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# Private Equity 2022

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## **Switzerland: Law & Practice**

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# SWITZERLAND

## Law and Practice

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## 1. Transaction Activity

### 1.1 M&A Transactions and Deals

In 2021, M&A activity across all industries in Switzerland increased significantly, reaching a new high compared to the last few years. With almost 290 transactions in the first half of 2021, compared to just 140 at the same time in 2020, Swiss M&A activity got off to a good start. The second half of 2021 was even stronger than the first, with almost 300 deals finalised in contrast to the 200 deals in the second half of 2020. It is safe to say that 2021 was a successful year for M&A activity in Switzerland with a total of over 600 transactions completed. Low interest rates, appealing lending terms, and economic stimulus measures played an important role in a record-breaking 2021 despite lingering concerns over the COVID-19 pandemic.

The first half of 2022 saw a continuation of the growth of 2021. However, the stock market's downward trend, the possibility of unchecked inflation, and Russia's invasion of Ukraine undoubtedly reduced M&A investors' appetite for risk. A lower total number of M&A transactions is anticipated for the year 2022 compared to the year 2021.

Private equity investors are, however, expected to remain very active in Switzerland in the second half of 2022 with a focus on Swiss small to medium-sized enterprises (SMEs) in the industrial, telecommunications (TMT), and pharmaceuticals, healthcare and life sciences sectors. Swiss SMEs continued to be attractive targets for investors in the first half 2022, especially for European buyers (61%, with the remainder being primarily North American and Asian buyers).

The year 2021 was already marked by a high degree of private equity investor activity in Swit-

zerland, with financial investors actively engaged as either buyers or sellers. The coming deal activity in private equity will most likely increasingly focus on sustainability topics. With private equity buyers currently sitting on a large amount of dry powder and COVID-19 concerns easing, a positive trend for private equity transactions in 2022 is likely. However, the above-mentioned factors (in particular the lending terms for debt finance) might impact this positive trend.

### 1.2 Market Activity

While the COVID-19 pandemic had an adverse effect on some economic sectors and citizens' social lives, M&A activity in Switzerland unexpectedly recovered quickly after the first lockdown in 2020 and M&A deal activity developed favourably in 2021 as market participants quickly adapted to the new environment (eg, fewer physical and more virtual meetings, and remote signings and closings).

The TMT, industrial markets, pharmaceuticals, healthcare, and life sciences sectors had notably strong deal flow and volume in M&A transactions. In terms of outbound transactions, continued popularity for these sectors is anticipated in 2022. Incoming transactions are likely to see similar popularity with the addition of the industrial sectors. Increased M&A activity in the financial industry, particularly in the asset and wealth management sector, may result from the gradual implementation of the laws under the Financial Institutions Act (FinIA).

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. The market continues to witness a lot of transactions where a seller wishes to keep/re-invest a certain minority stake in the target company. This may be a result of the (still)

low interest rates and the overall positive market environment but certainly also helps to ensure management continuity.

## 2. Private Equity Developments

### 2.1 Impact on Funds and Transactions

In general, private transactions are not extensively regulated in Switzerland and the parties have great flexibility to determine the transaction structure as well as the contractual framework. Compared to public M&A transactions, which are highly regulated, private M&A transactions are less densely governed and many provisions of the Swiss Code of Obligations of 30 March 1911 that would apply to share or asset transfers can be excluded in favour of a contractual framework.

However, in recent years financial and corporate regulations have increased. In this respect, it should also be noted that even if Switzerland is not a member of the European Union, EU Directives and Regulations still have an important impact on Swiss policy-making.

#### Data Protection and Privacy

An example of EU regulations affecting the regulatory landscape in Switzerland is the General Data Protection Regulation (GDPR). Even though Switzerland is not a member of the EU, the guidelines are directly applicable to all Swiss-based companies doing business in the EU, as the scope includes all businesses processing personal data of EU data subjects (eg, employees), or organisations that monitor the (online) behaviour of EU data subjects (eg, customers). In addition, EU companies are asking its Swiss business partners to be GDPR-compliant. Therefore, the GDPR has a major impact on numerous Swiss-based companies.

The Federal Act on Data Protection of 19 June 1992 (FADP) and the supporting Ordinance to the Federal Act on Data Protection of 14 June 1993 (DPO) are now undergoing a complete overhaul in Switzerland, partially in reaction to the GDPR and its ramifications. The FADP will be updated to reflect technical advancements and to comply with the GDPR. To ensure that data flow between Switzerland and the EU may continue without further restrictions, the FADP must be revised. On 1 September 2023, the new FADP and the related law are expected to come into effect, although the necessary decision by the Federal Council is still outstanding.

#### SPACs

Special purpose acquisition companies (SPACs) had record years in the USA in 2020 and 2021. In Switzerland the Directive on the Listing of SPACs was put into effect in Switzerland in December 2021, allowing SPACs to be listed on the SIX Swiss Exchange. As a result, these “blank-cheque firms” have entered the Swiss “investor” market. This directive requires that the de-SPAC be finished three years after the initial trading day. The first and sole SPAC in Switzerland was listed on 15 December 2021 and to the authors’ knowledge has not found an ultimate take-over target yet.

#### Sparks

The Swiss Financial Market Authority (FINMA) approved the new SIX Swiss Exchange equity section “Sparks” in 2021. Since October 2021, SMEs are now eligible to list on the SIX under streamlined, SME-specific regulations to get access to Swiss and foreign investors with sufficient financial means and experience. The benefits of Sparks also include enhanced liquidity due to the shares’ tradability and visibility by the company needing to adhere to more stringent regulatory standards (such as ad hoc advertis-

ing, disclosure of large shareholdings, and financial reporting). Businesses and investors have additional chances to expand by enabling SMEs to take advantage of SIX's benefits.

## Corporate Law Reform

On 19 June 2020, after some 13 years of preparatory work, the Swiss Parliament has finally approved a general corporate law reform amending the Swiss Code of Obligations (Corporate Law Reform). The Corporate Law Reform inter alia seeks to modernise corporate governance by strengthening shareholders' and minority shareholders' rights and promoting gender equality in boards of directors and in senior management. As of 1 January 2021, the Corporate Law Reform has partially entered into force (transparency and gender-representation requirements) and will enter into force in full by 1 January 2023.

## 3. Regulatory Framework

### 3.1 Primary Regulators and Regulatory Issues

#### Regulatory Reform

As mentioned in **2.1 Impact on Funds and Transactions**, private M&A transactions are not extensively regulated in Switzerland as there is no specific act regulating the acquisition of privately held companies. The main legal source is the Swiss Code of Obligations, which provides quite a liberal framework for transactions. Currently, Swiss law provides for only very limited foreign-investment restrictions: Foreign investors and financial sponsors are, broadly speaking, in most cases not restricted or treated differently from domestic investors.

However, following international developments, this may change in Switzerland. An initiative to

establish an approval authority for transactions subject to investment control was presented with the goal of providing a legal foundation for the evaluation of foreign direct investments. However, the conclusion of the discussions and the establishment of an investment control regime are still unclear. It is anticipated that the parliamentary deliberation process will last until 2023.

#### Real Estate

One exception to the liberal legal framework in Switzerland is the acquisition of real estate. Swiss law restricts the acquisition of real estate that is not permanently used for commercial purposes (non-commercial property), such as residential or state-owned property, undeveloped land or permanently vacant property (the Lex Koller). Legal entities with their corporate seat outside Switzerland are deemed as foreign under the regulations, regardless of who controls them. Further, legal entities with their corporate seat in Switzerland are deemed as foreign if they are controlled by foreign investors. The law takes a very economic view to determine whether a Swiss entity is foreign controlled; namely, it looks through the entire holding and financing structure, but is strictly formal as soon as an entity with its corporate seat outside Switzerland is involved.

#### ESG

The topics of sustainability and environmental protection, as well as social and responsible corporate governance, have gained increased attention and importance in Europe (and throughout the world) over the past few years (criteria of environmental social governance, ESG). With the introduction of ESG reporting requirements, Switzerland has followed the trend and has introduced stricter ESG requirements for Swiss companies.

Depending on their size and significance, certain companies will be subject to the new ESG reporting requirements.

Swiss businesses that are of public interest must create an annual, public ESG report that addresses non-financial issues. The requirement to create such a report primarily pertains to listed companies and banks that, together with the domestic or foreign businesses they control, have an average of at least 500 full-time positions annually over the course of two years and have sales revenue exceeding CHF40 million or a balance sheet total of at least CHF20 million. The report discusses non-financial issues such as the business strategy, newly developing threats to the environment, employees, and human rights, as well as the due diligence steps the firm has made to address ESG issues.

Compared to companies of public interest, SMEs are not yet compelled to issue such an ESG report. However, additional due diligence obligations apply if companies (including SMEs) with their registered office, head office, or primary place of business in Switzerland process or import specific minerals or metals originating from conflict or high-risk regions. Similar due diligence obligations apply to Swiss companies that provide goods or services for which there is a plausible suspicion that child labour was used in their manufacturing. SMEs are exempt from the due diligence obligations regarding child labour if their balance sheet totals, sales revenue and full-time employees fall below certain statutory thresholds.

It is anticipated that the due diligence obligations regarding child labour will be the most relevant obligation for private equity firms intending to invest in certain businesses. Moving forward, it is highly recommended that private equity buy-

ers also focus on the new reporting requirements when conducting a due diligence analysis of an acquisition target.

## 4. Due Diligence

### 4.1 General Information

The vast majority of legal due diligences are conducted on an exception basis only (ie, only highlighting red flags). Only in specific cases are summaries or overviews produced (eg, overview of key terms of the important business contracts, the employment agreements with key employees or lease overviews). The typical scope of a legal due diligence covers corporate matters, financing agreements, business agreements, employment (excluding social security and pension), real property/lease, movable assets, intellectual property (IP)/IT (review of an IP portfolio and contracts from a legal perspective), data protection and litigation. Compliance and regulatory topics are included to the extent relevant for the specific business.

### 4.2 Vendor Due Diligence

A vendor due diligence is not a standard feature in private equity transactions in Switzerland but is conducted in complex, large transactions to accelerate and facilitate the sales process.

The result of a vendor due diligence is typically a report which summarises material legal key terms and also highlights certain red flags. The vendor due diligence reports are often used as a starting point for the buyer's own legal due diligence and to define the focus of the buyer's own due diligence. However, vendor due diligence reports usually do not fully replace a buyer's own due diligence – even if reliance is granted (which is typically the case).



## 5. Structure of Transactions

### 5.1 Structure of the Acquisition

Most acquisitions of Swiss target companies by private equity funds are carried out by Swiss law-governed share purchase agreements with jurisdiction in Switzerland. In the case of a reinvestment or a partial sale, a shareholder's agreement is concluded in connection with the transaction.

The terms of the acquisition are different between a privately negotiated (one-on-one) transaction and an auction sale, as the "hotter" the auction, the more seller-friendly the terms of the acquisition agreement. This relates to the price certainty (locked-box v closing adjustment), transaction certainty (Conditions Precedent (CPs), hell or high water clause, etc) as well as the liability concept (warranty and indemnity (W&I) insurance, cap, specific indemnities, etc).

### 5.2 Structure of the Buyer

Given the vast flexibility in Switzerland, the full range of transaction structure can be seen. The most common structure for private equity funds to invest in or acquire a Swiss target company is to set up a special-purpose acquisition vehicle – the NewCo or AcquiCo. The AcquiCo may be held either directly or – mostly for tax or financing reasons – via another special-purpose vehicle in Switzerland or abroad. In view of an exit and the potential liability in connection therewith, the fund rather tends not to become a party to the acquisition or sale documentation.

### 5.3 Funding Structure of Private Equity Transactions

Swiss transactions are usually still – at least partially – debt-financed. Due to negative interest rates over the past years, banks have been more inclined towards financing transactions, and the

financing conditions remained favourable for funding investments in Swiss companies. Even though increases of interest rates have been announced in 2022, they remain relatively low with borrowing conditions still being generous. 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 due to thin-capitalisation rules). In view of the security package provided in connection with a debt-financed transaction, it is important to follow the restrictions on upstream and cross-stream guarantees, as well as other security interests granted by the target to the parent or an affiliate (other than a subsidiary).

Regarding the equity portion of the purchase price, the sellers typically request a customary equity commitment letter directly from the fund. However, such equity commitment letters are usually not to the direct benefit of the sellers but to that of the purchaser.

Traditionally, most of the private equity deals in Switzerland were majority investments. However, given the current "investment plight", increasingly, minority investments by PE funds are also being seen.

### 5.4 Multiple Investors

Club deals or syndicates of several private equity funds are primarily seen in larger transactions. In the context of private transactions, the parties have vast flexibility in structuring such club deals. The relationship among the club participants is in most cases governed by a shareholders' agreement.

In the context of public transactions, other rules apply to such co-investments, and the club participants are most likely to be qualified as acting in concert regarding the mandatory takeover rules (see also 7. Takeovers).

## 6. Terms of Acquisition Documentation

### 6.1 Types of Consideration Mechanisms

The two predominant forms of consideration structures used in private equity transactions in Switzerland are the locked-box mechanism and the net working capital (NWC)/Net debt adjustment as per closing. In the current (still) seller-friendly environment, a locked-box mechanism was used in the majority of the transactions in order to give price certainty to sellers.

Earn-outs and vendor loans have been seen less often recently but are not uncommon. Given that, earn-outs especially are usually used in cases where the seller remains as an employee of the target company post-closing, in which case, however, certain restrictions from a Swiss tax-law perspective may apply.

### 6.2 Locked-Box Consideration Structures

Due to the current sellers' market, locked box pricing mechanisms are often combined with an interest payment or cash-flow participation, respectively, for the period between the locked-box date and actual payment of the purchase price (ie, closing), and buyers tend to accept longer periods between the locked-box date and closing.

Leakage, however, is typically not subject to interest and will be compensated on a CHF-to-

CHF basis (unless considered permitted leakage).

### 6.3 Dispute Resolution for Consideration Structures

For locked-box consideration structures, it is unusual to have a dispute resolution mechanism in place because, in general, a one-off payment at closing is agreed, which has the effect that any leakage since the locked-box date is being considered and added to the consideration. Therefore, no additional dispute resolution mechanism is necessary.

Regarding completion accounts consideration structures, however, dispute resolution mechanisms are indeed common. Specifically, so-called appraiser mechanisms are agreed upon. If such a mechanism comes into use, a designated expert, mostly likely an auditing firm, determines the final and binding completion accounts and determines the adjustment of the purchase price in accordance with the respective agreement, if any.

### 6.4 Conditionality in Acquisition Documentation

The typical level of conditionality in Swiss private equity transactions is usually limited to the mandatory regulatory conditions, which are reflected in the transaction documentation as conditions precedent to closing. These typical regulatory conditions are approvals from regulating bodies; ie, a merger filing with the local competition authority, which evaluates whether the transaction would violate antitrust regulations, but also industry-specific regulations need to be considered; eg, licences in the pharmaceutical sector. Especially in transactions involving multiple jurisdictions, possible merger and foreign direct investment filings need to be taken into



consideration and might significantly prolong the period required to close after signing.

Depending on the transaction, it can be quite common to have further conditions such as financing or third-party consent. The latter in particular can be critical, in the case, for example, that the target has material agreements in place which are essential for the business and which contain change-of-control provisions, but the buyer has a strong interest in keeping such agreements in place, even after the transaction (eg, supply/customer or lease agreements).

Furthermore, material adverse change provisions, so-called MAC clauses, were quite often in use in the past, however, these have been used less lately. This is because sellers rarely accept these types of clauses in view of the transaction certainty in the current seller-friendly environment.

## 6.5 “Hell or High Water” Undertakings

In the current seller-friendly market, with a high number of auction sales, “hell or high water” undertakings are often included in the merger clearance closing conditions.

## 6.6 Break Fees

In public M&A transactions, break fees are not uncommon, but are only allowed by the Swiss Takeover Board if the amount of the break fee is proportionate and if it serves the purpose of lump-sum compensation for damages and does not constitute an excessive contractual penalty. In any case, a break fee is not allowed to restrict shareholders significantly in their freedom to accept or not accept an offer and/or deter potential competing offerors. The amount of the break fees is in most cases significantly less than 1% in relation to the transaction amount. For private M&A transactions, however, break fees

are an unusual instrument, since there are other mechanisms to keep the buyer indemnified due to a breach of contract. Reverse break fees are relatively rarely seen in private equity transactions since sellers often insist on actual financing proof.

## 6.7 Termination Rights in Acquisition Documentation

Usually, a private equity seller or buyer can terminate the acquisition agreement prior to closing if the conditions precedent to closing have not been met until a certain agreed date (ie, long stop date). Other than that, Swiss acquisition agreements typically do not contain any (ordinary) termination rights. However, under Swiss law under certain conditions there is a possibility to terminate a share-purchase agreement in the event of a severe breach of the agreement; any such termination right is usually – to the extent permissible – excluded as regards a breach of representations or warranties. In such a case of a termination, compensation for damages may be claimed.

## 6.8 Allocation of Risk

The typical methods for the allocation of risks are (i) representations and warranties for general (unidentified) risks and (ii) indemnities for specific risks identified during due diligence, eg, tax liabilities or pending litigation. In addition, with respect to risk allocation, there is a current trend towards so-called “quasi indemnities”, which are representations and warranties that are excluded from disclosure and the general cap, but still subject to the other limitations, such as the notification obligation, de minimis, threshold/deductible, damage definition, etc. In addition, risks can be allocated through the purchase-price mechanism as well as certain covenants.

Even though the details of risk allocation depend on the leverage and negotiating power of the buyer or seller, these methods are used regardless of whether the buyer or seller is a private equity fund.

## 6.9 Warranty Protection

The standard share-purchase agreements usually contain a catalogue of representations and warranties, covering the following (but not limited to those) areas: capacity, title to shares and corporate existence, shareholder loans, financial statements, ordinary course of business, material agreements, employment and social security, real estate, assets, environment, intellectual property, compliance with law, litigation, insurance and tax. In terms of limiting warranties, private equity sellers tend to limit these representations and warranties as much as possible while requesting buyers to take up a buyer policy W&I insurance.

With regard to disclosure of the data room, as a matter of principle, all information provided in the data room is considered as disclosed and therefore known, which is taken by the seller as an occasion to exclude any liability for what has been fairly disclosed.

## 6.10 Other Protections in Acquisition Documentation

As far as other protections go, indemnities are extremely often provided by the seller. Depending on the actual wording of such indemnity clauses, these clauses are mostly designed as guarantees, which oblige the seller to indemnify and compensate the buyer fully for any damage, irrespective of the fault of the seller. It should be noted that, under Swiss law, the sole usage of terms such as “indemnification” do not constitute this effect. Whether the indemnity clause has an effect as a guarantee depends decisively

on the formulation and design of the clause. Further, other kinds of guarantees – such as guarantees of a parent or group company, personal guarantee or bank guarantee – can be seen.

Furthermore, W&I insurances have been enjoying increasing popularity lately. However, such an insurance is subject to certain conditions, such as a positive due diligence. W&I insurances have another positive effect, insofar as a private equity bidder in an auction sale that would offer a W&I insurance might have a competitive advantage compared to other bidders, and therefore higher chances of winning the auction.

## 6.11 Commonly Litigated Provisions

While it is common that disputes in general arise from private equity transactions, it is rather uncommon that these disputes are litigated before ordinary courts or by arbitration. The Swiss approach for dispute resolution in connection with private equity transactions in general are settlements. However, in most cases it is subject to a careful contract-drafting to reflect potential conflicts in the contracts during the drafting process and to agree on dispute resolution mechanisms at an early stage.

Provision from which most disputes arise are consideration mechanisms as completion accounts, consideration provisions and representations and warranties.

## 7. Takeovers

### 7.1 Public-to-Private

In recent years, the number of public-to-private transactions was relatively limited, due to the fact that the share prices have been rather high, taking into account the remaining uncertainties with regard to the COVID-19 pandemic.

However, given the large number of long-term commitments of private equity funds and the vast investments of private capital in public companies since the outbreak of the COVID-19 pandemic, an increase of buy-outs of public companies might be expected, catalysed by a downturn in the public equity market. There has been more interest in public-to-private transactions in recent months and an increase is expected for the end of 2022 and beginning of 2023.

## 7.2 Material Shareholding Thresholds

The Financial Market Infrastructure Act (FinMIA) provides for a number of thresholds that trigger a notification and disclosure obligation, in the event that a private equity (PE) (directly, indirectly or in concert with a third party) reaches, falls below or exceeds a certain percentage of voting rights in a listed company. The relevant thresholds are 3%, 5%, 10%, 15%, 20%, 25%, 33⅓%, 50% or 66⅔% of the voting rights in a public company, irrespective of whether they are exercisable or not. If these thresholds are met, the PE must then notify the company, as well as the competent disclosure office within four trading days.

It should also be noted that financial intermediaries who acquire or dispose of shares or acquisition or sale rights on behalf of third parties are not subject to this notification duty.

## 7.3 Mandatory Offer Thresholds

Under Swiss law, a mandatory offer is to be made, when an investor directly, indirectly or acting in concert with third parties acquires equity securities which (together with the equity securities already owned (if any)) exceed the threshold of 33⅓% of the voting rights of the target company, whether exercisable or not. However, the shareholders' meeting of the target companies

may (i) either raise this threshold up to 49% of voting rights – the so-called opting-up – or (ii) decide that an offeror shall not be bound by the obligation to make a public takeover offer – the so-called opting-out; both of these have to be reflected in the articles of association accordingly.

## 7.4 Consideration

In private M&A transactions, consideration may consist of either cash, shares, securities or a combination thereof. Cash settlements tend to be more frequent, as share deals are usually only accepted by the seller if the shares given as consideration are readily marketable (which would be the case with listed companies). Tax considerations also typically play an important role in determining the type of consideration that is eventually agreed upon.

For public M&A transactions, the consideration can also be paid in cash or in securities or a combination thereof. However, Swiss corporate and takeover law demands equal treatment of all shareholders, which imposes certain restrictions on the offeror. Offering cash consideration to specific majority shareholders while offering securities to minority shareholders would not be allowed.

In conclusion, the type of consideration accepted will in each case largely depend on the individual circumstances of the transactions, eg, the shareholders involved and their intentions, type of transaction, etc. However, cash consideration has historically been, and is still, more frequent than a consideration in securities.

## 7.5 Conditions in Takeovers

The permissibility of conditions that may be attached to a public takeover offer depends on whether it is a voluntary or a mandatory offer.

With respect to mandatory offers, the competent authority only deems a limited number of conditions permissible, in particular a condition that there are no injunctions or court orders prohibiting the transaction and/or that necessary regulatory approvals will be granted, as well as conditions ensuring the ability of the offeror to exercise the voting rights (ie, entry in the share register, abolishment of any transfer/voting restrictions). Regarding voluntary takeover offers, the legal framework for conditions is more liberal, meaning that voluntary takeover offers may contain conditions which include minimum acceptance thresholds and no material adverse change (MAC) conditions. However, generally, it is not permitted for takeover offers to be conditional on the bidder obtaining financing, except for necessary capital increases in the bidder in connection with an exchange offer (*Umtauschangebot*).

The most common conditions are that the necessary approvals from regulatory bodies will be granted, such as merger control filings with the relevant Competition Commission, or other specific approvals from supervisory authorities in regulated sectors; eg, the bank or pharmaceutical sector.

## 7.6 Acquiring Less Than 100%

In a privately held company, a private equity buyer can, in general, secure additional governance rights by concluding a shareholder's agreement (eg, veto rights, the right to appoint the majority of the members of the board of directors or certain rights connected to dividends, as well as first-refusal rights, call options, drag-along rights, etc). The extent of the governance rights under a shareholders' agreement, however, is primarily subject to negotiations.

In a public company, the possibilities to conclude a relationship agreement are limited, because if

the shares covered by the agreement constitute an aggregate participation of more than 33⅓%, the signatories generally would be considered as a group, which would trigger the obligation of a mandatory offer. Moreover, it is not always necessary to formalise the investors' influence further: depending on the shareholding structure; ie, if the structure is very fragmented with many shareholders, 30% of the voting rights may be sufficient to secure decisive control in the company.

Regarding a squeeze-out in a public company mechanism, under Swiss law an investor has two options (i) under the FinMIA, a bidder holding 98% of the voting rights of the company may, within three months upon expiry of the offer period, file for the cancellation of the remaining shares against compensation in the amount of the offer price to the respective minority shareholder in a statutory squeeze-out procedure before the competent court (*Kraftloserklärung*), or (ii) by way of a squeeze-out merger, if the bidder holds less than 98% but at least 90% of the voting right, against compensation in accordance with the Swiss Merger Act. The threshold to initiate a squeeze-out merger is lower; however, it carries a higher litigation risk than the cancellation procedure.

## 7.7 Irrevocable Commitments

Irrevocable commitments to tender shares are not enforceable under Swiss tender-offer rules in case of a competing offer and therewith the Swiss Takeover Board establishes a level playing field for competing offers. According to Swiss takeover law, shareholders must be free to accept a superior competing offer.

## 7.8 Hostile Takeover Offers

In Switzerland, hostile takeover offers are generally allowed, but are, however, quite rare as,

generally, offers that are supported by the target company's board are more likely to be successful. Furthermore, in a friendly takeover the offeror and the target company will normally enter into a transaction agreement, pursuant to which the target's board of directors agrees to recommend the offer to its shareholders and not to solicit offers from third parties and therefore, provides for higher deal certainty, which would not be possible in a hostile takeover offer.

However, there appears to have been an increase in unsolicited takeover approaches, either alone or in partnership with a strategic or private equity firm, following the COVID-19 crisis and the recent downward trend in the financial markets, as there are many affordable companies on the market and investors are seeking new ways to deploy their capital. This is, however, not surprising, as, historically, activity has increased following market downturns.

## 8. Management Incentives

### 8.1 Equity Incentivisation and Ownership

Equity incentivisation of the management is very common in Swiss transactions since it is an extremely suitable instrument for retaining the management team in the long term and may also be attractive from a (Swiss) tax-law perspective. Although the equity incentivisation of the management depends to a great extent on the individual transaction, the typical management stake varies between 3% to 10%. Ideally, management gets to invest on the same terms as the investor to provide even more attractive conditions to the managers (see also **8.2 Management Participation**). Furthermore, the individual structure of the management participation is very much tax driven.

### 8.2 Management Participation

In Swiss transactions, there are two predominant structures for management incentive schemes: the "strip investments" and "sweet equity". In the case of the former, managers invest on the same terms and conditions as the financial investor, whereas in the case of the latter, managers receive a certain discount and/or different share classes. A sweet equity incentive scheme could, for example, be structured as follows: managers receive all ordinary shares while the financial investor receives a mix of ordinary shares and preferred shares with a fixed interest (or alternatively provides a shareholder loan). This leads to a certain envy ratio in favour of the managers. However, it should be noted that Swiss tax law sets rather narrow limits with respect to tax-exempt capital gains on sweet equity. To have "skin in the game" and to align fully the managers' interests with those of a financial investor, managers are generally asked to finance a substantial part of their investment with equity; ie, roughly 50% or more.

### 8.3 Vesting/Leaver Provisions

Equity participations of managers are usually subject to customary good and bad leaver provisions, which are mostly tied to the termination of the manager's employment or mandate agreement, or other events related to the manager personally (eg, death, insolvency, divorce, etc). Leaver events typically trigger call/put options, whereby the leaver qualification has an impact on the purchase price (ie, in the case of a bad leaver, the purchase price is a lower percentage of the fair market value).

Vesting provisions, either time and/or performance-based, are also common practice in management participations. Vesting provisions may vary depending on the parties involved and the kind of leaver events that have been agreed.

In practice, the most commonly seen arrangements involve time-based vesting with monthly or quarterly vesting over four years, a one-year cliff and end of vesting if the employment ends. The lapse of time together with the leaver event will then collectively have an impact on the purchase price (ie, portion of unvested shares are sold at a lower price versus portion of vested shared).

Furthermore, the parties often agree on a certain lock-up period (eg, three to five years) during which the manager may not transfer their shares and/or are limited with regard to the termination of their employment relationship (ie, a manager will be considered a bad leaver except in the case of a termination by the manager for good reasons or by the company without good reasons). Whereby, after expiry of that lock-up period, the manager may also terminate the employment relationship without good reason and is still considered to be a good leaver. For the determination of a good reason, reference is usually made to the provisions of Swiss statutory employment law (Articles 340c and 337 of the Swiss Code of Obligations), indirectly including Swiss case law. Hence, a manager is typically considered to have good reason to terminate the employment relationship in the case of, eg, a material salary decrease by the employer for no objective reasons or in the case of severe harassment at work. No good reason would be attributed to the manager, eg, if the employer has delayed making a salary payment.

In addition, the breach of provisions of a related agreement also commonly triggers good and bad leaver provisions, eg, if the manager materially breaches an investment agreement, corporate regulations of the company, or his or her employment or mandate agreement, the manager will be considered a bad leaver.

## 8.4 Restrictions on Manager Shareholders

One of the most common restrictive covenants in Switzerland are non-compete and non-solicitation undertakings during the time of the manager's investment and for up to three years thereafter. In particular, if the manager is simultaneously invested in the group as a shareholder and thus has various information and governance rights, a non-compete undertaking may be justified, even for the time after the manager has ceased to be an employee/director of the company.

However, based on Swiss statutory law, non-compete and non-solicitation undertakings may not exceed three years following the end of the employment relationship or the manager's exit as a shareholder. Further, they also need to be geographically limited as they otherwise would be considered an excessive undertaking on the part of the manager (eg, to the areas where the manager could harm the company with his or her knowledge). Excessive non-compete and non-restriction undertakings may be reduced by the court in the event that they are challenged, and the courts have broad discretion in doing so. The enforceability of non-compete and non-solicitation undertakings is often increased by stipulating contractual penalties for the manager or triggering bad-leaver provisions in the case of a breach by the manager.

## 8.5 Minority Protection for Manager Shareholders

Managers who are not re-investing sellers generally have limited minority-protection rights. The most common minority-protection right is the right of the manager to participate on the same terms and conditions as the investor in an Exit, which is ensured through drag- and tag-along rights.



However, depending on the negotiating power of management, additional minority-protection rights (such as veto rights, board-representation rights or anti-dilution protection) have been seen.

## 9. Portfolio Company Oversight

### 9.1 Shareholder Control

The level of control of a private equity fund largely depends on the type of investment; ie, whether it invests as a minority shareholder or a majority/sole shareholder.

Typically, private equity shareholders taking non-control positions seek protection via restrictions of the transferability of the shares, tag-along rights, and put-options, as well as certain governance rights, usually including the appointment of a representative on the board of directors and certain veto and information rights, which are, however, limited to fundamental rights with respect to the protection of their financial interest (dissolution, material acquisitions or divestures, capital increases, no fundamental change in business, etc).

In the case of a majority stake in the company, the private equity shareholder has extensive control over the company; ie, the majority in the board of directors and only limited restrictions due to veto rights to any minority shareholders. In addition, usually, protection rights regarding the shareholding of the company will be implemented (in particular, transfer restrictions, right of first refusal, and drag-along rights, as well as call-options on the shares of the minority shareholders) to have maximum flexibility, in particular with regard to a possible exit.

### 9.2 Shareholder Liability

As a general principle, under Swiss law there is a separation between a company and its shareholders, and the shareholder may not be liable for the actions of the company.

However, according to case law, under special, limited circumstances the legal independence of the company and its exclusive liability are considered abusive and therefore unlawful, and consequently the controlling shareholder might be held responsible (piercing the corporate veil).

Further, a private equity investor or an individual acting for it may be considered as a de facto director of the company (eg, in the case of a material decisive operational influence) and, consequently, be bound by directors' duties as well as held responsible for possible damages resulting from a breach of those duties.

Lastly, a private equity investor that (solely or jointly) controls a portfolio company which has infringed competition law could be made jointly and severally liable for paying the resulting fine, as, in Switzerland, holding companies tend to be found to be jointly and severally liable for the antitrust fines of their subsidiaries. Private equity investors should, therefore, implement a robust compliance programme in their portfolio companies to avoid antitrust law infringements.

### 9.3 Shareholder Compliance Policy

Typically, private equity funds impose their compliance policies – to the extent permissible – on the portfolio companies which are under their control, to standardise internal procedures (in particular with respect to reporting, data protection, anti-money laundering or specific regulatory matters) and to ensure the alignment with the minimum standards applicable to the fund.

## 10. Exits

### 10.1 Types of Exit

The typical holding period for private equity investments before they are sold or disposed of are three to ten years. Thus far in 2022, exits were with absolute majority conducted by trade sale.

As for other types of exits, eg, “dual track” on the one hand – an IPO and sale process running concurrently – it can be said that they depend heavily on the general market conditions. These can be seen quite often if an IPO is considered. However, if an IPO is not being considered, a trade sale (auction) process will often be the preferred route. On the other hand, a full exit at the listing – the sale of all shares held by the private equity seller – is in general not possible via an IPO. Therefore, the private equity seller will need to sell the remaining shares gradually or in one or more block trades.

### 10.2 Drag Rights

Drag rights or drag-along provisions/mechanisms are common in private equity transactions in Switzerland, as an investor typically wants to ensure that, in the case of an exit, potential buyers may acquire 100% of the shares in the target company, which increases the attractiveness of the sale. Hence, unless the potential buyer intends to continue, eg, with the investment of managers, the drag-along right will typically be utilised within the course of a transaction.

The threshold to trigger the drag-along mechanism usually relates to the shareholding of the investor but is usually at least 50%.

### 10.3 Tag Rights

In accordance with the high frequency of drag-along rights, tag-along rights are also very com-

mon, especially for the management shareholders, while they are less common for institutional co-investors. As tag-along rights are typically subordinated to drag-along rights, and due to the fact that the retention of management shareholders will regularly be addressed at an earlier stage of the transaction, as well as in view of the deal certainty, the utilisation of such rights by the management shareholders is rather rare.

Even though it may depend on the leverage of the negotiating parties, the threshold to exercise the tag-along rights is usually also at least 50%.

### 10.4 IPO

On an exit by way of a Swiss initial public offering (IPO), the underwriters require sponsors and other large shareholders to enter into lock-up arrangements, usually for a period of six months after the IPO. For the company, its directors and managers, however, often a lock-up of 12 months is agreed. After the lapse of the lock-up, the sponsor will sell down shares, depending on prevailing market conditions pursuant to “dribble-out” trading plans or by way of accelerated book-buildings or block trades to single buyers.

Typically, such lock-ups are put in place for shareholders holding more than 3% of shares in the company.

While in Switzerland shareholders’ agreements are typical and usually terminated upon the IPO, relationship agreements concluded post-IPO are quite unusual. Nevertheless, the conclusion of a few relationship agreements have been seen recently. Such arrangements may include board-appointment rights and joint sell-down or other “orderly market” arrangements.

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