SWITZERLAND

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In 2002 the overall number of transactions in Switzerland was 13% lower than in 2001. The number of mergers decreased by 20% and cross-border takeovers by Swiss enterprises decreased by 50%. However, in 2002 the number of co-operations considerably increased. The following trends were observed: enterprises chose to co-operate rather than merge, transactions between Swiss companies increased and, finally, a large amount of transactions involved only business units or divisions, rather than entire enterprises.

Highlights and trends 2002

M&A transactions

M&A transactions included among others Zürcher Kantonalbank that purchased the participation in BK Vision, Pharma Vision and Spezialitäten Vision from Mr. Ebner to clear a substantial financial engagement. RMF Investment Corp. was taken over by British Man Group and St. Galler Kantonalbank acquired Hyposwiss Zürich. Lombard Odier & Cie. and Darrier Hentsch & Cie. combined to the private bank Lombard Odier Darrier Hentsch & Cie. (LODH). The regional banks Valiant, Luzerner Regionalbank and IRB Interregio Bank combined under the common holding roof of Valiant Holding AG. In 2002 Nestlé made two major acquisitions in North America: the US ice cream business was merged into Dreyer's and the acquisition of Chef America, Inc. was announced, a leading US-based frozen food product business. Novartis on one hand purchased Slovenian generics group Lek and sold its food and beverage business to Associated British Foods. Roche made a public takeover offer for the shares of Disetronic in early 2003 and Berna Biotech acquired Dutch Rhein Biotech by a public takeover. The Swiss arm of Accounting firm Ernst & Young took over the business of Arthur Andersen in Switzerland after the worldwide network of the latter collapsed.

A number of Swiss companies went through restructurings and several acquisitions took place in the course of bankruptcy or creditor protection procedures during 2002. The most prominent and highly discussed example was SAirGroup (the parent company of the former Swissair), which filed for creditor protection in October 2001. During the course of this procedure, the flight operations were transferred to former Crossair, which thereafter was renamed "Swiss" (Swiss International Airlines Ltd.). So far the following SAirGroup companies were sold: Atraxis, Gate Gourmet, Nuance Group, Swissport, and SR Technics Group. Another Swiss company that attracted public attention by seeking for creditor protection was Swiss Dairy Food that ended up being sold to six different companies.

Stock exchange/capital markets

The bearish stock market in 2002 supported a trend of share capital reductions and share buy-backs[1]. Only a few, but rather weighty, capital increases were instituted by Zurich Financial Group (Sfr3.7bn) and Swiss (Sfr2.3bn), among others. At the same time, new listings at the SWX Swiss Exchange were rare: the main segment saw only one rather small IPO (Precious Woods, Sfr11mn). A biotech start-up company, Cytos Biotechnology, also became listed on the main segment after taking over the already-listed Asklia through means of a reverse takeover. Comet and the investment company ProgressNow! changed their listing from the BX Berne Exchange to the main segment of the SWX.

During 2002, SWX closed down the listing segment "new market" after only three years. The decision was made after several candidates, in light of the unfavourable market conditions, postponed or even cancelled their IPOs. Since fall 2001 no new IPOs have taken place in the SWX "new market".

The Admission Board of SWX decided to only allow IFSR[2] and US GAAP[3] accounting standards in the main segment of SWX. All annual financial reporting will have to meet these accounting requirements beginning in business year 2005 and intermediary financial statements in 2006. It is important for listed companies to prepare previously reported financial data in a way that will allow sufficient comparability with that prepared under the new accounting standards.

Furthermore, SWX also adopted a Corporate Governance Directive[4] in 2002. The directive urges the issuers of securities at SWX to release certain information regarding corporate governance in their annual reporting. The principle "comply or explain" is applicable, meaning that everything not disclosed

requires a substantial explanation. The management activities of the directors and members of management, including the basis and elements of their compensation (inclusive of golden parachutes), must be disclosed. This is limited, though, to details concerning the members of the board and the management as an entire group, and no details of individual members are required. Supplemental to the Corporate Governance Directive is the "Code of Best Practice"[5] recently issued by Economie Suisse, the leading Swiss business association. This code contains non-binding recommendations for the corporate governance of listed and non-listed companies.

Regulatory framework for M&A transactions in Switzerland

Commercial law aspects

Generally, foreign investors use (newly-formed) Swiss entities as vehicles for carrying out acquisition transactions in Switzerland. The acquirer may either purchase all or merely a majority (50%, 66 2/3%) of the shares and voting rights (share deal) or only certain assets and liabilities (asset deal), or might merge with the target or subscribe for shares which have been issued for the purpose of the acquisition.

Since most companies in Switzerland are controlled by a limited group of shareholders, M&A transactions are most commonly effected through share deal. 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 at SWX Swiss Exchange are really controlled by public shareholders that hold more than 50% of the voting rights.

In certain cases, however, asset deals are preferable or even imperative, in particular if only part of a business is acquired, if the target disposes of liabilities that are uncertain, unknown or very significant and if sufficient warranties are unavailable or if the target has financial problems. Asset deals in Switzerland generally present more technical difficulties than share deals. In particular, asset deals require the detailed enumeration and the singular transfer of each acquired item pursuant to the respective statutory requirements (i.e. a public deed for real property, shares of limited liability companies, etc.). Entire contracts may only be transferred with the consent of the other contracting party, except employment, lease and insurance contracts, which may be transferred under certain conditions. In general, creditors must consent to the acquirer's assumption of the target's debts unless an entire business is transferred. In such a case, the seller remains jointly and severally liable for all liabilities of the transferred business for a period of two years. The former employer in particular remains jointly liable for all existing employment obligations for a certain period of time. There is a controversy if this also applies if a business is taken over in connection with a financial restructuring.

In general, Swiss contract law[6] leaves relatively broad contractual flexibility to the parties of purchase agreements and it contains only few mandatory rules. In practice, purchase agreements under Swiss law 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 a 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) either 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 need to be precisely defined.

Swiss law sets forth that every buyer has a duty to examine purchased goods as soon as reasonably possible and to immediately inform the seller of any defects. The purchaser may also rescind the agreement under certain circumstances, in particular if representations and warranties prove to be false, if such right has not previously been waived. Quite often the parties will exclude this right, since a rescission normally does not provide an acceptable solution for warranty problems. The seller is not liable for any defects of 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.

Public takeovers

According to the Swiss Stock Exchange Act (SESTA)[7] 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, $33^{1/3}$, 50 or $66^{2/3}$% 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 $33^{1/3}$% 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 or intra-group transfers, for debt restructuring purposes). The bidder must submit to the Takeover Board an offer prospectus 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 foresee certain clauses in contracts (change of control, golden parachutes, etc.).

Corporate law aspects

Corporate law has various implications for M&A transactions. For instance, the seller and/or purchaser might be restructured in connection with the transaction and approvals, publications and filings must be made (e.g. to the commercial register). In the following paragraphs only a few of these aspects are highlighted.

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 for the transaction. This allows the seller to control the information flow, structure the selling process, and 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 to strictly limit the number of persons involved in the transaction. For the purchaser, the due diligence review is also of decisive 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 hidden reserves. This substantially influences the clarity of financial data, meaning that the purchaser will often need additional comfort by conducting a financial due diligence review. Furthermore, respective representation and warranty clauses, especially with regard to the accuracy and completeness of the financial data and the absence of contingent liabilities, are included in the purchase agreement. Basically, due diligence reviews should at least cover 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.

By means of a statutory merger, the total assets and liabilities of a Swiss company may be absorbed.

Mergers need to be based on the recent financial statements (balance sheet) of the absorbed company. Apart from regulatory approvals, the approval by the general assemblies (and/or the board) of the involved companies are required. Additionally, the registration of the merger in the commercial registry is required and specific creditor protection measures apply. Shareholders of the absorbed company must be compensated with shares of the surviving company and only limited cash payments are allowed.

Taxes

For individual shareholders the profit realised by selling shares normally constitutes a capital gain that is tax-free under Swiss tax laws. 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 being that the seller is not entitled to a tax-free capital gain for the profit made on the sale. To avoid this, sellers will most likely 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. For tax reasons, the seller will most likely then have to wait five years before selling the shares. The transfer of assets is principally subject to Swiss Value Added Tax (VAT). The tax can be accounted for by declaration to the Federal Tax Authorities within 30 days after 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 holidays (up to 10 years) to 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. In no event do employees 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 contract by meeting the relatively short statutory notice period rather than eventual 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 have 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. This in particular applies since the bilateral treaties, signed between Switzerland, the EU and the EU member states entered into force in 2002. In any case, although EU citizens do not have to meet as 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 an 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 of all the loss of funds must be addressed.

Other regulations

Foreign investors are basically 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."**[8] Basically, 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 (rule of thumb: 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 likely be refused, and violators may be punished with criminal sanctions. Therefore, 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" having 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[9]. 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 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: (i) combined world-wide reported turnover of at least Sfr2bn or reported sales in Switzerland of at least Sfr500m and (ii) more than Sfr100m 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 the said thresholds. Merger control procedures might take anywhere from one month, if no further examination is considered necessary, to five months, if further procedures are initiated.

New legislation

Merger act

The Merger Act[10] is expected to be adopted by the parliament in 2003 and will enter into force approximately in 2005. On one hand, the Merger Act will be a Swiss adaptation of European Directives in the area of corporate law. On the other hand, the Merger Act will reform and codify the various instruments for company restructurings and presents a modern and comprehensive federal law that will introduce useful instruments for M&A transactions in Switzerland.

Among other things, the Merger Act will positively allow 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 shares of the surviving company, or a choice of either one. It will also be 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, approval requirements will be loosened and intra-group mergers and spin-offs simplified. One key reform is the possibility of transferring business assets and liabilities based on an inventory, which will substantially facilitate asset deals in Switzerland. Enterprises registered in the commercial registry may choose to transfer assets and/or liabilities by registering the transfer in the commercial registry without having to observe the transfer requirements of each single item.

Limited liability companies

The law applicable to limited liability companies (LLC) is also undergoing a reform. At this stage of the process, it should be noted that the current restrictions regarding foreign board members of Swiss companies will be abolished in all probability before 2004. The other provisions of the amendment of the LLC law will enter into force after the Merger Act.

The new LLC law will raise the minimal capital requirements for LLCs from the current minimum of Sfr20,000 to Sfr40,000 and at the same time abolishes the maximal limit, which is currently at Sfr2m. Larger LLCs will be required to have their annual reports audited. The incorporation of LLCs and stock corporations by a single individual will be permitted.

Notes:

1. A comprehensive list of share buy back transactions can be found under http://www.copa.ch/intro_en.html

[2] International Financial Reporting Standards (IFRS) are issued by the International Accounting Standards Board (IASB) and include IAS, SIC IFRS, IFRIC

[3] United States Generally Accepted Accounting Standards (US GAAP)

[4] SWX Swiss Exchange Directive on Information regarding Corporate Governance, available in English under http://www.swx.com/admission/admission_en.html

[5] available under www.economiesuisse.ch

[6] Swiss Code of Obligations, available in English under http://www.amcham.ch/publications/m_obligations.htm

[7] Federal Act on Stock Exchange and Securities Trader (SESTA), available under http://www.copa.ch/intro_en.html

[8] 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.

[9] Federal Act on Cartels and other Restraints on Competition (ACART), available under http://www.weko.ch/site/e/gesetze.html. The ACART is currently being reformed

[10] Federal Act on Mergers, Spin-offs, Transformations and Transfer of Business (Merger Act), available under http://www.ofj.admin.ch/d/index.html

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