Switzerland
– A short investors guide for M&A transactions

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There was a great deal of activity in the Swiss M&A market in 2003. Overall, the number of M&A transactions affecting Swiss companies increased by 17%. Private equity firms were involved in more than 10% of the transactions. The number of mergers increased by more than 20% and cross boarder takeovers by Swiss enterprises by 40%. On the other hand, the number of co-operations grew by more than 60%.

Transactions in 2003

Swiss outbound investments included amongst others, the takeover by Xsatra of Australian MIM (CHF4bn.), the purchase by food and beverage giant Nestlé of US Dreyers Grand Ice (CHF3.6bn.), and the acquisition by pharmaceutical group Roche of the US diagnostic company Igen Inc (CHF0.8bn.). Some of the most important inbound transactions included the public takeover of Centerpulse by the US Zimmer group, the acquisition of Gaba Holding by Colgate Palmolive and the takeover of Bon-appétit group by the German Reve Konzern. The failure of the family owned Erb group was the biggest collapse in Switzerland since Swissair and led to a sell-out of the Erb group companies. As a consequence, the Belgium Alcopa group acquired part of the Erb automotive business, Arbonia Forster group bought the kitchen producer Piatti and Auto-Interleasing took over the Erb finance and leasing arm. Closure is expected shortly of the sale of the world's second largest coffee trader Volcafé, that also belongs to the Erb group.

SWX Swiss Exchange (SWX)

SWX announced the closing of the New Market by March 31, 2004. After that date, all new market companies will be automatically listed in the main segment. For financial years commencing on or after January 1, 2005 (fiscal 2005), only IFRS[3] and US GAAP[4] will remain as officially recognised accounting standards for companies whose equity securities are listed in the main trading segment of SWX.

In the fall of 2003, the SWX Admission Board proposed new rules on the obligation to disclose management transactions in relation to listed companies. Generally, transactions must be disclosed when the following thresholds are reached by the sale or acquisition of shares: 5%, 10%, 20%, 33.3%, 50% or 66.6%. The proposed new directive, to be published in the final version in the first quarter of 2004, requires additional transparency for "directors' dealings" of members of the board of directors and of the management board of listed companies. All transactions in financial instruments of the company to which they belong, carried out directly or indirectly and exceeding a threshold of CHF100,000, must be reported to the company within four exchange days. The company is then required to forward the report to SWX, within two exchange days, for publication on the SWX website. The name of the person concerned is not published, only an indication of their position.

Regulatory framework for M&A transactions in Switzerland

Contract law aspects

Generally, foreign investors use (newly-formed) Swiss entities as vehicles to carry out acquisitions in Switzerland. The acquirer may choose to purchase a majority (51%, 67%) or all of the shares and voting rights (share deal) or to cherry-pick certain assets and liabilities (asset deal). Alternatively , the acquirer might consider merging with the target or subscribing for newly issued shares.

Since most companies in Switzerland are controlled by a limited group of shareholders, M&A transactions are most commonly effected through share deals. Interestingly, this also applies to listed companies, since the majority of them are controlled by a limited number of private shareholders. Only about one fourth of the companies listed on the SWX are really controlled by public shareholders who hold more than 50% of the voting rights.

In certain cases, however, asset deals are preferable or even imperative. This is particularly so if only part of a business is acquired; if the target disposes of liabilities that are uncertain, unknown or very significant and effective warranties are unavailable; or if the target is in a poor financial situation. In the past, asset deals were technically rather complicated since a detailed enumeration and the singular transfer of each acquired asset and the consent of all contract parties[5] was required. In addition, creditors had to consent to

the acquirer's assumption of the target's debts, unless the entire business was transferred. The new Swiss Merger Act[6] will substantially simplify asset deals (see section on new legislation).

Apart from a few mandatory rules, Swiss contract law[7] grants to the parties of purchase agreements a relatively broad flexibility. In practice, under Swiss law purchase agreements may be drafted in one of the national languages or in any other language, in particular in English. The main focus of a purchase agreement should be on the description of the purchased object and the determination of the purchase price. Generally, the price will either be based on the balance sheet or the earnings of the target, with payment of the purchase price usually being made either in cash or in shares.

A precise and comprehensive wording of the representations and warranties, which are normally included in Swiss purchase agreements, is important. Under Swiss law, statutorily implied warranties for a share deal only relate to the title of the shares (and the certificates), but not to the underlying business. Therefore, the purchaser should insist on specific representations and warranties regarding the acquired business and companies (e.g. incorporation and corporate governance, compliance, financial information, liabilities, contracts, taxes, etc.). On the other hand, the seller will most likely want to limit its liability (as far as permitted under Swiss law) by agreeing on a de minimis limit and/or a cap for warranty claims. In particular, conditions constituting a breach of warranty and the procedures for resolving such breaches should be precisely defined. Swiss law provides that every buyer has a duty to examine purchased goods as soon as reasonably possible and to inform the seller of any defects immediately. The purchaser may also rescind the agreement under certain circumstances, in particular if representations and warranties prove to be false, along as the right to do so has not previously been waived. Quite often the parties will exclude this right, since rescission does not normally provide an acceptable solution for warranty problems. The seller is not liable for any defects in the purchased goods of which the purchaser had knowledge. This is particularly relevant if a due diligence examination has been carried out prior to the signing. The statutory period of limitation is one year unless, it is extended by the parties in the purchase agreement.

Corporate law aspects

The application of corporate law has various implications for M&A transactions. For instance, it might be necessary to adapt the legal structure of the target in connection with the transaction, approvals may have to be sought and publications and filings must be made (e.g. to the commercial register). A few of these aspects are highlighted in what follows.

For liability, and other reasons, due diligence reviews are standard in most M&A transactions in Switzerland. In practice, it is essential for the seller to organise an up-to-date and well-structured data room containing all documents and information relevant to the transaction. This allows the seller to control the information flow, structure the selling process, and thereby to control the transaction. The collection and organisation of the documents must be planned well in advance. For secrecy reasons, it is often recommended that the data room be set up at a location separate from the premises of the target and that the number of persons involved in the transaction is strictly limited . For the purchaser, the due diligence review is also of the utmost importance. Unlike in other European jurisdictions, private companies in Switzerland are not required to publish any financial information and, under Swiss statutory accounting principles, they are even allowed, to a certain extent, to build up hidden reserves. This substantially influences the clarity of financial data, meaning that the purchaser will often need the additional comfort afforded by conducting a financial due diligence review. Furthermore, appropriate representation and warranty clauses, especially with regard to the accuracy and completeness of the financial data and the absence of contingent liabilities, are usually included in the purchase agreement. Due diligence reviews should, at the very least, cover the legal, tax/ VAT and financial aspects of the target. In addition, environmental, insurance, IT, or other aspects, depending on the particular situation, should be closely examined.

The assets and liabilities of a Swiss company may be absorbed by means of a statutory merger. Mergers take place based on the recent financial statements of the absorbed company (max. six month old). Apart from regulatory approvals, the approval by the general meetings (and/or the board) of the companies involved are required. Additionally, the merger must be registered in the commercial registry and specific creditor and shareholder protection measures will apply. Shareholders of the absorbed company must be compensated either with shares of the absorbing company or with a cash payment (cash out merger)[8]. Minority shareholders (up to 10%) might be squeezed out against payment of the market value of their shares by means of a statutory merger.

EU law compatibility

Generally, Swiss company law is compatible with EU law, particularly since its overall reform in 1992. Most of the relevant EU directives in the field of company law were incorporated into Swiss law on an

independent basis[9]. However, Swiss company law also contains certain material, and in practice important, differences to EU law[10]. In particular, the transparency requirements and the financial reporting standards for non listed companies are not in line with EU standards. Swiss company law does not require a "true and fair view" in financial reporting and still allows for hidden reserves and earnings for non-listed companies[11]. Foreign investors should keep this in mind when examining investments in Switzerland.

Public takeovers

According to the Swiss Stock Exchange Act (SESTA)[12] the conclusion of an acquisition agreement regarding a participation in a listed company having its domicile in Switzerland must be reported to the stock exchange and the company within four trading days if the purchaser (or several purchasers acting in concert) thereby reaches, exceeds or falls below the following thresholds: 5%, 10%, 20%, 33.3%, 50% or 66.6% of the voting rights. Certain exceptions apply or might be requested. Listed companies in Switzerland are also required to disclose in their annual report the names of all shareholders holding more than 5% of (or options for) the voting rights.

If a shareholder exceeds a participation of 33.3% of the voting rights, then he has an obligation under the SESTA to submit a takeover offer to purchase all of the existing securities of the target company. Voluntary public takeovers are also permissible under Swiss law. In their articles of incorporation, companies may raise the threshold for a public takeover offer to 49% (opting-up) or might even exclude that obligation (opting-out). SESTA regulates both friendly and unfriendly takeover offers and also addresses share buy backs by the company itself. Basically, the public takeover offer must be submitted within two months after the acquisition of the participation. Since the bidder must disclose the purchase of the shares (those which exceed the above-mentioned thresholds) within four stock exchange trading days, a preliminary announcement of the takeover offer and price may be made. Thus, the bidder can fix the price and limit the target's options to take defensive measures. In this case, however, the offer must be made within six weeks from the preliminary announcement.

Public takeover regulations are controlled by the Takeover Board, which is subordinate to the Federal Banking Commission. The Takeover Board may, in particular, grant exceptions from the obligation to make a public takeover offer (e.g. for temporary of intra group transfers, for debt restructuring purposes). The bidder must submit an offer prospectus to the Takeover Board, which contains all relevant information necessary to make an informed decision regarding the takeover offer. The prospectus must be reviewed by a recognised accounting firm or stock broker. Normally, takeover offers are subject to certain conditions precedent (e.g. regulatory approval, inscription in the shareholders book as shareholder with voting rights, capital increase for financing the takeover, new appointments to the board of directors of the target, etc.). The bidder might also reserve the right to withdraw the offer in certain cases. The takeover offer must be open at least 20, and not more than 40, trading days and the pricing of a public takeover offer is subject to certain restrictions.

After a successful takeover, the squeeze-out of minority shareholders is possible if the bidder holds more than 98% of the voting rights. The bidder must file a lawsuit against the target company and ask for the invalidation of the respective shares against payment of the offer price within three months after the completion of the offer.

The board of directors is only allowed to take defensive measures against hostile takeovers prior to the announcement of a public takeover (pre-bid). For instance, the articles of incorporation may provide for preferred voting rights or voting limitations, restrictions regarding the transferability of shares or stricter voting quorums. The company can also repurchase up to 10% of its own shares on the market or may insert certain clauses in contracts (change of control, golden parachutes, etc.).

Taxes

For individual shareholders the profit realised by selling shares under Swiss tax laws normally constitutes a tax free capital gain. Therefore, sellers in Switzerland generally prefer share deals over asset deals. Companies held by private shareholders often retain earnings and do not make dividend payments over several years in order to benefit from a tax-free capital gain if the company is sold. In particular, if the purchaser (partially) finances the acquisition with reserves of the target company itself (e.g. through loans or stock dividend payments or if the target is merged with the acquisition vehicle), then the tax authorities might consider this as a so-called "indirect partial liquidation" with the consequence that the seller is not entitled to a tax-free capital gain for the profit made on the sale. To avoid this, sellers will probably insist on clauses in the purchase agreement which make the purchaser liable if the capital gain is taxed due to any action of the purchaser. Buyers, on the other hand, will want to limit their exposure for the tax liabilities of the seller. In practice, parties usually request a binding opinion (tax ruling) from the competent tax authorities in order to limit such tax risks. Furthermore, the seller may be considered a

securities dealer or the transaction could be taxed as income based on tax evasion, particularly if the sale is made to a company controlled by the seller(s).

The sale of assets is normally taxed for individual and company sellers (direct taxes). In the case of a potential sale, business assets are often transferred to a new company. Depending on the structure of the asset deal, the seller might, for tax reasons, have to observe a five year waiting period before selling the shares. The transfer of assets is principally subject to Swiss Value Added Tax (VAT). The tax can be accounted for by a declaration to the Federal Tax Authorities within 30 days of the asset transfer.

Foreign investors might benefit from certain tax incentives which most of the Cantons grant to attract new companies. Incentives range from a complete tax holiday (up to 10 years) through reduced taxation for a certain period to administrative aid.

M&A transactions bear many tax risks, but there may also be an opportunity to optimise the structure from a tax point of view. Therefore, tax issues should be addressed early in a transaction and a tax specialist should be employed.

Employment matters

Statutory employee protection measures in Switzerland are relatively moderate compared to other European jurisdictions. However, Swiss law provides certain rules which must be considered in M&A transactions. Specifically, sellers have information and consultation duties in asset deals. Employees never have the right to approve a transaction. If a business or part of it is transferred, basically all employment contracts are transferred along with the business. In such case, the employees have the right to terminate their individual employment contracts by working the relatively short statutory notice period rather than their contractual notice periods. This is of particular significance for contracts of the upper management or of key persons, which usually contain longer contractual notice periods.

Foreign nationals enjoy only restricted access to work in Switzerland and the percentage of foreign workers allowed is based on a strict quota system. Foreign investors are not free to reinforce the staff of a Swiss target company with foreign employees. There are certain guidelines and regulations which must be followed. However, for specialists and top management employees, work and residence permits are normally obtainable without major difficulties. Basically, foreigners are required to seek a work and residence permit before beginning to work in Switzerland. It is important to note, however, that EU-citizens may enter the Swiss labour market with much more ease than other foreigners[13]. In any case, although EU citizens do not have to meet such high standards for entry as other foreign nationals, foreigners are required to file for a work and residence permit with the Cantonal authorities. Any person in violation of the work permit regulations may be prosecuted.

Another area which must be closely examined in any M&A transaction is the pension regulations, since they vary substantially in different enterprises. In Switzerland, pension funds are allocated to separate legal entities with different management bodies. Legally, they do not belong to the employer. Therefore, the acquisition of a Swiss company does not automatically include the employee pension fund. Specific clauses regarding the pension regulations must be included in purchase agreements and issues such as the adaptation of the pension organisation and regulations, governmental approvals, the transfer of funds, the treatment of surpluses and, most importantly, the loss of funds must be addressed.

Other regulations

Foreign investors are allowed to purchase shares or assets of Swiss enterprises without material restrictions and without a need for governmental authorisation. Certain exceptions apply for regulated industries, such as banks, and for the acquisition of real property.

The acquisition of real property in Switzerland by foreigners is regulated by the so-called "Lex Koller."[14] Foreign individuals or companies controlled by foreigners must receive governmental authorisation in order to buy real property in Switzerland if the property involved is not used as a permanent establishment. The acquisition of the controlling position of a Swiss company (the rule of thumb is one third or more of the shares or voting rights) is subject to governmental approval if the purpose of the company is to hold, acquire or sell real property or if an operating company owns land reserves of a certain value. Transactions violating the provisions of Lex Koller are considered null and void, the inscription in the land registry will most probably be refused, and violators may be punished with criminal sanctions. It is obvious, therefore, that compliance with Lex Koller is essential. When in doubt, it is recommended that the buyer analyse the particular situation in depth and seek confirmation by the competent authorities in advance.

"Concentrations" that have an effect on the Swiss market are subject to the Swiss merger control regulations, as laid down in the federal law on cartels and one respective ordinance[15]. If it is likely that the transaction will have an impact on the EU common market, then the companies are also required to comply with EU law, especially with the merger control directive. The Swiss and EU merger control procedures might well run in parallel. The definition of

a concentration under Swiss cartel law is broad and includes not only mergers (incl. exchange of shares), but also the acquisition of a controlling majority (reaching a decisive influence) and concentrative joint ventures. The aim of the cartel law is to examine, and if necessary, prevent, the creation of structures which may have a harmful effect on competition in Switzerland. In principle, the Federal Competition Commission must be given notice of concentrations prior to the completion of the transaction. However, the following thresholds must be reached:

- combined world-wide reported turnover of at least CHF2bn or reported sales in Switzerland of at least CHF500m; and
- more than CHF100m individual reported turnover in Switzerland of at least two of the enterprises concerned. Enterprises with a dominant market position in Switzerland have a duty to notify, irrespective of these thresholds. Merger control procedures might take anywhere from one month, if no further examination is considered necessary, to five months, where further procedures are initiated.

New legislation

Swiss Merger Act[16]

The new Swiss Merger Act comes into force on July 1, 2004 and represents a new codification of the various instruments for company restructurings in Switzerland.

Among other things, the Merger Act allows the merger of companies as debt restructuring measures, triangular mergers (compensation with shares of a third company), and cash out mergers. In a merger agreement, the parties may agree to a compensation in cash, in the shares of the surviving company, or a choice of either. It is now possible to squeeze out minority shareholders by a majority vote of at least 90% against reimbursement of the real value of their shares in cash. Furthermore, there will be a loosening of the approval requirements and intra-group mergers and spin-offs are being simplified.

One key instrument of the new law is the possibility of transferring business assets and liabilities based on an inventory. This substantially facilitates asset deals in Switzerland. Enterprises registered in the commercial registry may choose to transfer assets and/or liabilities by simply registering the transfer in the commercial registry without the need to observe the transfer requirements for each single item.

Limited liability companies

The law applicable to limited liability companies (LLC) is undergoing a reform. The new LLC law will raise the minimal capital requirements for LLCs from the current minimum of CHF20,000 to CHF40,000 and at the same time abolish the maximal limit, which is currently at CHF2m. Larger LLCs will have to have their annual reports audited. The incorporation of LLCs and also stock corporations by a single individual will be permitted. Through the reform the LLC will become an even more interesting vehicle for carrying out acquisitions of smaller businesses or for joint ventures. In particular, it is possible to impose duties on the shareholders directly in the by-laws of an LLC, which is not the case for stock companies.

Notes:

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3 All the norms (IAS, SIC, IFRS, IFRIC) issued by the IASB (International Accounting Standards Board) are collectively referred to as IFRS (International Financial Reporting Standards).

4 US GAAP (United States Generally Accepted Accounting Principles).

5 except employment, lease and insurance contracts.

6 Federal Act on Merger, Demerger, Conversion and Transfer of Assets and Liabilities (Merger Act), available in English under www.amcham.ch/publications/m_obligations.htm.

7 Swiss Code of Obligations (CO), available in English under http://www.amcham.ch/publications/m_obligations.htm.

8 For tax reasons, however, this might not be favourable for individual shareholders.

9 Lately the Third EU Company Directive on Mergers (78/855/EEC) and the Sixth Company Directive on Spin-offs (82/891/EEC) were incorporated in the new Swiss Merger Act (see footnote 6).

10 For an overview of the company law see Baudenbacher, Carl, Aspekte der Europakompatibilität, Der Schweizer Treuhänder 1991, page 608 et seq.; regarding the new Federal Merger Act see Nufer, Marc, Die Europakompatibilität des neuen Schweizeischen Fusionsgesetzes, in Carl Baudenbacher (Hrsg.), Aktuelle Probleme des Europäischen und Internationalen Wirtschaftsrechts, Basel 2002.

11 For listed companies, however, the "true and fair view" principle applies, see Art. 66 SWX listing rules

12 Federal Act on Stock Exchanges and Securities Trader (SESTA), available in English under http://www.copa.ch/intro_en.html.

13 Exceptions and transition periods apply, in particular for citizens of the new eastern EU countries.

[14] Former "Lex Friedrich", i.e. Federal Act on the Acquisition of Real Property by Foreigners, available under http://www.ofj.admin.ch/e/index.html. The Lex Koller is currently being partially reformed.

[15] Federal Act on Cartels and other Restraints on Competition (ACART), available under http://www.weko.ch/site/e/gesetze.html. Please note that the ACART and in particular the sanction regime was modified substantially.

[16] (see footnote 6)

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