

Swiss Commercial Law Series

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**Swiss
Mergers & Acquisitions
Practice**

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Abbreviations

References to Acts and Ordinances are to the original Acts and Ordinances as amended

ARR/FER	Accounting and Reporting Recommendations (‘Fachempfehlungen zur Rechnungslegung’)
BGE	Decision of the Swiss Federal Supreme Court (‘Bundesgerichtsentscheid’)
Cartel Act	Federal Act on Cartels and other Restraints on Competition of 6 October 1995
CC	Swiss Civil Code of 10 December 1907
CHF	Swiss francs
CO	Federal Code of Obligations of 30 March 1911
E	Spain
F	France
FBC	Federal Banking Commission
G	Germany
IAS	International Accounting Standards
Lex Koller	Federal Act on the Acquisition of Real Property by Foreigners of 16 December 1983
Merger Act	Federal Act on Mergers, Separations, Transformations and Transfers of Businesses (not yet in force)
SESTA	Federal Act on Stock Exchanges and Securities Trading of 24 March 1995 (Stock Exchange Act)
SESTO	Ordinance on Stock Exchanges and Securities Trading of 2 December 1996
SESTO-FBC	Ordinance of the Federal Banking Commission on Stock Exchanges and Securities Trading of 25 June 1997
SPC	Swiss Penal Code of 21 December 1937
TO	Ordinance of the Takeover Board on Public Takeover Offers of 21 July 1997
UK	United Kingdom
US	United States of America
US GAAP	Generally Accepted Accounting Principles

I Introduction

1 Switzerland's Political and Economic Background

Switzerland has been a *federal state* since 1848. Today, the confederation comprises 26 cantons (states), each with its own constitution, parliament, government and courts. Cantons are sovereign insofar as their sovereignty is not limited by the *Federal Constitution*. In particular, the cantons retain legislative authority to organize the judiciary and civil justice, while legislation in the field of civil procedure and civil law, including corporate and securities laws, is a federal matter.

The political situation in Switzerland is very stable despite its different cultural backgrounds and one of the highest population densities in the world, with a population of 7.2 million at the end of 2000. Switzerland's four major political parties have shared power in the *Federal Council* – the federal executive body – for more than thirty years.

Traditionally, Switzerland's international relations have been determined by a policy of armed neutrality. However, this has not prevented Switzerland from participating in UN sanctions, for example during the Gulf crisis. Switzerland is a member of the *Council of Europe*, the *European Free Trade Association* (EFTA), the *Organization for Economic Cooperation and Development* (OECD) and has been a signatory of the *General Agreement on Tariffs and Trade* (GATT). Switzerland joined the *World Trade Organization* (WTO) in summer 1995 and the *International Monetary Fund* and the *Bretton Woods Institutions* in 1992. In the same year, Swiss voters decided against joining the *European Economic Area* (EEA), which was created to assure a common market for the *European Union* (EU) and the EFTA countries. Since then, despite a somewhat ambiguous relationship with the EU, Switzerland has sought to make Swiss laws and regulations compatible with EU directives on a voluntary basis, especially in the field of commercial law. On 21 June 1999, Switzerland and the EU signed seven bilateral agreements covering civil aviation, overland transport, free movement of persons, research, public procurement markets, agriculture and elimination of technical barriers to trade. The agreements need to be ratified and are expected to come into force in 2001.

The Swiss gross national product reached CHF 389 billion in 1999 (up 2.4 per cent from 1998), which represents one of the highest per capita GNPs of all industrialised countries. Switzerland's unemployment rate had been below one per cent for years, until it rose above 2 per cent in 1992, only to drop below 2 per cent again in May 2000. Today, 60 per cent of the working population are employed in the service sector.

A total of CHF 60.6 billion was raised on the Swiss capital market in 1999 (up from 57.5 billion in 1998), and foreign issuers accounted for 56 per cent of this sum. At the end of 2000, interest rates for 10-year Swiss treasury bonds stood at about 4 per cent, the SWX Swiss Exchange ranked ninth world wide in terms of capitalisation, having surpassed the CHF 1,200 billion level, and the Swiss performance index (SPI) closed at 5500 (1 June 87 = 1000).

2 Mergers and Acquisitions Activities in Switzerland

Mergers and acquisitions activities in Switzerland had been growing steadily, from 139 in 1980 to 194 in 1985 and 410 in 1990, until the figure dropped to a low of 220 in 1995 due to a recession. Since then, the number of publicly announced transactions has been on the increase again; in 2000, 378 mergers & acquisitions were reported.

A Swiss company or its business may be acquired by way of either a public takeover bid or a private acquisition agreement. Based on a private acquisition agreement control can be obtained in several ways, including (a) a purchase of a controlling block of shares from the shareholder of the target company, (b) a purchase of the assets and liabilities (collectively the business) of the target company, where the contract is entered into with the target represented by its board of directors, (c) a contract providing that the target company will increase its share capital (possibly by creating super voting stock) and that the acquirer will subscribe for all newly-issued shares, or (d) a merger agreement between the target and the acquirer.

The purchase of a controlling block of shares is the technique most commonly used. Many of Switzerland's corporations are either privately-held or controlled by a group of shareholders, even if listed on the SWX Swiss Exchange. Of all the listed companies only about 25 to 30 per cent are truly public, where more than 50 per cent of the share

capital is held by financial investors without co-ordinated strategic interests. Therefore, almost all acquisitions in Switzerland are made either by a *private agreement*, a *merger* or a *friendly takeover*. Although the usual type of consideration still involves cash payments, share-for-share deals have become increasingly popular. For example, the acquisition of *Winterthur Insurance* by *Credit Suisse* was successfully completed in a share-for-share transaction in 1997.

The most important Swiss companies acquired by foreign offerors over the past few years include *Feldschlösschen* (by Carlsberg/DK), *Swisscom Mobile* (Vodafone/UK), *Cablecom* (by NTL/US), *TAG Heuer/Ebel/Zenith* (by LVMH/F), *Keramik Laufen* (by Roca Radiatores/E), *Bally* (by Texas Pacific/US) and *Elektrowatt* (by Siemens/G). Conversely, important foreign entities have been purchased by Swiss companies, such as *Dobbs International/US* (by Swissair), *Olsten Group/US* (by Adecco), *Paine Webber/US* (by UBS) or *Donaldson, Lufkin, Jenrette/US* (by Credit Suisse).

Several *unsolicited takeover bids* have been made under the new takeover rules, which entered into effect on 1 January 1998, the most notable involving Deutsche Post International B.V. in relation to all registered shares of Danzas. The first *unfriendly takeover* under the new regime was carried out by *Tsufa* to acquire all bearer shares of *Big Star*.

The number of *management buy-outs* and *leveraged buy-outs* has been growing over the past few years as well: companies like *Saia-Burgess*, *Miracle*, *Phonak*, *Komax*, *Disetronic*, *Charles Vögele* and *Geberit* attracted considerable attention by going public following a management or a leveraged buy-out.

The *largest Swiss transactions* involved special forms of *mergers* by which existing parent companies formed a joint subsidiary into which they subsequently merged. This way Ciba-Geigy and Sandoz merged into *Novartis*, and Swiss Bank Corporation (SBC) and Union Bank of Switzerland (UBS) merged into *UBS AG*.

Finally, several important *spin-offs* and *cross-border combinations* were carried out recently, including the spin-off of *Ciba Specialty Chemicals* from Novartis, the spin-off of *Lonza Group* to the shareholders of algroup in view of the combination between algroup and Alcan Aluminium, and the spin-off of *Syngenta* from Novartis (as well as from AstraZeneca/UK).

The major Swiss banks and a number of specialized companies provide a whole range of *M&A services* – including searches for possible targets, evaluations of the merits of an envisaged transaction or arrangements relating to the necessary financing. Specialized law firms normally draft the acquisition agreement. However, since tax considerations greatly influence the drafting of the documents and the structuring of a transaction in general, tax advisors and legal counsel should closely co-operate, or lawyers should be involved who are capable of advising not only on corporate and securities laws but also on tax issues. Accounting matters are usually dealt with by the accounting firms.

There is a clear *trend in Switzerland* towards importing *Anglo-American M&A standards*, as to style and substance. This is true not only for privately agreed mergers & acquisitions agreements, where the American style is getting the upper hand, but also for hostile takeovers, where expressions such as *raider*, *white knight*, *poison pill*, *golden parachute* (see V.5.2) have now become part of Swiss legalese. Further changes in the Swiss mergers and acquisitions field can be expected in the wake of the imminent revisions of Swiss merger and tax laws (see II.1 below regarding the new Merger Act).

II General Considerations

1 Legal Sources

In 1881 the Swiss federal legislature enacted the *Federal Code of Obligations* ('CO'). Major revisions occurred in 1911, 1936 and in 1992 (regarding Swiss company law). In 1907, the *Swiss Civil Code* ('CC') was enacted, which entered into force in 1912. Together, these codes contain the bulk of the law concerning family and inheritance matters, property, contracts, torts, restitution, partnerships, as well as corporate matters and securities regulations.

While the law on movable and real property, as well as security interests, such as pledges, is laid down in the CC, the CO contains most of the relevant provisions in relation to the acquisition of Swiss companies and their organisation, including:

- Articles 620–763 CO regarding the organization of a corporation (in German 'Aktiengesellschaft' – 'AG', and in French 'Société Anonyme' – 'SA', *see* II.2.1 and II.3.1 below);
- Articles 748–751 CO on mergers of corporations;
- Articles 184–215 CO regarding the purchase of movables – including the purchase of shares;
- Article 181 CO concerning certain aspects of the transfer of a business.

Moreover, the CO provides rules regarding:

- the formation, performance, and consequences of breach, of contracts;
- the rescission of contracts on the grounds of material error or fraud;
- the employer/employee relationship;
- the assignments of claims and liabilities; and
- promissory notes.

In 2000 the Swiss Federal Council proposed a bill entitled the *Federal Act on Mergers, Separations, Transformations and Transfers of Businesses* ('Merger Act'), which is expected to enter into effect in 2001. The proposed law will replace the provisions on mergers and transformations contained in the CO and will close certain regulatory gaps. Its main purpose is to increase the flexibility of businesses changing their legal form and transferring assets and liabilities to different legal entities. In addition, partial revisions of various tax laws will ensure that re-organisations of Swiss companies are not unduly hindered by negative tax implications. The Merger Act will be concerned with the following corporate transactions:

- statutory mergers;
- demergers, or split-ups, where an existing company is split in two and where the shareholders of the existing entity will become shareholders of the two new companies;
- spin-offs where a part of the business of an existing company A is hived off to a company B in which the shareholders of company A will become shareholders as well;
- transfers of a business or parts of a business where the assets and liabilities in question are transferred by operation of law;
- transformations of companies.

The *Federal Act on Stock Exchanges and Securities Trading of 24 March 1995* ('Stock Exchange Act', 'SESTA') regulates stock exchanges, securities dealers, and insofar as listed companies are concerned, mandatory disclosures of shareholdings and public takeover offers. The provisions relating to disclosures of shareholdings and tender offers came into force on 1 January 1998.

Other relevant statutory regulations involve the banking sector, anti-trust or competition matters and the acquisition of real property by foreign residents (*see* III below). In practice, federal and cantonal tax laws also have an important bearing on the structure of a transaction (*see* II.5 below).

2 Swiss Business Organisations

2.1 *The Company Limited by Shares ('Corporation')*

Most businesses in Switzerland are organized as corporations ('Aktiengesellschaften' – 'AG' or 'SA'; *see* II. 1 above). The minimum share capital requirement is CHF 100,000. Prior to July 1992 it was CHF 50,000, and companies incorporated before 1985 are permitted to maintain a share capital of CHF 50,000.

In general, shareholders' obligations do not extend beyond the contribution of the issue price for the shares. The share capital may be increased by a majority vote of the shareholders in what is called an *ordinary share capital increase*, or, alternatively, out of authorized or conditional share capital. When creating *authorized share capital*, the shareholders authorize the board of directors to issue shares up to a pre-determined amount within a period of two years. *Conditional share capital* is used in connection with convertible bonds or option rights; it allows the holders of conversion or option rights to automatically determine the increase by exercising their rights. The shareholders' resolution necessary to create authorized or conditional share capital requires a majority of two thirds of the votes represented at the meeting and the majority of the nominal value of the shares represented (unless provided otherwise in the articles of incorporation). Authorized and conditional share capital may not exceed 50 per cent of the ordinary capital.

A reduction of share capital is also possible but requires, *inter alia*, a notice to the creditors.

For tax purposes, the maximum debt-equity ratio is generally six to one.

The *articles of incorporation* define organizational requirements. More specifically, the corporation must have a board of directors, auditors, and a shareholders' meeting, which must be convened at least annually. The board may manage the company itself, though many companies have chosen a two-tier system where a management runs the day-to-day business and the board of directors performs supervisory functions. If such a two-tier structure is to be adopted, the board must issue so-called *organizational rules*, which define the competencies of the board and the management. The majority of the directors of a Swiss corporation must be Swiss citizens resident in Switzerland,

subject to exemptions granted by the competent authorities in certain circumstances.

A corporation may issue bearer shares or registered shares. In the case of *bearer shares*, possession of the certificate is sufficient evidence of title, and a transfer is achieved by simple delivery of the certificates to the transferee. *Registered shares* are transferred by transfer of possession and by endorsement of the certificates. In addition, the transferee must be entered in the corporation's share register. Since July 1992 the following additional rules apply to registered shares:

If the *registered shares are not listed on a stock exchange*, the corporation can disapprove a transfer of all rights attached to the shares (Article 685c III CO) within three months of the request by asserting a valid ground for refusal, which must be defined in the articles of incorporation. It may also refuse to approve the transfer if it is prepared to repurchase the shares at their real value (Article 685b CO) either for its own account or for the account of a shareholder. Finally, the company may object against the transfer if the acquirer fails to confirm that he is purchasing the shares for his own account. Special rules apply where the shares are transferred by operation of law (succession, bankruptcy, etc.; see Articles 685b IV, 685c II CO).

If the *registered shares are listed on a stock exchange*, the company may refuse to approve the transfer but only in relation to the *voting rights* and based on a provision in the articles of incorporation stating that the interest of any single shareholder may not exceed a certain percentage. Many of the listed companies have adopted a 3 per cent limit, which also applies to shareholders acting in concert. Another possible ground for refusal by companies owning real estate is foreign nationality due to restrictions on foreign ownership of interests in such entities (see Article 4 of the transitory provisions to the CO and III. 2 on the so-called *Lex Koller*). For the purposes of registration, the acquirer must declare that he is holding the shares for his own account; furthermore there are special rules applying to transfers effected by operation of law (Article 685d III CO). Although the acquirer immediately becomes a shareholder upon purchase of the shares, his voting rights are suspended until he is approved as a shareholder by the company (Article 685f III CO). Notice of refusal must be given by the company to the transferee within 20 days, failing which the company is

deemed to have acquiesced in the transfer (Article 685g CO). A shareholder who is rejected under these rules must still be registered, albeit only as a non-voting shareholder.

Furthermore, the transferability of bearer and registered shares may be affected indirectly by provisions in the articles of incorporation *limiting the number of votes* a shareholder may cast in the shareholders' meeting. For example, prior to May 1989 Nestlé's articles of incorporation provided that no shareholder may represent more than three per cent of the entire share capital (including bearer shares and registered shares) in a shareholders' meeting; subsequently, bearer shares were abolished and Nestlé now has a single class of registered shares. Another example involves UBS prior to the merger with SBC. UBS had a clause in its articles limiting the number of votes a shareholder (or several shareholders acting in concert) could cast in a shareholders' meeting to 5 per cent. This notwithstanding, there has been a general trend in Switzerland towards either abolishing or relaxing any limitations of voting rights.

The company may issue bearer *and* registered shares, or registered shares with different nominal values. As the articles of incorporation may provide that every share carries one vote irrespective of its nominal value, *super voting shares* may be created by issuing, for example, registered shares with a nominal value of CHF 10 and bearer shares with a nominal value of CHF 50 (or any multiple of the nominal value of registered shares up to the tenfold, *see* Article 693 CO), to the effect that holders of registered shares will hold more voting rights relative to their investment. Since July 1992, however, super voting shares have been ineffective in connection with resolutions on certain important matters (*see* Article 693 III and 703 CO) due to the requirement that approval by the majority of the capital represented is required.

2.2 Other Types of Corporations

The limited liability corporation ('Gesellschaft mit beschränkter Haftung' – 'GmbH') and the co-operative ('Genossenschaft') are of minor practical importance. They numbered approximately 23,000 and 14,000 respectively at the end of 1999. Since 1992, when the minimum share capital for companies limited by shares was raised to CHF 100,000 and

when companies limited by shares were required to appoint qualified auditors, the number of newly formed limited liability corporations has increased, given that the minimum capital of such entities is only CHF 20,000 and auditors are in certain circumstances not required at all. However, the law relating to limited liability corporations is currently being revised to align it with the requirements applying to corporations.

2.3 Partnerships and Limited Partnerships

Comparatively few business entities in Switzerland are organized as partnerships. At the end of 1999, approximately 17,000 partnerships ('Kollektivgesellschaften') and 4,000 limited partnerships ('Kommanditgesellschaften') were recorded in the commercial register. Partnerships are often transformed into corporations before being sold because:

- an acquiring corporation may only become a limited partner;
- the transfer of shares is technically much simpler than the transfer of a business; and
- the seller may realize a tax-free capital gain from the sale of shares, whereas a profit resulting from the sale shares in a partnership will generally be taxed as income.

Tax authorities will only accept a tax-free transfer of the business from the partnership to the corporation if:

- each partner retains the same proportion of control; and
- each partner abstains from selling his shares for a period of at least five years.

Therefore, if partners consider selling their business, they are usually well advised to transform it into a corporation at least five years prior to the sale, despite the fact that corporate income – as opposed to partnership income – is taxed at two levels, the corporate level and the personal level (dividends). In order to minimize their tax burden, shareholders in a closely-held corporation can abstain from drawing dividends during the last years before the sale, and then sell their shares for a higher and (tax-free) consideration (*see* II.5 below concerning the limitations on this type of tax planning).

3 Corporate and Commercial Law Matters

3.1 Corporate Law Matters

Article 530 *et seq.* CO regulates the organisation of Swiss companies. The following chapters are concerned with corporations only (Article 620–763 CO), for corporations constitute the predominant legal business structure in Switzerland. Furthermore, Swiss company law lays down rules on the transferability of shares (*see* II.2.1) and defines the corporate action required to transfer shares or a business. In addition, the new Merger Act will deal with re-organizations of companies.

Approval by the shareholders of the acquiring or surviving corporation (‘acquirer’) is necessary if:

- the business of the target company is outside the statutory purpose of the acquirer – the shareholders must then approve changes in the articles of incorporation of the acquirer, which requires a resolution to be passed with a majority of at least two-thirds of the shares represented, combined with an absolute majority of the total share capital voted (*see* Article 704 I.1 CO);
- the consideration for the acquisition takes the form of shares (or equity linked bonds) – the shareholders must then approve an increase in the share capital in order to issue the shares, unless sufficient authorized share capital is available;
- under the new Merger Act, the merger agreement, the demerger or spin-off agreement, and the transformation agreement will each have to be approved by the shareholders’ meeting.

The *shareholders* of the *target* will have to approve the transaction by:

- selling their shares; or
- in the case of a merger or a sale of all assets followed by a liquidation of the company, by a resolution in the shareholders’ meeting (*see* Article 704 CO requiring a majority of two thirds of the votes represented in the meeting).

Special *disclosure requirements* apply if the transaction is financed by an *increase* in the *share capital* of the acquirer, irrespective of whether the subscribers pay in kind or in cash (Articles 650 II.4, 628,

634, 652e, 652f CO – *see* IV.3.3 below). The board will have to issue a report detailing how the valuation of the target company was made, and the auditors of the acquiring corporation will have to confirm that this valuation meets accepted standards (Article 652f CO). Moreover, a prospectus will be required if the shares are offered to the public (Article 652a CO).

A shareholder, or a group of shareholders, holding ten per cent or more of the share capital of a corporation may at any time request that the board of directors call a shareholders' meeting (Article 699 III CO) with a specific agenda – for instance, the election of new directors, who may have indicated that they will enter into a merger agreement or enter the acquirer into the shareholders' register.

The target is not required to give information regarding itself to the acquirer nor has the acquirer, even after the purchase of a majority of the target's shares, a direct right to inspect the shareholders' register in order to find out how to contact other shareholders. Rather, the acquirer will have to inform the shareholders about his offer through the press or other media (potentially subjecting the offer to the takeover rules). If the target has issued bearer shares, not even the target will be able, at least theoretically, to contact its shareholders, and will have to respond by public announcement as well.

Basic information may be obtained from the *commercial register*, such as:

- the contents of the articles of incorporation;
- the share capital;
- the number and types of shares; and
- the names of directors, managers and officers.

The records kept with the office of debt collection might give further indications as to the financial strength of the target company.

Except for listed companies and companies with listed bond issues, there is no requirement to publish financial statements. However, shareholders and creditors are entitled to receive a balance sheet and a profit and loss statement (Article 697h CO). Under the new Merger

Act, the shareholders of a Swiss company involved in a merger, spin-off, or transformation will be entitled to inspect the financial statements covering the last three business years. Although the accounting rules introduced in 1992 improved the required quality of financial information, many companies voluntarily comply with international accounting standards or the standards imposed by the fourth and seventh EU directives. A recent study has shown that out of the 40 leading companies 18 applied IAS, 17 the rules of the EU-directives and one applied US-GAAP. Listed companies which do not follow any of these internationally accepted accounting standards have to apply a local set of rules, commonly referred to as ARR/FER (*see* II.6.1.1), in accordance with the Listing Rules of the SWX Swiss Exchange.

In this context, it should be noted that balance sheets of Swiss companies often do not reflect the true and fair value of a company because the board of directors may form *hidden reserves* by undervaluing assets and making unnecessary provisions (*see* II.6.2 below). The main reason for the directors to create hidden reserves is that Swiss corporate taxes are based on statutory (unconsolidated) accounts; depreciating assets or creating provisions are thus means to reduce earnings relevant for tax purposes. In addition, as a corporation usually allocates part of the reported earnings to *free reserves*, the pay-out ratio of Swiss companies has traditionally been small in relation to their real earnings.

Since July 1992, corporations with listed shares must disclose their major shareholders in a note appended to the balance sheet (*see* Article 663c CO). Since 1998 shareholders holding more than 5 per cent of the shares in a Swiss company listed on a Swiss stock exchange have to disclose their holdings to the company concerned and to the stock exchange on which the shares are listed.

If securities are publicly issued, the CO requires the production of an ‘issue prospectus’ the contents of which are quite limited in scope (*see* Article 652a CO), as opposed to those of a ‘listing prospectus’ as per the Listing Rules of the SWX Swiss Exchange.

3.2 Commercial Law Matters

The acquisition of shares (including controlling blocks) of a corporation is regulated by Articles 184–215 CO relating to the sale of movable goods. Many of the rules contained in these Articles are not

mandatory and may be waived tacitly or by oral or written consent. In particular, Articles 190 and 214 (concerning default by either party), Article 185 (concerning the passing of risks and benefits with regard to the purchased shares or assets), and Article 192 *et seq.* (concerning breaches of representations and warranties) form the cornerstones to be considered when drafting a share purchase agreement.

In the event of a sale of a controlling block of shares, the Swiss Federal Supreme Court has held that statutory law does not imply terms into the agreement as to the state and condition of the underlying business and that the buyer will have to seek express representations and warranties in that regard to be legally protected. However, on various occasions the Court has allowed an acquirer to rescind the contract even in the absence of a warranty clause (*see* IV.3.4.1 below) if the net value of the business turned out to be considerably lower than expected on the grounds of ‘material error’.

Article 201 CO requires the buyer to examine the purchased goods as soon as possible and to object immediately if defects are uncovered. This also applies to the purchase of shares. Article 210 CO provides that all claims for defects of the purchased goods (or breaches of warranty) are time-barred unless the acquirer instigates court proceedings within one year of completion of the sale. Neither Article 201 nor Article 210 CO is mandatory, and legal counsel of the acquirer should insist on adapting these rules to the special circumstances (*see* IV.3.4.5 and IV.3.4.6 below).

Based on Article 205 CO the acquirer may rescind the contract if representations and warranties prove to be untrue. However, in many cases the seller will want the acquirer to waive this right (at least for the period subsequent to completion of the agreement) and confine himself to damages or indemnity payments for breach of contract by the seller (*see* IV.3.4.3 below). Finally, Article 200 CO stipulates that the seller shall *not* be liable for a breach of warranty if the acquirer knew the defects of the purchased good (or the underlying business), unless specific warranties as to the absence of such defects were given. Especially where an extensive due diligence has been carried out prior to signing the agreement, the acquirer should insist that the applicability of this clause be excluded in the contract.

4 Listed Companies

4.1 General

Whereas prior to 1997 the cantons were empowered to enact laws regarding stock exchanges and securities trading, SESTA introduced a comprehensive federal regime in relation to these matters. The respective provisions came into force on 1 February 1997. SESTA, besides regulating securities dealers, notifications of significant shareholdings, and tender offers, sets forth the general requirements to be met by stock exchanges seeking authorization from the Federal Banking Commission. The system is basically one of self regulation, leaving the production of rules for listing and trading to the stock exchanges. The most important stock exchange authorized under SESTA is the *SWX Swiss Exchange*, which is one of the leading stock exchanges in Europe.

The SWX Swiss Exchange became the world's first fully integrated electronic trading, clearing and settlement operation in August 1996. As of the end of December 2000, 416 companies were quoted on the SWX Swiss Exchange, of which 252 were Swiss corporations. Over the past few years, there has been a trend in Switzerland towards a single share structure, with a number of large listed corporations having opted for the system of registered shares with deferred printing or no printing at all. Where a company still has more than one class of shares, bearer shares often trade at a premium over registered shares because of their free transferability and because registered shares trade in a smaller market (as they are often owned by Swiss investors). Participation certificates, in general, trade at a discount due to their lack of voting power.

The SWX Swiss Exchange offers a wide range of *listing segments*, including the Main Market, Investment Companies, New Market, Local Caps, International Bonds, Repos, and Real Estate Companies, each of which is governed by special rules. A company applying for listing on the Main Market of the SWX Swiss Exchange must:

- have presented accounts for at least three complete financial years, unless an exemption is granted;
- have consolidated capital resources ('Eigenkapital') of at least CHF 25 million;

- show that if equity securities are listed for the first time, the (off-floor) capitalisation is at least CHF 25 million, or, if debt securities are listed, the total nominal amount is at least CHF 20 million, or, if derivatives are listed, the relevant capitalization requirements are satisfied, which vary depending upon the kind of the underlying securities;
- show that a sufficient number of shares has been distributed to the public by the time of admission of the securities for which listing is sought.

The listing application must include, among other things, a listing prospectus containing the information set forth by the Listing Rules of the SWX Swiss Exchange. In addition, under the Listing Rules, quoted companies have certain continuing disclosure obligations.

Trading in domestic securities on the SWX Swiss Exchange is settled by cash transactions within three business days. Exchange members enter purchase and sale orders directly into the electronic books of the SWX Swiss Exchange, where they are automatically matched.

Historically, *off-the-floor trading* has been a special feature of the Swiss securities market. There is still a large number of registered broker/dealers in Switzerland who are not members of the SWX Swiss Exchange and, therefore, are under no obligation to process orders by means of the electronic SWX matcher. Banks which are licensed to act as broker/dealers often offset their customers' purchase and sale orders at the current market rates. However, securities dealers subject to SESTA must report all on- and off-exchange transactions in Swiss and foreign securities listed on a Swiss exchange, with a few exceptions. The national clearing and depository system, SIS SegalInterSettle AG, makes physical delivery of the shares unnecessary if the purchaser and the seller are both customers of a member bank.

EUREX – the EUROpean EXchange – was set up as a joint venture between the SWX Swiss Exchange and Deutsche Börse AG through the merger of DTB Deutsche Terminbörse and SOFFEX (Swiss Options and Financial Futures Exchange). EUREX is a fully computerized exchange trading standardized options.

Since the coming into force of SESTA, listed companies and their shareholders must comply with a new and comprehensive regime regarding disclosure of shareholdings and tender offers rules.

SESTA makes *disclosure of shareholdings* mandatory if shares of a company, which is incorporated in Switzerland and whose equity securities are listed, are purchased or sold and if, as a result of such sale or purchase, certain thresholds in relation to the voting rights are exceeded, whether or not such rights may be exercised. The relevant percentages are 5, 10, 20, 33⅓, 50 and 66⅔ per cent. The notification must be made to the stock exchange and to the company concerned within four trading days after the disclosure obligation arises. Non-observance of these reporting duties is an offence which can result in a fine. Furthermore, in the context of a tender offer, each person who holds at least 5 per cent of the voting rights in the target company or in the company whose shares are offered in exchange for shares of the target must notify the Takeover Board and the stock exchange of each transaction in these shares by midday on the trading day following the transaction.

4.2 *virt-x*

The SWX Swiss Exchange and Tradepoint Financial Networks PLC are currently forming a UK based joint venture called *virt-x*. *virt-x* aims to become the top market for trading in Europe's biggest 600 blue chip equities by the end of 2001. It is expected to go live by the end of June 2001.

In future, a distinction will have to be drawn between the listing of securities and their admission to trading. The securities in question will continue to be listed by the SWX Swiss Exchange, the UK Listing Authority (UKLA) and other recognised listing authorities based on the relevant listing requirements, and, separately, will be admitted on certain conditions (capitalisation, trading volume, etc.) to trading by *virt-x* as a recognised investment exchange supervised by the Financial Services Authority (FSA). As to the Swiss jurisdiction, the procedure for listing and the continuing obligations of listed companies will be as at present.

4.3 *Insider Dealing and Market Manipulation*

Since 1988 insider trading is a criminal offence as per Article 161 of the Swiss Penal Code. Prior to 1988, insider dealing was prohibited under special circumstances only – for instance, if a tippee received inside information that qualified as a business secret of the company in question.

A person who has information as an insider with respect to a listed company is liable to a fine and/or imprisonment if said person (a) abuses a confidential fact (usually by dealing) or makes such confidential fact known to a third party, (b) foresees that the dissemination of such confidential fact will have a significant effect on the share price of a listed security, and (c) realizes a profit for himself or another person. Furthermore, a person who learns a confidential fact from an insider commits an offence if said person (commonly referred to as a ‘tippee’) abuses the information as set forth above provided that the insider transmitted the confidential information intentionally. Insiders can be directors, managers, auditors, agents, and any of their auxiliaries. A ‘confidential fact’ is deemed to be a fact involving an issuance of securities, a merger or an event of similar significance. Hence, the definition of a ‘confidential fact’ is narrower than that of a ‘price sensitive fact’, which is relevant in the context of the *ad hoc* publicity requirements imposed by the Listing Rules of the SWX Swiss Exchange.

Since the insider trading article was enacted in 1988, convictions for insider dealing have been rare. The reasons are twofold. First, as set forth above, the expression ‘confidential fact’ is narrowly defined, effectively excluding much price sensitive information from the Article’s field of application. Secondly, it has proven very difficult for the prosecution to establish that a confidential fact was brought to a tippee’s attention by an insider acting intentionally.

Criminal sanctions for insider trading are applied *ex officio*, the maximum penalty amounting to imprisonment of three years or a fine of CHF 40,000 (or more in certain circumstances, as far as insiders are concerned). Tippees may be fined for the same amounts or be imprisoned for up to one year. Gains derived from insider transactions are seized by the authorities. Sellers who have suffered a loss may also bring a claim in tort against the insider or the tippee, and may rescind the purchase if they were induced to sell their shares to the insider.

Furthermore, together with the enactment of the Stock Exchange Act, Article 161^{bis} SPC relating to the prohibition of market manipulations was adopted. This Article forbids any attempt to significantly influence the price of securities traded on a Swiss stock exchange by way of spreading misleading factual information or by entering into fictitious purchases and sales. However, Article 161^{bis} SPC does not penalise legitimate market stabilisation activities.

5 Taxation

5.1 General Remarks on Taxation and Social Security in Switzerland

5.1.1 Taxation of Corporations and Partnerships

Income of Swiss corporations and individuals is taxed by (a) the federal government, (b) the cantons, and (c) the municipalities. Cantonal taxes vary to some extent with respect to the calculation of taxable earnings and considerably with respect to the overall tax burden, as each canton and each municipality sets its own tax rates.

A partnership is not subject to taxation as an entity; instead, partners are taxed individually according to the income each of them receives or is entitled to. In contrast, corporate revenues are taxed as income of the corporation and as income of the shareholders when dividends are distributed.

Many cantons do not tax dividend income of holding companies in order to avoid a third level of taxation. However, the cantons levy a tax on the stated capital (plus reserves).

The tax disadvantage of the corporate structure as compared to the partnership structure is partly outweighed by the fact that private capital gains realized by shareholders through the sale of shares are generally tax-free. As a consequence, many closely-held companies often do not distribute dividends, but retain earnings so that their shareholders may realize a tax-free capital gain when selling shares.

5.1.2 *Social Security Contributions*

Social security contributions are levied on partnership income and on income of employees. While those who are self-employed must contribute between 5.1 and 9.5 per cent of their annual income (depending on total earnings), the payroll deduction for employees is 5.05 plus 1.5 or 0.5 per cent (depending on the amount of unemployment insurance to be paid), with the same amount to be matched by the employer. Shareholders in private companies who are also employed by the company sometimes prefer to draw a high salary, as this will lower the taxable income of the corporation; such tax planning will, however, increase the amount of social security to be paid.

5.1.3 *Other Taxes*

Most other relevant taxes are levied by the federal government. These taxes include (a) withholding taxes, (b) securities issuance taxes, (c) securities turnover taxes (stamp duties); and (d) value added taxes, currently at a rate of 7.6 per cent.

Cantonal taxes include taxes on gains arising out of the sale of real property or real estate transfer taxes.

5.2 *Taxation of the Seller*

5.2.1 *Individual as Selling Shareholder*

Capital gains of individuals are tax free, unless the assets involved are business assets (i.e. related to the business of an individual) or unless a company repurchases its own shares without reselling them in a certain period of time (often referred to as ‘direct partial liquidation’). Majority shareholders who are employed by the company therefore often prefer to pay themselves low salaries (thus increasing corporate taxes, *see* II.5.1.2), accumulate profits and then sell the company, thereby realizing a non-taxable capital gain (*see* IV.1 below).

In some instances, the federal and some cantonal tax authorities have taxed capital gains of individuals, either based on a broad interpretation of the provisions defining income or based on the argument that in a given case the sale of the shares boiled down to tax avoidance. The tax authorities’ decisions rest on the doctrines of ‘transference’

(‘Transponierung’) and ‘indirect partial liquidation’ (‘Indirekte Teilliquidation’), which have been upheld by the Swiss Federal Supreme Court.

Typically, the following situations can arise where income taxes on capital gains may have to be paid by selling individual shareholders:

- (a) An individual sells the shares for a price exceeding the nominal value of the shares to a holding company which he controls. Here, income tax will usually be levied, both on the federal and the cantonal level, on the difference between the purchase price and the nominal value. The reasoning is that, upon liquidation of the company, shareholders have to pay income tax on the difference between the liquidation proceeds and the nominal value of the shares. If the company were liquidated after the transfer of the shares to a holding company, this tax could be avoided because the holding company – which pays only a reduced income tax – would not realize any gain (or only a gain to the extent that the liquidation proceeds exceed the book value of the shares, respectively the purchase price). On the other hand, the shareholder would receive the market value of the shares from the holding company and realize a tax-free capital gain from the sale of these shares.
- (b) An individual may also be taxed on a sale of shares to an unrelated corporate acquirer if the target company holds large amounts of cash or other non-business related assets provided there is some sort of co-operation between the seller and the purchaser. The tax authorities have argued that this is justified because a seller would normally pay out the cash as a dividend before transferring the shares (or sell non-business-related assets and distribute the proceeds). In practice, this theory of indirect partial liquidation is usually applied where the purchaser must finance the acquisition by loans and refinances the purchase price through the target company, for example by causing it to pay out unusually high dividends after the acquisition or by merging with the target within a certain period of time after the purchase. This method of assessing taxes has been heavily criticised by the legal doctrine, and some cantons have reconsidered their position. The canton of Zurich, for instance, will tax this imputed income of the seller only in cases of tax avoidance (a criteria of which is, *inter alia*, an unusual structure

of the transaction). Since the risk of such a tax being levied increases in the event that the acquirer finances the purchase out of liquid assets of the target, the seller often insists on covenants in a purchase agreement restricting the purchaser's ability to make use of such liquid assets for up to 5 years after the acquisition.

Withholding tax (*see* II.5.3.6 below) may also be levied on the corporation in alternatives (a) and (b), as the imputed income of the seller can be regarded as a constructive dividend.

5.2.2 *Individual as Seller of Share in a Partnership*

A partner selling his share in a partnership is liable for income tax (and social security contributions) on the difference between the purchase price and the tax basis of his participation (usually equivalent to his contribution to the partnership plus already taxed retained earnings).

5.2.3 *Corporation as Seller of a Business or of Shares*

The sale of shares or of a business will be taxed as income to the selling company on the amount of the difference between the purchase price and the tax basis of the shares (respectively the assets minus liabilities in the case of a sale of a business). In some cantons, holding companies are exempt from income tax and, therefore, not taxed on income derived from a sale of their participation on the cantonal level; but income tax at 9.8 per cent is levied on such companies on the federal level.

5.2.4 *Security Turnover Tax*

If either the seller or the acquirer qualifies as a fiscal securities dealer – which is the case, *inter alia*, for holding companies with a capital in excess of CHF 500'000 – or if a fiscal securities dealer (such as a bank) acts as an intermediary in the transaction, there is a *turnover tax* of 0.15 per cent on Swiss securities and 0.3 per cent on foreign securities, to be paid by the dealer. The tax is shared if both parties are dealers, and the dealers generally have the possibility of shifting the tax burden on to their clients (i.e. the seller or the purchaser). Only very recently,

the Federal Stamp Duties Act has been amended to exempt transactions involving certain institutional investors as well as Swiss banks trading Swiss securities on foreign exchanges (such as virt-x; *see* II.4.2) from security turnover taxes.

5.2.5 Taxation on the Transfer of Real Property

If real property is transferred, for example in an asset purchase, a tax on the transfer of real estate and often a special tax on gains arising out of such transfer will become due. Many cantons also tax the transfer of shares, on the basis of this same tax, if the target company holds mainly real property. The tax on the transfer of real property is usually split between the parties; the tax on gains derived from such transfers is generally borne by the seller, although the parties may agree otherwise.

5.3 Taxation of the Acquirer

5.3.1 In general

The acquirer will account for the purchased shares in the target company as a participation in its balance sheet (there is no consolidation for tax purposes – *see* II.5.4.1 below). Tax authorities generally do not allow the purchaser to write off the participation in the new subsidiary, unless the subsidiary encounters serious financial difficulties. Also, the acquirer will not be able to use losses carried forward by the new subsidiary unless it merges with it.

In the event of a business purchase, the acquirer may step up the book value of the assets in order to reflect the purchase price. It may also post an account for the purchased goodwill, or add it into a previously established goodwill account. In future years, assets may be written off and goodwill may be amortized. Losses carried forward by the acquirer may be offset by future gains of the target.

5.3.2 Security Turnover Tax

The acquirer must pay security turnover tax if he is a fiscal securities dealer (*see* II.5.2.4 above).

5.3.3 *Stamp Duty and Taxation of 'Agio'*

If the acquirer issues shares in order to finance the acquisition, there is a stamp duty of one per cent of the value received by the acquirer (provided the share capital exceeds CHF 250'000) if the shares are subscribed by existing shareholders or the public in order to raise cash. No stamp tax is due if shares are given as consideration to the seller provided that the transaction qualifies as a merger or a re-organisation for tax purposes.

5.3.4 *Related Acquirer*

If the acquirer is a related party of the seller (e.g. a shareholder), a transfer below the fair market value will be deemed to be a constructive dividend paid by the seller to the acquirer, triggering income taxes and withholding taxes of 35 per cent (*see* II.5.3.6 for refunding). Normally, no taxes are due if a parent company transfers assets and liabilities, or shares of a third company, to a Swiss subsidiary.

5.3.5 *Income Tax Arising out of a Sale of the Target's Assets*

If the acquirer finances the purchase out of the sale of assets of the target, it will realize income to the extent that proceeds of the partial liquidation are distributed to it as dividends. Such tax may be subject to an inter-company dividend received exemption.

Tax authorities will also tax *constructive dividends* (i.e. loans bearing interest below rates fixed by the tax authorities; sale of assets by the target to the acquirer below market value). Furthermore, both declared and constructive dividends are subject to a 35 per cent withholding tax that may be reclaimed by a Swiss acquirer, usually upon filing his tax return (*see* II.5.3.6 for refunding by foreigners).

5.3.6 *Withholding Tax*

Dividend payments generally are subject to a 35 per cent withholding tax that can be fully reclaimed by a Swiss recipient upon filing his tax return (*see* II.5.3.5 above). Foreign shareholders may reclaim withholding tax in accordance with applicable double tax treaties.

Withholding tax may not be reclaimed if the structure of a transaction is considered to be a tax avoidance scheme. The competent tax authorities tend to consider undistributed reserves of a Swiss company as potentially subject to withholding tax and often treat transactions avoiding withholding tax on these reserves as tax avoidance. To illustrate, one can think of a sale of shares by a foreign resident (who would be subject to withholding tax) to a Swiss resident (who may reclaim this tax in full) who then immediately pays out all cash as dividends in order to finance the purchase. Because there is a certain degree of uncertainty as to what the authorities will consider to be tax avoidance, obtaining a tax ruling is useful if foreign residents are involved.

With regard to the drafting of a sale and purchase agreement, it is important to keep in mind that withholding tax paid by the target is economically borne by the acquirer.

5.4 Taxation in the Case of Mergers and Other Corporate Restructurings

5.4.1 In General

Though Swiss statutory tax laws are fragmentary in respect of restructurings, as a general rule, mergers, separations and transformations will not be hindered by prohibitive taxation if certain conditions are met. Assuming these conditions are satisfied, the transfer of reserves and profits of one Swiss corporation to another on the occasion of a merger, separation or transformation is exempt from withholding or income taxation; as regards securities issuance tax, a rate of zero per cent applies.

Currently Swiss tax law does not allow a company to consolidate different group companies' balance sheets for tax purposes (*see* II.5.3.1 above). If such consolidation is necessary (e.g. because of losses carried forward, or because of the necessity to offset interest payments of the acquirer with income generated by the target), the acquirer may prefer to merge with the target, purchase the business of the target, or purchase the shares of the target and merge with the new subsidiary. The third option will have to be chosen if the acquirer does not want to issue shares as consideration (*see* II.5.4.5 below).

5.4.2 Tax Consequences for Shareholders of the Disappearing Entity in Case of a Merger

As capital gains of individual shareholders are tax-free (*see* II.5.2.1 above), the question of whether an exchange of shares in a merger constitutes a sale is of practical relevance only with regard to shares held by corporations. Generally, a merger will not be regarded as a sale and corporations will be allowed to take over the old tax basis of the shares.

However, most cantons levy income tax when the nominal value of the shares received by the shareholders of the target company exceeds the nominal value of the shares in the target (*see* II.5.2.1 above for the reasoning behind this tax).

5.4.3 Tax Consequences for the Disappearing Entity in Case of a Merger

If assets and liabilities are transferred to the acquirer at book value, no income or withholding taxes are incurred. Prior to the enactment of the Federal Tax Harmonisation Act, Swiss cantons were allowed to tax the hidden reserves of the target if the acquirer was incorporated in a different canton. In most cantons there is no tax on the transfer of real property in the case of a merger.

5.4.4 Tax Consequences for the Surviving Entity in Case of a Merger

In the event of a merger, no stamp duty is levied on the shares issued by the surviving entity. Income tax will be paid on the joint income of the two companies after the merger. Losses carried forward by one of the two entities may be used to offset future income of the combined entity.

5.4.5 Merger of Parent Company with Subsidiary

If a subsidiary is merged with the parent company, the difference between the book value of the assets and the liabilities will rarely equal the value of the subsidiary as it appears in the balance sheet of the parent. By virtue of this, there will be either a (taxable) merger gain or a merger loss (often accounted for as positive or negative goodwill). Tax

authorities usually refuse to accept an amortization of this goodwill for tax purposes. The taxation of a merger gain is, however, subject to the inter-company dividend received exemption.

If the acquirer has been established solely for the purchase of the target shares – the purchase price being financed by loans – and if the target is then merged into the acquirer in order to offset the income of the target with interest payments on the loan, tax authorities may consider such a structure as tax avoidance and refuse to honour claims for repayment of withholding taxes levied on future dividends.

Significant modifications to the general tax rules apply to holding companies and domiciliary companies which are often virtually tax exempt on the cantonal level. This tax exemption sometimes makes it worthwhile to consider the establishment of a Swiss holding company as an acquisition vehicle for the purchase of Swiss or foreign businesses. However, there are limitations as to capital, financing and distribution of dividends if the Swiss holding company seeks to take advantage of a double taxation treaty in order to minimise withholding taxes levied on the dividends distributed by foreign operations to the holding company.

5.4.6 Separations

While no tax consequences arise from a horizontal separation, as a general rule, in the event of a vertical separation (including spin-offs) deferral of income taxation in relation to gains and hidden reserves and exemptions from stamp duties and from withholding taxes will be available only on condition that (a) the assets and liabilities are transferred on the basis of existing book values, (b) tax liabilities incurred by the transferring company are assumed by the receiving company, and (c) business operations are continued and the ownership structure is not changed during a certain period of time. In practice, tax authorities have accepted spin-offs from publicly held entities provided that the spun-off entity will not become a private company with one dominant shareholder during a period of 5 years after the spin-off.

5.5 Merger Act

Various tax laws are currently being revised in order to align them with the goal of the Merger Act to increase the flexibility of Swiss companies restructuring themselves. The main emphasis of the tax revisions currently undertaken is placed on the principle that taxation of hidden reserves should not be triggered by any acts of re-organization but should be deferred until business profits are actually realized on condition that (a) the assets and liabilities are transferred at their existing tax basis (book value) and (b) the parties concerned continue to be subject to taxation in Switzerland.

How exactly these general principles will be applied in various tax laws is still unclear. For instance, in the event of horizontal and vertical separations further conditions will apply; in particular, as per the proposals by the Federal Council, there would still be a condition that shares may not be sold above their nominal value during a period of five years following the restructuring, unless there was no intent to sell the shares at the time of separation. In the case of mergers, withholding and income taxes may still be levied if the Federal Council's proposal is accepted that differences in the nominal values of the shares in the disappearing entity and those of the surviving entity as well as cash compensations should continue to be taxable as income on the part of the shareholders.

6 Accounting

6.1 General Principles

6.1.1 Sources of Reporting and Accounting Rules

Swiss company law prescribes the basic reporting and accounting principles (Articles 957 *et seq.* and 662 *et seq.* CO). More specifically, the board of directors of a Swiss corporation must prepare a business report for each business year, including audited statutory financial statements, an annual report of the directors and audited consolidated financial statements if required. As a general principle, accounts must be prepared in accordance with 'accepted accounting principles' such as completeness, clarity and materiality, prudence (conservatism), going-

concern, and consistency. In addition, the law prohibits set-offs between assets and liabilities and between income and expenses. While Swiss company law contains rules governing statutory accounts in relation to format, valuation principles, reserves, and dividends, all it provides regarding consolidated accounts is that they must be prepared in accordance with generally accepted accounting principles and that the methods applied must be disclosed in the footnotes.

Switzerland, though not a member of the EU, is still very much influenced by EU Directives. This notwithstanding, the CO does not satisfy all the requirements of these Directives at present. Therefore, in October 1998, an expert panel commissioned by the Swiss Government has proposed amendments to the existing law (*see* below II.6.1.6) so as to bring it into line with the EU Directives. The draft will have to be discussed in parliament and is not expected to be enacted in the near future.

Since Swiss company law does not provide a clear definition of what ‘accepted accounting principles’ are, the core of the accounting rules rests on recognised practices of the accounting profession. *The Swiss Institute of Certified Accountants and Tax Experts* (‘Schweizerische Treuhand-Kammer’) has published accounting and auditing standards and interpretations in the *Swiss Auditing Handbook* (‘Schweizer Handbuch der Wirtschaftsprüfung’). Though not strictly legally binding, the Swiss Auditing Handbook reflects the accepted practices of the accounting profession in Switzerland.

Moreover, *The Swiss Foundation for Accounting and Reporting Recommendations* (‘Schweizerische Stiftung für Fachempfehlungen zur Rechnungslegung’) has issued recommendations on valuation and presentation relating to both individual and group accounts (the emphasis being on the group accounts). This set of rules, the so-called *Accounting and Reporting Recommendations* (ARR, ‘Fachempfehlungen zur Rechnungslegung/FER’), reflects to a large extent internationally accepted accounting standards. Listed companies have to comply with ARR/FER as a minimal standard in accordance with the Listing Rules of the SWX Swiss Exchange (but may also choose IAS, US GAAP or the EU standards); unlisted companies are under no legal obligation to do so and may opt for a different set of accepted accounting principles.

6.1.2 *Tax Relevance of Statutory Accounts*

The Swiss tax authorities raise revenues based on the *statutory accounts* (subject to certain adjustments). As a result, Swiss companies are encouraged to create significant hidden reserves by understating assets and overstating liabilities and to keep disclosed profits low. This practice is in line with accepted accounting principles for statutory accounts, in particular the principles of prudence (conservatism) and realisation as promulgated by the CO, and has so far been accepted by the Swiss tax authorities. Also, the conservative approach is underpinned by the fact that the major investors in Swiss companies are banks and financial institutions whose primary interest is in the security of their investments and the servicing of debt, rather than in the disclosure of increases in profits and the distribution of dividends.

6.1.3 *Principal Users of Accounts*

The most important users of financial statements are shareholders and creditors. Under Swiss law, there is no general requirement to publish accounts or file them for public inspection with a governmental body. Exceptions apply to listed companies and companies with outstanding bonds (*see* Article 697 h CO), which must either publish the audited financial statements subsequent to the approval by the general meeting in the Swiss Commercial Gazette or provide a copy free of charge to anybody requesting it within a year of the shareholders' resolution. Investment funds are subject to strict supervision and have to file accounts with the supervisory authorities. In addition, banks and insurance companies are required to publish their accounts annually, six-monthly or quarterly, depending on the company's size, in the Swiss Commercial Gazette and further newspapers, as specified in the articles of incorporation.

Shareholders are generally entitled to receive or inspect the business report, including the financial statements, the directors' annual report, the audit report and the board's proposal for profit appropriation, at the company's head offices and branches at least 20 days before the ordinary general meeting takes places, which must be held within six months of the balance sheet date.

Creditors may inspect the audited financial statements of Swiss corporations if there is a valid ground to do so. However, the company

may deny such a request due to overriding company interests or following the settlement of the relevant debts. In practice, however, the banks as the most important providers of (debt) finance in Switzerland are in a position to require detailed financial information, irrespective of their limited legal rights, including management accounts, and in some cases they will even insist on being directly represented on the board of directors.

6.1.4 Audit

Historically, prior to becoming independent through management buy-outs, most of the major firms of auditors were owned by Swiss banks; nowadays, the profession is dominated by the five large international accounting firms (Arthur Andersen, Deloitte Touche, Ernst and Young, KPMG and Pricewaterhouse Coopers).

Under Swiss law, *audit requirements* differ depending on the category into which a company falls:

- (a) As a rule, Swiss corporations must have statutory auditors. The auditor's report for the statutory financial statements need not comment on whether these statements show 'a true and fair view'. However, a recommendation must be made to shareholders as to whether they should approve or reject the financial statements, which may be with or without qualification. The standard form of an audit report in relation to consolidated financial statements confirms that the accounts give a true and fair view of the company's financial position, the result of operations and the cash flow in accordance with the applied standard and that the statements comply with Swiss law.
- (b) The involvement of specially qualified auditors is required for audit work relating to companies with total assets of more than CHF 20 million and/or revenues of more than CHF 40 million and/or an average annual number of employees of more than 200 and those with bonds outstanding or with listed securities. In practice, Swiss certified public accountants are eligible for the position of 'specially qualified auditors', although some other qualifications are also sufficient, including qualifications obtained in foreign jurisdictions

(e.g. UK chartered accountants) provided experience in and knowledge of Swiss law can be proven.

- (c) Only specially authorized auditing firms may be appointed to undertake an audit required for a bank. Audit reports relating to banks go directly to the Federal Banking Commission and are not made public.

6.1.5 Role of Accountants in Acquisitions

The accounting profession often plays an important role in the provision of detailed accounting and financial information relating to the target. The information is provided primarily to the management of the acquirer, but it is also frequently requested by sponsors and providers of finance in view of general appraisals in relation to particular transactions. Normally, the main purpose of the investigation is to assure that the financial statements are correct; sometimes, the work includes the production of a valuation and can be extended to cover comments on a whole range of accounting and business matters, including the effects of an acquisition on the consolidated accounts of the acquirer.

6.1.6 International Comparability and Expected Revision of Swiss law

Switzerland has traditionally based its accounting practices on minimal legal requirements and on a largely tax driven presentation. Accordingly, there has been little compliance with international standards. However, the Swiss accounting profession has made a number of attempts to revise Swiss practices over recent years to bring them into line with internationally-accepted principles. The resulting ARR/FER standards are nowadays widely accepted and by virtue of their incorporation into the Swiss listing requirements the minimum standard for listed companies. ARR/FER in certain areas go beyond of what the 4th and the 7th EU Directives require. Moreover, a large number of Swiss companies apply International Accounting Standards (IAS), and some of the multinational Swiss groups have introduced or are in the process of introducing US Generally Accepted Accounting Principles (US GAAP).

The proposed revision of Swiss company law by the *Swiss Reporting and Auditing Act* will be in line with what is required under the EU guidelines. More specifically, under the new law (a) the accounting rules will be binding for all types of Swiss companies, (b) internationally accepted accounting standards (such as ARR/FER, IAS, US GAAP) will have to be applied by medium and large Swiss companies, (c) a true and fair view will have to be given in financial statements (while certain adaptations in view of tax filings will still be permissible) and (d) more modern valuation principles will have to be applied.

6.2 Statutory (Unconsolidated) Financial Statements

6.2.1 Contents and Format of Accounts

The statutory financial statements are prepared on a stand-alone basis for an individual company. They comprise a balance sheet, an income statement and the notes. A cash-flow statement is not required. Prior to 1992, there was no general accounts format. Since then, the disclosure in the statutory financial statements of all companies, other than those covered by existing special legislation, have been standardised with a minimum classification of 26 items in the balance sheet and 15 in the profit and loss account.

6.2.2 Valuation Basis

Statutory accounts are prepared on a historical cost basis. As a general rule, companies are required to value their assets not in excess of the lower of cost and market value. In addition, the board of directors may value assets at amounts lower than the maximum value laid down by statutory law (*see* II.6.1.2 above).

Tangible fixed assets are valued at historic cost. The revaluation of fixed assets above cost is prohibited by law with a few exceptions. Depreciation is strongly influenced by tax regulations, according to which only amounts charged in the books qualify as tax deductions. The tax authorities specify maximum depreciation rates for tax purposes, which are often in excess of the true economic rate, and accordingly significant hidden reserves may exist against fixed assets.

Intangible assets, such as trademarks and goodwill, may be shown but at a value restricted to their cost, less appropriate amortisation. Pur-

chased goodwill must be written off over a reasonable period, usually over five to ten years. Where the goodwill relates to trade marks or long-term licences, a longer period may be used. Formation costs, such as legal fees and pre-incorporation costs, together with stamp duty paid on shares, may be capitalised but must be amortised over a period of five years or less.

A provision for non-paying accounts receivable is usually deducted directly from the total of accounts receivable, although the allowance is sometimes shown as a liability. Normally five to ten per cent of the gross balance is provided and is allowed as a deduction for tax purposes.

Details of contingent liabilities, guarantees and charges, for which no provision has been made, must be disclosed in a footnote to the balance sheet, although no details need be given.

As a consequence of the historical cost basis approach, the statutory accounts usually show less equity than is actually available. In addition, the equity and income situation may be distorted by the increase and decrease of hidden reserves and due to the realisation principle, according to which unrealized gains may be deferred and treated as income only when they are realized.

6.2.3 *Reserve Accounting*

Swiss law provides that 5 per cent of the annual profit must be allocated to the general reserve until the latter has reached 20 per cent of the paid-in share capital. After having reached the 20 per cent limit, the following must still be paid into the general reserve:

- (a) any share premium (also referred to as 'agio'), i.e. any surplus over the nominal value upon the issue of new shares after deduction of the issue cost to the extent such surplus is not used for depreciation or welfare purposes;
- (b) the excess of the amount which was paid in on cancelled shares over any reduction on the issue price of replacement shares; and
- (c) 10 per cent of the amounts which are distributed as a share of profits on top of a dividend of 5 per cent (calculated on the nominal value).

To the extent it does not exceed half of the share capital, the general reserve may only be used to cover losses, to support the company in

times of financial distress and to counteract or alleviate the consequences of unemployment.

However, holding companies are exempt from the obligation to build up reserves as set out in (c) above once they have reached the 20 per cent threshold and are free as to the use of the general reserve irrespective of the circumstances.

The remaining net profits are at the disposal of the shareholders' meeting.

6.3 Consolidated Financial Statements

6.3.1 Obligation to Prepare Consolidated Accounts

If a company controls other companies by a majority of votes or by other means, it must prepare consolidated accounts, unless the group during two consecutive years has not had a balance sheet total exceeding CHF 10 million, net sales exceeding CHF 20 million, or more than 200 employees per annum on average. However, consolidated accounts have to be prepared in any case if a company has outstanding bonds or shares quoted on a stock exchange, or if shareholders holding at least 10 per cent of the share capital request the production of such accounts, or if it is necessary to produce such accounts to provide reliable information on the company's financial position and result of operations.

Any company included in the consolidated accounts of a parent company, which is established and audited according to Swiss law or equivalent foreign standards, is not required to prepare separate consolidated accounts provided it makes the parent's accounts known to its shareholders and creditors in the same way as its own individual company accounts. Such a company is, however, required to establish separate consolidated accounts if it must publish its individual company accounts because of outstanding bonds and shares quoted on stock exchanges or if consolidated accounts are requested by shareholders who hold at least 10 per cent of the share capital.

Swiss company law requires that the consolidated accounts be prepared in accordance with generally accepted accounting principles and that the consolidation and valuation principles be disclosed in the footnotes to the consolidated accounts. Today, the vast majority of the major Swiss companies present their accounts based on ARR/FER or

IAS. A few multinational Swiss groups prepare consolidated statements in accordance with US GAAP or the EU standards. This notwithstanding, based on current Swiss law unlisted Swiss companies are still allowed not to present a view which is not true and fair (given that hidden reserves are still permitted).

6.3.2 *Accounting Treatment of Mergers and Acquisitions*

Swiss company law remains silent on the accounting treatment of mergers and acquisitions. In practice, ‘purchase accounting’ is the method most commonly used, as opposed to ‘pooling of interests accounting’, which has been applied in a few large Swiss combinations. From an accounting perspective, which may be different from the legal or tax viewpoint, a purchase is the acquisition of one company by another, whereas the pooling of interests method is the uniting of ownership interests of two or more companies by the exchange of shares. The choice between purchase accounting and pooling accounting has an effect on the reported results because only purchase accounting leads to a goodwill reducing the return on equity due to the obligatory amortization. Whether this finally affects stock prices is controversial given that it is unclear whether the markets always correctly adjust for the variation in reported results following the choice of either purchase or pooling of interest accounting.

Under the *purchase method*, if the purchaser pays more or less than the fair value of the net assets acquired, the difference between the purchase price and the book value of the purchased net assets will be reflected as positive or negative goodwill. In practice, there are two ways goodwill can be treated. Either it may be written off immediately against retained earnings, which is permissible under ARR/FER but prohibited under IAS or US GAAP. Or goodwill may be capitalised and amortised over its useful life, i.e. over 5 to 20 years, as an expense through the income account. The results of the acquired company may be brought into the group accounts from the beginning of the year in which the acquisition is made and disposals eliminated from the beginning of the year in which the disposal is made.

Under the *pooling of interest method* the existing book values for assets and liabilities of the entities involved are simply combined by adding

up each item of the balance sheets. As a consequence, no goodwill results and the acquired assets and liabilities are not restated to fair values. Since the return on equity is therefore not affected, businesses sometimes show a preference for the application of pooling of interests accounting. However, it is not at the reporting companies' discretion to opt for pooling of interest or purchase accounting. Rather, under IAS and US GAAP the requirements for the application of pooling of interests accounting are very stringent and are generally met only where there is a merger between entities of similar size. Swiss law and ARR/FER provide more flexibility in this respect due to the absence of detailed regulations.

It is important to bear in mind that the choice between the purchase and the pooling of interests method and the ensuing differences in treatment of goodwill has no effect on distributable profits. A group's ability to distribute profits to its shareholders depends on the reserves and profits of the top legal entity, and since goodwill is a balance which arises on consolidation, its write-off in the consolidated accounts has no impact on the top company's reserves and earnings that may be distributed to its shareholders.

III Regulatory Environment

1 Merger Control

The *Federal Act on Cartels and other Restraints on Competition of 6 October 1995* ('Cartel Act') introduced preventive merger control in Switzerland when it entered into effect on 1 July 1996.

Article 9 of the Cartel Act provides that the Competition Commission must be notified of concentrations which have an effect in Switzerland if in the business year preceding the concentration (a) the undertakings concerned have reached a combined world-wide turnover of at least CHF 2 billion, or combined sales in Switzerland amounting to at least CHF 500 million, and (b) the turnover of at least two of the undertakings concerned in Switzerland was CHF 100 million or more. It is generally the latter requirement which determines in practice whether a notification must be made. Besides, notification is required if one of the undertakings concerned has been held in previous proceedings to benefit from a dominant position in a relevant market and the concentration affects the same market.

The 'undertakings concerned' include the merging companies as well as the controlling and the controlled enterprises. The term 'concentration' is defined widely to include not only statutory mergers but also an acquisition of control and the establishment of what is called a 'concentrative' joint venture. A joint venture is deemed to be concentrative if it performs all functions of an autonomous enterprise on a lasting basis (3 to 5 years) and continues the business activities of at least one of the controlling undertakings.

Merger control procedures commence by a notification to the Competition Commission, which must occur prior to completion of the agreement leading to the concentration. The Competition Commission decides within one month whether to instigate proceedings to further examine the concentration or whether to clear the transaction. If further proceedings are instigated, the examination must be finalised within 4 months, resulting either in the approval of the concentration or its (partial) prohibition. An appeal may be taken from the decision of the

Competition Commission to the Appeal Competition Commission and then to the Federal Supreme Court.

The Competition Commission may prohibit a concentration if its examination reveals that the concentration creates or strengthens a dominant position, as a result of which effective competition can be eliminated in a given market, and conditions of competition in another market are not improved at the same time so as to outweigh the disadvantages of the dominant position in the relevant market.

Concentrations falling within the ambit of the Swiss merger control are also subject to EU competition rules if they are likely to have an impact on the European market. As a result, there may be notification duties vis-à-vis two authorities.

2 Regulation involving Real Estate (Lex Koller)

The *Federal Law on the Acquisition of Real Property by Foreigners of 16 December 1983*, as amended on 1 October 1997 (referred to as *Lex Koller*), provides that the acquisition of real property and the acquisition of shares in companies or of businesses owning real property requires authorisation from the cantonal authorities, unless the property involved is used as a permanent business establishment. In particular, *Lex Koller* applies to a purchase of shares in a company owning real property not used for business purposes if:

- (a) the acquirer is a foreigner, a foreign corporation or a Swiss corporation controlled by a foreigner;
- (b) such acquirer obtains or reinforces a controlling position – the test being, *inter alia*, whether foreign ownership is in excess of one-third of the share capital; and
- (c) the market value of the real property not used as a permanent business establishment is more than a certain percentage of the market value of the total assets of the company. As the law is silent on what that percentage is, there is some controversy among legal writers as to whether the relevant threshold should be set at 33 1/3 or at 50 per cent.

If the value of the real property not used as a permanent business establishment is not clearly below the relevant threshold, the acquirer must seek confirmation by the competent authorities that *Lex Koller* does not apply. Where the value of such property exceeds the relevant threshold, the foreign purchaser must seek the approval of the competent authorities to acquire a controlling interest, which is given on certain grounds only. No authorisation will be granted in any case if the real property is near a military site, or if the acquisition is considered contrary to public interest.

It is of particular importance to ensure compliance with the obligations imposed by *Lex Koller* because a purchase of shares in a company holding non-business related Swiss real estate without the necessary authorisation is deemed null and void.

3 Employment of Foreign Nationals

Switzerland imposes strict limitations on the possibility of foreign nationals working in Switzerland. Each canton has an annual quota of working permits in proportion to the size of its economy. If a foreign group purchases a Swiss corporation, the acquirer therefore cannot expect to be able to staff the newly-acquired company entirely with non-Swiss management. However, working permits for top executives, skilled technicians and specialists essential to the smooth operation of a business will usually be granted – subject to the availability of such permits under the cantonal quota.

The bilateral agreement between Switzerland and the EU relating to the free movement of persons, expected to enter into effect in the year 2001, provides for a gradual opening of the labour markets by introducing the freedom of movement for EU citizens in respect of Switzerland in several stages during a transitory period of 12 years. Vice versa, the interval until freedom of movement for Swiss citizens takes effect is only 2 years. The freedom of movement will include the right of entry into the other party's territory, the right of residence and the right of access to an economic activity.

The rules with respect to citizens of countries not forming part of the EU basically remain unchanged, and special regulations continue to apply to certain jurisdictions, such as for example the US.

4 Restrictions on and Incentives for Foreign Investment

There are currently no restrictions on capital transactions between Switzerland and other developed countries. However, the Swiss National Bank may regulate the country's money supply and implement credit and currency policies. Foreign-based entities wishing to raise debt capital in Swiss francs must report the transaction to the Swiss National Bank.

Under certain circumstances the Swiss government may prohibit the sale of securities of Swiss companies, as it did in 1978, in order to control the exchange rate of the Swiss franc. Currently, no such rules are in force.

Foreigners may acquire all types of domestic assets or shares in domestic companies without requiring authorisation, with the exception of (a) companies engaged in certain regulated businesses, such as banks, and (b) real property or companies holding real property (*see* III.2 above).

Until 1992 many Swiss corporations had limited the transferability of registered shares to foreigners in their articles of incorporation. The revised company law confines these limitations to certain regulated businesses and to companies owning real property not used for business operations.

The sale of an ongoing business that requires a licence, or a concession, to operate (e.g. the transport business, certain activities in the health sector and the importation of certain agricultural products) may be subject to approval by the competent authorities. However, licenses will usually not have to be renewed if shares of a licensed company are sold.

Generally, investment incentives are available only to new enterprises or new investments by existing businesses. Therefore, the purchase of an existing business normally does not entitle the acquirer to investment incentives except if the business becomes engaged in new projects. Even then, it will often prove helpful to incorporate a new entity in order to take full advantage of incentives offered to newly-established companies.

Incentives vary considerably from one canton to another, sometimes even from one municipality to the other. As a general rule, available incentives fall into one of the following categories:

- (a) tax incentives – reduction of income and capital taxes for up to ten years (in some areas even on the federal level) or extraordinary depreciation allowances;
- (b) finance incentives – subsidies for interest payments or guarantees for loans;
- (c) administrative incentives – help in locating adequate premises (possibly also sale of land below market value) and ease in obtaining work permits.

Areas such as Zurich or Basel will offer fewer incentives than regions with ailing industrial sectors. Federal incentives are generally limited to less developed areas, although a new federal law on venture capital came into force on 1 May 2000 introducing general tax incentives for venture capitalists.

5 Financial Conglomerates

The recent past has witnessed the emergence of large financial conglomerates seeking to provide a whole range of financial services under one roof, including banking and insurance. However, Swiss law imposes *restrictions* on the possibility of acquiring companies subject to insurance and banking regulation.

More specifically, Swiss insurance law provides that *insurance companies* may not operate businesses other than insurance businesses, unless an exemption is granted by the supervisory authorities. Acquisitions of equity stakes in companies conducting non-insurance business are subject to authorization if certain limits in relation to the capital of the companies involved are exceeded. A recent case in point involved the acquisition of *Banca del Gottardo* by *Rentenanstalt/Swiss Life*. A merger between an insurance company and a non-insurance company is generally disallowed. However, Swiss insurance companies are not restricted in offering their services as *intermediaries* in non-insurance transactions.

Banking law is more liberal with regard to activities not falling within its primary scope of regulation: *banks* are generally permitted to offer financial services other than banking provided the necessary authorisations are obtained. Moreover, as a rule, a bank may acquire shares in companies other than banks within certain limits relating to the bank's own funds, though these limits do not apply to the acquisition of a participation in insurance companies. A bank is therefore free to acquire an insurance group, as evidenced by the acquisition of *Winterthur Insurance* by *Credit Suisse* in 1997.

IV Share and Business Acquisitions

1 Purchase of Shares or of a Business?

Whether the acquirer purchases the business or the shares of a Swiss target company will depend primarily upon whether:

- the target is organized as a corporation;
- the acquirer wants to purchase the entire business or only part of it
 - for example a branch;
- there is a likelihood of hidden liabilities;
- the assets are easily transferable;
- tax and accounting considerations favor one approach over the other;
- assets must be pledged in order to finance the transaction.

Swiss parties usually opt for selling shares rather than assets and liabilities, for the transfer of shares is a much easier transaction in practice than the transfer of a business where title for every asset, contract and governmental authorization must be transferred individually. In addition, business transfers generally require the consent of third parties or the relevant governmental agencies. Where real property is involved, a registration of the new owner is required, which may trigger special taxes (*see* II.5.1.3 above). While the new Merger Act will simplify the acquisition of business assets by providing for a transfer by operation of law, the procedure to sell a business will still be more burdensome than a sale of shares, entailing the production of a detailed inventory, a registration in the commercial register, information of the shareholders, joint and several liability of the seller for a certain interval and other measures to protect the interests of creditors and employees.

Corporation tax will be levied on the target selling its business with respect to the amount by which the consideration received exceeds the book value. In addition, the individual shareholders will be taxed on dividends (or liquidation proceeds), which are treated as ordinary

income. In contrast, an individual shareholder generally realizes a tax free capital gain by selling his shares (*see* II.5.2.1 above). The seller will therefore in most cases insist on a share deal. For the acquirer, the purchase of a business offers two advantages from a tax viewpoint: (i) he may set off financing costs directly against income of the purchased business (since these costs and the income will arise in the same legal entity); and (ii) the acquirer may furthermore write off assets of the purchased business in the future, given that a step-up of values is generally possible, and therefore benefit from tax savings in the future. These advantages, however, usually do not outweigh the advantages which the seller derives from a share transaction. Therefore, most parties agree to a share deal, especially where the seller somewhat lowers the purchase price in order to reflect the fact that he profits from the share deal structure.

Where there is a purchase of shares, certain other advantages may arise. For instance, the target company will become a subsidiary of the acquirer, which not only leads to limited liability of the parent but also facilitates a future re-sale. If the business of the target should be combined with that of the acquirer, the two entities can merge after the acquisition. The necessity to pledge assets in connection with the transaction (e.g. as a security for financing by a bank) will also favour a purchase of shares over the purchase of a business because under Swiss law a pledge is valid only if the pledged goods are actually transferred to the pledgee, which effectively rules out pledges of business assets, for they would run counter to commercial needs.

The acquisition is structured as a purchase of a business if a share deal is not feasible due to the legal organization of the enterprise concerned or because the acquirer wants to purchase only part of the business, or if there is a danger of a considerable amount of hidden liabilities that cannot be dealt with by warranties of the selling shareholder(s). In these cases, the acquirer will purchase all, or part, of the assets of the target and assume all, or part, of the (known) liabilities.

2 The Acquisition Process

2.1 Negotiations/Letter of Intent

Private acquisition agreements are generally negotiated by the seller's and the acquirer's senior managements, assisted by their lawyers, who normally become involved when one party, usually the acquirer, wishes to draft a letter of intent.

Ordinarily, the seller will insist that the letter of intent contain confidentiality undertakings, which, together with the provisions regarding exclusive negotiations, are meant to be legally binding, whereas there is normally no right to enforce the execution of a definitive agreement. The parties should not fix the purchase price in a letter of intent without appropriate reservations because many aspects of the transaction, in particular taxes or unknown liabilities, which will have a bearing on the price, are rarely considered during the first stages.

If a party does not negotiate in good faith and eventually refuses to sign the contract, the other party may have a claim based on *culpa in contrahendo* to be compensated for the costs incurred in connection with the negotiations (e.g. legal fees, travel expenses) or as a result of arrangements made in view of the execution of the contract (e.g. due to the hiring of a manager for the new subsidiary). The seller may have a claim for damages against an acquirer acting in bad faith if the seller had turned down other prospective purchasers who no longer wish to purchase the business. However, *culpa in contrahendo* does not give rise to a claim for lost profits.

If the basic structure of the transaction has been agreed, it is usually up to legal counsel of the acquirer to prepare a first draft of the purchase agreement. Although this draft normally favors the position of the acquirer, it should not be extremely one-sided so as to be acceptable as a basis for further negotiations and to avoid a counter-proposal by seller's counsel or a request for a more balanced new draft.

After the signing of the letter of intent, the parties sometimes agree to a timetable, which quite often proves to be too optimistic; nevertheless, it is a useful tool for addressing the issues the parties will have to consider before, and after, the execution of the agreement.

2.2 *Public Announcement*

Under Swiss corporate law an acquirer is under no general duty to disclose his shareholdings in the target or to publicly announce his intentions. However, since July 1992 the target company is obliged to disclose its major shareholders. Reporting requirements also arise under the Stock Exchange Act if the target is a listed company (*see* II.4.1 above). Sometimes, the so-called ‘ad hoc publicity’ rules force the party whose shares are listed on the SWX Swiss Exchange to disclose negotiations if there are rumours in the market. Once a contract is signed, the transaction is generally publicly announced, but quite often without specification of the purchase price.

2.3 *Investigating the Target Company*

Parties to a private acquisition agreement are almost inevitably faced with the problem that the seller is reluctant to disclose details about the target company for as long as it is uncertain whether the acquirer is willing to purchase the business at an acceptable price. Therefore, on the one hand, the seller will want to sign the agreement before giving the acquirer full access to data regarding the business. On the other hand, the acquirer will not want to be bound until he knows exactly whether the business meets his expectations.

A variety of techniques have been developed in order to mitigate this problem:

2.3.1 *Technique 1*

If technique 1 is applied, the acquirer is given only very limited access to the business of the seller until the signing of the agreement, but is provided with detailed warranties as to the state of the affairs. The acquirer may then freely inspect the target’s business after the signing of the agreement and will have the right to rescind it prior to completion if the warranties prove to be materially incorrect. After completion, indemnity payments will be due if the acquirer discovers a breach of warranty. The procedural advantage of this technique is that information is given by the party which can most easily produce it (it is much more efficient if the seller represents and warrants that it has full title

to the real property and that the buildings are in compliance with the applicable laws than if the buyer's attorneys look into these issues). Verification of the information is possible after completion, as long as the warranties remain in force and as long as indemnity claims can be brought.

However, this technique is not suitable when damages or indemnity payments would be an insufficient remedy for the acquirer – for example, where title to certain assets or patents is of such importance to the acquirer that the possibility of rescinding the contract or seeking indemnity payments will not afford adequate protection.

2.3.2 Technique 2

Here, an inspection is carried out by a third party, generally an accounting firm, which signs a confidentiality agreement relating to information obtained during the audit. Such an audit will not only cover the question whether the last balance sheet fairly reflects the financial situation of the target, but will also extend to issues such as the validity of contracts with key employees.

2.3.3 Technique 3

According to technique 3 the acquirer is given full access to the business of the target, even prior to the signing of the agreement, but signs an undertaking that he will treat all information confidentially, particularly if the transaction is not completed. This procedure is usually not suitable if the acquirer is a competitor of the target (or seller).

The tendency in Switzerland is to use a combination of the methods described as techniques 1 and 3.

2.4 *Signing and Completion (Closing)*

Usually the purchase agreement will provide for an interval between the signing of the agreement and its completion. This interim period will be used to obtain third parties' consents or governmental authorizations. It will also allow the acquirer to arrange for the financing of the transaction and possibly to inspect the business of the target (*see* IV.2.3 above).

On completion, the parties exchange the shares (or transfer the business) against payment of the purchase price. As the warranties will usually be given either as at the date of the last balance sheet, or as at the signing of the agreement, the period pending completion must be regulated by contract. Normally the seller will promise that the target company will not enter into any contracts involving expenditure or liabilities in excess of a certain amount outside the ordinary course of business without the written consent of the acquirer (*see* IV.3.4.11 below); often, certain representations and warranties are confirmed to be correct as at completion.

Simultaneous signing and completion is possible where no interim period is necessary.

3 The Share Purchase Agreement

The nature and length of a sale and purchase agreement depends on the business of the target, the method by which information is exchanged (*see* IV.2.3 above) and the bargaining power of the seller and the acquirer. These three elements influence the number of warranties given by the seller. The agreement usually contains the clauses set forth hereinafter.

3.1 *Recitals*

The agreement will contain *recitals*, which summarize the basis of the understanding between both parties and describe the transaction in summary. The parties sometimes expressly state that the recitals shall have no binding effect, although this is usually unnecessary because the recitals do not address specific duties of the parties.

3.2 *Sale of Shares*

The agreement will provide that a certain number of shares is to be sold free from all liens and encumbrances. It may be worth noting here that, if share certificates have been issued, their transfer by virtue of statutory law excludes a transfer of liens or encumbrances provided the acquirer deals in good faith (*see* Article 935 CC for bearer shares, and Articles 968 and 1006 CO for registered shares).

The wording of the clause will often refer to an extract of the commercial register evidencing the number, type and nominal value of the shares issued. If not all of the shares are purchased, the serial numbers of the shares to be sold will be enumerated.

The clause will further provide for the duty of the seller to deliver the shares on completion and specify, according to the type of shares (*see* II.2.1 above), whether the shares must be simply handed over (bearer shares) or whether they also need to be endorsed (registered shares) and/or whether the board of directors of the target company must approve the transfer (certain type of registered shares). In the latter case, minutes of the respective board decision must be delivered upon completion.

If no share certificates have been issued, title is transferred by written assignment.

Finally, the clause will provide for the acquirer's duty to accept delivery of the shares on completion. This makes it clear that acceptance of the shares is a contractual duty of the acquirer, allowing the seller to withdraw from the contract (in accordance with Article 102 *et seq.* CO) if the acquirer defaults (*see* also Article 211 I CO).

3.3 Purchase Price

The agreement will provide for the acquirer's obligation to pay the purchase price on completion to the seller, or possibly into an escrow account. The consideration may take the form of cash or shares (with respect to shares, *see* IV.6 below). If the parties have agreed on a cash consideration, a money transfer or the delivery of a banker's draft will be arranged. The exchange of shares against consideration takes place at the completion meeting, where each party can check whether the other is able to perform its main obligations under the agreement.

Acquisitions in Switzerland tend to be settled by *cash payments*. Tax planning and accounting aspects sometimes thwart alternative methods of financing (*see* IV.1 above). Swiss acquirers will often finance a transaction by raising the necessary cash for the purchase by increasing their share capital in spite of the fact that Swiss law treats an increase of the share capital made in view of an acquisition similar to a contri-

bution-in-kind (Article 652c and 628 CO), even if only cash is raised, so that special rules apply (*see* II.3.1 above).

A shareholder of a Swiss corporation has a statutory right to subscribe newly-issued shares in proportion to his holding prior to the new issue ('pre-emption right'). A Swiss acquirer therefore will either have to raise the cash to finance the purchase by issuing the shares to its shareholders, or by seeking the shareholders' approval to waive their pre-emption rights and offering the shares to a third party or to the public, a decision requiring not only a majority of two-thirds of the shares represented (Article 704) but also what is called 'valid grounds'.

The parties will often base their price negotiations on the target company's most recent *balance sheet*, and, as balance sheets of unlisted Swiss companies rarely reflect a fair value of the company – due to hidden reserves – (*see* II.6.2 above), sometimes on internal or management accounts.

The parties often agree that a certain amount will have to be paid in excess of the value of the net assets of the company in order to compensate the seller for *goodwill*. This will depend on:

- the earning power of the target;
- hidden reserves in the balance sheet;
- the target's goodwill (in the strict sense of the word);
- synergy effects the acquirer intends to realize;
- tax consequences of the transaction; and
- the bargaining power of the acquirer and the seller.

Sometimes the parties agree on the payment of a goodwill amount to be determined by an accounting firm as at a certain date – usually the completion date – according to certain accounting rules; the exact purchase price is therefore still to be determined when the parties sign the agreement.

An alternative to setting the price in relation to the balance sheet is to determine the consideration by reference to the results of the target for a certain period after completion ('earn-out formula'). Earn-out formulas are used especially where the seller retains management of the target

company after selling his shares. Such formulae are quite common in the professional services sector – particularly for public relations, accounting or consultancy firms – where the parties intend to retain the services of the founders and key employees of the company. A seller might be willing to accept a comparatively low salary for his future services under such a formula for tax reasons, because he may realize a tax-free capital gain from a higher purchase price, whereas his income as an employed manager will be taxed at ordinary rates and, furthermore, will be subject to social security payments. From the point of view of the acquirer, an earn-out formula should also be to his advantage as it ties the consideration to be paid to the performance of the business. The acquirer furthermore will be able to finance the purchase price partially from a distribution of dividends from the target company.

The employment contract to be agreed with the seller will have to include, *inter alia*:

- clauses regarding the management of the target company;
- a list of transactions for which the seller will need the approval of the acquirer;
- a provision that the seller may not renounce his salary (which he might be tempted to do in order to reach profit targets);
- usually a non-competition clause for a certain period of time after termination of the employment relationship.

In addition, the purchase agreement will contain rules for the computation of profits, defining, for example:

- interest rates on inter-company loans;
- rates of depreciation and amortization of good-will;
- amount for research and development expenditures;
- creation of reserves (e.g. for taxes, warranty claims);
- treatment of work in progress, etc.

Another possible method to determine the purchase price is the application of a multiplier to the *net profits* of the target's business or to the value of its *principal assets* (e.g. a patent or real property).

Often the question of *deferred taxation* is raised towards the end of negotiations. To a large extent Swiss companies are allowed to write off assets for accounting and tax purposes; consequently, Swiss companies may incur considerable tax liabilities when their operations are sold or liquidated. Therefore, the acquirer will argue that part of his tax burden must be borne indirectly by the seller and that the purchase price must be lowered accordingly. The seller will take the position, however, that in an on-going business deferred taxes are of minor importance and would become due only if the acquirer liquidated the business – something the seller would not expect the acquirer to do.

Even if the parties agree on a fixed price, and not a formula, the contract should specify how the parties arrived at the specific figure. This will facilitate the computation of reduction payments (*see* IV.3.4.3 below) to be made by the seller if warranties prove to be untrue.

If the seller has granted loans to the target company, it should be specified whether the loans will be assigned to the acquirer, and, if such transfer is contemplated, whether payment of the purchase price includes consideration for the assignment. If the seller has borrowed money from the target, the parties will usually agree that the acquirer assumes the debt of the seller against an appropriate deduction of the purchase price.

The parties sometimes agree that the acquirer shall pay part of the consideration into an *escrow* account – for example until the inspection of the business can be completed or until a settlement is reached in a major dispute in which the target company is involved. Similarly, the acquirer may seek to delay the payment of part of the consideration for a variety of reasons, while still guaranteeing payment of the purchase price.

3.4 Warranties and Indemnities

3.4.1 General

The parties usually devote much of their time to the ‘reps and warranties’ section of the agreement. In contrast to other jurisdictions, Swiss warranties are usually included in the main agreement and are not listed in a separate schedule.

The Swiss Federal Supreme Court has held in a number of cases (*see e.g.* BGE 79 (1953) II 155; 97 (1971) II 43; 107 (1981) II 419; 108 (1982) II 102) that the statutory remedies for defects in purchased goods (Article 197 *et seq.* CO – *see* II.1 above) apply only to the share certificates as such and not to the business represented by these shares. Consequently, the purchaser will want to ensure that warranties are given by the seller with respect to the business itself. The relevant court decisions have been heavily criticised by legal writers, yet to no avail.

Warranties given by the acquirer are usually of minor importance. In practical terms, parties sometimes annex an extract of the commercial register evidencing that the acquirer's representatives have authority to sign the agreement.

Where Swiss courts had to adjudicate claims brought before them on the grounds of material defects of acquired businesses, they have on various occasions allowed the aggrieved party to have recourse to Article 24 I.4 CO, which provides that a contract may be rescinded based on a party's material error at the time when the agreement was made. Since a rescission of the contract often does not prove to be an adequate solution, however, it is common for the parties to waive the right to rescind the agreement due to a breach of representations and warranties or a material error. One reason for the scarcity of published court decisions in this area might be that many private acquisition agreements contain an arbitration clause.

A number of customary warranties given by the seller are enumerated in IV.3.4.11 below.

3.4.2 *Who should give Warranties*

Normally only controlling shareholders will be able and prepared to give warranties as to the condition of the business (*see* IV.2.3 above on the relationship between warranties and information). Minority shareholders, however, will sometimes also have to provide indemnities on a *pro rata* basis.

Under Swiss law it is unusual for the target company itself to give warranties, as is sometimes the case in other jurisdictions. This is because:

- (a) a payment under such a warranty would in fact economically be made by the acquirer; and
- (b) such a payment could be considered as a constructive dividend to the shareholder, subject to withholding tax.

From the acquirer's viewpoint, it makes sense, however, to obtain warranties from the target relating to the period prior to completion if a breach of warranties discovered during a pre-completion due diligence allows the acquirer to rescind the contract (*see* IV.2.3.1); in such an event, the purchaser may also want to claim damages for a breach from the target, and not only from the seller.

3.4.3 Remedies for Breach

The legal remedies for a breach of warranties are derived from general principles of contract law and the law relating to the sale of movable goods. These principles do not always provide an adequate solution in the context of an acquisition agreement. Therefore, the parties usually seek to vary the operation of statutory law by agreeing specific contractual terms.

The agreement will often provide that the purchaser is not required to complete the transaction if a material breach of warranty is discovered before completion (*see* IV.2.3.1 above). However, the parties usually exclude any right to rescind the agreement after completion, thus in effect waiving actions for rescission on the grounds of Article 205 CO relating to grave defects and Article 24 I.4 CO relating to material errors (*see* above IV.3.4.1). Furthermore, Article 207 III CO restricts the right to rescind the agreement where the acquirer has modified the purchased goods.

If a breach of warranty is discovered after completion (or prior to it, but the acquirer decides to complete the deal anyway), the acquirer may seek a *reduction of the purchase price*. Generally, Swiss courts apply the *relative method* to determine the appropriate reduction. This operates by reducing the purchase price, say CHF 72, in proportion to the ratio of the 'true value' of the goods without the defects, say CHF 60, to the 'true value' of the goods with the defects, say CHF 40, so that in this instance the relevant proportion would be 3 : 2, meaning that the reduced purchase price would amount to 48. In practical terms, it will

hardly be possible to establish ‘true values’. Therefore a judge is likely to ask: ‘What would the parties have agreed in good faith had they both known of the existence of the breach of warranties when entering into the contract?’ The liability will amount to the difference between the purchase price and the value so found by the judge.

The parties sometimes prefer to agree on *indemnities*, in the strict sense of the word, stating in the agreement that the seller will keep the buyer protected from a specific loss in relation to certain matters, for example debts of the target turning out to be bad. Where there are indemnities, it is unnecessary to ask what the value of the shares is or would be. The seller will simply have to discharge his payment obligation and may not argue that the acquirer would have purchased the shares for the same consideration even if the acquirer had known of the breach when signing the agreement. Technically, such a warranty clause qualifies as a guarantee as per Article 111 CO.

Indemnities may be given in favour of the target company itself, although agreements sometimes provide that the acquirer may elect to directly receive the payments. Reduction payments are always paid to the acquirer.

Swiss law also provides for damages under certain circumstances – for example if the acquirer suffers a damage as a result of a breach of warranty that is not covered by either an indemnity or a reduction of the purchase price.

3.4.4 *Limitations on Liability*

Often the seller will seek to limit his liabilities in relation to warranties and indemnities by asking for a *maximum liability* to be stated in the agreement (possibly amounting to the purchase price or a certain percentage of the purchase price). In addition, the parties may agree *minimum limits* to be reached before a claim can be brought. On the one hand, what is typically negotiated is that no claims may be made unless the *aggregate of all claims* exceeds a certain threshold (for example one per cent of the purchase price). On the other hand, a *de minimis* limit may be agreed on *individual claims*, which means that even where the threshold has been exceeded a claim may not be pursued unless it is worth a certain amount, say CHF 5'000. If the minimum limit is exceeded, the buyer will want to ensure that the full amount to the first

Swiss franc can be recovered, in which case the minimum limit is often referred to as a *threshold*, whereas the seller will try to negotiate that his liability shall only arise to the extent the minimum limit is exceeded in which case it is called a *deductible*.

In this context, it should be noted that under Swiss law a maximum limit is ineffective insofar as the seller has caused a damage by gross negligence (Article 100 I CO).

3.4.5 *Notification of Breach*

Article 201 CO provides that the buyer must examine the ‘purchased goods’ (i.e. in the present context, the business) as soon as practicable in the ordinary course of business and that the seller must be notified forthwith of any defects for which he is liable under the warranty. Should the purchaser fail to comply with this notification duty, the sale and the sold products are deemed to have been approved, except where there are defects which could not have been discovered in the course of a normal examination. Where hidden defects are later uncovered, immediate notice must be given, failing which the hidden defects are deemed to have been accepted.

The duty to immediately examine the business and notify the seller of any breach is usually relaxed in a share purchase agreement by allowing the acquirer to notify the seller of any breach discovered at any time during a stated period.

3.4.6 *Limitation of Actions*

Article 210 CO provides for a time limit of one year from the date of delivery for bringing a claim for breach of warranties. The parties sometimes extend this limitation period to two or three years, and often agree longer intervals for claims involving tax and environmental matters.

3.4.7 *Joint and Several Liability*

Pursuant to Article 143 CO, there is no joint liability of debtors (i.e., in the present case, the selling shareholders) unless it is so stated in the contract.

3.4.8 *Qualification of Warranties as to Knowledge*

Warranties are often qualified as being given to the best knowledge and belief of the seller. This will not protect a seller who either knew, or should have known, of a defect had he applied due care or made reasonable enquiries (Article 3 CC). Under certain circumstances, the knowledge of directors, managers and officers of the target will be imputed to the seller.

Warranties are sometimes also qualified in terms of *materiality*. The seller might, for example, state that there are no ‘material’ proceedings pending, or threatened, against the target. Normally, it will be advisable to expressly define what ‘materiality’ means.

3.4.9 *Structure of Warranty Clauses*

The following areas are generally covered by warranty clauses:

- (a) the target (incorporation, shares, ownership, assets);
- (b) the target’s accounts;
- (c) the target’s business and contracts; and
- (d) dealings of the target since the date of the most recent balance sheet and the signing of the agreement or even until completion.

Statements as to the conduct of business until completion are, strictly speaking, undertakings by the seller to conduct the business in a certain manner, rather than warranties confirming a given state of affairs.

3.4.10 *Disclosures*

Warranties are usually given subject to matters disclosed either in the agreement itself or in a separate disclosure letter, which is annexed to the agreement.

3.4.11 *Text of Warranties*

Typical warranties may cover the following points:

(a) *Warranties as to the target*

- The buyer will usually require warranties to the effect that the target is duly incorporated and existing in accordance with Swiss law, as evidenced by an extract from the commercial register, which may be annexed to the agreement. The extract informs the acquirer about the number, type and nominal value of all outstanding shares, the dates of amendments in the articles of incorporation, and lists all persons entitled to sign on behalf of the target.
- The parties sometimes also agree to annex a copy of the articles of incorporation and of important resolutions by the board of directors – especially the resolution regarding the entering of the acquirer in the shareholders' register. The seller will then warrant that these are true copies of the original documents.
- A further warranty in this context will assure the acquirer that all corporate documents are in order, including the minutes of the shareholders' meetings and the meetings of the board of directors.

(b) *Warranties as to the accounts presented to the acquirer*

- If the parties have conducted their price negotiations based on the most recent financial statements of the target (see IV.3.3 above), the warranty in relation to the accounts will be of utmost importance. The buyer will want to seek confirmation that the balance sheet and the profit and loss statement (usually annexed to the agreement) have been drawn up in accordance with generally accepted accounting principles. Also, the warranty may state that the assets are neither individually nor collectively overvalued and that the liabilities are not undervalued or unaccounted for. This general warranty is often specified by detailed warranties for certain assets (e.g. real property or patents, where extracts of the respective registers may be annexed to the contract) or certain liabilities (e.g. taxes or social security contributions). This is especially important where the balance sheet does not adequately reflect the financial situation of the business (see II.6 above). Furthermore, the seller will be asked to warrant that

there are no contingent liabilities (to be accounted for in the notes to the balance sheet) and no other liabilities for which reserves should have been provided.

- Leased or rented property does not appear in the balance sheet, so the acquirer will often want the seller to warrant that such property is at the disposal of the target and that it is in good working condition.
- The purchaser may also seek to obtain a warranty by the seller stating that the target has conducted its business in the ordinary manner since the date of the last balance sheet and has not, and will not pending completion, enter into any transaction outside the ordinary course of business. This clause may also be inserted as a ‘covenant’ of the seller.
- Sometimes, the buyer will furthermore wish to include a warranty dealing with the inventory and its saleability within a certain period of time.

(c) *Warranties as to compliance with contracts and law*

- It is common for a seller to warrant that the target, its business and the sites are in compliance with all applicable laws and regulations. Compliance with building and construction laws, environmental regulations and statutes relating to safety standards of certain equipment is of particular importance in this context. With regard to regulated businesses, this clause will assure the acquirer that the business is operated in accordance with the applicable regulations.
- Furthermore, the purchaser will usually want the seller to warrant that there are (i) no defaults under any material contract, (ii) no claims against the target in relation to existing contracts, unless provided for, and (iii) no notices, threats or indications as to the termination of material contracts because of the transaction (for instance due to a change of control clause).
- The seller will also have to warrant that there is no litigation or administrative proceeding, pending or threatened, against the target unless disclosed.

- Sometimes, the buyer seeks a warranty that the assets are adequately insured.
- In addition, the seller will normally have to warrant that the target has not entered into (material) agreements and contracts other than those disclosed in an annex. The relevant contracts can be defined with respect to the contractual commitment (e.g. contracts resulting in an expenditure in excess of a certain amount, or contracts binding the target for a period of more than a certain number of years), or may contain a list of generically important agreements (e.g. licensing agreements, lease agreements, credit or loan agreements, consulting and joint venture agreements). Moreover, the acquirer may wish to include in this list all contracts between the target and the seller.
- Further clauses typically deal with taxes and obligations towards employees (including pension funds; *see* IV.3.8).

3.4.12 *Conduct Pending Completion*

A clause regulating the target's conduct pending completion is sometimes inserted either in the covenants section or in the section of the agreement dealing with warranties. Technically, two interim periods should be distinguished: (a) the period between the date of the last balance sheets and the signing of the agreement, and (b) the period between signing and completion. During the latter, the seller will still control the business but will do so on behalf of the acquirer. Therefore, the seller usually will undertake to cause the target to transact business only in the ordinary course and to seek written approval from the acquirer for certain important transactions. Often this clause can refer to the warranty clause enumerating important contracts (*see* IV.3.4.11 above).

3.5 *Covenants and Undertakings*

This clause may contain, *inter alia*:

- (a) A *non-competition clause*, which prevents the seller not only from directly competing with the target but also from participating in

competing enterprises, sometimes supported by a penalty payment obligation (Article 160 CO) on the part of the seller. The non-competition clause should be reasonably limited geographically and as to time and subject because courts may apply by analogy the relatively strict standards applying to non-competition clauses for employees (Article 340 *et seq.* CO). Furthermore, competition law considerations (*see* III.1 above) also necessitate a limitation as to scope, time and territory.

- (b) An *undertaking from the seller to enter into certain agreements* with the target, particularly, where prior to the sale the target was a subsidiary of the seller and where it will continue to provide certain services to its former parent in future; similarly, it may become necessary upon the sale to formalize oral agreements with former group companies. If, to take an example, the target holds patents, it may request the acquirer to procure that the target enters into a licence agreement with the seller.

A seller in a service business will often undertake to enter into an employment or consulting agreement with the target. Frequently, tax considerations will have a bearing on the question whether the seller prefers comparatively low compensation for his services as an employee or consultant in view of a higher purchase price for the shares, as the latter variation might lead to a tax-free capital gain (*see* II.5.2 above). This undertaking is often given additional weight by a clause specifying that signing of the employment contract is a condition precedent to completion of the purchase agreement. A party may then not unreasonably refuse to sign the employment contract in order to avoid completion of the purchase agreement (*see* Article 156 CO and IV.3.6 below).

- (c) An undertaking by the acquirer that for a certain period of time the *target will not terminate* any of its *employment contracts* and the acquirer will not liquidate the company.
- (d) An undertaking by the parties *to treat the purchase agreement and its contents confidentially* during a certain interval. In certain circumstances, however, the parties must be able to disclose confidential information due to legal requirements to report an acquisition (*see* II. 4 above). If the acquirer is a listed company and if officers

of the acquirer (or seller) intend to trade in the shares of the acquirer, an announcement will be inevitable, as such trading may amount to insider dealing in the absence of adequate information given to the public (*see* Article 161 of the Swiss Penal Code).

- (e) Sometimes the *conditions for conducting the business* of the target pending completion will be spelled out here as well.

3.6 Conditions

The agreement may contain a number of conditions that must be fulfilled prior to completion, including:

- (a) *Approval from third parties*, such as key employees, customers, suppliers, landlords and banks. Such approval is necessary when contracts with third parties contain a change of control clause, or when contracts may be terminated at a relatively short notice – for example credit agreements with banks, employment contracts and possibly lease agreements.

Instead of insisting on certain undertakings (*see* IV.3.5 above), the parties may prefer to make the signing of certain agreements a condition precedent to completion. It is often useful to specify the exact form of the consent or agreement required in order to avoid uncertainty at the completion meeting.

- (b) *Governmental authorizations*, for example clearance from the competition or the tax authorities.
- (c) *Shareholders' approval*, where necessary (*see* II.3.1 above).

In general, the parties should be aware of Article 156 CO, which provides that a condition is deemed 'fulfilled' where one of the parties has attempted in bad faith to prevent it from being satisfied.

3.7 Completion (Closing)

This clause specifies when and where completion will take place. The seller will often seek assurance that the cheque received is credited to his account on the same day when the shares are transferred, i.e. on completion.

Furthermore, the agreement will enumerate the documents to be exchanged on completion, such as:

- (a) Letters of resignation from the members of the board of the target.
- (b) Consents and authorizations by third parties and a board resolution agreeing to the transfer of registered shares to the acquirer and the entering of the acquirer in the shareholders' register.
- (c) Assignment of a shareholders' loan and signed copies of the target's agreements with the seller.
- (d) A report to be prepared by the accountants who have examined the books and inventories of the target.

3.8 Other Provisions

Other provisions of a typical share purchase agreement may cover the following topics:

- (a) *Employees and pensions*: Swiss employers may either set up their own pension fund or insure employees with an existing fund, as set out in the *Federal Act on Compulsory Pension Plans of 25 June 1982*. Pension funds are legal entities distinct from the employer. An acquirer will therefore not enter into a direct legal relationship with the target's pension fund upon the acquisition.

A surplus in the fund does not accrue directly to the target, but can sometimes be used for a contribution holiday. Technically, the target is not liable for underfunding provided it has always made the contributions due, although the target will often have a 'moral obligation' to fill existing gaps. Specific terms in the purchase contract are necessary in case new pension arrangements must be made; for example, where employees used to be members of a pension fund of the seller's group, there must be provisions for a split of the fund (*see also Article 23 of the Federal Act on Vested Benefits of December 17, 1993*). If the pension fund must be terminated, amended and/or partially distributed, governmental authorities must approve the arrangement. In all other cases, the employees will remain beneficiaries of the target's pension fund.

- (b) *Insurance coverage*: insurance arrangements must sometimes be re-considered, especially where the target is a group company insured under an umbrella insurance policy.
- (c) *Entire agreement*: this clause will specify that the signed agreement, together with its annexes, contains the entire agreement of the parties and supersedes any previous understanding or contract.
- (d) *Modifications*: modifications will usually have to be made in writing.
- (e) *Costs*: it is usual to provide that each party bears its own costs (i.e. lawyers' and accountants' fees); if a security turnover tax is levied on the transaction (*see* II.5.2.4), the parties should specify who will have to bear this tax.
- (f) *Notices*: This clause will specify the manner in which any notices are required to be given, e.g. whether communications by fax or e-mail constitute valid notices under the agreement.
- (g) *Applicable substantive law*: Swiss law usually is agreed to be the governing law if the target is a Swiss company. A foreign law might be chosen if, for example, both the seller and the acquirer are nationals of the same non-Swiss jurisdiction.
- (h) *Jurisdiction*: parties often agree that disputes will be submitted to a Swiss arbitral tribunal or a Swiss court, or possibly – as a compromise – to the Swiss courts at the domicile of the target. The latter choice is only possible if at least one of the parties is a resident in Switzerland or if Swiss law is applicable to the contract (Article 5 III of the Federal Act on Private International Law) since *forum non conveniens* rules may apply to domestic cases (i.e. where both the seller and the acquirer are Swiss companies and/or Swiss nationals).

3.9 Signatures

No notarization or filing of the acquisition agreement is necessary in order to make the document binding. A Swiss party's authorized signatories (as evidenced by an extract of the commercial register) will sign the agreement; no corporate seal need be affixed or stamped onto the document.

It is common for the parties to initial all pages of the agreement, although this is not a legal pre-requisite.

4 The Business Purchase Agreement

4.1 In General

The main difference between a business purchase agreement and a share purchase agreement lies in the fact that the former must specifically enumerate the assets sold and the liabilities transferred. With respect to the liabilities, the parties usually agree on a public notice of the transfer in order to avoid the necessity of approval by all the creditors. Otherwise, the business purchase agreement will look similar to the share purchase agreement with the exceptions referred to below.

Swiss law generally requires consent by the creditors to the assumption of a debt by a new debtor (Article 176 CO). However, where an entire business is transferred and where the transfer is publicly announced, Article 181 CO dispenses with such consent. Instead, in order to protect the creditors, the seller remains jointly liable with the acquirer for two years after the transfer; for unmatured claims the two year period commences on the day the claim becomes due.

4.2 Breach of Warranties

It is usual to contractually specify the consequences of a breach of warranties in Swiss acquisition agreements because Swiss statutory remedies are inadequate (*see* IV.3.4.3), and Swiss law is unclear on the question whether a reduction in the purchase price is to be made based on the effect the breach has with respect to the business as a whole or with respect to the value of the respective asset.

4.3 Employees

Employees may terminate their contracts where there is a business transfer if they do not agree to be taken over (Article 333 CO). In addition, Article 333a CO provides for an information duty of the employer. However, employees must respect the legal notice period of one to

three months depending on the duration of their employment (Articles 336a and 336b CO). Therefore, Article 333 CO is of practical relevance only to the extent that important employees of the target have long-term contracts or contracts with long notice periods.

4.4 Consent of Third Parties

Often, consents from third parties (*see* IV.3.6 and 3.7 above) or governmental authorizations will be necessary for a business transfer. Non-assignment clauses in agreements with third parties will have to be waived by the third parties concerned.

4.5 Completion

As each asset, contract and liability must be individually transferred according to the applicable rules, the clause regulating completion activities usually contains a detailed list of the documents to be produced in order to evidence the various transfers.

4.6 Merger Act

Under the Merger Act registered companies and sole traders will be able to transfer assets and liabilities by the simple act of entering the transfer into the commercial register, based on a written business transfer agreement specifying:

- the name, registered office and legal type of the entities involved;
- an inventory listing the assets and liabilities to be transferred;
- the value of the assets and liabilities to be transferred;
- the consideration to be received (if any);
- a list of the employment relationships to be transferred.

Unless the assets concerned are insignificant, the shareholders of the company transferring parts of its business must be informed in a note to the annual financial statements, or where no such financial statements must be prepared, in a general meeting. The board must set forth and explain the purpose and the consequences of the business

transfer, the transfer agreement, the consideration as well as the consequences for the employees and a social plan (if any). As far as transferred liabilities are concerned, the transferring company will be jointly and severally liable with the acquirer for a period of three years, which in the case of unmatured claims starts to run from the due date. In certain circumstances, a duty to secure creditors may arise.

5 Management Buyouts and Leveraged Buyouts

5.1 *Management Buyout*

A management buyout is a transaction by which the target's managers and, due to their lack in financial strength, equity and debt investors, such as banks or funds, jointly acquire the shares of the target company. The goal of the buyers is to finance the acquisition by making use of the company's assets and to service the company's loans from future earnings so as to obtain the maximum tax advantage. This is achieved usually by the formation of an acquisition company, which purchases the shares of the target into which it is merged after a certain period of time. While debt investors expect regular interest payments, a (partial) repayment of the loans and sometimes an option to purchase shares (in the event of mezzanine facilities), equity investors are hoping to achieve an appropriate return in view of the company's expected development and the prospect of being able to sell the shares. Companies which have recently been listed on the SWX Swiss Exchange following a management buyout include *Saia-Burgess*, *Schaffner Elektronik* and *Burkhalter Group*.

As a rule, arrangements between a corporation and its managers or directors do not have to be disclosed, in contrast with other jurisdictions. However, a breach of the general duty of care and loyalty of managers and directors may either result in the transactions being void – if they are not in the best interest of the corporation, or, if in the light of third party interests the transactions are not declared null and void, it may at least expose the incumbent managers and directors to personal liability vis-à-vis the shareholders, the company or the creditors who have suffered a damage.

There is no body of precedents clearly defining the duties of management if it purchases its own business. The general duty of care and loyalty seems to indicate that managers should seek an independent valuation of the business in order to protect themselves against personal liability. No such valuation is necessary where all the shareholders approve the transaction provided they have been able to take an informed decision.

An additional layer of complexity arises sometimes if the seller is a private individual. Though private individuals are normally capable of realising a tax free capital gain by disposing of shares held in their private portfolios, the tax authorities have taken the position that a management buyout may boil down to an indirect partial liquidation of the company (*see* II.5.2.1). If this is the case, capital gains are taxable even if they are made by a private seller. Since the criteria applied by the tax authorities vary and sometimes lead to unpredictable results, in practice, tax rulings should be sought to clarify the situation in each given case.

5.2 Leveraged Buyout

Leveraged buyouts basically operate like management buyouts. The main difference is that the initiative for the buyout is taken by debt and equity investors rather than by the management of the company. The formal purchaser will usually be a newly formed acquisition company that will be merged into the target after the share acquisition in order to ensure an efficient structure for tax purposes, which allows to set-off interest payments with earnings and which leads to an acceptable debt-equity ratio. The investors normally take an active part in the management of the company after the acquisition so as to make it ready to be floated in 2 to 5 years. The major leveraged buyouts in the past few years involved companies like *Charles Vögele*, *Geberit* and *Soudronic*.

Where a bank finances an acquisition, it will want to take the shares of the target as a security. Business assets, with the exception of real estate, are usually unsuitable as collateral since under Swiss law a pledge of movables involves a transfer of possession. This is a further explanation as to why in general there is a preference to acquire shares rather than the on-going business of a corporation (*see* IV.1 above):

shares can be pledged without affecting the day-to-day business of the target.

Should the seller be prepared to grant a loan to the acquirer, it is important to note that under Articles 717 and 884 CC the transfer of ownership in shares retained by the seller as collateral for his loan to the acquirer might be held invalid by a Swiss court.

Tax considerations might exclude the possibility of the target granting a loan to the acquirer. In addition, the target's securing of the debt incurred by the acquirer to finance the acquisition might be considered *ultra vires*. Therefore, the acquirer may have to cause the target to sell assets not required for the running of the business and to declare a dividend in the amount necessary to refinance the transaction.

6 Share-for-Share Deals (Quasi-Mergers)

6.1 *In general*

As stated above (*see* IV.3.3), the consideration for an acquisition may take the form of cash or shares. More specifically, the parties may agree that the consideration shall be satisfied by the purchaser issuing shares to the seller in exchange for the seller's shares in the target company. Where shares are used as consideration, the transaction is referred to as a *share-for-share deal*. If all the shares of the target company are acquired, a share-for-share transaction has an effect similar to that of a merger, where the shareholders of the disappearing entity receive shares of the surviving entity. Therefore, this type of transaction is sometimes referred to as *quasi-merger*. Important quasi-mergers in the recent past involved the acquisition of *Winterthur Insurance* by *Credit Suisse* and the acquisition of *Hoechst* by *Clariant*.

However, in contrast to a statutory merger, the target company is not deleted in the commercial register in a quasi-merger but continues to exist as a subsidiary of the purchaser. Consequently, the acquirer's and the target company's rights and obligations vis-à-vis third parties remain unaffected. One of the main reasons why a share-for-share deal may suit a seller who is a private individual subject to Swiss taxation is that capital gains are tax free if they are made on the exchange of shares in a share-for-share transaction, whereas statutory mergers may result

in taxes being levied from private individuals in certain circumstances (*see* II.5.4 above). If an acquirer offers its shares to the seller, in general the seller will accept consideration in this form only if the shares are readily marketable. More often than not, this rules out share-for-share deals involving private companies as buyers.

In a situation where the buyer and the seller disagree as to the form which the consideration should take, in that the buyer wishes to offer shares whereas the seller wishes to receive cash, a *vendor-placing* could be envisaged. Though rare in practice, this type of placing involves an arrangement whereby the buyer transfers its shares to the seller and has its financial advisers organize a placing of these shares with institutional investors while promising the seller a certain amount of proceeds out of such placing.

6.2 Procedural Aspects

Quasi-mergers are often based on an agreement between the buyer and the target company in which the parties agree to combine their businesses on the basis of a certain exchange ratio. In addition, the buyer commits to creating the required shares if necessary and to submitting an exchange offer to the shareholders of the target company. If the target company is listed on the SWX Swiss Exchange, the buyer must observe the Swiss takeover rules.

Prior to 1992, the issuance of the acquirer's shares to the seller as consideration for the purchase of the seller's shares was hard to achieve because, on the one hand, authorized share capital was not available, and, on the other hand, the holding of treasury stock was restricted.

Authorized share capital has been introduced to Swiss company law in July 1992 (*see* Article 651 CO). However, the amount of authorized capital may not exceed 50 per cent of the outstanding ordinary capital and the authorization to the board of directors to issue new shares may only be given for an interval of two years. Furthermore, pre-emption rights of existing shareholders must be disapplied, which requires a special quorum and valid grounds (*see* Articles 652b and 704 CO). If new shares are issued to the seller, the exchange of the acquirer's shares for the shares of the seller will be considered as a contribution-in-kind to the acquirer. Therefore, the increase is further com-

plicated by the requirement of (a) a special report to be made by the board of directors, assessing the target company on the basis of a valuation and (b) an auditors' report confirming the accuracy of the statements contained in the special report (Articles 652e, 652f CO). The shareholders must approve the capital increase by a special majority of two-thirds of the shares represented at the meeting (Article 704).

Treasury shares are now generally permitted, but in aggregate they must not exceed 10 per cent of the share capital (20 per cent in exceptional cases, *see* Article 659 CO).

V Takeover Regulation

1 Scope

1.1 Public Takeover Offers

The takeover rules embodied in the Stock Exchange Act and its implementing ordinances govern public offers for shares of a Swiss company of which at least one class of equity securities is listed on a Swiss stock exchange (Article 22 SESTA). Recently, the Federal Banking Commission ruled that offers for shares of foreign companies listed on the SWX Swiss Exchange and managed in Switzerland are also subject to SESTA. The Swiss takeover rules do not operate, however, if none of the target company's equity securities are listed.

Public takeover offers are widely defined to cover offers to purchase or to exchange shares. Exactly what the term 'public' means is unclear and depends on the circumstances of a particular case, especially on the question whether the offerees are in a position to negotiate rather than merely accept or reject an offer. Creeping tender offers, where a stake is steadily built up by purchases on or off the exchange, do not fall within the ambit of the Swiss takeover rules; however, such a tactic is difficult to pursue due to the rules relating to the disclosure of important shareholdings (*see* II.4.1).

Despite the fact that most public offers are made to acquire the entire equity capital, SESTA also covers partial offers. Furthermore, companies carrying out capital restructurings must generally have regard to the takeover rules, though the Takeover Board has clarified (in the case of Zurich Allied) that the rules must be applied with a certain flexibility if no change of control is involved, for instance in the event that the shareholders of a trading company are offered shares in exchange for shares in a newly formed holding company.

A bid which is supported by the board and management of the target company is generally referred to as a *friendly offer*, whereas an offer which does not carry the recommendation of the board is called *hostile*. SESTA regulates both friendly and hostile offers.

1.2 Purchase of Own Shares

Public offers by a listed company on its own shares are deemed to be takeover offers, albeit in certain circumstances the company may be exempt from the takeover rules. In particular, buybacks which involve 2 per cent of the shares at maximum are generally exempt. Furthermore, buybacks which satisfy the following conditions may be exempted by the Takeover Board on a case-by-case basis:

- the buyback offer involves a maximum of 10 per cent of the votes or the share capital;
- completion of the buyback programme will not result in the shares being delisted;
- the buyback offer relates to all listed equity securities;
- the company has committed itself to notifying the Takeover Board and one of the principal electronic media specialised in disseminating stock market information on the first trading day after the offer period of the number of tendered shares;
- in addition, certain other conditions must be satisfied depending on whether the shares are offered to be repurchased at a fixed price or at market price.

Further exemptions may be granted by the Takeover Board if an application is made not less than 10 trading days before publication of the offer and if the contemplated offer ensures compliance with the principles of equal treatment, transparency, fairness and good faith.

1.3 The Takeover Board

The Swiss Takeover Board is appointed by the Federal Banking Commission, the supervisory authority for stock exchanges and securities trading in Switzerland. It is the Takeover Board's responsibility to ensure compliance with the takeover rules. To this end, the Takeover Board may request all information it deems relevant from an offeror or a target company. The Takeover Board issues recommendations to the parties involved in a takeover in each case and states whether the takeover rules are complied with. If the recommendations are rejected or

disregarded, the Takeover Board informs the Federal Banking Commission. The Federal Banking Commission may then issue a binding order against which there is a right of appeal to the Federal Supreme Court.

In practice, it is customary for offerors to contact the Takeover Board at an early stage of the process, especially if there is any doubt whatsoever whether a proposed course of action is in accordance with the takeover rules. Besides, offerors usually submit drafts of the prior announcement, the offer prospectus and the summary of the offer to a delegation of the Takeover Board for preliminary approval.

2 Procedure

2.1 *Takeover Timetable*

The dates in the left-hand column are given by reference to the day when the offer is published (P-Day).

P - six weeks	Voluntary prior announcement of the offer in at least two national newspapers and through the electronic media
P - Day	Publication of the offer in at least two national newspapers and through the electronic media (including a reference to the prospectus)
P + 10	End of the cooling-off period, which may be waived in certain circumstances
P + 15	Publication of the position report by the target company's board of directors unless the report has been published in the prospectus
P + 30/50	End of offering period, having lasted at least 20 trading days (10 trading days in exceptional circumstances) and not more than 40 trading days
P + 31/51	Calculation of the shares tendered on a provisional basis and notification to the Takeover Board, the Swiss Exchange and through the electronic media

P + 34/64	Publication of final interim result
P + 44/64	End of additional offer period, which must be granted if the offer is successful
P + 45/65	Notification of the provisional end result to Takeover Board, Swiss Exchange and through the electronic media
P + 48/68	Publication of the final end result
P + 54/74	Settlement

2.2 Prior Announcement

Under the Swiss takeover rules, the offeror may inform the markets of its intention to launch a tender offer in what is called a ‘prior announcement’ (‘Voranmeldung’) before the offer is actually made (*see* Article 7 *et seq.* TO). This leaves the offeror an interval of six weeks to prepare the offer documents. If the offeror needs clearance from competition or other authorities prior to be able to launch the offer, the Takeover Board may extend the six weeks period.

Due to the offeror’s obligation to proceed with the offer within six weeks, the decision to make a prior announcement must not be taken lightly. A prior announcement is particularly advisable in the event that (a) the SWX Swiss Exchange’s ad hoc publicity rules would require disclosure to the markets anyway, for instance when price-sensitive information concerning a contemplated offer is leaking, (b) a competing bid is being prepared of which the market should be advised as soon as possible, (c) clearance needs to be obtained from the Competition Authorities before an offer can be made, (d) the offeror wants to lock in the minimum offer price in case of a mandatory offer (*see* V.7), or (e) the offeror wants to restrict the target’s options concerning defensive measures.

The prior announcement must contain:

- the offeror’s name and registered office;
- the target company’s name and registered office;
- the equity securities to which the offer relates;

- the price of the offer;
- the date of publication of the offer and its duration;
- conditions attached to the offer.

If a prior announcement is made, as per Article 9 TO the main consequences are that

- (a) the date of the prior announcement, rather than the date of publication of the offer, is the point in time (i) when the offer price is determined in the event of a mandatory offer, (ii) as from when notification duties arise for the offeror as well as for the target's important shareholders, and (iii) as from when certain defensive measures are prohibited; and
- (b) the announced price of the offer may not be changed to the disadvantage of the persons to whom the offer has been extended, unless the target company is subject to a due diligence investigation and the change can be objectively justified or unless the announced offer price is depending on the price the offeror will have to pay for an acquisition of a significant holding.

Since the offer price published in the prior announcement is generally binding, for all practical purposes the offeror must have arranged financing of the transaction at this stage already, albeit information on the type of financing and a confirmation by the special auditors that the necessary funds are available will have to be provided in the final prospectus only.

2.3 Publication of the Offer

The offer must be published in a prospectus containing information on the offeror, the financing, the offer price, the securities to which the offer relates and the target company (*see* V.4.1 below). Although the prospectus must be submitted to the Takeover Board not later than the date of publication, the offeror will normally provide the Board with a copy as early as possible to prevent it from asking for amendments after publication, which would have to be published again. Furthermore, the cooling-off period may be waived by the Takeover Board after review of the prospectus before publication provided that the prospectus includes the report of the board of directors of the target company.

A summary of the prospectus must be published in at least two national newspapers in German and in French and must be made available to one of electronic media specialised in disseminating stock market information (Telekurs, Reuters, Bloomberg, etc.). It must be clearly indicated where the prospectus can be obtained free of charge.

2.4 Offering Period and Publication of Results

The normal offer period of between 20 and 40 trading days may be reduced to 10 trading days provided that the offeror already holds the majority of the voting rights in the target company before the publication of the offer and the report of the target company's board has been included in the prospectus. Conversely, an offer period of less than 40 trading days may be extended to the maximum period if the offeror has reserved the right to do so in the prospectus.

On the business day following the day on which an offer is due to expire the offeror must make an announcement through the electronic media and must simultaneously inform the SWX Swiss Exchange and the Takeover Board. This provisional interim announcement must state the number of equity securities acquired and held by the offeror and specify whether the conditions of the offer (if any) have been fulfilled. The definitive interim result must be published not later than four trading days after the expiry of the offer.

If the offer is successful, the offer period must be extended and the offer may be accepted during an additional period of 10 trading days after publication of the interim results. The final results will then be published again, first on a provisional basis and then in definitive form.

3 General Principles

The classical takeover situation involves an offer by a Swiss or a foreign company to acquire the whole or part of the equity capital of a listed Swiss company. The obligations and requirements arising in such a takeover for the offeror, the target company and their respective boards of directors are numerous. The general principles which apply to all transactions can be summarised as follows:

3.1 True and Complete Information and Equal Treatment of Shareholders

The offeror must publish the offer in a prospectus, the contents of which are set out below. The prospectus must contain true and complete information so as to enable the shareholders of the target company to reach an informed decision whether to tender their shares or not. While this is not specifically spelled out in the Act, it may be assumed that the general prospectus liability provisions will apply to the offer prospectus if it contains false or misleading information or relevant information is withheld.

In addition, the offeror must treat all shareholders of the target company equally (*see* Article 24 II Sesta and Article 10 TO). This has several implications. In relation to the offer price, while it may be fixed at the discretion of the offeror, provided the offer is not subject to the mandatory offer rules (*see* V.7 below), the principle of equal treatment requires that all shareholders of the target company are entitled to get the best price paid by the offeror to any one of them. If the offeror continues to buy shares of the target on and off the exchange during the offer period, the best price paid must be offered to all shareholders. The Takeover Board has decided that due to the best price rule the offeror may not buy target shares at a price higher than the offer price during a period of 6 months after the offer has expired.

Furthermore, equal treatment extends to different classes of securities in that the offer must cover all classes of listed equity securities of the target company, to the exclusion of options or warrants. If a partial offer is made, the acceptances are taken into account on a pro-rata, as opposed to a first-come-first-served, basis.

3.2 Conditions and Withdrawal of the Offer

Conditions may be attached to the offer. *Suspensive conditions* are generally permissible, provided their satisfaction is not in the offeror's control (*see* Article 13 I TO). Suspensive conditions usually involve acceptances of a certain percentage of the securities to which the offer relates, official authorisations (competition commission, federal banking commission, etc.), or the registration of the offeror in the share register in case of registered shares. When the offer expires, it must be

clearly stated whether the condition has been fulfilled. The offeror may also reserve the right to waive certain conditions. *Resolutive conditions*, where the fulfilment or non-fulfilment of the condition can be ascertained only after the end of the offer period, require the approval of the Takeover Board (*see* Article 13 IV TO), which is normally granted where there are pending anti-trust clearances.

An offer may be withdrawn only if the offeror has expressly reserved the right to do so in the event that a condition is not fulfilled (*see* Article 16 TO). Withdrawals are permissible only if they are linked to the non-fulfilment of a condition.

3.3 Disclosure Obligations

The offeror and any other person holding at least 5 per cent of the voting rights of the target company must report all purchases and sales of equity securities of the target company to the Takeover Board and the SWX Swiss Exchange during the interval from publication until lapse of the offer (*see* Article 31 SESTA and Article 37 *et seq.* TO). The disclosure must be made not later than 12 noon on the business day following the day of the transaction. The Takeover Board may recommend publication of the disclosed transactions in certain circumstances.

3.4 Persons Acting in Concert

Persons acting in concert are persons who co-ordinate their conduct by contract or any other method to purchase or sell securities or exercise voting rights in a company. As a general rule, persons acting in concert with the offeror must be disclosed in the prospectus and comply with the obligations incumbent upon the offeror, such as the obligation to treat shareholders equally, to notify transactions and to comply with transparency requirements. The shareholdings of persons acting in concert with the offeror are added to those of the offeror when calculating the offer's interim and final results.

3.5 Conduct of the Target Company

The board of directors of the target company normally advises its shareholders whether to accept or reject the bid in a special report,

which is published either as part of the bidder's prospectus (in the event of friendly offers) or separately not later than 15 trading days after publication of the offer (*see* Article 29 Sesta and Article 29 TO). Instead of making a recommendation, the board may merely enumerate advantages and disadvantages of the proposed offer. The directors must assure that no statements are made which could mislead shareholders or the market and must not have regard to their personal situation as directors of the target company. Directors should also be mindful that any commitments they enter into with an offeror may restrict their freedom to advise shareholders in the future. This may lead to conflicts of interest or to a breach of the directors' fiduciary duties. Besides, they may not take any frustrating action by employing defensive tactics intended to significantly alter the assets or liabilities of the target company (*see* V.5.2 below).

4 Takeover Documents

4.1 *Offer Prospectus*

The persons to whom the offer is extended must be given sufficient information to enable them to reach an informed decision as to the merits of the offer (*see* Article 24 Sesta and Article 17 TO). More specifically, the following points have to be covered by the offeror in the prospectus:

In relation to the offeror (*see* Article 19 TO):

- name, registered office, equity capital and main activities of the offeror;
- identity of the shareholders or groups of shareholders holding more than 5 per cent of the voting rights, including the percentage of their shareholdings;
- the shareholders who directly or indirectly control the offeror insofar as this is significant for the recipients of the offer;
- person acting in concert with the offeror if this is significant for the recipients of the offer;

- the address where the offeror's latest published financial statements can be obtained;
- the offeror's shareholdings in the target company in relation to capital and voting rights, irrespective of whether these rights may be exercised or not;
- the number of equity securities in the target company purchased and sold by the offeror in the 12 months preceding the offer, including the highest purchase price.

In relation to the financing (*see* Article 20 TO):

- type of financing;
- confirmation by special auditors that the necessary funds are available;
- in the event of an exchange offer the offeror must confirm that all necessary measures have been taken to procure the securities to be exchanged.

In relation to the targeted securities and the offer price (*see* Article 21 TO):

- capital of the offeror;
- securities to which the offer relates;
- in the event of a partial offer, the maximum number of securities to which the offer relates;
- the price offered for each security, or in the event of an exchange offer, the exchange ratio.

In relation to the target company (*see* Article 23 TO):

- the offeror's general intentions in relation to the target company;
- existing agreements between the offeror and the target company, its shareholders or its key persons;
- confirmation by the offeror not to be privy to confidential information in relation to the target company, which the offeror received either directly or indirectly from the target company and which could

be of material relevance to the decisions of the persons to whom the offer is extended; this requirement is of particular importance where due diligence exercises have been carried out by the offeror prior to the offer.

Further disclosures are required in case of public exchange offers (*see* Article 24 TO), including information on the securities offered as consideration and on the company of which the securities are offered. If the securities offered are not listed, an auditor's valuation report must be included in the prospectus.

The offer prospectus must be reviewed prior to its publication by either an auditor authorized to audit Swiss securities dealers or by a securities dealer authorized under SESTA. The review covers the completeness and accuracy of the prospectus, compliance with the principle of equal treatment and the availability of funds to finance the offer. Its results are to be included in a written report in the offer prospectus.

4.2 Target's Defence Document (Board Report)

The directors of the target company must publish a report whenever a public offer is extended to the target's shareholders or when a previous offer has been revised (*see* Article 29 SESTA and Article 29 TO). When making its recommendation, the directors must be careful not to be swayed by personal interest since they have a fiduciary duty to act in the best interests of the company.

The report setting forth the position of the target's board of directors must contain sufficient information and advice to enable the shareholders to reach an informed decision. The published information must be true and complete. In particular, the report must state the intentions of the shareholders who own more than 5 per cent of the voting rights, provided the board has knowledge thereof, and the intentions of the target with respect to defensive measures, including shareholders' resolutions planned in this respect. In addition, potential conflicts of interests of directors and senior managers must be disclosed and the measures taken to prevent such conflicts from affecting the shareholders of the target must be highlighted in the report.

It is probable that besides the report a number of further documents will be issued by the target company, including press releases, adver-

tisements and other communications to the market. While the takeover rules do not specifically address such additional documents, the board should ensure that the information contained in these documents is in accordance with the facts and does not omit anything likely to affect the import of such information. Further, the board should keep in mind that the board report must be true and complete so that material information published prior to the report must be reflected in the report and disclosures of significant matters after the publication of the report may entail a duty to amend and re-publish the report.

5 Defensive Measures by the Target Company

5.1 In general

During the course of an offer, the board of the target company may not enter into legal transactions which would have the effect of significantly altering the assets or liabilities of the target company without the approval of the shareholders in a shareholder's meeting (*see* Article 29 II SESTA). Although this means that in general the board of the target company may not take steps designed to make the company less attractive to the offeror or harder for it to acquire, there are certain permissible manoeuvres to defeat a hostile bidder, especially if they are put into place before an actual bid has surfaced.

5.2 Defensive Measures

In this context, the question arises whether in takeover situations the shareholders' meeting may generally deal with subject matters for which under general corporate law the board of directors is exclusively responsible. In the absence of a body of precedents, the answer to this question is controversial. Legal commentators agree, however, that the shareholders' meeting may not simply re-delegate the general power to adopt defensive measures to the board of directors before a tender offer is made, whereas it seems to be permissible for the shareholders' meeting to authorize the board in advance to take specific measures, should a hostile bid arise.

Transactions entered into by the board of a target company in violation of the restrictions on frustrating actions are null and void and may therefore be challenged by any person at any time.

Permissible pre-offer techniques include:

- (a) *Restrictions of the transferability of registered shares*, which can be achieved by Swiss companies through a clause in their articles of incorporation stipulating a maximum shareholding that no shareholder may exceed, generally expressed as a percentage of 2 to 5 per cent of the outstanding share capital. Yet, the articles of incorporation often make it clear that the board of directors may grant exceptions to this rule, thus entrusting the incumbent management with discretion to give preference to a white knight over a raider.

If the registration of a bidder is refused within 20 days after notification of the transfer, the bidder must still be registered as a shareholder without voting rights (Article 685f). As a consequence, a raider may increase his relative voting power even by acquiring shares without voting rights. If the articles of incorporation fix the maximum at 10 per cent, a raider could purchase that percentage plus a further 60 per cent of the shares, for which he will be registered as a non-voting shareholder. Still, among the shares carrying voting rights he will control 25 per cent, which is often sufficient to change the board of the company.

Acquirers have tried to circumvent transfer restrictions by making their offer conditional upon a shareholders' meeting changing the articles of incorporation or by making the offering conditional upon the board of directors declaring that it will enter the acquirer in the share register.

- (b) *The creation of super voting shares and the placing of shares with 'friendly' parties* requires a qualified majority vote in the shareholders' meeting and valid grounds for the disapplication of pre-emption rights. This double hurdle will generally be difficult to pass.
- (c) *Buybacks of own shares* of up to ten per cent of the share capital are generally permissible under certain circumstances specified by the

Takeover Board (*see* V.1.2 above). Shares held by the target or by its subsidiaries cannot be voted (Article 659a and 659b CO).

- (d) *Limitations of shareholders' voting rights* in accordance with Article 692 II CO. The articles of incorporation may also limit the number of shares any one person may represent (Article 689 II CO). Many Swiss companies have included such clauses in their articles which have proven to be a very effective anti-takeover device. Companies may create such rules by a majority vote in the shareholders' meeting. Legal doctrine generally requires that there are justifiable reasons for such a measure and that the shareholders be treated equally. If the board of directors is empowered to grant an exception, the – so far unresolved – question arises under what circumstances the board may do so; recent court cases have even held such clauses to be invalid if they give full discretion to the board.
- (e) *Staggered boards*, where each year a certain percentage of all directors is elected for a defined period, though increasingly popular, are not in any case an effective anti-takeover device under Swiss law because the shareholders' meeting may force directors to step down at any time (Article 705 CO).

Defences adopted by Swiss companies were for a long time supported by the practice of Swiss banks to vote the shares represented by them on behalf of their clients in favour of the management of the company (the total of such shares often constituted 30 to 50 per cent of all shares present in a meeting). Because the banks' role has changed since Swiss company law was amended in 1992, requiring banks to seek specific instructions from their clients prior to voting the shares (Article 689d CO), the outcome of shareholders' resolutions adopting frustrating actions for bidders should now be less evident.

As opposed to the pre-offer techniques set out above, most post-offer manoeuvres are proscribed by the Swiss takeover rules (*see* Article 35 II TO), including:

- a *scorched earth* policy where the board either sells or buys business assets at a value or a price of more than 10 per cent of the balance sheet total;

- a *crown jewel option* whereby the target's management grants a third party a right to acquire a part of the company's most valuable business assets or intangibles if these are designated as crown jewels by the offeror;
- *golden parachutes*, i.e. agreements between the company and its directors or senior managers providing for unusually generous payments to be made in the event they resign from their position;
- the *issuance of new shares or bonds with conversion or option rights* based on authorized or contingent share capital without pre-emption rights or priority subscription rights of the existing shareholders, unless the shareholders' meeting which created the authorized or the contingent share capital expressly resolved that the board will be entitled to issue new shares in the event of a tender offer by a third party as well.

Still, there are some commonly used techniques that are permissible under the Swiss takeover rules, provided they do not substantially affect the company's assets, such as:

- *defensive lawsuits* against the bidder;
- finding a *white knight* willing to acquire the company and to enter into a competing bidding process;
- *re-capitalisations* of the company to increase its short-term value to the shareholders, for instance by borrowing and paying out generous dividends;
- *greenmail* payments to the bidder by buying back the shares at a price above market value and entering into a standstill agreement;
- *Pac Man defences*, i.e. bids launched by the target company to acquire the hostile bidder.

6 Competing Offers

6.1 Procedure

Occasionally, a company attracts the attention of more than one bidder. The guiding principle in relation to competing offers is that the shareholders of the target company must be free to choose between the initial and the competing offer (*see* Article 30 II Sesta and Article 47 *et seq.* TO). A competing offer may be published at any time but not later than three trading days prior to the expiry of the initial offer. The offer period of the competing offer must equal that of the initial offer and may not be shorter than 10 trading days.

As a consequence, if the initial offer would lapse before the end of the competing offer period, the initial offer is automatically extended until the expiry of the competing offer, and the shareholders who have accepted the initial offer may withdraw that acceptance until the initial offer expires. After a competing offer is made, the initial offer may be revised or withdrawn until 5 trading days before the expiry of the (extended) initial offer. Revised offers are treated as new offers although the cooling-off period is reduced to three trading days and the offer period to 10 trading days.

6.2 Equality of Information

The target company must treat offerors equally, mainly by providing any information given to one offeror or potential offeror promptly to another offeror or bona fide potential offeror even if the other offeror is less welcome. This should be kept in mind by the directors of a target company when faced with a welcome bid, for any information divulged to a friendly suitor may have to be disclosed subsequently to an unwelcome raider. Still, unequal treatment of individual bidders may be permissible based on the consent of the Takeover Board on the grounds of overriding interests of the target company. Especially competitors may therefore not receive all the information supplied to other offerors.

The directors of the target company are personally liable for any contravention of the principle of equal treatment (Article 754 CO) and are well-advised to seek independent outside counsel to avoid the pitfalls of favouring one offeror over the other instead of creating a level playing field for all would-be bidders.

7 Mandatory Offers

7.1 General

Whilst the general takeover rules relate to voluntary takeover offers, under SESTA a person may be required to make an offer to buy all the equity capital of a company in certain circumstances. No such mandatory offer requirements exist for example under US federal laws. What triggers a mandatory offer is an acquisition of equity securities resulting in a shareholding exceeding $33\frac{1}{3}$ per cent of the voting rights of a target company, irrespective of whether such voting rights may be exercised (Article 32 SESTA).

Though mandatory offers are generally governed by the same rules and regulations as voluntary offers, they differ insofar as the offer price and the conditions attached to the offer are concerned. The offer price may not be lower than the current market price and may not be more than 25 per cent below the highest price paid by the offeror in the preceding 12 months for equity securities of the target company. The offer price may be settled by cash payment or in exchange of equity securities. Except with the consent of the Takeover Board, mandatory offers – unlike normal tender offers – may not be made subject to conditions. Exemptions may be granted by the Takeover Board on important grounds, such as an antitrust or another clearance, the transfer of all voting rights of the targeted securities, or the non-disposal of crown jewels by the target.

Moreover, the Swiss takeover rules provide that if a partial offer is made resulting in the offeror receiving shares in excess of $33\frac{1}{3}$ per cent of the voting rights of the target company, the terms applying to mandatory offers must be fulfilled from the beginning (*see* Article 10 V TO). This, if strictly applied, could have undesired effects for it would mean that an offer could not be made conditional as a general rule, for instance on the offeror receiving acceptances in excess of a certain percentage of the voting rights of the target shares. The Takeover Board has therefore applied a relaxed standard and allowed conditions such as the one mentioned before in the event of a partial offer as a consequence of which the relevant threshold is exceeded.

The mandatory offer must be made not later than two months after the threshold has been reached.

7.2 *Opting-Out, Opting-Up and other Exemptions*

In contrast with the City Code, SESTA allows a Swiss target company to opt out of the mandatory offer rules by adopting an article to this effect in its articles of incorporation. Furthermore, target companies may opt up the threshold triggering a mandatory offer requirement in their articles of incorporation from 33⅓ to 49 per cent (Article 32 I SESTA).

In any event, the obligation to make a mandatory offer does not apply to (a) a capital restructuring involving a capital reduction immediately followed by a capital increase so as to offset a loss and (b) the underwriting of securities by banks or securities dealers provided the securities exceeding the relevant threshold are re-sold within three months.

Further, the Takeover Board may exempt offerors from the obligation to make an offer in justifiable cases, for example where

- voting rights are transferred within a group,
- the total voting rights of the target company are reduced and as a result of such reduction the threshold is exceeded,
- the threshold is exceeded only temporarily,
- the shares are received without consideration,
- the purchaser is not in a position to control the company.

If an exemption is granted, the respective decision is published in the Swiss Commercial Gazette and the shareholders of the target company may raise objections with the Federal Banking Commission within ten trading days.

8 Squeeze-Outs

8.1 *Conditions*

The right to squeeze out remaining security holders is triggered if (a) there has been a takeover offer to acquire the securities of the target company, and (b) the offeror has acquired more than 98 per cent of the voting rights of the target company upon expiry of the offer, including

dormant voting rights and voting rights held in concert with third parties (*see* Article 33 SESTA). As regards the latter condition, the question has arisen whether in order to be able to invoke the squeeze out provisions the 98 per cent threshold must be reached at the end of the offer period or whether voting rights acquired after the expiry of the offer but prior to the court action (*see* below) will count towards the tally. The Takeover Board's view is that the courts should be allowed to decide this question on the merits of each individual case.

In contrast with other jurisdictions, under the Swiss takeover rules no application can be made to a court to reduce the 98 per cent threshold. Conversely, there is no right on the part of the minority shareholders to be bought out by the offeror.

8.2 Procedure

Once 98 per cent of the target's voting rights have been acquired, the procedure for vesting the remaining 2 per cent in the offeror is rather burdensome. After the expiry of the offer, the offeror must bring a court action against the company within 3 months with a motion to cancel the outstanding shares (and possibly other equity securities). The court must then publish the action on three occasions and inform the remaining security holders that they may join in the proceedings within a time period of not less than 3 months after the first publication was made.

Once the offeror has shown that the conditions for a squeeze-out are fulfilled, the court officially cancels the outstanding shares (and possibly other equity securities). Subsequently, the target company, on the one hand, reissues the securities to the offeror against payment of the offer price or exchange of the offered shares and, on the other hand, passes on the price paid by the offeror or the shares received from the offeror, as the case may be, to the holders of the securities which have been cancelled.

8.3 Merger Act

Under the Merger Act, an additional method will be available to cash out minority shareholders. It involves a merger between the offeror and the target company after the completion of the tender offer based on a simplified merger procedure, provided that (a) the offeror holds at least

90 per cent of the voting shares and (b) the remaining shareholders of the target company are offered the option to receive shares of the surviving company or a cash compensation.

VI Mergers and Joint Ventures

1 Statutory Mergers

1.1 General

Swiss statutory corporate law is concerned with mergers of corporations ('AG'), corporations with unlimited partners ('Kommandit-AG') and co-operatives ('Genossenschaft'). In a recent decision, the Federal Supreme Court has clarified, however, that mergers are permissible for and between all types of Swiss companies, provided that (a) the legal forms of the companies involved are compatible, (b) the ownership and voting rights of the members are safeguarded, and (c) potential interests of creditors are not negatively affected. Swiss company law provides for two types of mergers. In a *consolidation* (Article 749 CO) the assets and liabilities of two or more companies are amalgamated into a new entity by operation of law. This method was rarely used prior to 1993 because of negative stamp tax implications; despite the fact that the relevant tax rules have changed, consolidations are still rare in practice.

The preferred method is to merge the target into the acquirer so that the assets and liabilities of the target are transferred to the acquirer by operation of law and the target shareholders receive shares in the acquirer in exchange for their shares (*absorption*). A well-known merger was that of *Ciba* with *JR Geigy*, where for tax reasons the latter was merged into the former, which was subsequently renamed *Ciba-Geigy*.

Over the past few years, large mergers involving important Swiss groups have been carried out through the formation of a joint subsidiary into which the parent companies were subsequently merged. This structure facilitates the timing of shareholders' meetings while competition clearances are outstanding and is more acceptable to parties where there is a merger of equals, as technically none of the two entities survives. It was used in the merger between *Sandoz* and *Ciba-Geigy* to form *Novartis*, and between *Swiss Banking Corporation* and *Union Bank of Switzerland* to create *UBS*.

Sometimes the acquirer is merged into the target (a *reverse takeover*), especially in cases where the target is listed on a stock exchange

while the larger acquirer is not. The target then has to increase its share capital by more than 100 per cent so that the shareholders of the acquirer become the majority shareholders of the target.

Technically a merger requires an agreement between the boards of directors of both companies and the necessary shareholders' approvals. It is uncertain whether, under Swiss law, the shareholders of the acquirer must expressly approve the merger. In practical terms, they often have to give their consent, at least indirectly, because they must resolve to increase the share capital of the acquirer if authorized capital is not available.

Mergers are also a means by which a parent company may acquire the assets and liabilities of a subsidiary. If a subsidiary is merged into the parent, no shares are exchanged, and the assets and liabilities of the subsidiary take the place of the shares on the balance sheet of the parent. The difference between the book value of these shares and the book value of the net assets of the subsidiary is accounted for as a merger loss or gain (*see* II.5.4.5). A merger of the subsidiary into the parent is sometimes advisable for tax reasons, since Swiss tax law does not allow consolidation of revenues and expenditures arising within a group of companies.

1.2 Merger Agreement

1.2.1 In General

A merger involves the transfer of the assets and liabilities of the target to the acquirer against the transfer of shares of the acquirer to the target shareholders and the dissolution of the target in the commercial register.

The merger agreement is negotiated between the management of both companies and is subject to the shareholders of the disappearing entity accepting the transaction in a shareholders' meeting with a majority of two-thirds of the shares represented and a majority of the represented capital (Article 704 CO). The acquirer's shareholders must approve the merger, at least indirectly, because they must generally agree to an increase in the share capital in order to issue the necessary shares to the target shareholders unless the acquirer has a sufficiently large authorized share capital. As yet no court has been called upon to

decide whether the special rules regarding the issue of shares in the case of a contribution-in-kind also apply to a merger (*see* II.2.1 above), but commercial registers generally require that these rules be applied by analogy.

The law contains rules to protect the creditors of the target (Article 748 CO) similar to those applied in a liquidation: the directors of the acquirer are responsible to keep the assets of the target separate from the acquirer's assets, until all creditors are either secured or satisfied. Notice is then given to the commercial registrar who will strike the target from the register.

No shares are issued where a subsidiary is merged into its parent company. It is generally recognized that no approval of the parent's shareholders is necessary.

1.2.2 Form of a Merger Agreement

A typical merger agreement will contain the following clauses:

- (a) a statement of the parties' intention to merge the target into the acquirer;
- (b) the exchange ratio and possible cash payments to achieve a more practical ratio (e.g. one target share for one acquirer share plus CHF 100; in lieu of ten acquirer shares for nine target shares); such a clause will generally refer to a balance sheet of the target attached to the agreement and often also to fairness opinions which confirm that the exchange ratio is fair;
- (c) warranties and indemnities if there is a majority shareholder, who must give the respective warranties personally, as the target company will cease to exist after the completion of the merger;
- (d) possibly a right of the acquirer to inspect the business of the target after signing but before completion, with a right to rescind the agreement in the event that a material breach is discovered (exercisable sometimes only before, sometimes even after the merger has been approved by the shareholders);
- (e) covenants of the target – i.e. the right, or obligation, to pay out certain dividends in order to attain the agreed exchange ratio;

- (f) conditions – specifically shareholders' approval and possible consents by third parties;
- (g) costs, applicable law, jurisdiction.

1.2.3 Lock-up Arrangements

Lock-up arrangements providing for high penalty payments in the event the merger is not completed (e.g. if the target shareholders refuse to approve the transaction in view of a higher offer from a third party) may not be binding because they might constitute an *ultra vires* act of the target's board of directors. Payments made to compensate the other party for costs and expenses incurred in connection with a merger transaction (including management time) are, however, widely considered to be permissible.

1.3 Merger Act

1.3.1 In General

Under the new Merger Act, companies can merge either by way of an *absorption*, where one company merges into another, or by way of a *combination*, where both companies are dissolved and the businesses are combined into a new company. Mergers are possible between most types of Swiss companies. Undercapitalized companies or companies on the brink of bankruptcy, the assets of which do not cover at least half of the equity capital stated in the articles of incorporation, may merge with another company provided the other company has freely disposable reserves to cover the deficit in equity.

According to the Merger Act the exchange ratio may be set in such a way as to provide for a *cash payment* which does not exceed one tenth of the respective value of the shares. The companies involved in the merger may also agree in the merger agreement that their members may choose between shares in the surviving company or a cash compensation, or that only a cash compensation should be paid. If the *balance sheet* forming the basis of the merger agreement is older than 6 months or material changes in the financial condition of the company have occurred, an interim balance sheet must be produced.

1.3.2 Procedure

The top executive body of the companies involved must enter into a *merger agreement*. The agreement must include:

- the name, the registered office and the legal form of the companies involved;
- the exchange ratio for the shares and possibly the amount of the cash compensation, respectively, information on the membership in the surviving company;
- the procedure for the exchange of the shares;
- the point in time as from when the new membership rights entitle to a share of the balance sheet profits;
- the point in time as from when the acts of the disappearing entity are deemed to be carried out for the account of the surviving company;
- special privileges and benefits granted to the top executive bodies, managers and auditors;
- the members with unlimited liability (if any).

The members of the highest executive body of the companies involved must furthermore prepare a *report* on the merger setting forth and explaining, from a legal and an economic point of view, the purpose and the consequence of the merger, the merger agreement, the exchange ratio and possibly the amount of the compensation, the reasons why a compensation is to be paid in lieu of shares, special considerations in connection with the valuation of the shares in view of the determination of the exchange ratio, the amount of the capital increase of the surviving company (if any), possible personal obligations and liabilities arising for the members of the disappearing entity as a result of the merger, consequences of the merger for the employees and the contents of a social plan (if any), consequences of the merger for the creditors of the companies involved, and information on the authorizations received and to be obtained from supervisory and state authorities.

Specially qualified auditors must review the merger agreement, the merger report and the balance sheet on which the merger is based and

confirm the fulfillment of certain requirements in a written *auditor's report*. The members of the companies are entitled to inspect the merger agreement, the merger report, the special auditor's merger report as well as the financial statements of the last three business years.

The merger must then be approved by the *general meetings* of the members of the companies in accordance with certain *super majority requirements*, which vary depending on the type of company involved. If the merger agreement provides for a cash compensation only, the merger must be approved by at least 90 per cent of the members of the disappearing company who are entitled to vote. The resolution of the members of the general meetings of the companies involved must be registered with the commercial register. The merger becomes effective when the respective entries in the commercial registers are made. It is at the point of registration when all the assets and liabilities of the disappearing company are transferred to the surviving company by operation of law.

A *simplified procedure* applies to mergers of companies limited by shares ('AG'), corporations with unlimited partners ('Kommandit-AG') or limited liability corporations ('GmbH') if the surviving company owns all of the shares of the disappearing company which are entitled to vote or if one entity or person or a group of persons acting in concert own all the shares entitled to vote of the companies involved in the merger. If, as a consequence of the merger, the surviving company does not own 100 per cent but at least 90 per cent of the shares entitled to vote, a simplified merger procedure applies provided that (a) the minority shareholders are offered the option to receive either shares of the surviving company or a cash compensation and (b) no personal liability arises for these minority shareholders as a result of the merger.

1.3.3 Protection of Creditors and Employees

The surviving company must secure the claims of the creditors of the companies involved in the merger upon a request of the creditors within three months after the effective date of the merger. The creditors must be advised of this right by three publications in the Swiss Commercial Gazette. No publication is required if a special auditor confirms that either no claims are known or that no claims are expected to arise which

the surviving entity will not be able to satisfy. The duty to secure claims does not apply if the company proves that the merger does not jeopardize the satisfaction of the claims. Instead of providing security, the company may discharge individual claims provided that other creditors are not suffering any damage as a result thereof.

2 Joint Venture

Companies may be combined not only by a merger but also by a joint venture agreement whereby each party transfers certain assets to a new entity in exchange for shares.

Joint ventures may be formed as partnerships (Article 530 *et seq.* CO), although more commonly they are organized as corporations, where the relationship between the shareholders (and to some extent the organization of the joint venture) is governed by shareholders' agreements.

A typical agreement will contain clauses covering the following topics:

- (a) Contributions of each partner to the joint venture, share capital of the entity, domicile and name of the company, its purposes and an agreement to elect an auditor acceptable to both parties.
- (b) Composition of the board of directors and the competencies of such board. The parties usually undertake to vote their shares in favour of a nominee of the other party. Rules on decision-making of the board, and the presidency of the board are also included. Generally, the shareholders' meeting will have more competencies than is typical in a public corporation. Often the parties agree that certain transactions can only be entered into with the approval of all parties involved (or with the approval of all board members), whereas for other transactions a majority vote in the shareholders' (or board) meeting will be sufficient. If both parties hold 50 per cent, there may be certain deadlock devices.
- (c) Rules regulating transactions between the joint venture and the parties as well as duties of the parties to participate in future increases in the share capital.

- (d) Dividend policy.
- (e) Put and call options, rights of first refusal and 'drag and tag along' clauses in the event of a transfer of the shares to a third party.
- (f) Non-competition clause; confidentiality clause.
- (g) Termination of the joint venture.
- (h) Applicable law and jurisdiction.

3 Cross-Border Combinations

3.1 Cross-Border Statutory Mergers

Under the current legal regime a statutory merger between a company incorporated in Switzerland and a company incorporated abroad is impossible to accomplish in practice. Therefore, in order to carry out a statutory merger, one of the two companies must move its legal domicile to the country where the other company has its registered office, so that the merger can then be executed subject to the law applicable in that jurisdiction.

The situation will change when, together with the Merger Act, new provisions will enter into effect in the *Federal Act on Private International Law of 18 December 1987* in relation to mergers of a foreign company into a Swiss company, and vice versa:

- Mergers of foreign companies into Swiss companies will be permissible under Swiss law if the law applicable to the foreign disappearing entity allows such merger and if the requirements arising under the foreign law are satisfied. Besides this, the merger will be subject to Swiss law.
- Conversely, according to Swiss law a Swiss company will be able to be merged into a company domiciled abroad provided that the Swiss company can prove that (a) by way of such merger, its assets and liabilities are transferred to the foreign company and (b) the rights of its shareholders are adequately safeguarded by the foreign company. The Swiss company is subject to Swiss law applying to a disappearing Swiss entity in a Swiss merger, which means that

the creditors of the Swiss company must be advised of the merger and their right to be secured for their claims. Apart from that, the merger is subject to the applicable foreign law.

A company registered in the Swiss commercial register may only be deleted based on a report by specially qualified auditors confirming that the creditors' claims have been secured or satisfied or that the creditors have agreed to the dissolution of the company. In addition, if the Swiss company is the disappearing company and a foreign company the surviving entity, it must be shown that the merger has become effective under the applicable law, and a specially qualified auditor must confirm the vesting of new membership rights in the members of the disappearing Swiss company or the payment of the necessary compensation.

3.2 Dual Headed Joint Venture Structures

Since cross-border statutory mergers are unachievable in practice under the law currently in force, cross-border combinations have been carried out by way of joint ventures of various types and structures, three of which are set out below.

3.2.1 Dual Headed Structure

Under the dual headed structure the shareholdings of the members of the companies involved remain unchanged, whereas the businesses are combined by bringing them under the roof of a jointly held holding company based on a shareholders' agreement (*see* VI.2 above) between the parent companies.

A dual headed joint venture which attracted considerable attention in the past was the 'merger' between *ASEA* and *Brown Boveri* (BBC). ASEA and BBC each transferred its business and subsidiaries into a newly-formed corporation called *Asea Brown Boveri*, and each received 50 per cent of the shares in the new company. The shareholders of ASEA and BBC kept their shares, but the two companies were transformed into holding companies, each with the main asset consisting of a 50 per cent interest in the joint venture. The same structure was used in the merger between *Zurich Insurance* and *Allied plc*. However, both

double headed structures have been transformed into single headed structures recently, as it was thought to be of advantage to the groups involved to have only one shareholders' base in view of future acquisitions and the liquidity in the market.

3.2.2 *Synthetic Merger*

Another form of a dual headed structure is what is called a *synthetic merger*. A synthetic merger is not a merger in the legal sense but merely a pooling in an agreed manner of future income generated in the businesses of the companies concerned (generally in proportion to the valuation of the companies). Technically, this can be achieved by a swap of minority equity stakes in the parties' subsidiaries and an allocation of preference shares to the minority shareholders to equalize profits. The pooling agreement will require the parties to distribute such dividends to the parent level if necessary.

A synthetic merger does not require a combination of the businesses under a holding structure as described above. The pooling can cover both operating income and extraordinary income, arising for example as a result of a spin-off or a sale of a part of the business to a third party (or even a liquidation).

From a Swiss tax perspective, the minority participation should be worth at least CHF 2 million (market value) or represent at least 20 per cent of the share capital. If this is the case, the dividend paid to a Swiss parent qualifies for the participation exemption from Swiss income taxes. However, such payments may still lead to (unrecoverable) withholding taxes. To avoid withholding taxes, distributions to the other party may possibly be altogether avoided, except in the event of extraordinary revenues as a result of spin-offs or a sale of part of the business.

A synthetic merger may in many instances prove to be too complicated in the long run and not provide enough flexibility in the event of necessary reorganizations. In practice, a synthetic merger has not yet been successfully completed, though it has been the preferred structure of large transactions that were aborted for commercial reasons.

3.2.3 *Single Headed Structures*

Single headed structures can be accomplished in several ways. One technique involves the combination under a holding entity of the two companies concerned (identical to the dual headed structure). In a second step, one of the parent companies launches a tender (exchange) offer to the shareholders of the other company, thus becoming the parent entity of both businesses.

Another technique presupposes the formation of a Newco initially held by a trustee and, subsequently, a tender offer by Newco to the shareholders of the companies to be combined, as a result of which Newco will become the parent company of both businesses. This technique emphasizes the idea of a partnership of equals. In a second step, Newco can still merge with the party which is domiciled in the same country. This allows a squeeze-out of those shareholders of the merged entity who have not tendered their shares.

VII Hive-downs, Spin-offs and Demergers

1 General

Swiss corporate law does not provide for a process whereby parts of a business are transferred by operation of law against the issuance of shares by the recipient to the shareholders of the company from which the business is demerged or spun off. Rather, to accomplish demergers or spin-offs the company concerned must first hive off the respective business parts to another entity, either by a sale or by a contribution in kind, before the actual demerger or spin-off can take place.

2 Hive-Downs (Horizontal Separations)

2.1 Corporate Law Issues

A hive-down involves the transfer of assets and liabilities from a company to a subsidiary in order to separate one business from another. The subsidiary is usually formed by a contribution in kind consisting of the business to be separated from the parent company. Contributions in kind entail the disclosure in the articles of incorporation of (i) the transferred assets and liabilities, (ii) their valuation, and (iii) the name of the person(s) contributing them. Furthermore, the hive-down may have to be approved by the shareholders' meeting of the company from which the business is separated, with a super-majority of two thirds of the voting rights and the absolute majority of the nominal value of the shares represented, unless the articles of incorporation provide otherwise. Hive-downs are sometimes also referred to as horizontal or downstream separations.

If a joint venture is formed by two companies, where each company contributes part of its business, two hive-downs are required to form the new joint venture corporation. Apart from this special case, hive-downs are usually a method employed to implement a group structure, or a spin-off (*see* VII.3 below).

2.2 Taxation

For tax purposes, hive-downs are not considered to be corporate reorganizations, which are subject to certain conditions in order to qualify as tax-free transactions (*see* VII.3.2). In contrast with spin-offs (vertical separations), hive-downs do not result in a decrease of assets of the company from which a business is separated. Rather, in exchange for the transferred business, the company receives shares in the newly formed subsidiary equal in value to the hived down business assets and liabilities. Therefore, hiving down a business normally does not trigger any tax duties, though the tax authorities may require certain holding periods.

3 Spin-Offs (Vertical Separations)

3.1 Corporate Law Issues

In Switzerland, a spin-off is normally achieved by way of a dividend-in-specie (the method used for example by Givaudan) or a rights issue (the method used by Ciba Specialty Chemicals, Lonza and to some extent by Syngenta) to the shareholders of the company from which a business is spun off. Spin-offs are effected in two steps. The first step consists of hiving down the business to be spun-off to a newly formed subsidiary (*see* VII.2 above). In a second step, the ties between the parent company and its newly formed subsidiary are severed by means of a dividend in specie consisting of the entire share capital of the newly formed subsidiary which is paid to the shareholders of the parent company. Alternatively, the parent company as the sole shareholder of the subsidiary can resolve a rights issue where the subscription price is considerably lower than the market value of the shares. The parent then waives its preemption rights for the benefit of its shareholders who have the option of exercising the rights against payment of the reduced subscription price. This is usually combined with some sort of rights trading which enables those shareholders of the company who are private individuals to realize a tax-free capital gain on the sale of the subscription rights. In either event, the spin-off normally requires not only the shareholders' approval of the parent company but also a formal shareholders' meeting of the newly formed company resolving either

to distribute a dividend in specie or to increase the share capital by means of a rights issue.

3.2 *Taxation*

Swiss statutory tax law is fragmentary as regards corporate reorganizations. The tax authorities' practice is ever changing so that careful tax planning is required in each given case. As a general rule, in the event of corporate reorganizations, deferred taxation of gains and hidden reserves, as well as exemptions from stamp duty and withholding tax are available on condition that (a) the assets and liabilities are transferred on the basis of existing book values, (b) tax liabilities incurred by the transferring company are assumed by the receiving company, (c) business operations are continued and the ownership structure is not changed during a period of 5 years. The last condition is considered to be met in the case of a publicly held company if during the relevant interval it does not turn into a private company with one dominant shareholder.

4 MergerAct

The proposed Merger Act will introduce a procedure whereby a part of an existing business may be directly spun off to a new or existing company against the issue of shares to the shareholders of the company from which the business is separated ('spin-off'). In addition, the Merger Act regulates demergers by which a company splits its business and hives off the different parts to its existing shareholders ('split-up'). The original company, after the bifurcation, will be dissolved and deleted from the commercial register. The Merger Act further clarifies that spin-offs and demergers may be based on financial statements dating back six months provided no material changes in the financial condition of the companies have occurred; otherwise interim financial statements must be produced. Businesses may be demerged or spun off symmetrically, where the shareholders end up with participations in all the companies in proportion to their original holdings, or asymmetrically, where the participations in one or several of the companies involved may be different from the original shareholdings.

Technically, the following documents are required to effect a separation: a separation agreement or a separation plan, a separation report and an auditors' report.

The separation agreement or plan must include:

- the name, registered office and legal form of the companies involved;
- an inventory including designation, separation and allocation of the items of the business to be transferred;
- the exchange ratio in relation to shares and cash payments (if any);
- the procedure for the exchange of shares;
- the date as from when new membership rights entitle to a share of the balance sheet profits;
- the point in time as from when actions by the transferring company are deemed to be taken for the account of the receiving company;
- special privileges and benefits granted to the members of the top executive bodies, senior management or auditors;
- a list of employees to be transferred.

The *separation report* must be prepared by the board of directors or senior management and must set forth and explain, from a legal and an economic point of view:

- the purpose and consequences of the separation;
- the separation agreement or separation plan;
- the exchange ratio for shares and the amount of cash payments, respectively the membership rights in the receiving company;
- special considerations regarding the valuation of shares in view of the determination of the exchange ratio;
- personal obligations and liabilities possibly arising for members of the company as a result of the separation;
- consequences of the separation for the employees of the companies involved in the separation as well as the contents of a possible social plan;

- the effects of the separation on the creditors of the companies involved in the separation.

The separation agreement or plan and the separation report must be reviewed by *special auditors* who, in a written report, must set out whether the intended share capital increase (if any) of the receiving company is sufficient to safeguard the rights of the members, whether the exchange ratio or the cash payment is justifiable, which method was used for what reasons to determine the exchange ratio, and how, if several methods were used, they were applied in order to determine the exchange ratio and what special circumstances were taken into consideration when determining the value of the shares in view of the determination of the exchange ratio.

Each of these documents must be made available for inspection to the members of the company at least two months prior to the resolution of the shareholders' meeting. Prior to the shareholders' meeting the creditors of the companies involved in the separation must have been publicly advised of their right to ask for a security in relation to their potential claims. The rights of each creditor to be secured does not apply, however, if the company can prove that the separation does not jeopardize the claims of the creditors. In the event that creditors of the company to which the respective claims were allocated are not satisfied, the other companies involved in the separation are jointly and severally liable. However, those other companies are liable only to the extent that the claims in question have not been secured by the company which is primarily liable and provided the latter has been the subject of bankruptcy proceedings or transferred its domicile abroad thus rendering enforcement proceedings more difficult.

Subsequently, the *shareholders' meeting* resolves the separation by means of a spin-off or a split-up with a super majority of two-thirds of the votes represented in the meeting and an absolute majority of the share capital present. In the event of an asymmetrical separation at least 90 per cent of the members of the company who are entitled to vote must approve the separation.

Finally, the board of directors must file the shareholders' resolution in relation to the separation with the commercial registry. The separation becomes effective upon registration in the commercial register. At this point in time the assets and liabilities specified in the inventory are transferred by operation of law to the receiving companies.

VIII Transformations

1 Current Situation

Swiss statutory corporate law addresses transformations of companies only in the single case where a corporation ('AG') is transformed into a corporation with limited liability ('GmbH'), as set forth in Articles 824 *et seq.* CO. The transformation process involves the transfer of the business to a new corporation with limited liability when the latter is entered into the commercial register and the dissolution of the corporation transferring its business in the commercial register after the corporation's creditors who do not accept the new company as debtor have been secured or satisfied. The Federal Supreme Court has made it clear recently, however, that the statutory rules are not meant to be exhaustive and held that transformations are generally permissible on condition that the following requirements are met:

- the legal forms of the companies involved must be compatible;
- the ownership and voting rights of the members must be safeguarded;
- the transformation may not jeopardize (potential) interests of creditors.

Based on these principles, so far corporations with limited liability ('GmbH'), co-operatives ('Genossenschaft') and associations ('Verein') have been transformed into corporations ('AG') in practice.

2 Merger Act

2.1 *In General*

As a rule, under the Merger Act a company will be able to change its legal form, referred to as 'transformation', while keeping its legal identity (i.e. a change of form as opposed to a change of subject). Since the company to be transformed will not be deleted but will continue to exist in different form, legal relationships with third parties will not be affected.

Generally, the rights of the members of the company must be safeguarded despite the transformation. Each member has the right to receive at least one share of the new company. Though transformations are permissible for almost all types of companies, in certain cases transformations will be disallowed due to fundamental differences in the legal or business organization of the companies involved. For example, a corporation will not be able to be transformed into a general or limited partnership. Likewise, it will not be possible to transform a company into a foundation. If the balance sheet on which the transformation report is based, dates back more than 6 months or the financial conditions have materially changed, an interim balance sheet must be produced.

2.2 Transformation Procedure

The transformation process involves the following steps:

- The top executive body of the company prepares a *transformation plan* which needs to be approved by the meeting of the members of the entity. The transformation plan must contain information in relation to the name, the registered office and the legal form prior and after the transformation, the new articles of incorporation, as well as the number, the type and the number of shares the members of the entity will receive after the transformation, respectively information on the membership in the company after the transformation.
- Furthermore, the top executive body of the company must prepare a written *transformation report*. The report must set forth and explain, from a legal and an economic point of view, the purpose and the consequences of the transformation, compliance with the requirements in relation to the formation of the new legal form, the new articles of incorporation, the transformation ratio of shares or membership details after transformation. Personal obligations and liabilities which might arise for the members due to the transformation, as well as the obligations imposed on the members as a result of the new legal form of the company.
- Specially qualified auditors must review the transformation plan, the transformation report, as well as the balance sheet which forms

the basis of the transformation. Furthermore, members of the company have a right of inspection of the transformation plan, transformation report, special audit report as well as the financial statements of the last three business years.

- Transformations of companies limited by shares ('AG'), corporations with unlimited partners ('Kommandit-AG'), limited liability companies ('GmbH'), co-operatives ('Genossenschaft') and associations ('Verein') require the *approval of the general meeting* of the members of the company, and, depending on the type of company involved, different super majority voting requirements apply.
- The transformation will become effective at the time when the resolution of the general meeting is entered into the commercial register.

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