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Good times ahead?

Hans-Peter Schwald, Marc Metzger and Martin Bürkle of Staiger Schwald & Partner dicuss the highlights of a good year in Swiss M&A, and analyse the potential for the future

As Switzerland is neither part of the European Union (EU) nor of the European Economic Area (EEA), European legislation is not applicable to Swiss M&A. Mergers and acquisitions (private and public) are primarily regulated by the Swiss Code of Obligations (CO) and – depending on the particular transaction structure – the Swiss Merger Act. Moreover, M&A transactions that exceed a certain threshold are subject to the Swiss Act on Cartels and other Restraints of Competition (Cartel Act) and the Merger Control Ordinance (see below). Finally, public takeovers are governed by specific regulations for listed companies (see below). For foreign involvement in an M&A transaction, no further (specific) restrictions or limitations apply. Exceptions relate to certain regulated industries (such as banks, securities dealers and insurance companies) where special requirements, governmental approvals or duties of notification have to be considered.

Public takeovers

For public takeovers, transactions where a foreign or Swiss company acquires the whole or part of the equity securities of a listed Swiss company, the Federal Act on Stock Exchanges and Securities Trading (SESTA) and its ordinances, namely the Stock Exchange Ordinance (SESTO-FBC) issued by the Federal Banking Commission (FBC) and the Takeover Offer Ordinance (TOO) issued by the Takeover Board (TOB) apply additionally. The TOB reviews all public takeover offers that are subject to the SESTA and is authorized to issue (non-binding) recommendations to the parties involved; the FBC renders binding administrative decisions if the relevant parties reject or fail to comply with the TOB's recommendations.

In general, the SESTA governs both public takeover offers by shareholders or third parties and public offers by a company to repurchase its own shares. It is solely applicable to public takeover offers relating to equity securities in target companies incorporated in Switzerland whose securities at least partly are listed at the SWX Swiss Exchange (SWX). The SESTA applies to both friendly and hostile takeover offers.

The SESTA is not applicable to non-public offers unless they lead to shareholdings exceeding 33.3% of the voting rights in the target company. However because of the requirement to disclose substantial shareholdings (rules described below), a potential buyer's possibilities for a creeping tender offer are limited.

While the takeover rules generally relate to voluntary offers, whoever acquires, directly, indirectly or acting in concert with third parties, equity securities in a target company incorporated in Switzerland exceeding the threshold of 33.3% of the voting rights (whether or not such rights may be exercised), is obliged under the SESTA to make an offer to the other shareholders with a view to acquiring all listed equity securities of the company. Thereby, the respective offer price shall be at least as high as the stock exchange price and shall not be less than 25% below the highest price paid by the offerer in the preceding 12 months for equity securities of the target company.

The SESTA allows that the shareholders' general assembly of a Swiss company in its articles of association may raise the mentioned statutory threshold of 33.3% of the voting rights to a maximum of 49% (so-called opting-up). It is even possible to completely exclude the obligation to make a public takeover offer (opting-out) provided that the exclusion is implemented prior to the company's equity securities being admitted to official listing on a stock exchange in Switzerland. A considerable number of the companies listed at the SWX have implemented opting-out clauses as described, whereas only a limited number of listed companies have chosen an opting-up.

If the relevant turnover thresholds are reached, the following concentrations of enterprises are subject to pre-merger notification: (i) statutory mergers of previously independent enterprises and (ii) any transactions by which one or more enterprises obtain direct or indirect control over a previously independent enterprise. The latter includes the obtaining of joint control over a concentrative joint venture.

According to the Cartel Act pre-merger notification to the Swiss Competition Commission of a concentration is triggered if the enterprises concerned reach the following turnover thresholds in the last accounting period prior to the concentration: (i) joint worldwide turnover of at least SFr2 billion ($1.68 billion), or joint turnover in Switzerland of at least SFr500 million, and (ii) individual turnover in Switzerland of at least SFr100 million by at least two of the enterprises concerned. Specific provisions apply for insurance companies, banks, and other financial intermediaries.

Legislative changes

To begin with, the FBC strengthened the shareholding disclosure rules: a partial revision of the SESTO-FBC came into force as of July 1 2007. This partial revision includes in particular (i) the introduction of an obligation to notify exchange, purchase and sale rights regardless whether to be executed in kind or not (amendment of article 13 paragraph 1 SESTO-FBC), and (ii) the cancellation of the privilege for exchange, purchase and sale rights not exceeding 5% of the voting rights (cancellation of article 13 paragraph 3 SESTO-FBC). As a result, in order to calculate the threshold(s) to be disclosed, shares and options need always to be added and cash-settlement options must be taken into consideration as well.

Another relevant change in legislation is the revision of the provisions regarding the disclosure of identity of major shareholders in the SESTA. As mentioned, under current legislation shareholders that hold a stake under 5% in a listed company can remain anonymous. This has been widely criticised as too low a threshold, especially as it is possible for a prospective bidder to control up to 10% of the shares of a target company through a combination of options and long positions. In reaction to this, the Swiss parliament has approved to lower this threshold to 3 percent in June 2007. Furthermore, it is made clear in the new wording of the provision (article 20 SESTA) that call and put options as well as other financial instruments which allow the owner to sell or buy shares are also relevant for the duty to disclose. The changes are expected to enter into force on December 1 2007 unless a referendum is taken against them.

The new tax legislation on the so-called indirect partial liquidation, which came into force on January 1 2007, will have a positive

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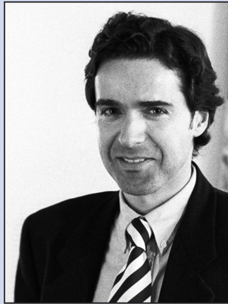

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impact on M&A in Switzerland. The concept of indirect partial liquidation has been a major issue among tax practitioners in Switzerland for over 20 years. Initiated by the federal tax authorities and upheld by the Swiss Supreme Court, tax-free capital gains made by individuals on a dept-financed sale of shares to a corporation were qualified as taxable (dividend) income on a regular basis as such a transaction was considered a de facto liquidation of the target. With regard to the fact that federal tax authorities could qualify a transaction as indirect partial liquidation even a long time after the closing of the deal, the sale of a company to a legal entity had become increasingly difficult as it had been fairly unpredictable when such tax consequences would apply.

The new legislation (article 20a paragraph 1 section a of the Federal Act on Direct Federal Tax) has brought an increase in clarity regarding the question as what is to be considered a partial liquidation. According to a draft circular of the federal tax authorities on the new provision, a transaction will only trigger dividend-type taxation if (1) the transaction involves a sale of shares, (2) shares representing at least 20% of the target company are sold, (3) privately held shares are sold to a corporate or other business purchaser, (4) within a period of five years after the sale, assets of the target are distributed to the buyer, (5) these assets constitute substance of the company, (6) the distributed substance must have been held at the time of the transaction and is not required for the operational business of the target company, furthermore, the target company legally must have been in a position to distribute such assets to the shareholders even before the transaction in question took place, (7) the seller knew or should have known at the time of the sale that assets would be extracted in order to finance the transaction.

The new legislation also affects sales made in the tax year 2001 and following if no final and binding decision regarding the taxation of these sales has yet been made. Such retroactive provision is a novelty in Swiss tax law.

Even though the new provision noticeably increases legal certainty on the subject, some questions remain to be answered by federal tax authorities. Among others, the definition of "substance not required for the operational business of the target company" will be a key issue as neither civil nor tax law provide an exact definition. In any event, it is strongly recommended that any proposed transaction be submitted to the tax authorities for approval in a binding tax ruling.

Even under the new legislation, in many cases the buyer will not be able to merge with the acquired company within the five-year period mentioned above. The acquirer should also be very careful when restructuring the target company in order not to risk facing tax consequences.

Another recent development relates to the following: in the course of the Limited Liability Company Law revision, entering into force at the beginning of 2008, numerous commercial law provisions have been adapted or fundamentally changed for reasons of harmonization and practicality. Most of these changes may only have an indirect impact on M&A activities, though. With regard to cross-border transactions it should be mentioned that the requirements as to domicile and nationality for the members of the board of directors will be relaxed considerably. In future, the company must be represented by one person domiciled in Switzerland, although this requirement may be fulfilled by a member of the board of directors or an executive director. It will thus be possible that none of the board members are domiciled in Switzerland. Furthermore, in a desire for simplification, the requirement that the members of the board of directors must be shareholders of the company will be dispensed with. Accordingly, no mandatory or qualifying share for board members will be necessary. As a consequence, an express right on the part of the board members to attend at, and submit motions to, the shareholders' meeting will be stipulated.

Due diligence

In Swiss M&A the due diligence process is standard practice but varies for each transaction. Ideally, the prospective buyer develops – in a due diligence request list – a series of tailor-made, precise questions relevant for its investment decision and determines what information will be needed. Generally, the disclosure duties of privately held companies are set out in the CO and are very limited. Unlike publicly held companies, privately held companies neither have to disclose or file any financial information to the market nor have to reveal the identity of any shareholder. The only source of information regularly available is the competent commercial register. On the other hand, companies listed on the SWX are required to publicly publish at least the annual financial statements and – depending on the company structure and certain operating figures, respectively – the consolidated financial statements. Companies listed on the SWX are also required to publish (at least semi-annually) an interim financial report as well as a comprehensive business report (annually). Such a business report must contain the board's annual report, the auditor's report, the audited financial statements, corporate governance information

and the identity of shareholders and organized groups of shareholders with more than 5% of the company's share capital. According to the Listing Rules of the SWX, publicly held companies are obliged to report certain board and senior management transactions on the one hand and to disclose to the market facts that may be price-relevant (so-called ad hoc publicity) on the other hand. Furthermore, shareholders and groups of shareholders acting together are required to report to the SWX purchase and sale transactions as well as certain options and rights in the listed company, provided that such shareholders or group of shareholders reach, exceed or fall below certain thresholds (3% (as of December 1 2007 unless a referendum is taken), 5%, 10%, 20%, 33.3%, 50% or 66.6% of the voting rights).

Transactions and future prospects

The year 2006 showed a record number of major M&A transactions globally. In Switzerland, key domestic transactions included Oerlikon's (formerly Unaxis Holding) takeover of Saurer. Nestlé bought Novartis Medical Nutrition. Standout acquisitions of Swiss companies by foreign bidders were French AXA's acquisition of Winterthur Insurance from the Credit Suisse Group and the takeover of Serano International by Merck, Germany, from the Bertarelli family. The acquisition of Falconbridge, Canada, by the Zug-based commodity trader Xstrata stands out as the biggest transaction of the year. Other major cross-border acquisitions by Swiss companies include UBS's takeover of Brazilian Banco Pactual and Swiss RE's acquisition of GE Insurance Solutions from General Electric Capital. Finally, Phonak Holding bought Danish ReSound and Swisscom purchased British Vodafone's 25% interest in Swisscom Mobile, thereby increasing its stake to 100%.

The global number of M&A deals of the first half-year of 2007 even surpassed the figures of the year before, with record levels in the financial and energy sector. In Switzerland, the acquisition of the supermarket chain Denner by market leader Migros stands out as the most talked-about domestic M&A transaction so far this year. Coop, the number two in Swiss retail trade, bought all Swiss shops of French competitor Carrefour, and Nestlé acquired the majority of the shares of mineral water producer Henniez. Key cross-border transactions include the takeover of SIG Holding by Rank Group, New Zealand, and French SCOR's acquisition of Converium Holding.

Despite the record numbers in the first six months of 2007, the turbulence in the international credit markets following the mortgage crisis in the US is expected to have a negative impact on the total volume of M&A this year, as transactions are getting more expensive due to higher credit costs. Leading M&A experts agree that the peak period for M&A is over and global advisory companies like KPMG and PricewaterhouseCoopers expect the overall deal volumes in 2007 to be lower than those in 2006. True to these predictions, August 2007 saw the smallest number in average transaction volume since November 2004. It is not likely that Switzerland will be an exception to this international development.

Globally, the US is still leading in terms of total volume of M&A activity though Europe has caught up and is considered to be the most promising market for transactions at the moment. In Europe and elsewhere, private equity companies have played a key part in M&A this year, involved in almost 25% of the volume of all transactions in the first half-year of 2007, nearly twice as much as the same period in the year before. In Switzerland, the Austrian venture capital company Victory has received considerable media attention after the acquisition of Oerlikon in 2005, which in turn took over Saurer, and the purchase of a 20% stake in the technology company ASCOM in January 2007.