Christoph Neeracher

PRIVATE EQUITY IN
SWITZERLAND

Christoph Neeracher specialises in international and domestic M&A transactions (focusing on private M&A and private equity transactions, including secondary buyouts, public-to-private transactions and distressed equity), transaction finance, corporate restructurings, relocations, corporate law, general contract matters (eg, joint ventures, partnerships and shareholders' agreements) and all directly related areas.

He is experienced in a broad range of national and international transactions, both sell and buy side (including corporate auction processes), and in assisting clients in their ongoing corporate and commercial activities. Additionally, he represents clients in litigation proceedings relating to his specialisation.

Philippe Seiler has a broad experience in M&A transactions in various industries (inter alia, manufacturing and engineering, IT, watch, real estate and logistics). In addition to large-scale transactions and takeovers, he focuses on small and midsize M&A transactions, private equity transactions, management buyouts and outsourcing projects.

Further, Philippe Seiler focuses on reorganisations and restructurings, general contract and commercial law and real estate transactions, along with data protection and unfair competition.

Philippe Seiler

What trends are you seeing in overall activity levels for private equity firm buyouts and investments in your country during the past year or so?

Christoph Neeracher & Philippe Seiler: Compared to 2015, the number of transactions in Switzerland in the beginning of 2016 has declined but (primarily due to the Syngenta takeover) with a higher overall transaction volume. However, compared to the first quarter of 2016, the amount of deals increased by 38 per cent in the second quarter of 2016, and the second quarter of 2016 even brought a market increase of 96 per cent in the value of the quarter's 10 largest deals compared to 2015. A high level of activity has been observed in all industry sectors, whereby investments were more frequent in industrial and consumer goods companies. Broadly speaking, the Swiss M&A and private equity market seems to be in good shape and the positive trend observed since January 2016 seems to continue.

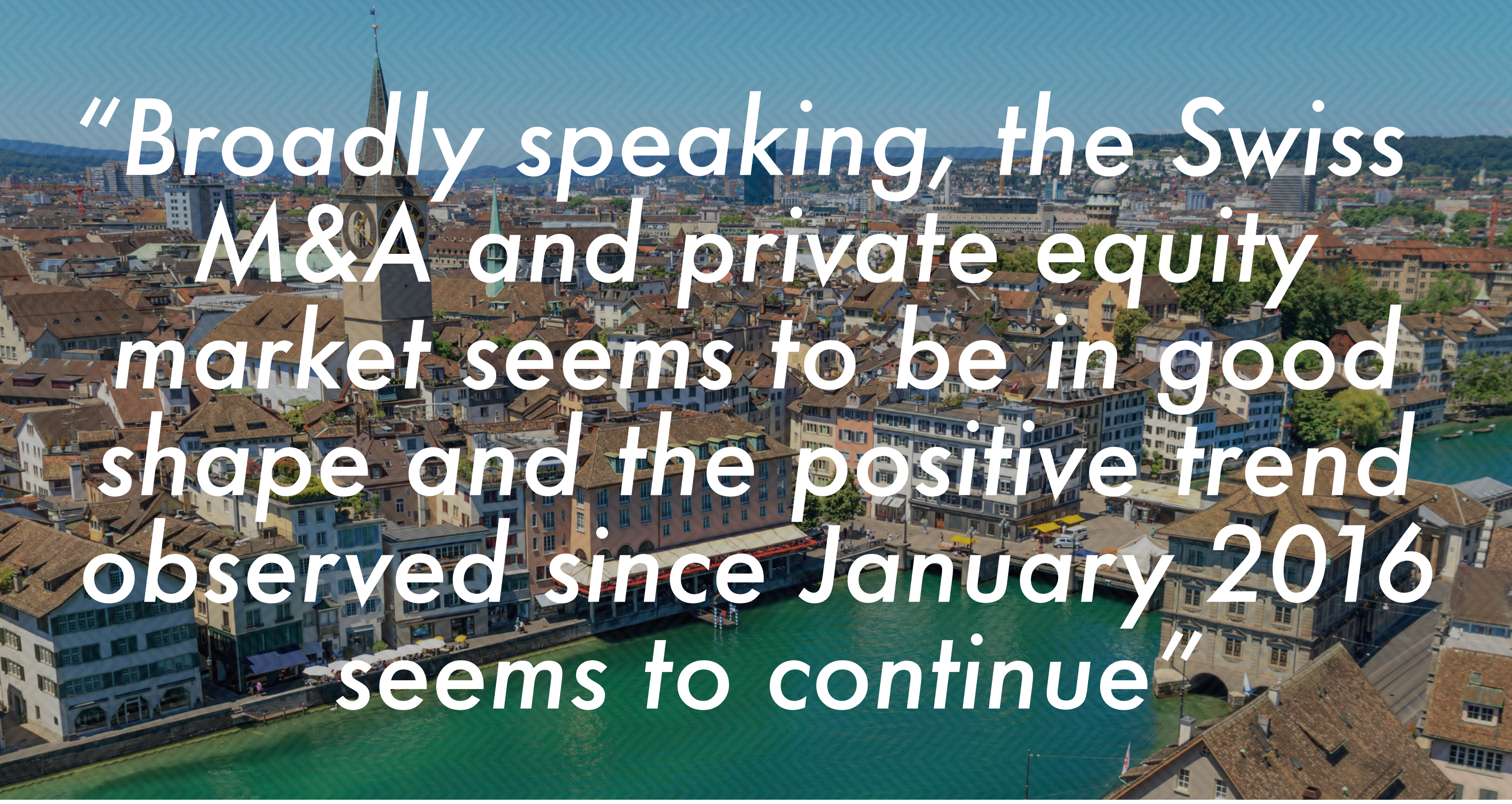
We see in particular the following key factors for this positive trend. First, after some hesitation in past years, the acquisitions of Syngenta, gategroup, KrausMaffei and SR Technics clearly show that Chinese investors are willing and capable of investing outside of their own country. Thus, Chinese investments in Switzerland will play an increasing role in the future. Second, the current interest environment facilitates the funding of possible acquisitions and puts pressure on investors to invest. Third, Switzerland remains attractive for investors with various investment opportunities – in particular due to succession planning. A study of Credit Suisse estimates that in the next five years approximately 80,000 SMEs will need to deal with succession planning.

However, in particular, the strong Swiss franc and the uncertainties in connection with Brexit may have some negative impacts on M&A activity in Switzerland in 2016.

Looking at types of investments and transactions, are private equity firms continuing to pursue straight buyouts or are other opportunities, such as minority-stake investments, partnerships or joint ventures, also being considered?

CN & PS: Private equity firms active in Switzerland follow a wide range of strategies, including control and non-control deals, club deals and joint ventures with corporates. We have recently seen many transactions where the seller or sellers wish to keep a certain minority stake in the target company. Such sellers often prefer straightforward Swiss structures; accommodating such preferences may give a bidder an important competitive advantage.

As Swiss law does not prevent or restrict the participation of two or more private equity firms in a club or group deal, several private equity investment were syndicated. Typically, private equity players taking non-control positions seek protection via



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shareholders’ agreements, which usually not only restrict the transferability of the shares, but also include board appointment rights as well as provisions regarding voting undertakings for certain or even all board or shareholders’ resolutions. In this respect, Swiss law provides ample flexibility and Swiss market practice has, in recent years, reached a high level of sophistication.

What were the recent keynote deals? And what made them stand out?

CN & PS: In February 2016, China National Chemical Corporation (ChemChina) announced their takeover of Syngenta AG for over US$43 billion. This announced takeover has been the largest deal this year so far. However, the takeover still needs approval from the competent Chinese authorities. Also, the other acquisitions of Chinese buyers in 2016 are keynote deals as they give an indication of the increasing importance of Chinese investments in Switzerland. These include the acquisition of a majority stake in SR Technics Group by HNA Aviation Group; the public tender offer of HNA Group for gategroup Holding; and the acquisition of Kraus MaffeiGroup by China National Chemical Corporation.

Does private equity M&A tend to be cross-border? What are some of the typical challenges legal advisers in your jurisdiction face in a multi-jurisdictional deal. Are those challenges evolving?

CN & PS: Cross-border private equity M&A deals have always been a major pillar in an overall busy M&A market in Switzerland. The discontinuation of the minimum Swiss franc–euro exchange rate in January 2015, which made the Swiss franc more expensive compared with the euro, had two negative effects on Swiss inbound M&A transactions: first, Swiss targets tend to be more expensive for foreign investors; second, potential Swiss targets that sell to the Eurozone (of which there are a fair number) suffer from lower margins. One and a half years later, it seems that these negative effects have been overcome to a certain extent. It is still unclear to what extent Brexit will impact on cross-border M&A activity.

Cross-border transactions with Swiss involvement create challenges for the legal advisers involved, as coordination and communication become the key success factors. Furthermore, countries like China have complicated approval procedures when state-owned enterprises intend to invest in foreign companies. These outbound-investment controls are challenging as they may be very unclear and for the contracting party only hardly understandable. Thus, getting all legal advisers on the same page, by assigning clear responsibilities and committing to strict deadlines from kick-off to closing, is critical, in particular where coordination has to take place between different law firms that are dispersed over different time zones. Although such transactions are not always without friction, the major Swiss corporate law firms are experienced in handling multi-jurisdictional M&A transactions and dealing with fast-paced private equity dealmaking.

What are the current themes and practices in financing for transactions? Have there been any notable developments in the availability of debt financing or the terms of financing for buyers over the past year or so?

CN & PS: Due to the negative interest rates, banks are more inclined towards financing transactions and the financing conditions remain favourable for funding investments in Swiss companies. In fact, investing is now more attractive than keeping money in a bank account. This is the reason why there currently seems to be an oversupply of interested investors.

Bidders looking to invest are very flexible with regard to transaction financing. This is due to the fact that Swiss corporate law only stipulates limited restrictions on a company's debt-to-equity ratio (however, from a Swiss tax-law perspective, de facto limitations exist). Securing bank financing can be challenging, as banks are still cautious and require specific guarantees when lending funds to borrowers. However, with the current (negative) interest rates, banks have indeed become more inclined to provide financing. It is standard market practice that pledges are taken by the financing institutions to protect their rights. It is not unusual that both the shares in the portfolio company and the shares in any of its material subsidiaries are pledged. Additionally, financing banks secure the financing by requiring that existing debt is refinanced and that existing securities will be released and used as collateral. Various restrictions apply to upstream and cross-stream guarantees, as well as to other security interests granted by the target to the parent or an affiliate (other than a subsidiary). As Swiss corporate law requires the approval of the shareholders from both companies in addition to the board of directors, structured financial planning is very important. In fact, this planning is a responsibility of the board that cannot be delegated. Should the company go bankrupt because of excessive debt incurred, personal liability of the board members is possible. Further, the articles of association of the company may have to be changed before it is able to grant security interests, as the company's purpose according to its articles of association must provide the basis for the granting of security interests.

How has the legal and policy landscape changed during the last few years in your country?

CN & PS: In the past few years, regulation has become a central strategic dimension for financial intermediaries. The complexity of the regulatory initiatives are growing, the requirements and costs for the market participants are increasing, while the strategic scope is getting smaller. Even if Switzerland is not a member of the European Union, the European directives play an important role.

As part of a new Swiss legislation aimed at preventing money laundering and tax evasion, any entity acquiring 25 per cent or more of a non-listed Swiss company must inform the latter regarding the acquiring entity's beneficial owner and update such information in case of changes. In standard private equity structures, the administrative burden of the new legislation can – in our view – be minimised by implementing a practicable solution compliant with the rules. As, typically, the general partner takes the relevant decisions regarding the fund and its portfolio companies, the individuals controlling the general partner (respectively controlling the ultimate shareholder of the general partner) should be disclosed as beneficial owners. If such individuals cannot be determined, the top executive officer (chairman or CEO) of the general partner, respective of its ultimate shareholder, may be disclosed.

Publicly listed companies on a Swiss stock exchange are subject to a new law approved by the Swiss voters in 2013, which is intended to limit fat-cat salaries. The law, which also includes criminal charges if violated, sets forth a range of mandatory rules on transparency and compensation that have increased administrative costs for companies. The law prohibits, inter alia, severance payments, advance payments and similar extraordinary payments to directors or senior managers, and requires the articles of association to include rules on additional remuneration for the board and senior management. Furthermore, as of the annual general meeting 2015, shareholders must approve the aggregate compensation of the board of directors and the senior management. Additionally, the voting rules at the shareholders' meeting have been overhauled, which strengthens the role of the independent proxy advisers.

What are the attitudes to private equity among policymakers and the public? Has there been any noteworthy resistance to private equity buyouts by target boards or shareholders? Does shareholder activism play a significant role in your country, and if so, how has it impacted private equity M&A?

CN & PS: As the political system in Switzerland is organised as a direct democracy, the Swiss voters are ultimately the policymakers. Therefore, public opinion is often in the forefront of new regulations and laws. Public opinion in Switzerland in relation to large corporations – especially in the finance sector – has been fairly negative after the financial crisis. However, it seems that public opinion is again shifting back to a more pro-business approach. Public opinion in Switzerland is generally also positive towards foreign investors – which has recently been shown by the sale of various companies to Chinese buyers. As a consequence, there is no regulatory framework specifically targeted at such transactions.

In recent years, shareholder activism has risen significantly. As this is a phenomenon that primarily affects listed companies, in general there is no direct connection between shareholders.

What levels of exit activity have you been seeing? Which exit route is the most common? Which exits have caught your eye recently, and why?

CN & PS: The conditions under which a private equity firm has the ability to exit its investment depends very much on the terms of the shareholders'

THE INSIDE TRACK

What factors make private equity practice in your jurisdiction unique?

Switzerland's stable political system, liberal economy, highly educated workforce, sophisticated and efficient legal environment and traditionally mild tax regime all contribute to an excellent environment not only for private equity, but also as a business environment in general.

What three things should a client consider when choosing counsel for a complex transaction in your jurisdiction?

Without a doubt, the most important thing is deal experience, followed by industry knowledge and availability.

What is the most interesting or unusual matter you have recently worked on, and why?

Every deal raises interesting and unique questions. Definitely very interesting were the two acquisitions we made for Chinese buyers in 2016, the acquisition of SR Technics and the acquisition of KrausMaffei. The sale by Valora of its Naville logistics and distribution business has also been a challenging transaction since the transaction perimeter, as well as the transition services, had to be carefully defined.

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agreement. Contractual arrangements regarding transfer restrictions and exit rights are particularly decisive. While the right to coerce the other shareholders to a sale (drag-along) or to unilaterally request an IPO can facilitate the exit of the private equity investor, the minimum rights of the common shareholders (for example, minimum valuation thresholds) may have a limiting effect. Ultimately, the terms agreed upon are a direct reflection of the parties negotiation leverage.

According to the European Private Equity and Venture Capital Association (EVCA), the number of exits in Switzerland is almost at the level reached in the past year. The most prominent exit routes by amount have been trade sales and sales to another private equity firm. Exits through an IPO on the SIX Swiss Exchange are still less common. One reason for this low exit activity lies in the fact that the SIX Swiss Exchange's listing conditions in terms of an IPO are very strict.

However, despite these regulatory hurdles, IPOs still play an important role in Switzerland as recent examples show. In June 2016, Investis Holding SA, a residential property company in the Lake Geneva region and a national real estate services provider, raised 733 million Swiss francs through the IPO. The shares closed at 57.3 Swiss francs on the first day of trading, almost 8 per cent higher than the IPO price of 53 Swiss francs. On April 2016, the shares of VAT were listed and admitted to trading on SIX Swiss Exchange. A total of 13.8 million existing shares have been sold in the IPO of VAT, corresponding to 46 per cent of the share capital. The total placement volume amounted to 621 million Swiss francs. In the beginning of 2015, Sunrise Communications AG raised 2 billion Swiss francs (US$2.2 billion) in the biggest initial public offering on the country's stock exchange in eight years.

Looking at funds and fundraising, does the market currently favour investors or sponsors? What are fundraising levels like now relative to the last few years?

CN & PS: The trend for portfolio rebalancing by shifting into the less crowded but rising private equity markets has continued. This positive investor sentiment has led to numerous successful fundraisings by a number of Switzerland's leading private equity players. These included Partners Group's announcement of raising a total of US$1.35 billion in 2015.

Since the overhaul of the Swiss collective investment schemes legislation in 2013, private equity funds often qualify as collective investment schemes under Swiss law (the Collective Investment Schemes Act (CISA)). Under the revised CISA, there is no distinction between public distribution and private placement. As a result, only the concept of 'distribution' is relevant to determine the admissibility of offering interests in private equity funds in or from Switzerland. Following the CISA revision, fundraising has become more complex in the past few years. In particular, special attention has to be paid to what kind of investors can be approached for fundraising. In short, interests in private equity funds may still be freely offered to regulated financial intermediaries such as banks, securities dealers, fund management companies and insurance companies in Switzerland ('super-qualified investors'). Fundraising from these super-qualified investors does not qualify as 'distribution', and is therefore not subject to the distribution rules of the CISA. The offering of interests in private equity funds to qualified investors is different, as this may be subject to legal and regulatory requirements. Under the revised CISA, private equity funds or the general partner (who acts for the private equity fund), respectively, must appoint a Swiss representative and a paying agent in Switzerland. Furthermore, the sponsors or other entities offering interests in a private equity fund to qualified investors must either obtain a distributor licence from the Swiss regulator, FINMA or, in the case of foreign sponsors acting on a cross-border basis, be licensed to distribute fund interests in their respective home countries. Furthermore, the definition of 'qualified investors' has significantly changed under the revised CISA. Whereas pension funds are generally deemed to be qualified investors, foundations, family offices and high-net-worth individuals are usually deemed to be non-qualified investors. However, they can be treated as qualified investors if specific requirements are fulfilled. Therefore, sponsors and private equity funds should seek legal advice from securities lawyers.

Talk us through a typical fundraising. What are the timelines, structures, and the key contractual points? What are the most significant legal issues specific to your country?

CN & PS: In Switzerland, private equity funds typically seek to raise capital in 'private placements' of interests in accordance with exemptions from the CISA approval requirement with regard to the fund. Approval by FINMA is required for the distribution of fund interests to non-qualified investors, whereas no such requirement exists for the fundraising with qualified investors. Generally speaking, private equity fundraising is effected by one-on-one presentations by general partners to investors (LPs), often set up by specialised placement agents. These presentations typically involve the distribution of a private placement memorandum or other marketing documents. Although it is not a requirement under Swiss law, it is advisable to include specific Swiss disclaimer language in all offering or marketing material, and legal advice should be sought from securities lawyers before any investor is contacted. Furthermore, as already mentioned, fundraising must take place in accordance with all the applicable legal and regulatory requirements.

How closely are private equity sponsors supervised in your country? Does this supervision impact the day-to-day business?

CN & PS: Fundraising in Switzerland is nearly always made as a 'private placement' of interests in the private equity fund. If sponsors seek to raise funds from professional investors other than super-qualified investors (for example, regulated financial intermediaries, in particular qualified investors), they must be supervised in Switzerland (only Swiss domiciled sponsors) or be licensed to market interests in the funds. Entities distributing interests in private equity funds on the basis of a FINMA distributor license are not subject to prudential supervision once granted a licence.

What effects has the AIFMD had on fundraising in your jurisdiction?

Switzerland is not a member of the European Union and therefore has no obligation to implement the AIFMD. However, EU directives have a significant impact on Swiss legislation as Switzerland implements large parts of European directives through legislation.

To allow FINMA to licence Swiss AIFMs and to ensure that such AIFMs are compliant with the AIFM Directive, the Swiss federal parliament approved a

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partial revision of the collective investment schemes legislation (CISA). In line with the AIFMD, the revised CISA regulates any manager of Swiss and foreign funds. Furthermore, the CISA introduced a new regime governing the distribution of funds in Switzerland. A legislation for financial services and products offered to investors in Switzerland, the Federal Financial Services Act (FFSA) and Financial Institutions Act (FIA) is going to enter into effect on 1 January 2017. It is expected that the FFSA and the FIA will have a substantial and hopefully positive impact on fundraising in Switzerland.

What are the major tax issues that private equity faces in your jurisdiction? How is carried interest taxed? Do you see the current treatment changing?

CN & PS: Major tax issues include limitations on the acceptance of debt push-downs, rules regarding indirect partial liquidation for acquisitions of shares from Swiss resident individuals, rules in relation to employee, management participation and potential tax consequences of non-compete undertakings in the context of transactions.

Switzerland has no tax consolidation for income tax purposes and dividend income from subsidiaries is virtually tax exempt for a Swiss company. The consolidation of financing expenses of a Swiss acquisition company with the operating profits of a Swiss target company can generally be achieved by merging these companies (debt push-down). Mergers in Switzerland may generally be conducted in a tax-neutral way if the tax liability remains in Switzerland and the assets and liabilities are transferred at their (tax) book value. However, based on the tax-avoidance doctrine, Swiss tax authorities often deny the tax-effective deduction of interest against the target's taxable income upon a merger of a pure acquisition vehicle with the target where the acquisition vehicle could not have used the interest deduction itself due to the lack of taxable income. As a consequence of this practice, alternative debt push-down strategies, such as cascade purchases, leveraged dividends and equity to debt swaps, have been developed to secure (at least partially) tax-effective deduction of interest.

As a Swiss particularity, 'indirect partial liquidation' taxation generally applies in the event that Swiss resident individuals sell at least 20 per cent shares in a Swiss or foreign company held as private assets to an acquirer holding the shares as business assets if the target company has distributable reserves and non-business required assets at the time of the transfer, and such assets are distributed within five years after the share transfer. If an indirect partial liquidation event is triggered, part of the sale proceeds is reclassified from tax-free capital gain into taxable dividend income in the hands of the individual selling share-holder. In principle, any distribution out of distributable reserves existing at closing (ordinary or construed dividends, including merger proceeds) caused by the buyer during the first five years after the disposal is considered harmful if and to the extent the target group had non-operating assets at the time of disposal. Although such income tax arises with the sellers, it typically results in a liability for the buyer as the sellers will ask for an indemnity in the SPA in case the buyer triggers such an indirect partial liquidation event post-closing.

The Swiss tax provisions on employee participations, together with the corresponding circular letter, provide a legal basis for the taxation of financial benefits derived from employee participations. It regulates, inter alia, the taxation value of employee shares, the taxation point of employee stock options and the treatment of artificial employee participations, which do not provide for an allocation of ownership rights. Management participation programmes generally aim to obtain a tax exempt capital gain for the Swiss resident managers upon exit. However, depending on the individual terms, (part of) the income may qualify as fully taxable employment income. There is no special taxation rate applicable to carried interest in Switzerland: Swiss resident managers can generally only benefit to a certain extent from a tax exempt capital gain or privileged dividend income if they hold at least 10 per cent shares, provided that no part of the carried interest is deemed employment income. The taxation of such privileged dividends currently ranges between about 10 per cent and 25 per cent, depending on domicile in Switzerland. Recently, Swiss tax authorities have been stricter regarding the taxation of deemed considerations for non-compete undertakings of private sellers of shares. In short, if a person sells his or her shares in a company, the capital gain is considered as a tax-free capital gain. Nevertheless, if in connection with such a sale the person undertakes to non-compete, the Swiss tax authorities may requalify part of the sales proceeds into taxable income, which is subject to income tax. The qualification of income as employment income generally also triggers social security contributions (currently about 11 per cent in total for employee and employer).

Overall, Swiss law provides a friendly environment for corporate acquisitions. Concerning acquisitions of Swiss companies, Swiss individual sellers often opt for a share deal to ensure their tax-free capital gain, often leading to restrictions for the buyer under the indirect partial liquidation clause in the SPA.

Looking ahead, what can we expect? What will be the main themes in the next 12 months for both private equity M&A and for fundraising?

CN & PS: Since January 2016, M&A activity in Switzerland has increased and we are fairly optimistic that this positive trend will continue. A key driver is, in particular, the low interest rates that facilitate the funding of investments and create a high demand on private equity investments. In addition, we can probably expect further investments of Chinese buyers in Switzerland.