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8

Private M&A

Christoph Neeracher, Philippe Seiler and Raphael Annasohn[1]

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. Projects that could have a discouraging effect on (foreign) investors are approached with a certain degree of caution.

With the entry into force of the Federal Act on the Implementation of Recommendations of the Global Forum on Transparency and Exchange of Information for Tax Purposes on 1 November 2019, 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 to convert their bearer

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shares into registered shares by the end of April 2021. If the company had not complied with its obligations, 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) is made, the commercial register will reject the registration of amendments to the articles of association. As a consequence of the duty to disclose the beneficial owner of shares pursuant to article 697j of the Swiss Code of Obligations – which mainly provides that the acquirer of shares exceeding 25 per cent or more of the share capital or voting rights of a Swiss non-listed company must give notice of the beneficial owner of this position to the company – owners of bearer shares that have fulfilled the reporting obligation are automatically registered in the share register of the company. Up until today, there are still several companies whose articles of association provide for bearer shares. As of 1 November 2024, shares of shareholders that have not been entered in the share register will be legally void and those shareholders will lose all rights associated with those shares.

On 19 June 2020, the Swiss parliament approved a general corporate law reform amending the Swiss Code of Obligations (the Corporate Law Reform) which entered into force as of 1 January 2023. The Corporate Law Reform modernises corporate governance by strengthening shareholders' and minority shareholders' rights and promoting gender equality in boards of directors and in senior management. In this regard, listed companies have to reach a minimum threshold of 30 per cent of women for the board of directors and 20 per cent for management. In case of non-compliance with these thresholds, companies have to explain in their remuneration report why these thresholds have not been met and indicate the measures planned to remedy the situation. The provisions of the Ordinance on Excessive Compensation (the Minder Ordinance) applicable to listed companies have been integrated into the Code of Obligations, with only a few changes. Furthermore, the Corporate Law Reform facilitates 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 Corporate Law Reform 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. Moreover, the general assembly may pass its decisions

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by means of a written circular resolution. Finally, the Corporate Law Reform introduces certain disclosure requirements for commodity firms (report of payments made to public authorities) and allows the share capital to be fixed in a foreign currency.

From 1 January 2023, companies have two years to make any necessary amendments to their articles of association and organisational regulations. Regarding gender representation, listed companies have five years to comply with the new provisions for the board of directors and 10 years for the management board.

On 3 March 2020, the Swiss parliament entrusted the Swiss government to create a draft bill introducing a control over foreign direct investments in Swiss companies, including setting up a licensing authority to monitor the transactions concerned. The purpose of investment control is to avoid possible threats to public order as a result of foreign investors taking over a domestic company. It should also prevent major distortions of competition in the event of the acquisition of a domestic company by a foreign state or state-related investors. The consultation period ended in September 2022 and the results are currently being evaluated. A date for the entry into force and the concrete form of such law are still pending. However, it seems that such a law will be limited to investments by foreign states or near-state institutions and to investments in critical sectors (eg, defence, energy or health).

Development of private M&A activity

The record year 2021 was followed by another high-transaction year. In 2022, 647 transactions involving a Swiss participation were recorded (compared with 604 in 2021). The volume of transactions with Swiss involvement decreased from US$170 billion to US$139 billion, which still represents a 120 per cent jump as opposed to 2020. Similar to 2021, outbound deals were approximately twice as high as inbound deals, as in 44 per cent of overall transactions with Swiss participation Swiss companies acquired foreign entities, compared with 23 per cent of inbound transactions. The share of domestic transactions slightly increased to 20 per cent of all transactions (16 per cent in 2021).

With 194 transactions, the number of private equity transactions remained at a comparable high level as in 2021. However, the overall deal value of private

equity transactions decreased by 57 per cent compared with the previous year. M&A activity involving private equity accounted for 30 per cent of the overall Swiss M&A market. The private equity market managed to overcome challenging market situations, driven by a high level of dry powder, low interest rates and generally favourable borrowing conditions.

As in the prior year, the technology, media, and telecommunications (TMT) sector was particularly attractive, taking advantage of the pandemic situation and reporting one-fifth of all transactions both in terms of the number of deals. A substantial number of transactions were reported in the financial services sector, with an increase of 26 per cent compared with 2021. The pharmaceutical industry also remained at a high level owing to strong growth prospects (ageing population, prevalence of lifestyle diseases, focus on prevention), as well as the consumer goods sector.

Important factors for ongoing strong M&A activity in 2022 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, and so have consolidation waves in various sectors (such as healthcare, TMT and consumer markets). 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 was apparent in 2022, yet is still noticeable in 2023 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 2022. 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

The highest-volume transaction of 2022 was the merger between the Dutch chemical company Royal DSM and the Swiss flavours and fragrance group Firmenich, with a deal value of US$20.7 billion.

A noteworthy transaction in the consumer goods sector was the acquisition of 93 per cent of the shares in Swedish Match by Philip Morris at the end of 2022 to expand its portfolio. The transaction value was US$18.9 billion.

A recent transaction in the private equity sector was the acquisition of a significant minority stake in Breitling AG by Partners Group from CVC Capital Partners. By completing this transaction, Partners Group now holds a majority stake in Breitling AG.

These three transactions demonstrate that the market recovered quickly following the covid-19 pandemic and that the year 2021 should not be considered a mere outlier in terms of the number of transactions.

Outlook 2023

After a certain slowdown in 2020 owing to the covid-19 pandemic, M&A activities achieved historical levels in 2021 and 2022. Despite problems in global supply chains and the war in Ukraine, the high M&A level is likely to remain in 2023, despite a certain slow-down in the deal flow.

The global recovery, however, remains fragile, showing signs of headwinds. The threat of the end of negative interest rates and inflation could affect the valuation of businesses, hence making investors less likely to engage in large transactions. The geopolitical situation may also have an impact on the M&A market, as the price of commodities (oil and gas) has reached all-time highs.

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(s), 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 share- holders' 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 whether 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 2022, 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

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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 by 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. Deferred purchase price elements (such as earn-outs) or vendor loans have been seen occasionally in recent deals as a consequence of the covid-19 pandemic.

Conditions

Owing to the sellers' market we experienced in 2022 (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, the 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, especially in the healthcare and industry sectors.

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.

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