Corporate Finance/M&A - Switzerland

Overview (July 2008)

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July 16 2008

Legislative Framework

The Swiss Code of Obligations governs M&A transactions and the Swiss Act on Stock Exchanges and Securities Trading governs acquisitions of participations in listed companies, both friendly and hostile. If the acquisition structure includes a merger, demerger or asset deal, the provisions of the Swiss Merger Act, in force since July 1 2004, apply. In addition, the Swiss Antitrust Statute applies to the extent that the turnover of each of the parties involved exceeds certain thresholds.

If a transaction structure provides for the issuance of new securities by an issuer listed on a stock exchange, the listing rules of that stock exchange apply.

Impact of recent legislative changes

In the past two years the disclosure rules applying to shareholdings in listed companies have been much debated among M&A practitioners, potential target companies and regulators. Prompted by a number of recent cases in which corporate raiders secretly built up significant stakes in Swiss listed companies and then confronted both the target and the remaining shareholders with a dominating minority stake, the Federal Banking Commission (FBC) and the Federal Parliament have implemented stricter disclosure rules. The new rules are aimed at derivative structures used by corporate raiders to avoid early disclosure of their acquisition plans.

Until 2007 anyone building up a stake in a company that is listed on a Swiss stock exchange and has its registered office in Switzerland had to publicly disclose a holding of more than 5% of the company's shares or options. According to Article 20 of the Swiss Act on Stock Exchanges and Securities Trading, further reporting requirements were triggered if the stake exceeded or fell below the threshold percentages of 10%, 20%, 33.33%, 50% and 66.66% of the voting rights. In addition, the stakes of parties acting directly or indirectly in concert had to be reported on an aggregate basis.

The obligation to disclose significant shareholdings has several aims. On the one hand, it is designed to ensure equal treatment of market participants through improved transparency with respect to price-sensitive shareholding structures - that is, to prevent information advantages that can be abused by a potential corporate raider. On the other hand, it aims to prevent clandestine acquisitions by way of creeping tender offers as well as the covert sale of significant shareholdings on or off the stock exchange. The previous regulations allowed investors to remain incognito as long as they bought less than 5% of a target's voting shares and less than another 5% in call options or other derivative positions entitling them to acquire voting shares. The previous regime was heavily criticized since the combination of long positions and option positions allowed a potential acquirer to control up to 10% of the voting shares without having to reveal its identity and thus to gain a significant interest in a target company without the market's or the target company's knowledge. Further, corporate raiders often combined these techniques with cash-settled derivative positions or stock lending transactions which allowed them to line up shareholdings - giving them a controlling interest in a target company without appropriate disclosure and thus without allowing the target to organize its defence or another bidder to launch a competing offer.

In two steps Parliament and the FBC have tried to close certain loopholes that allowed corporate raiders to sneak up on Swiss companies. On the one hand, an amendment to Article 20 of the act was passed, which decreases the lowest percentage threshold triggering a reporting requirement from 5% to 3% and adds new disclosure thresholds of 15% and 25%, in line with the requirements of other European stock exchanges. Further changes provide for tougher consequences for violations of the reporting requirements: in particular, the voting rights of an acquirer that did not disclose its shareholding according to the relevant provisions can be temporarily suspended, or, if acquired with the intention subsequently to submit a tender offer, suspended permanently. In addition, Parliament has introduced an amendment that defines the notion of 'indirect acquisition' more clearly. That definition - together with the implementing provisions (also amended) - now explicitly includes other transactions or agreements, in particular options, swaps or similar transactions, that a person enters into with the view to subsequently launching a tender offer, even if the transaction or agreement provides for a cash settlement and thus does not give a firm entitlement to request the sale or delivery of the shares.

On the other hand, the FBC has introduced several amendments to the implementing provisions of the act, which eliminate the former exemption for cash-settled options in its entirety and require the aggregation of all acquired positions in the underlying shares and any derivative positions. The amendments also introduce a reporting obligation for the acquisition and sale of put options or other rights to sell the underlying shares and the writing of call options (or the granting of other rights to acquire the underlying shares). These had previously been exempt from the obligation to disclose. In addition, changes between long positions held through call options and shares resetting from the exercise of options have to be reported if a threshold is reached. These changes, especially the exemption for cash-settlement derivatives, mean that cash-settled swaps with or without embedded physical options or forwards relating to the underlying shares will have to be disclosed if the notional amount (ie, the notional number of shares), together with any other direct or indirect positions or derivative positions held, exceeds a threshold percentage and these positions are built up with a view to launching a public offer. Further, new provisions in the implementing ordinance clarify that a netting of positions is not possible - for example, call options and put options on the same underlying shares cannot be netted. They must be aggregated and disclosed separately - that is, in a long basket and a short basket. These new rules are in line with the prevailing view that any netting possibility shall not allow a potential corporate raider to disguise its holdings in the target. Further guidance on those issues is provided in the explanatory notes of the FBC. They also give calculation examples.

Violation of the obligation to report a qualified shareholding in a listed company can result in a fine that can be set at an amount up to double the purchase price or the sale proceeds. The amount of the fine is calculated on the difference between the new shareholding held by the acquirer and the last reported shareholding. In addition, the FBC, the target company or a shareholder of the target company can request that the voting rights of an acquirer that did not disclose its shareholding according to the relevant provisions be temporarily suspended (for up to five years) or - if the acquisition was made with the intention subsequently to submit a tender offer - suspended permanently.

Significant Transactions in 2007

In general, both the volume and number of M&A transactions increased in 2007 compared to 2006, but were still considerably below the record year of 2004. The number of reported national transactions decreased by about 3%,(1) while the number of cross-border transactions increased slightly. The biggest national transaction was the sale of the baby food division of Novartis to Nestlé for about Sfr6.7 billion ($6.6 billion). Important transactions of Swiss targets by foreign acquirers include:

- the acquisition of SIG Holding by Rank Group (see below);
- the acquisition of the hospital group Hirslanden by Medi-Clinic Corp for €1.8 billion;
- the acquisition of the real estate portfolio of the Cerberus Group by Pirelli for €1.7 billion;
- the acquisition of Banca del Gottardo by BSI from Swiss Life for €1.1 billion; and
- the acquisition of Selecta Management AG by Allianz from Compass Group for €1.1 billion.

Further transactions include the acquisition of a participation in UBS by Singapore Investment Corporation in the amount of Sfr11 billion and the sale by UBS of its interest in Julius Bär for Sfr1.1 billion. Swiss companies were also active on the M&A scene: by far the largest transactions were concluded by Swisscom, which acquired Fastweb for Sfr3.7 billion, and by Petroplus, which acquired BP PLC for Sfr1.1 billion. Another important transaction was the failed sale of the Jelmoli real estate division to a consortium led by Delek Global Real Estate for €2.1 billion; it did not close, due to financing difficulties of the buyers.

In 2007 various public tender offers were launched, including Merck's offer on Serono, the Finck family's offer on von Roll, Nestlé's offer on Henniez, CRH's offer on Gétaz Romang and Capio's public offer on

Unilabs. Capio's offer led to ferocious but ultimately unsuccessful campaigns by minority shareholders regarding the offer price. The offeror, relying on an outdated Swiss Act on Stock Exchanges and Securities Trading rule that deviates from the principle of equal treatment of all shareholders by allowing a premium of up to 25% for acquisitions not directly linked to an offer, offered the minority shareholders considerably less than the majority shareholders that sold to Capio immediately before the public offer.

Also in 2007 there were a few hostile offers, among them:

- the offer by Glarner Kantonalbank on Bank Linth which failed in view of a more attractive bid of Liechtensteinische Landesbank acting as white knight;
- CVC Capital Partners' and Ferd's hostile offer on SIG Group, which was successfully challenged and defeated by the white knight Rank Group selected by the board;
- SCOR's successful hostile bid on Converium; and
- Laxey's offer on the local construction firm Implenia.

Implenia's defence strategy based on its statutory voting right restrictions has succeeded so far, even though some aspects of the battle will be reviewed by the courts in view of Laxey's lawsuit against Implenia's board. The FBC recently decided that Laxey violated its disclosure obligations by building up its shareholding in Implenia before the public offer.

Regulation of Foreign Involvement

In general, foreign investors acquiring an interest in a Swiss business - by way of a share purchase or an asset deal - are faced with few restrictions and limited requirements to obtain government authorization. Exceptions apply to certain regulated industries, mainly in the area of banking and finance (eg, relating to the acquisition of banks, securities dealers or asset management companies), where special approval requirements or notification obligations apply. Similar restrictions apply to the acquisition of a substantial interest in a Swiss insurance company.

In an asset deal transaction, restrictions and approval requirements may stem from the fact that the legal entity conducting the business changes. Certain permits, concessions or public franchises cannot be transferred from the selling entity to a new entity. Further restrictions govern the acquisition of real estate in Switzerland by foreigners to the extent such real estate is not used, or not intended to be used, for commercial purposes (ie, it is residential property or farm land). The relevant legislation is under revision. The government intends to liberalize it further.

Principal Disclosure Requirements

The rules for private transactions are set forth in the Code of Obligations. The seller's disclosure obligations under the code are limited and depend on the circumstances - that is, the negotiations between the parties, the contractual disclosure obligations and the extent to which the buyer can rely on the seller's statements in view of the circumstances.

In private M&A transactions, extended disclosure is usually granted once the prospective acquirer has entered into a confidentiality agreement. The documents to be disclosed are prepared either based on a due diligence request list provided by the acquirer or according to the secrecy needs of the seller, which prepares a data room. This is typical in an auction procedure.

Although private companies, whether organized as corporations, limited liability companies or cooperatives, have no obligation to file or disclose financial information, corporations which have shares listed on a stock exchange or have issued bonds are obliged to publish the annual and consolidated financial statements, if applicable. In addition, companies listed on a stock exchange are required to comply with various additional disclosure obligations. In particular, they are obliged to publish any changes with respect to significant shareholders within two days of receipt of such information and to disclose immediately price-relevant information (*ad hoc* publicity).

Further, listed companies must publish an interim financial report at least semi-annually and a comprehensive business report annually. The business report contains:

- the board's annual report;
- the auditors' report;
- the audited financial statements (standalone and consolidated);
- information relating to corporate governance; and
- information relating to shareholders and organized groups of shareholders holding more than 5% of the company's share capital.

If a transaction includes the issuance of new equity or debt instruments to be listed, the prospectus and listing requirements of the relevant stock exchange apply. In a public offer, the Swiss Act on Stock Exchanges and Securities Trading and its implementing regulations govern the content of the offering prospectus in detail. An independent auditor needs to confirm its accuracy and completeness.

Prospectus Liability

So far, prospectus liability has not played a significant role in M&A transactions in Switzerland, even though the act and its implementing regulations govern the content of offering prospectuses to be used in a public tender offer.

The act does not specify the consequences of a violation of its rules relating to the content of prospectuses. According to the prevailing view, the liability of an offeror would thus have to be determined according to the general rules relating to prospectus liability stipulated in the code. Based on these provisions, a person or legal entity directly or indirectly responsible for a prospectus being incorrect is liable for damages caused by its act or omission. In a recent case the Federal Supreme Court confirmed that plaintiffs have the burden of proving their reliance on a wrong or misleading statement in the prospectus when entering into transactions. Under Swiss law, no statutory or legal presumption of reliance exists.

Material Adverse Change Clauses

In private transactions the buyer commonly requests the inclusion of a material adverse change (MAC) clause in order to limit its risks resulting from changes in the period between signing and closing. The default provisions of the code place that risk on buyers unless they can claim error, fraud or duress, or request the application of the *clausula rebus sic stantibus* (things remaining as they are) rule. The form and content of a MAC clause vary depending on the nature and size of the transaction. Further, considering the seller's market in recent years, buyers in certain cases have had to accept clauses that were limited in their reach and thus provided only limited protection. In general, there are no legal restrictions relating to the content of a MAC clause. The parties are free to narrow or widen the scope of the clause according to their relative bargaining power. The clause usually gives the purchaser the right to pull out of the deal and walk away from an acquisition, or at least to renegotiate the terms of the transaction before closing, if events occur that are detrimental to the target company.

In voluntary public tender offers the Takeover Board considers MAC clauses admissible to the extent that they do not enable the offeror to cancel its offer based on an insignificant deterioration of the target's results. Thus they give the offeror decisive control regardless of whether the condition is fulfilled. The board requires that a MAC clause be based on meaningful thresholds. In its recent decisions the board has repeatedly concluded that MAC clauses providing for a threshold of 10% relating to earnings before the deduction of interest, tax and amortization or turnover are acceptable, but that thresholds of 5% relating to equity or turnover are borderline cases. Conversely, in a mandatory tender offer, MAC clauses are not allowed.

Unresolved Due Diligence Issues

One of the major unresolved issues surrounding M&A transactions relates to the limitations of financial assistance granted by the target company to the acquirer in the form of loans or guarantees. It is generally accepted that upstream or sidestream guarantees or loans by a target company in favour of the acquiring new parent company or one of its affiliates shall be granted only against adequate consideration based on market conditions and to the extent that the parent company has the financial capacity to repay its loans. However, there is a debate about whether and to what extent - even if the above-mentioned conditions are met - the target's ability to grant financial assistance is limited to the target's freely disposable shareholders' equity; and if so, at what point in time such freely disposable equity shall be determined:

- at the time of the granting of the guarantee or loan;
- at the time of the start of the proceedings for enforcement; or
- at both times, whereby the lower amount is relevant.

Further, practitioners debate whether the target's auditors should determine the amount on the basis of an audited annual or interim balance sheet, and whether the amount to be paid by the target needs to be approved as a distribution by a duly convened meeting of the target's shareholders. Since there is practically no guidance from court decisions on these issues, practitioners will have to continue to try to find a balance between legal certainty and practicality.

Public Takeovers

Regulations and regulatory bodies governing public takeovers

The Swiss Act on Stock Exchanges and Securities Trading governs public tender offers on issuers listed on an exchange in Switzerland. Pure merger transactions, however, are subject not to the provisions of the act, but to those of the Merger Act. The Swiss 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. This happens if an acquirer directly or indirectly controls more than 33.3% of the company's voting rights. Exceptions apply if the target had increased this threshold in its articles of incorporation to up to 49% (opting up) or if the latter contain an opting-out clause.

Furthermore, once a public offer has been pre-announced, the 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. Such measures must be submitted to the shareholders' meeting for approval. The board can no longer issue shares based on authorized share capital without granting subscription rights to the existing shareholders, except in limited cases. In addition, the target may not enter into incentive plans, severance agreements or other similar arrangements with members of the board or senior management with unusually high compensation.

Compliance with the rules provided for in the act is supervised by the Takeover Board, which issues orders in the form of binding recommendations. Any recommendation rejected by one of the parties can be brought to the FBC for review. The latter can also issue binding administrative orders if a party does not comply with the board's recommendations. Any party can make an appeal to the Federal Administrative Court against decisions of the FBC and a further appeal to the Federal Supreme Court.

The Swiss Antitrust Statute provides for a preventive merger control procedure led by the Swiss Merger Control Commission if a transaction exceeds certain thresholds.

Thresholds for disclosing an interest

Shareholders and groups of shareholders acting in concert have to report to the issuer and the relevant stock exchange purchase or sale transactions as well as certain derivative positions in a Swiss company listed on an exchange in Switzerland, if they reach, exceed or fall below the thresholds of 3%, 5%, 10%, 15%, 20%, 25%, 33.33%, 50% or 66.66% of the voting rights. During a public tender offer, further disclosure obligations relating to transactions in the shares of the target and in the offeror's exchanges apply (see, for example, the ruling of the board dated February 27 2008 relating to Implenia).

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Endnotes

(1) For detailed statistical figures see M&A Review 2008.

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