PRACTICE GUIDES

Swiss M&A

Second Edition

Contributing Editors
Ueli Studer, Kelsang Tsün and Joanna Long

LEXOLOGY®
Getting The Deal Through

Swiss M&A

Practice Guide

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Legal framework and recent changes

Switzerland continues to provide a generally favourable legal framework for private M&A, giving parties extensive contractual freedom in agreeing on the terms to apply to a transaction. In addition, in spite of other jurisdictions' tightening on foreign investment control and certain political aspirations to introduce the same in Switzerland, there are to date still very few restrictions in this respect. However, there were political undertakings to intensify foreign investment control in 2020. Most noteworthy is the initiative to suspend (albeit temporarily) an exemption clause in the Act on the Acquisition of Real Estate by Persons Abroad (or Lex Koller), which exempted the sale of business premises to a foreign buyer from the permit requirement. Up-to-date real estate that is not used for residential purposes is not subject to an approval by the competent authority. Such a temporary suspension might have had a far-reaching impact on the M&A market and transaction structuring and was luckily rejected in the legislative process.

In June 2019, the Swiss parliament passed the Federal Act on the implementation of the recommendations of the Global Forum on Transparency and Exchange of Information for Tax Purposes. This act is a step towards increasing transparency and preventing money laundering as well as tax evasion in relation to the legal and beneficial ownership of shares in Swiss legal entities and marks the continuation of implementations of the Financial Action Task Force's (FATF/GAFI) recommendations. The key duty, stated in article 697j of the Swiss Code of Obligations, refers to any person that by itself or acting in concert acquires 25 per cent or more in the share capital or voting rights of a non-listed Swiss company having to disclose to the beneficial owner of this position to the company. If the person acquiring the 25 per cent stake is a legal entity, its beneficial owner is defined, under the new law, as the individual exercising control by analogy with the consolidation rules under Swiss statutory accounting rules. In this context, an individual is considered to control a legal entity if it holds, directly or indirectly, a majority of votes in the ultimate management body, if it directly or indirectly has the right to appoint or

1 Christoph Neeracher, Philippe Seiler and Raphael Annasohn are partners with Bär & Karrer AG.

remove a majority of the members of the supreme management or administrative body or if it is able to exercise a controlling influence based on the articles of association, a contract or comparable instrument. If there is no such individual, the person acquiring the 25 per cent stake is required to make a negative declaration to the company. To ensure effective compliance with the transparency obligations and the associated record-keeping duties, criminal sanctions apply to relevant violations under the Swiss Criminal Code, in addition to the corporate law effects of failing to comply with disclosure duties (in particular, suspension of voting and dividend rights).

As of 1 May 2021, bearer shares are permitted only if the company has securities listed on a stock exchange or if the bearer shares are structured as intermediated securities. If such exceptions are applicable, this needs to be registered in the commercial register. In the absence of such exceptions, companies had convert their bearer shares into registered shares by the end of April 2021. If the company had not complied with its obligations by 1 May 2021, the bearer shares were automatically converted into registered shares by the commercial register and the company had to amend its articles of association. Until such an amendment (ie, the conversion of bearer shares into registered shares) has been made, the commercial register will reject the registration of amendments to the articles of association.

On 19 June 2020, after over a decade of preparatory work, the Swiss parliament finally approved a general corporate law reform amending the Swiss Code of Obligations (the Corporate Law Reform). The Corporate Law Reform seeks to modernise corporate governance by strengthening shareholders' and minority shareholders' rights and promoting gender equality in boards of directors and in senior management. It also replaces the provisions of the Ordinance on Excessive Compensation (the Minder Ordinance) applicable to listed companies, with only a few changes. Furthermore, the Corporate Law Reform aims to facilitate company formation, makes capital rules more flexible and revises the rules on corporate restructurings. Pursuant to this revision, the board of directors is required to monitor a company's liquidity and is further obligated to take measures to ensure solvency. Beyond this, the revision modernises the way in which general meetings of shareholders may be conducted as it allows for the holding of virtual meetings, which may also take place abroad, while universal meetings can also be held in written or electronic form. Finally, it introduces certain disclosure requirements for commodity firms (report of payments made to public authorities).

The effective date of the Corporate Law Reform has not yet been determined, but we expect that it will enter into force in 2022 (unless submitted to a vote of the Swiss people as a result of an optional referendum). After coming into force, companies have two years in which to make any necessary amendments to their articles of associations and organisational regulations.

On 1 January 2020, two new acts entered into force: the Financial Services Act (FinSA) and the Financial Institutions Act. Although primarily addressing the financial services industry, the FinSA in particular could become relevant in the context of (public) M&A transactions. The FinSA contains rules regarding the duty to publish an issuance prospectus in a public offering of securities. It sets out the required content of prospectuses, bringing the requirements in line with international standards and those already applied by SIX Swiss Exchange for listing prospectuses, and replacing the outdated rules of the Swiss Code of Obligations, which only required very limited disclosure.

Development of private M&A activity

In 2020, 363 recorded transactions involved Swiss corporations (compared to 402 in 2019) and the transaction volume has decreased by more than 50 per cent as opposed to 2019. Similar to 2019, outbound deals were approximately twice as high as inbound deals, as in 42 per cent of overall transactions with Swiss participation Swiss companies acquired foreign entities, compared to 23 per cent of inbound transactions.

Private M&A transactions accounted for the majority of the overall Swiss M&A market both in terms of the number of deals and deal value in 2020. However, private M&A activity is often driven by public M&A transactions and vice versa. For example, following a public-to-private transaction, which typically involves a public tender offer and subsequent squeeze-out and delisting, there are usually disposals or bolt-on acquisitions to focus, transform or grow the target company's business. Conversely, for private equity sponsors in particular, IPOs have gained significance as an exit strategy, sometimes also as part of a dual-track approach.

Private equity firms continue to be an important pillar of the Swiss M&A market, being involved in almost half of the recorded Swiss deals in 2020. At the same time, Swiss private equity firms continued to expand their presence globally. Successful fundraising ensured that private equity sponsors had the necessary dry powder to engage in acquisitions. Additionally, with private equity sponsors typically being highly leveraged, they have particularly benefited from (continuing) low interest rates and generally favourable borrowing conditions.

After a decline in transaction volume at the beginning of the covid-19 pandemic caused by the uncertainties related thereto, M&A activity picked up again in the second half of 2020 and continues to remain strong to this date. Particularly, the IT and the pharmaceuticals and life sciences sectors continue to offer very attractive and sought-after investment opportunities.

Important factors for ongoing strong M&A activity in 2020 were, in our view, Switzerland's stable political and regulatory environment, with very few investment restrictions, in combination with very attractive potential investment opportunities – besides large cap targets, this in particular also includes small and medium-sized enterprises dealing with succession planning. Last but not least, transformation and portfolio reshaping have continued to account for a substantial portion of M&A (showcased, eg, by Migros' sale of Globus, Vifor's divestment of OM Pharma and Franke's sale of Franke Water Systems), and so have consolidation waves in various sectors (such as healthcare and telecommunications, media and technology (TMT)). Overall, private M&A deals in Switzerland have been delayed rather than cancelled as a result of the covid-19 pandemic. In the short and medium term, the pandemic will likely also lead to a certain shift of the driving factors of M&A activity in Switzerland. In sectors where the covid-19 pandemic has had (and continues to have) a significant impact (such as travel or holiday and related sectors), the main focus of M&A transactions will be on distressed companies in need of financial aid and reorganisational matters. This trend will in our view continue far into 2021 (and possibly even 2022), and companies will increasingly dispose of non-core assets and businesses in an attempt to secure or achieve more financial stability.

Cross-border transactions have always been key to Switzerland's M&A landscape and continued to be a driving force in 2020. The significance of cross-border deals can also be observed with respect to private equity investments. In terms of jurisdictions, western European countries were involved in over half of all Swiss transactions, both from an inbound and outbound perspective.

Landmark transactions

On 2 February 2020 (shortly before the start of the covid-19 pandemic in Switzerland and the first nationwide lockdown), Migros-Genossenschafts-Bund (MGB), Switzerland's largest retailer and private employer, announced the sale of its department store Magazine zum Globus AG (Globus) together with eight prime real estate properties in Zurich, Basel, Berne and St Gallen to a consortium of Austrian SIGNA and Thai Central Group. Despite the uncertainties and difficulties caused by the covid-19 pandemic, the transaction was successfully closed in May 2020.

In mid-2020, a noteworthy transaction was the sale of the Swissbit, a leading Swiss-based manufacturer of secure, high-quality storage and embedded Internet of Things (IoT) solutions to private equity investor Ardian.

The end of 2020 saw another major TMT deal with the sale of Avaloq Group AG, a global leader in digital banking solutions and wealth management technology based in Switzerland, to Japan-based information technology giant NEC Corporation.

These three transactions are proof of the M&A market's and its participants' ability to quickly adapt to new situations (such as travelling and meeting restrictions owing to covid-19), as physical signings and closings often shifted to purely remote virtual signings and closings, a shift that will likely leave its imprints even after the covid-19 pandemic.

Notable private M&A deals signed in the first five months of 2021 include the partnership of private equity investor CVC Capital Partners with the International Volleyball Federation (FIVB), as well as the acquisition of Franke Water Systems AG by Equistone Partners Europe.

Typical stages of Swiss private M&A transactions

The process of private M&A transactions differs substantially depending, inter alia, on the parties involved and the envisaged form of transaction. However, owing to the recent sellers' market and the ongoing trend towards an ever more competitive and sophisticated market, structured transactions and corporate auctions along the lines described below have become market practice in Switzerland.

In the first stage, the seller and its advisers prepare the sale documentation and marketing materials. This is followed by a marketing phase in which the seller's financial adviser, or less often the target's executive management, initiates first contact with potential bidders. The latter are then required to execute a non-disclosure agreement in order to receive further information in the form of an information memorandum. Based on this, bidders may decide to make a non-binding offer, which is followed by the due diligence phase for selected bidders. In this stage of the process, in addition to data room review, usually management presentations take place and expert sessions are set up. Seller's and bidders' counsel will regularly also have a first exchange on the sell-side draft transaction documents. After binding offers are submitted and the seller enters into negotiations with the chosen bidder, parties proceed to the signing of the transaction agreements. In spite of generally limited conditionality in Swiss transaction agreements in the recent sellers' market, there is usually a certain lapse of time between signing and closing to account for the necessary governmental approvals and pre-closing covenants. During this phase, the parties typically have to fulfil certain obligations and follow contractually agreed rules of conduct. The technicalities of closing itself vary depending on the form of transaction and target business. For the post-closing phase, the parties may agree on certain restrictive covenants (non-competition and non-solicitation) of the seller and covenants (such as

continuation of the business, direct and indirect partial liquidation tax covenants combined with a respective indemnity in case of a private individual seller) of the purchaser.

Typical governance arrangements

The predominant legal form for private M&A transactions in Switzerland is the stock corporation, irrespective of deal size. Sometimes, limited liability companies are used instead, which is usually because they are treated as transparent for US tax purposes.

A stock corporation is governed by a board of directors that has a supervisory function and certain inalienable duties with regard to strategic and other important aspects (eg, appointment of senior management). Directors must be individuals and they are appointed ad personam (ie, proxies or representation by other persons is not permitted). The board of directors usually delegates day-to-day management responsibilities to management on the basis of a respective authorisation in the company's articles of association. Details of the delegation are set out in organisational regulations enacted by the board of directors.

Further particularities on governance, including board and management composition and specific quorum requirements, are commonly also reflected at a contractual level in a shareholders' agreement. While the articles of association of a company are filed with the commercial register and therefore publicly available, there are no public disclosure requirements with regard to shareholders' agreements and organisational regulations in the private environment.

Shareholders' agreements

General

Swiss law provides for far-reaching flexibility with regard to contractual arrangements in shareholders' agreements, and Swiss market practice has reached a high level of sophistication in this respect. However, certain limitations need to be taken into consideration.

As a general rule, shareholders' agreements are only enforceable against their respective parties, and there is an ongoing debate in Swiss legal doctrine as to the extent to which a target company itself can be party to a shareholders' agreement. While certain administrative obligations of the target company are acceptable in the view of a majority of commentators, it is questionable whether further obligations can be validly entered into by the target company under a shareholders' agreement. A further important limitation is that the directors of a company must act in the best interest of the company pursuant to mandatory Swiss corporate law. This needs to be taken into consideration in the context of enforcing certain provisions under shareholders' agreements. It should also be noted that shareholders' agreements may not have unlimited terms or set out to remain in force for the entire lifetime of a company. Rather, the maximum term should be set at about 20 to 30 years (alternatively at, eg, 10 years with automatic extensions). Non-competition covenants of shareholders in favour of the company are usually enforceable if the shareholders (jointly) control the company and the covenants are limited geographically and in scope of activity to the business of the company.

Veto rights

Private M&A investors in the Swiss market follow a wide range of investment strategies, which, beside classic control deals, also include non-control deals, club deals and joint ventures between financial investors and corporates. We have also seen various transactions in recent times where a seller retained a minority stake or rolled into the buyer's structure with minority

participation. With several shareholders in a company, protection is usually sought via detailed minority and majority rights in shareholders' agreements.

There are certain restrictions with regard to implementing the same in a Swiss company's corporate documents. At shareholder level, high quorums can be introduced for specific decisions in the articles of association to the extent that such arrangements do not lead to a per se blocking of the decision-making in the company. At board level, veto rights for individual board members cannot be implemented in a company's articles of association or other corporate documents. However, such veto rights are often agreed on a contractual level between parties. As a consequence, while decisions taken in breach of such contractual arrangements would be valid from a corporate law perspective, they may lead to consequences under the shareholders' agreement.

The specific veto rights of minority investors usually depend on the size of the stake held. Investors with stakes up to 20 per cent usually have only fundamental veto rights aimed to secure the protection of the investor's financial interest. Such rights include veto on the dissolution or (de facto) liquidation of the target company and fundamental changes to its business, pro rata rights to participate in capital increases and other financing measures as well as maximum leverage provisions. Minority shareholders with a more significant stake (20 to 49 per cent) typically are also granted a say on material business decisions and the composition of board and management. At shareholder level, statutory law also provides for certain blocking rights of important matters for shareholders holding at least one-third of all votes. These include, inter alia, certain forms of capital increases, the dissolution of the company and the merger or demerger of a company under the Swiss Merger Act.

Questions surrounding the concept of control under competition law regulations or accounting standards (in the context of consolidation) also need to be taken into consideration with regard to minority rights and can have an impact on contractual arrangements between parties in specific cases.

In addition, specifically for private equity investors holding a minority stake, exit rights are usually key and therefore a heavily negotiated point in the context of shareholders' agreements.

Recent trends

W&I insurance

There has been a noticeable increase in the use of warranty and indemnity (W&I) insurance in Swiss private M&A deals in Switzerland. In the sellers' market that continued into early 2021, buyer policies have become a popular solution for bridging the 'liability gap' where a seller is willing to give a set of representations and warranties but wants to cap its liability at a level that the buyer is not comfortable with. In such cases, a W&I insurance policy can increase the overall cover to a level that is acceptable to the buyer.

In this context, stapled W&I insurances have been more widely used by sellers in auction processes, whereby sellers will initiate a buyer policy process themselves and usually provide bidders with a non-binding indications report in the data room during the due diligence phase. This is not only a means to expedite the W&I insurance process and to prevent the latter from interfering with the overall transaction timeline, but can also help to prevent insurance providers from going into exclusivity with certain bidders at an early stage of the process.

If the liability cannot be capped or excluded owing to the lack of negotiation power of the seller, which, as mentioned, has more rarely been the case in the past year, seller policies are

used (especially by financial sponsors). In this way, the risk of potential outstanding claims can be shifted to an insurer in order to be able to distribute the exit proceeds to the greatest extent possible to investors immediately following closing.

In any case, the impacts of obtaining W&I insurance on the overall process of a transaction should be considered by the parties at an early stage to ensure smooth coordination of the different workstreams (including in particular due diligence). This should also include awareness of the limitations of insurance coverage, which are typically as follows:

- liabilities from known facts and matters identified in due diligence or information otherwise disclosed by the seller;
- forward-looking warranties;
- certain tax matters, for example, transfer pricing and secondary tax liabilities;
- pension underfunding;
- civil or criminal fines or penalties where insurance coverage may not be legally provided;
- post-completion price adjustments and non-leakage covenants in locked-box deals;
- certain categories of warranties, for example, environmental matters or product liability; and
- liabilities arising as a result of fraud, corruption or bribery.

Purchase price

Locked-box pricing mechanisms are widely used and accepted in Swiss private M&A transactions, which can be perceived as unusual in particular for US and Asian bidders looking to invest in Swiss companies. Sellers aiming to limit balance sheet risks and reduce the risk of post-closing purchase price adjustment disputes have often been successful in pushing towards using locked-box pricing mechanisms in the recent sellers' market. As a consequence, locked-box pricing mechanisms are often combined with an interest payment or cashflow participation for the period between the locked-box date and actual payment of the purchase price (ie, closing), allowing sellers to participate in the generated cashflows. Buyers also tend to accept longer periods between the locked-box accounts date and closing. Conversely, deferred purchase price elements (such as earn-outs) or vendor loans have been seen more often in recent deals as a consequence of the covid-19 pandemic.

Conditions

Owing to the sellers' market we have experienced into early 2021 (other than in the context of 'fire sales'), sellers have usually pushed towards reducing conditionality to an absolute minimum in order to increase transaction certainty. Especially in highly competitive auctions, bidders have been reluctant to introduce conditions precedent so as not to impair the overall attractiveness of their offers.

As a result, in particular MAC clauses have largely disappeared, and so have change-of-control waivers, with buyers usually taking the economic risk in order to secure a deal. But even the outcome of merger control assessment may be a criterion for certain sellers to move forward with a specific bidder, and we have therefore increasingly often encountered 'hell or high water' clauses included in merger clearance closing conditions.

Exit routes

In cases where a private equity or other investor is invested in a target jointly with another party, terms of the shareholders' agreement are usually decisive with regard to the conditions under which the investor is able to exit as well as the specific exit route.

The most frequently seen exit routes in Swiss deals are (still) trade sales to a strategic investor or secondary buyouts by a private equity firm. Exits by way of an IPO on the SIX Swiss Exchange have become more common in recent years.

We continue to see dual-track processes pursued by exiting investors. While there is inherent complexity in running simultaneous IPO and M&A sale processes, sellers hope to increase deal certainty with the dual track, specifically in times of volatile and unpredictable markets, and to maximise valuation.

Appendix 1

About the Authors

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Christoph Neeracher is a partner and head of private M&A/private equity. He 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, venture capital, startups, corporate restructurings, relocations, corporate law, general contract matters (eg, joint ventures, partnerships and shareholders' agreements) and all directly related areas such as employment matters for key employees (eg, employee participation and incentive agreements).

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

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