange Act. Therefore, by its *LEM* decision⁽³⁾ (for further details please see "[Takeover Board becomes more lenient regarding opt-out clause](#)"), the board had restricted its previous practice. The board stated that it is primarily the shareholders' responsibility to appeal a shareholders' decision within two months, in accordance with Article 706. According to the *LEM* decision, the board's sole responsibility is to review whether the reasons and consequences of the opt-out clause were explained transparently at the shareholders' meeting, so that each shareholder could make a free and conscious decision with regard to the introduction of the clause. If the opt-out clause is deemed to be selective in the material sense, the requirements relating to the explanations provided to shareholders are more stringent. The board stated that – in principle – it will not review the validity of an opt-out clause if enough transparency was provided. An obvious abuse of rights remains reserved.

In the case at hand, the board applied this new practice and concluded that the introduction of the opt-out clause had been accepted by BT&T Timelife's shareholders in 2008 with a majority of the votes. Moreover, the board of directors had explained that the majority shareholder (Meier) could increase his participation above 49% without having to launch a public takeover bid; thus, the introduction of the opt-out clause was in the interest of Meier, who was already then the majority shareholder. Further, the board was of the opinion that the current transaction had not been planned when the opt-out clause was introduced, and that it could not have been predicted. The board concluded that the information provided by the board of directors was transparent and complete; the situation at the time of the decision and the (potentially) conflicting interests of the minority and majority shareholders had been made clear and comprehensible. Since the introduction of an opt-out clause had been accepted by the shareholders and not appealed within two months, the clause was deemed to have been validly introduced.

The board also commented on the introduction of the opt-out clause by Alpha. The clause had been introduced before the shares were listed. Therefore, the board was of the view that future shareholders would acquire shares in knowledge of the opt-out clause.

The board concluded that no mandatory offer obligation was required for the envisaged transaction, since both opt-out clauses were valid.

Advanced Digital Broadcast

4T SA, Luxembourg holds 41.27% of the share capital of Advanced Digital Broadcast Holdings SA. The shares of Advanced Digital are listed on the SIX Swiss Exchange. At a June 15 2012 shareholders' meeting, Advanced Digital's shareholders approved the introduction of an opt-out clause which was proposed by 4T SA. 4T SA indicated that it

envisaged increasing its voting rights to above 49%, and that it wanted to avoid a mandatory offer obligation. The board of directors did not make a statement with regard to the introduction of the opt-out clause, but supported it once it had been approved by the shareholders. The board was of the opinion that if 4T SA were to increase its participation in Advanced Digital, a stable shareholder structure would be ensured, and that Advanced Digital would benefit from such structure.

4T SA filed an application to the Takeover Board and requested confirmation that, based on the approved opt-out clause, a mandatory offer obligation would not be triggered if 4T SA were to increase its participation in Advanced Digital above 49%. The board⁽⁴⁾ deemed the introduction of the opt-out clause to be invalid and ineffective. As a result, a mandatory offer obligation would be triggered if 4T SA were to increase its participation as envisaged.

The board summarised its current practice and concluded that the *LEM* decision (as mentioned above) was insufficient to ensure equal treatment of the shareholders and adequate legal certainty of transactions, as the controlling shareholder could impose the opt-out clause on the minority shareholders. Furthermore, where a shareholder does not yet have a controlling majority, but wants to introduce an opt-out clause for its own benefit, it is insufficient - from a Securities and Stock Exchange Act point of view - to set up transparency requirements and, moreover, to rely on the fact that shareholders can file suit if they consider themselves prejudiced within the meaning of Article 706 of the Code of Obligations.

Additionally, the board took into account that the Swiss legislature recently abolished the possibility to pay control premiums in corporate takeovers; this provision will enter into force on April 1 2013 (for further details please see "[Control premium](#)"). As a result, more companies may want to introduce an opt-out clause in order to avoid the mandatory offer obligation. According to the board, this leads to an increased need to clarify the board's practice with regard to the introduction of opt-out clauses after a company's listing.

Following the doctrine, the board adheres to a certain train of thought: when a shareholders' meeting has been informed sufficiently before a decision is taken, one can assume that the decision is in the company's interest and, hence, in the interest of all shareholders. However, this presumption is valid only when all shareholders are affected by the decision in the same way. In case of discrepancies in the impact on shareholders, the presumption can be maintained only when the majority of potentially negatively affected shareholders also approve the decision. To determine whether such shareholders approve the decision, a second isolated vote by these shareholders would be ideal. If the decision taken by the majority of the shareholders is also approved by the majority of potentially negatively affected shareholders, the decision can be justified to be in the company's interests and, hence, the presumption is restored.

In the past, this procedure has been criticised by the Financial Market Supervisory Authority (FINMA), due to the absence of a legal basis. However, the board is of the view that this procedure is the most suitable way to ensure legal certainty and to prevent shareholders that will not profit from an opt-out clause from incurring prejudice in the sense of Article 706 of the Code of Obligations. Furthermore, the board considers that Article 22(3) of the Securities and Stock Exchange Act, which states that shareholders can include any provision in the articles of association, provided that it is not to their disadvantage - according to Article 706 - provides sufficient legal basis. Should a second isolated vote not take place, it is sufficient for the votes of the potentially negatively affected shareholders to be counted separately.

As a result, the board presumes that when the majority of potentially negatively affected shareholders also approve the clause, this is presumably in their interests or at least justified by the purpose of the company and hence consistent with Article 706. However, this is not absolute. When particular and exceptional reasons exist, the board may review whether a disadvantage in the sense of Article 706 is at hand, not only when the potentially negatively affected shareholders disapprove the decision, but also when they approve the decision. In summary, it can be said that when an opt-out clause has not been approved by the double majority and when no special circumstances exist which would justify its validity, then the opt-out clause does not come into effect.

In the case at hand, since the majority of potentially negatively affected shareholders did not approve the introduction of the opt-out clause, the board presumed that the introduction of the clause would lead to prejudicial treatment of the shareholders. Such a presumption can be overturned when particular and exceptional circumstances lie at hand. 4T SA claimed that the introduction of the opt-out clause would lead to a stabilised shareholder structure, and that the liquidity of its shares would improve. The board was of the opinion that since 4T SA held 41% of the shares and could increase its participation to 49%, the shareholder structure was already stable. Furthermore, if 4T SA were to increase its participation above 49%, then the liquidity and the free float of Advanced Digital may improve only for a short period of time. The board concluded that

the arguments brought forward by 4T SA were of a general nature, since all listed companies could produce these arguments; hence, such arguments were insufficient to be classified as particular and exceptional circumstances which could overturn the described presumption.

The board further reiterated that the information provided to shareholders must be transparent. Shareholders must be informed about the intentions of the controlling shareholders and shareholder(s) seeking the introduction of the clause, as well as who stands to profit from the opt-out clause. In addition, they must be informed about the consequences of an opt-out clause in general and in view of the specific case. In the case at hand, the board concluded that the information provided to the shareholders was sufficient and transparent.

Since the presumption of prejudicial treatment of the shareholders could not be overturned, the board did not find it necessary to review the introduction of the opt-out clause in light of Article 706. Instead, it concluded that the opt-out clause had not been validly introduced and thus had not come into effect.

Comment

In the *BT&T Timelife* decision, the board considered whether the prerequisites which apply to the validity of an opt-out clause that has been introduced after listing also applied to Alpha. The board stated that if such prerequisites did not apply, the shareholders of BT&T Timelife would be at a disadvantage due to the merger by absorption. Since the introduction of the opt-out clause by BT&T Timelife was considered valid, this question did not have to be answered. Thus, only time will tell how this question will be answered.

Furthermore, the board did not discuss the effects of the merger in the *BT&T Timelife* decision. This is surprising, as an increase in shareholding by means of a merger has in the past - under certain conditions - not triggered a mandatory offer obligation. Conversely, pure merger transactions are subject not to the Securities and Stock Exchange Act, but to the Merger Act. An exception applies if one of the merging companies acquires a controlling stake in the other merging company before the effective date of the merger, thereby triggering the obligation to submit a public offer according to the Securities and Stock Exchange Act. However, in the *Hiestand* case, 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 and the ordinance on public takeovers, the board allowed the acquirer to postpone the offer and instead complete the merger, with the consequence that the obligation to submit a public offer lapsed due to the absorption of the target. If the merger failed, however, the acquirer will be obliged to follow through with its public offer.⁽⁵⁾ It is expected that such practice regarding mergers will continue to apply in the future, even though the board disregarded the merger in the *BT&T Timelife* decision.

These two decisions clearly show that board practice is still variable and can be expected to undergo further changes and/or clarifications. From the *BT&T Timelife* decision, it appears that the board will maintain the reformed practice that it introduced at the time of the *LEM* decision. However, in the *Advanced Digital Broadcast* decision, the board clarified that it will still review the validity of an opt-out clause in light of Article 706 where the majority of negatively affected shareholders do not approve the introduction of the clause, or when particular and exceptional circumstances exist. In particular, the board mentioned that the need for an investor in times of financial difficulties could be considered as "particular and exceptional circumstances". It will be interesting to see how such circumstances will be interpreted in the future.

Furthermore, a big question mark remains with regard to the view that FINMA would take if it had to evaluate current board practice. FINMA has not had to decide or comment on such a case. Thus, it will be interesting to see whether it shares the same view as the board when deciding on the validity of an opt-out clause and, in particular, on the two-step procedure that the board has proposed with regard to the approval of a decision by the shareholders' meeting.

In the past, minority shareholders could contest opt-out clauses only by contesting the resolution passed based on the Code of Obligations - not the Securities and Stock Exchange Act - before a civil court within two months from the shareholders' meeting. This was disadvantageous for minority shareholders and, therefore, the board's latest decision is welcomed. Minority shareholders can now contest the introduction of an opt-out clause before the board and, therefore do not have to contest the decision within two months before the civil courts.

In the *Advanced Digital Broadcast* decision the board took into consideration that the Swiss legislature has abolished the possibility to pay control premiums in corporate takeovers; a bidder can no longer pay the minority shareholders less than the majority shareholders, and all shareholders must be paid the same price. The board is aware of the fact that a bidder may want to avoid the mandatory offer obligation, as it wants to

pay a reduced price, and that it is in its interests that an opt-out clause be introduced so that the mandatory offer obligation can be avoided. As a result, there may be an increase in attempts to introduce opt-out clauses in order still to be able to pay a control premium. Therefore, the board has revised its lenient practice in the *Advanced Digital Broadcast* decision and made it more stringent.

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Endnotes

- (1) Takeover Board Decision 511/01, May 8 2012.
- (2) Takeover Board Decision 372/01, June 6 2008 and 372/02, July 15 2008 regarding Hiestand Holding AG.
- (3) Takeover Board Decision 490/01, September 22 2011.
- (4) Takeover Board Decision 518/01, October 11 2012.
- (5) 372/01 and 372/02.

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