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The end of the control premium

Alexander Vogel, Christoph Heiz, Andrea Sieber and Debora Durrer of Meyerlustenberger Lachenal look at the abolition of the pre-offer control premium in Swiss public M&A

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

In addition, the Federal Act on Cartels and Other Restraints of Competition (Antitrust Act) and similar antitrust regulation of any other jurisdiction in which the parties involved in the M&A transaction are active, need to be taken into consideration, particularly if the consolidated turnover of each of the parties involved is significant.

To the extent 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 Swiss corporate law dealing with the obligation to prepare a prospectus and the technicalities of a capital increase (all provided for in the Swiss Code of Obligations) have to be complied with. Furthermore, if the issuer is listed on a Swiss stock exchange the listing rules of such stock exchange – either SIX Swiss Exchange or BX Berne eXchange – will apply.

Significant transactions in 2012

The Swiss M&A market developed positively in the first quarter of 2012. The transaction volume reached a new record high of $63 billion. This high volume was partly attributable to the acquisition of Xstrata by Glencore International as the transaction volume amounted to approximately $30.6 billion. The first quarter was characterised by large transactions and Swiss purchasers acquiring targets outside of Switzerland. In general there were only few deals involving foreign acquirers and Swiss targets and Swiss sellers (Menz/Eschenmoser, *M&A Review 6/2012*, p.270–275). The second quarter saw a decline in both the number of transactions as well as the transaction volume which went down to $31 billion (Menz/Eschenmoser, *M&A Review 9/2012*, p.368–373). Nonetheless, the transaction volume after the first half of 2012 already surpassed the transaction volume of the whole of 2011. The largest transaction in the second quarter of 2012 was the acquisition of Pfizer Nutrition by Nestlé.

While the number of Swiss M&A transactions remained constant in the third quarter of 2012, the transaction volume declined significantly to $8.5 billion. The largest transaction in the third quarter of 2012 was the acquisition of Kazzinc by Glencore International. There was an increase in transactions involving Swiss purchasers and foreign targets. Reasons for this development can be found on one hand in the strong financial situation in which many Swiss companies found themselves and on the other hand in the relative strength of the Swiss franc compared to other currencies (see also Menz/Eschenmoser, *M&A Review 12/2012*, p.514–519).

In the fourth quarter of 2012, the Swiss M&A market again experienced an upward trend at least with regard to the volume of transactions, while the number of transactions decreased compared to the preceding quarters. Altogether the Swiss M&A market developed positively in 2012. There was an increase in the number of deals and even more in the transaction volume for the year 2012 compared to 2011, even when excluding the significant boost in the transaction volume attributable to the transaction between Glencore and Xstrata in the first quarter of 2012. The largest transactions in 2012 apart from the Xstrata transaction were the acquisitions of Pfizer Nutrition (USA) by Nestlé, of Alliance Boots by Walgreen Co. (USA), Viterra (Canada) by Glencore International and Actavis

"Switzerland is the only country which provides for an opt out mechanism"

Group by Watson Pharmaceuticals (USA) (Menz/Eschenmoser, *M&A Review 3/2013*, p.135–141). The only public offer on a Swiss issuer in 2012 was the mandatory offer of J. Safra Holding on the shares of Bank Sarasin after the acquisition of a majority stake from Rabobank.

As mentioned above, as in the previous year, cross-border activity in 2012 was influenced by the strength of the Swiss franc both in a positive and in a negative way: while Swiss targets appear rather high priced to foreign acquirers, the acquisition of targets outside of Switzerland is made more attractive for Swiss acquirers due to the current exchange rate levels which might change once the eurozone has returned to a more stable state. In addition, a lot of Swiss companies have relatively strong balance sheets compared to some foreign competitors. Thus, cash reserves were used for strategic acquisitions resulting in an increase in acquisitions outside of Switzerland. Nonetheless, the unresolved eurozone crisis was a dominating factor for dampening Swiss M&A activity in 2012 and may also have an impact on Swiss M&A activity in 2013.

Public takeovers

Public tender offers on issuers listed on an exchange in Switzerland are governed by Sesta. Pure merger transactions, conversely, are not subject to the provisions of Sesta, but to those of the Swiss Merger Act. An exception applies if one of the merging companies acquires before the effective date of the merger a controlling stake of the other merging company, thereby triggering the obligation to submit a public offer according to Sesta. In that case, however, 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 Sesta 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 company (see, for example, the *Hiestand* transaction (Takeover Board Decision 372/01 of June 6 2008 and 372/02 of July 15 2008), provided, however, that if the merger fails (in other words is not completed), the acquirer will be obliged by the Takeover Board to follow through with its public offer. However, in the *BTTL Timeline* transaction (Takeover Board Decision 511/01 of May 8 2012) the Takeover Board did not take into consideration that the increase in the shareholding was due to a merger and, thus, the Takeover Board reviewed whether in the particular case, the shareholders can be released from the mandatory offer obligation.

Sesta provides for a mandatory offer obligation in case a shareholder or a group of shareholders acting in concert exceeds a threshold of 33.3% of the voting rights in a company listed on the stock exchange. All member states of the European Union have also introduced such an obligation based on the EU Takeovers Directive (which also provides for a mandatory bid threshold of 33.3%), but many of them provide for a mandatory bid threshold of 30%. Switzerland is, however, the only country which provides for an opting out mechanism – a possibility that the shareholders of a listed company can choose to opt out from the mandatory offer obligation. Furthermore, the shareholders of the target can as an alternative option also increase the threshold in its articles of association to up to 49% (opting up). Opting out clauses have caused much discussion with the Takeover Board in 2012.

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

Compliance with the rules provided for in Sesta 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 Swiss Financial Market Supervisory Authority (Finma) for review. Against decisions of Finma any party can make an appeal to the Federal Administrative Court whose decisions are final.

Legislative changes

In the context of a larger overhaul of the regulatory framework with regard to insider trading, market abuse and similar practices, the Swiss legislature passed an amendment to the rules of Sesta governing the disclosure of shareholdings and the minimum price rules applicable in a public tender offer. In particular, the new rules: (i) extend the reach of the act to shares of companies with registered offices outside Switzerland; (ii) expand the supervi-

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sory instruments of Finma regarding compliance with disclosure obligations of market participants; (iii) change some important procedural provisions; and (iv) abolish the possibility for an offeror to pay a control premium to the controlling shareholders of a target company shortly before the launch of a public tender offer – the most significant and controversial change.

The abolition of the possibility to pay a control premium to certain shareholders before the launch of the offer was brought forward by the Federal government based on a proposal by the Takeover Board. The proposal was also supported by the SIX Swiss Exchange. The proponents' main argument for the change is that payment of a control premium significantly violates the principle of equal treatment and transparency, and therefore violates the legitimate interests of minority shareholders in a public takeover. It can be assumed that this change has also been triggered by the growing use of significant premiums in the recent past and the apparently increased willingness of both acquirers and sellers of substantial blocks to share the advantages of an unequal treatment of shareholders, while simultaneously taking the public blame for such perceived unfairness. In the opinion of the SIX Swiss Exchange, the possibility to pay a control premium to one or several significant shareholders is a significant disadvantage to the Swiss financial market in terms of international competitiveness. A further argument is that such option has been abolished in most European countries, since pursuant to the EU takeover offer guidelines, EU member states may not allow for any control premiums under their national laws.

Conversely, the opponents of an abolition of control premiums argued mainly that such abolition is an unjustified infringement of the principle of freedom of contract, since the ability to sell a controlling block represents an economic value which should justify being compensated by a control premium to be paid to the holder of such a controlling block. Further, the defender of the current statutory regime argued that an abolition would necessarily lead to an increase of the overall costs for a takeover, and thus would be likely to prevent a takeover in many cases. These arguments were the subject of heated debate, both in the legislative consultation procedure and in both chambers of Parliament. Finally, the latter decided – after protracted controversial debate – with a narrow margin to abolish the control premium as proposed by the Federal Council and the Takeover Board.

The revised version of article 32(4) of Sesta provides that the price of an offer must at least equal both the current stock exchange price and the highest price paid by the bidder for shares (or other equity securities of the target company) in the 12 months preceding the announcement of the offer. These revised provisions will effectively prevent a bidder from acquiring a block from a significant shareholder before the launch of the public offer at a price exceeding the offer price offered to the minority shareholders. A bidder that wishes to acquire – or a significant shareholder willing to sell – a significant block of shares at a higher price than offered to the public must do so at least 12 months before the announcement of the offer. The acquired interest must be – together with any shares already held by such bidder or any parties acting in concert with it – below 33.3% of the voting rights in order not to trigger a mandatory public offer, unless the articles of association of the target increase the relevant threshold for a mandatory public offer (opting up) or waive the applicability of the mandatory tender offer rules – including the minimum price rules – altogether (opting out).

The new rules relating to limiting the payment of control premiums are expected to come into force in April 2013. Bidders and sellers that are considering employing a control premium when structuring the sale of a target listed in Switzerland are, therefore, well advised to speed up their preparations in view of the fact that such structures will be impossible in the very near future.

Recent Takeover Board decisions

The issues which preoccupied the Swiss Takeover Board in 2012 concerned, among other things, buyback programmes and exemptions from the mandatory offer obligation provided for in Sesta. There are three cases which will be discussed below, whereby two cases concerned the validity of earlier introduced opting out clauses.

In the Cytos case, the Takeover Board was asked to grant a group of five larger investors individually and as a group an exemption from the obligation to make a public offer in case one of the five investors or the five investors as a group exceed the threshold of 33.3% in its shareholding of ailing Cytos Biotechnology. Cytos had entered into an investment agreement with the five investors,

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whereby the granting of such exemption by the Takeover Board was a condition for the implementation of the recapitalisation of Cytos. The Takeover Board came to the conclusion that Cytos was financially troubled and that the restructuring measures, which included an injection of additional capital, were necessary to secure the survival of Cytos in the midterm. Therefore, the Takeover Board granted in April 2012 the exemption from the mandatory offer obligation in accordance with article 32 paragraph 2 of Sesta which allows for exemptions in justified cases such as a restructuring in case of financial distress of the target company.

"Opponents of abolition argued that it is an unjustified infringement of the principle of freedom of contract"

The Takeover Board was confronted with the issue of opting out clauses twice in 2012. In the past, the Takeover Board had expanded its practice with regard to the evaluation of the validity of an opting out clause. Pursuant to the Sesta, the introduction of an opting out clause – after the listing of the shares on the stock exchange – is considered valid as long as it does not prejudice the interest of the shareholders within the meaning of article 706 of the Swiss Code of Obligations. Such a clause is, in particular, considered to be invalid if it is either selective in a formal sense (the person who is to benefit from the opting out clause is specifically mentioned in the clause), or selective in a material sense (the opting out clause is introduced in view of an upcoming transaction or for the benefit of a specific person and is, thus, in its consequence selective). If, however, an opting out clause had been introduced five years ahead of a transaction benefiting from the opting out clause, according to the Takeover Board it can be assumed that its introduction was not geared towards a particular transaction and thus is not selective in a material sense. Additionally, an opting out clause which is selective in a formal or material sense is valid, if the opting out does not prejudice the interests of the shareholders according to the applicable provisions of Swiss company law. In the *BTTL Timeline* decision the Takeover Board further restricted its former practice which it had already started narrowing in its *LEM* decision rendered in 2011 stating that the Takeover Board's sole responsibility is to review whether the reasons and consequences of the introduction of the opting out clause had been explained transparently at the shareholders' meeting so that each shareholder had the possibility to make a free and conscious decision with regard to the introduction of the opting out clause. If the opting out from the mandatory offer rules is deemed to be selective in the material sense, the requirements relating to the explanations provided to the shareholders are more stringent. The Takeover Board stated that – in principle – it does not review the validity of the opting out clause if sufficient transparency was provided. These prerequisites were deemed to be given in the BTTL decision and, therefore, the Takeover Board concluded that the introduction of the opting out clause was valid.

In the *Advanced Digital Broadcast* decision (Takeover Board Decision 518/01 of October 11 2012) the Takeover Board back-pedalled to a certain extent and concluded that the *LEM* decision was insufficient to ensure equal treatment of the shareholders and an adequate legal certainty of such transactions as the controlling shareholder can impose the opting out clause on the minority shareholders. Furthermore, the Takeover Board took into account that the Swiss legislator abolished the possibility to pay control premiums in corporate takeovers (see section above). As a result of this legislative change, more companies – influenced by their major shareholder(s) – may be tempted to introduce an opting out clause in order to avoid the mandatory offer obligation (thereby de facto allowing a majority shareholder to cash in a hefty control premium when selling its controlling block while leaving minority shareholders without an attractive exit option). This, according to the Takeover Board, led to an increased need to clarify the practice with regard to the introduction of opting out clauses after a company's listing. While the Takeover Board still applies the presumption that when the 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 its shareholders. This presumption is, however, only valid when all shareholders are affected by a decision in the same way. In case of discrepancies in the impact on the shareholders, the presumption can only be maintained when the majority of the potentially negatively affected shareholders also approves the decision. To determine whether such shareholders approve the decision, a second isolated vote by these shareholders or at least a separate count of votes of these shareholders needs to be organised. If the decision taken by the majority of the shareholders is also approved by the majority of the potentially negatively affected shareholders the decision can be justified by the company's interests and, hence, the presumption is restored. In the past such procedure has been criticised by Finma, which stated that there is no clear legal basis for it. The Takeover Board is of the view, however, that such procedure is the most suitable way to ensure legal certainty and to prevent shareholders not profiting from an opting out clause from incurring a prejudice. Furthermore, the Takeover Board deems article 22 paragraph 3 of Sesta, which states that the shareholders can include any provision in the articles of association as long as it is not to their disadvantage according to the relevant provisions of Swiss company law, to provide a sufficient legal basis to implement such procedural safeguards. Should a second isolated vote not take place, it sufficient for the votes of the potentially negatively affected shareholders to be counted separately. As a result, the Takeover Board presumes that when the majority of the potentially negatively affected shareholders also approve the clause, such clause is in their interest or at least justified by the purpose of the company and, hence, consistent with general principles of Swiss company law. However, this presumption is not absolute, but rather rebuttable. When particular and exceptional reasons exist, the Takeover Board may review whether a material prejudice lies at hand, even if the potentially negatively affected shareholders approve the decision. In summary, it can be said that when an opting out clause has not been approved by the double majority of all shareholders and the negatively affected shareholders and when no special elements lie at hand which would justify its validity, then the opting out clause is to be considered invalid.

Since the majority of the potentially negatively affected shareholders did not approve the introduction of the opting out clause in the case at hand, the Takeover Board concluded that the introduction of the opting out clause led to a prejudicial treatment of the shareholders. With regard to the question, whether this presumption is rebutted by particular and exceptional circumstances in the case at hand, the Takeover Board came to the conclusion that the arguments regarding a stabilised shareholder structure and an improvement of the liquidity of the shares which were brought forward by 4T are of a general nature, since all listed companies could bring forward these arguments and, hence, that such arguments are insufficient to be classified as particular and exceptional circumstances which could overturn the described presumption.

These two decisions clearly show that the practice of the Takeover Board is still variable and is likely to undergo further changes and/or clarifications. It will, in particular, be interesting to see whether Finma will follow the Takeover Board's practice should it be confronted in the future with the evaluation of the validity of an opting out clause introduced in the past.