

Access to Swiss Law
Nedim Peter Vogt
Editor

Ralph Malacrida
Rolf Watter

Mergers, Acquisitions and Corporate Restructuring

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Volume 1

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Table of Abbreviations

ARR/FER	Accounting and Reporting Recommendations ('Fachempfehlungen zur Rechnungslegung')
BGE	Decision of the Swiss Federal Supreme Court ('Bundesgerichtsentscheid')
Cartel Act	Federal Act on Cartels and other Restraints on Competition of 6 October 1995
CC	Swiss Civil Code of 10 December 1907
CHF	Swiss francs
CO	Federal Code of Obligations of 30 March 1911
DFTA	Federal Act on Direct Federal Taxes of 14 December 1990
DFTHA	Federal Act on the Harmonisation of Direct Cantonal and Municipal Taxes of 14 December 1990
FBC	Federal Banking Commission
IFRS	International Financial Reporting Standards
IPO	Initial Public Offering
Lex Koller	Federal Act on the Acquisition of Real Property by Foreigners of 16 December 1983
LLC	Limited liability corporation (GmbH in German)
MA/Merger Act	Federal Act on Mergers, De-Mergers, Conversions and Asset Transfers of 3 October 2003 (Merger Act as entered into force on 1 July 2004)
SESTA	Federal Act on Stock Exchanges and Securities Trading of 24 March 1995 (Stock Exchange Act)
SESTO	Ordinance on Stock Exchanges and Securities Trading of 2 December 1996
SESTO-FBC	Ordinance of the Federal Banking Commission on Stock Exchanges and Securities Trading of 25 June 1997
SME	Small or medium sized enterprise
SPC	Swiss Penal Code of 21 December 1937
TO	Ordinance of the Takeover Board on Public Takeover Offers of 21 July 1997
UK	United Kingdom
US	United States of America
US GAAP	Generally Accepted Accounting Principles
USD	US Dollar

I Introduction

1 Mergers and Acquisitions in Switzerland

Synergy is the cornerstone of mergers and acquisitions. Combining two companies allows for cost savings and earnings growth and, as a result, increased shareholder value. Yet merger and acquisition activity brings not only rewards but also risks. Corporate cultures may clash, opportunities for synergy may be misconceived, and redundancies may undermine operational capabilities. Any potential problem can be compounded when transactions cross national boundaries. In addition, the legal regime governing mergers and acquisitions is becoming increasingly complex. With all these complications, the aim of this booklet must necessarily be modest. As each successful corporate combination is based on solid legal foundations, whoever is looking for a sound footing in the relevant fields of Swiss law may wish to browse through this publication for a glimpse of the legal workings and documentation of an M&A deal. The authors hope that the material is neither too 'broadbrush' nor too narrow to provide readers with that essential basic insight.

As a general rule, a Swiss company or its business may be acquired by way of a public offer or a private acquisition. Based on a private agreement control can be obtained through (a) the purchase of a controlling block of shares, (b) the acquisition of a business (assets and liabilities), (c) the participation in a share capital increase, or (d) a merger. The purchase of a controlling block of shares is the technique most commonly used. Many of Switzerland's corporations, even those listed on the SWX Swiss Exchange, are either privately held or controlled by a group of shareholders. Of all the listed companies only about 30 per cent are truly public in the sense that the majority of the share capital is held by investors without co-ordinated interests. Therefore, other than by share purchases, acquisitions in Switzerland tend to be effected by friendly takeovers or mergers.

The major Swiss banks and a number of specialized consultancy firms provide a whole range of M&A services – including searches for possible targets, value analyses of potential opportunities, provision of competitive intelligence, corporate finance advisory services or the delivery of fairness opinions. Specialized law firms normally draft the acquisition documents. Since tax considerations greatly influence the transaction structure, tax and legal counsel need to co-operate closely. Accounting matters are usually dealt with by one of the big four accounting firms.

The Anglo-American drafting style has continually influenced Swiss M&A agreements. This is true for both private arrangements and takeovers, where expressions such as raider, white knight, poison pill or golden parachute have become part of Swiss legalese. Nonetheless, Swiss transaction documents continue to be conciser than their Anglo-American counterparts, not only because Swiss lawyers dislike verbosity (or lack elegance) but also because Swiss M&A transactions rest on statutory law and general principles of equity.

2 Corporate Restructuring

Beside acquisitions there are other methods to create shareholder value. In particular, breaking up can be a good thing to do as well. Restructuring ideally results in benefits coming from increased transparency for investors and greater accountability of managers, which leads to improved operating performance. This again will attract additional investors and more capital. Sometimes, there may also be a lack of synergy between two businesses with the effect that the combined entity is undervalued.

Various forms of corporate restructuring exist, including de-mergers (spin-off of a business into a separate legal entity with shares being either transferred to existing shareholders or sold on the market), equity carve-outs (IPO of a non-controlling stake in a subsidiary), or sell-offs (divestiture of a subsidiary). Tracking stock which is issued by a parent company to track the earnings of a division, though a popular restructuring method abroad, has not caught on in Switzerland.

Until recently, Swiss law lacked regulation specifically dealing with corporate restructuring. The absence of a defined legal process to efficiently re-structure business entities gave rise to the Federal Act on Mergers, De-Mergers, Conversions and Asset Transfers ('Merger Act'), which entered into effect on 1 July 2004. Its main purpose is to increase the flexibility of businesses changing their legal form and transferring assets and liabilities. In addition, various tax laws were partially revised to avoid re-organizations being frustrated by negative tax implications.

The Merger Act is concerned with the following types of corporate re-structuring:

- statutory mergers, which implicate the amalgamation of two entities;
- de-mergers where an existing company is split in two or where (part of) the business of an existing company is transferred to another company and where the shareholders of the divesting entity will become shareholders of the receiving company;
- conversions resulting in a new legal form for the same legal entity;
- asset transfers where assets and liabilities are transferred by operation of law.

3 Doing Business in Switzerland

3.1 Independence and Political Stability

The Swiss Confederation comprises 26 Cantons (states), each with its own constitution, parliament, government and courts. Cantons are sovereign insofar as their sovereignty is not limited by the Federal Constitution. In particular, they retain legislative authority to organize the judiciary and civil justice, while legislation in the field of civil procedure and substantive laws, including corporate and securities laws, is a federal matter.

Due to the fact that Switzerland's major political parties have shared power in the Federal Council – the executive body – for more than thirty years, the political situation is very stable despite the different cultural backgrounds of the 7.36 million Swiss and Switzerland's four official languages (German, French, Italian and Romansch).

Traditionally, Switzerland's international relations have been determined by a policy of armed neutrality. Switzerland is a member of the Council of Europe, the European Free Trade Association (EFTA), the Organization for Economic Cooperation and Development (OECD) and has been a signatory of the General Agreement on Tariffs and Trade (GATT). Switzerland joined the World Trade Organization (WTO) in summer 1995 and the International Monetary Fund and the Bretton Woods Institutions in 1992. In the same year, Swiss voters decided against joining the European Economic Area (EEA), which was created to pave the way for a common market of the European Union (EU) and the EFTA countries. Since then, despite a somewhat ambiguous relationship with the EU, Switzerland has sought to make Swiss laws and regulations compatible with EU directives on a voluntary basis, especially in the field of commercial law. In June 1999, Switzerland and the EU signed seven bilateral agreements covering civil aviation, overland transport, free movement of persons, research, public procurement, agriculture and elimination of technical trade barriers (Bilaterals I), which were approved in a referendum in 2000. In September 2002 Switzerland joined the United Nations. Some matters not addressed by the Bilaterals I were the subject of a second round of negotiations resulting in a new set of agreements (Bilaterals II), which were signed on 26 October 2004 and will now need to be ratified.

3.2 Positive Business Climate

Switzerland's GDP per head at purchasing-power parity was USD 30,500 in 2002. In consequence, though still 14 per cent above the European average, in the league of the richest nations Switzerland has been overtaken by Luxembourg, Norway and the US. The current unemployment rate at around 4 per cent is high by Swiss standards. Today, 72 per cent of the working population are employed in the service sector. As one Swiss franc in two is earned abroad, Switzerland continues to rely on its ability to export goods and services, particularly to Germany, other members of the EU and the US. In general, the Swiss are well aware that Switzerland is not as special as it used to be and that in order to stay world-class, it must take pains in catering for the needs of international investors. Against this backdrop, thanks to a rebounding economy and Switzerland's open and positive business environment M&A activity has picked up again. In 2004 471 deals have closed, which was 60 per cent above the 2002 levels. A further increase in transactions is projected for 2005 to 2006.

II Business Regulation

In 1881 the Swiss legislature enacted the *Federal Code of Obligations* ('CO'). Major revisions occurred in 1911, 1936, 1992 and 2004 (regarding Swiss company law). In 1907, the *Swiss Civil Code* ('CC') was enacted which entered into force in 1912. Together, these codes – supplemented by the *Merger Act* and the *Stock Exchange Act* – contain the bulk of the law concerning family and inheritance matters, property, contracts, torts, restitution, partnerships, as well as corporate matters and securities regulations.

1 Business Organisations

1.1 The Company Limited by Shares ('Corporation')

Most businesses in Switzerland are organized as *corporations* ('Aktiengesellschaften' – 'AG' or 'SA'). The minimum share capital is CHF 100,000. Prior to July 1992 it was CHF 50,000, and companies incorporated before 1985 are permitted to maintain it at that level.

In general, shareholders' obligations do not extend beyond the contribution of the shares issue price. The share capital may be increased by a majority vote of the shares represented in what is called an *ordinary share capital increase*, or, alternatively, out of authorised or conditional capital. When creating *authorized share capital*, the shareholders authorize the board of directors to issue shares up to a pre-determined amount within a period of two years. *Conditional share capital* is used in connection with convertible bonds or option rights; it allows the holders of conversion or option rights to automatically increase the equity by exercising their rights. The shareholders' resolution necessary to create authorized or conditional capital requires a majority of two thirds of the votes represented at the meeting and the majority of the represented nominal value of the shares (unless provided otherwise in the articles of incorporation). Authorized and conditional share capital may not exceed 50 per cent of the ordinary capital (except in the context of mergers).

A reduction of share capital requires, *inter alia*, a notice to the creditors and normally involves a procedure taking at least two months.

The *articles of incorporation* define organizational requirements. More specifically, the corporation must have a board of directors, auditors, and a shareholders' meeting, which must be convened at least annually. The board may manage the company itself, though many companies have chosen a *two-tier system* where the management runs the day-to-day business and the board of directors performs supervisory functions. The adoption of a two-tier structure entails the issuance of so-called organiza-

tional rules by the board of directors, which define the competencies of the board and the management. The majority of the directors of a Swiss corporation must be citizens of Switzerland, the EU or EFTA and must be resident in Switzerland, subject to exemptions granted by the competent authorities in certain circumstances.

A corporation may issue *bearer shares* or *registered shares*. At the end of 2003, 63 per cent of the listed companies had one class of registered shares, 11 per cent one class of bearer shares, and 26 per cent a mixture of bearer shares, registered shares and other membership rights. In the case of physically issued bearer shares, possession of the certificate evidences title to the shares, and a transfer is achieved by delivery of the certificate. Whereas certificated registered shares are conveyed by transfer of possession and endorsement of the certificates, non-physically issued shares require a written assignment. In addition, the transferee must be entered in the corporation's share register. Since July 1992 the following additional rules apply to registered shares:

- A corporation may refuse a transfer of the rights attached to *unlisted registered shares* (Article 685c III CO) within three months of the request by asserting a valid ground for refusal which must be defined in the articles of incorporation. It may also refuse to approve the transfer if it is prepared to repurchase the shares at their real value (Article 685b CO) either for its own account or for the account of a shareholder. Finally, the company may object against the transfer if the acquirer fails to confirm that he is purchasing the shares for his own account. Special rules apply where the shares are transferred by operation of law (succession, bankruptcy, et cetera; see Articles 685b IV, 685c II CO).
- If the registered shares are *listed* on a stock exchange, the company may refuse to approve the transfer but only in relation to the voting rights and based on a provision in the articles of incorporation stating that the interest of any single shareholder may not exceed a certain percentage. A substantial number of listed companies have adopted a three per cent limit, which also applies to shareholders acting in concert. Another possible ground for refusal by companies owning real estate is foreign nationality owing to restrictions on foreign ownership of interests in such entities (see Article 4 of the transitory provisions to the CO, and III. 2 on the so-called *Lex Koller*). For the purpose of registration, the acquirer must declare that he is holding the shares for his own account; furthermore special rules apply to transfers effected by operation of law (Article 685d III CO). Although the acquirer becomes a shareholder upon purchase of the shares, his voting rights are suspended until he is approved as a shareholder and entered into the share register (Article 685f III CO). Notice of refusal must be given by the company to the transferee within 20 days, failing which the company is deemed to have acquiesced in the transfer (Article 685g CO). A shareholder who is rejected under these rules must still be registered, albeit as a non-voting shareholder. A special feature of Swiss company law is what are called *dispo shares*. Dispo shares are registered shares in relation to which no application is made by the purchaser to be registered in the issuer's share register. According to legal commentators, holders of dispo shares technically do not qualify as shareholders, even though in practice they receive dividend payments through

the depositary banks based on voluntary payments of the issuer to remain attractive in the capital market.

Furthermore, the transferability of bearer and registered shares may be affected indirectly by provisions in the articles of incorporation limiting the number of votes a shareholder may cast. This notwithstanding, the general trend is to abolish or relax limitations of voting rights.

The company may issue bearer and registered shares, or registered shares with different nominal values. As the articles of incorporation may provide that every share carries one vote irrespective of its nominal value, *super voting shares* may be created by issuing registered shares with a nominal value of say CHF 10 and bearer shares with a nominal value of CHF 50 (or any multiple of the nominal value of registered shares up to the tenfold, see Article 693 CO) to the effect that holders of registered shares will hold more voting rights relative to their investment. Since July 1992, however, super voting shares have been ineffective in connection with resolutions on certain important matters (see Article 693 III and 703 CO) due to the requirement that approval by the majority of the capital represented is required.

1.2 Other Types of Corporations

The *limited liability corporation* ('Gesellschaft mit beschränkter Haftung' – 'GmbH') and the *co-operative* ('Genossenschaft') are of lesser practical importance. They numbered approx. 31,900 and 2,300 respectively at the end of 2001. Since 1992, when the minimum share capital for corporations was raised to CHF 100,000 and when companies limited by shares were required to appoint qualified auditors, the number of newly formed limited liability corporations has increased, given that the minimum capital of such entities is only CHF 20,000 and under certain circumstances there is no need to appoint auditors. However, the law relating to limited liability corporations is currently under revision to align it with the law governing corporations. The bill on the required amendments to the CO was made public in June 2004 and is now subject to debate in parliament.

1.3 Partnerships and Limited Partnerships

Comparatively few business entities in Switzerland are organized as partnerships. At the end of 2001, approx. 10,000 general partnerships ('Kollektivgesellschaften') and 1,600 limited partnerships ('Kommanditgesellschaften') were recorded in the commercial register.

2 Taxation and Company Accounts

2.1 Taxation and Social Security in Switzerland

2.1.1 Taxes on Income

Swiss resident individuals and companies are subject to taxation by the federal government, the cantons, and the municipalities. Cantonal taxes vary to some extent with respect to the computation of taxable earnings and considerably in the overall tax burden, as each canton and municipality sets its own tax rates.

A Swiss resident individual is taxable on his worldwide income, exclusive of capital gains deriving from the sale of privately owned assets. Swiss domiciled corporations are subject to corporate income tax for each accounting period on the net profit shown by the statutory accounts. Partnerships are transparent for tax purposes. The double taxation of corporations (on profits made) and its shareholders (on dividends received) is mitigated when it comes to holding companies where the so-called 'participation exemption' applies at the federal level and, in addition, where there is a holding privilege at the cantonal or municipal level.

Tax relief through a participation exemption is available for revenues deriving from (a) dividend payments on share participations representing 20 per cent of the company's capital or a fair market value of at least CHF 2 million, and (b) capital gains on disposals of shares representing not less than 20 per cent of the share capital held for a minimum of one year. A cantonal or municipal holding privilege is usually granted if (a) the company's object reflects a holding purpose and (b) either two thirds of the company's total assets consist of, or two thirds of its earnings are derived from, shares.

The tax disadvantage of doing business in a corporate structure as compared to a partnership is partly outweighed by the fact that capital gains on the sale of privately owned shares are tax-free for individual shareholders. Another special feature of Swiss tax law is that corporate taxes are generally deductible.

Non-resident companies will be subject to Swiss corporate income taxation if they have a permanent Swiss business establishment, invest in Swiss real property (or benefit from Swiss real estate as collateral), or join a Swiss partnership.

2.1.2 Withholding Tax

Withholding tax is payable by the debtor on income from movable property (interest and dividends) at a tax rate of currently 35 per cent. If the creditor is a Swiss resident, a total refund will be available based on the filing of a tax return. Foreign creditors may benefit from a (partial) relief in the form of a refund or a tax credit in accordance with the applicable double tax treaty (if any) between Switzerland and the creditor's country of residence. Zero per cent tax rates apply for example with respect to Den-

mark (tax credit for interest payments and dividends), France (tax credit for interest payments and dividends relating to holdings exceeding 10 per cent), Germany (tax credit for interest payments), and the US (tax credit for interest payments).

Since 1 January 2005 dividends of a Swiss subsidiary to its Swiss parent company are subject to a reporting procedure, which replaced a cash collection and refunding system, with the effect that cash dividends may now be paid without a withholding tax deduction, provided the parent owns at least 20 per cent of the subsidiary's capital.

Anti-avoidance provisions may apply relating to withholding tax relief. The competent tax authorities often treat transactions avoiding withholding tax on undistributed reserves as tax avoidance. Because there is a degree of uncertainty as to what the authorities will consider to be illegitimate tax structuring, obtaining a tax ruling is useful if foreign residents are involved.

2.1.3 Value Added Tax

The value added tax is payable on each phase of production, distribution and import of goods, domestic services and the procurement of services from abroad. The method of pre-tax deduction avoids tax accumulations such that the tax burden will only be borne by the end consumer. Turnovers generated by export deliveries and (transport) services for the benefit of persons abroad are generally exempted. The standard tax rate currently is 7.6 per cent. The system basically complies with the relevant European Union Directive.

2.1.4 Stamp Duties

Stamp duties arise for a Swiss company on the issuance of shares, bonds or money market papers (issue tax) or for a Swiss fiscal securities broker or a remote member of the SWX Swiss Exchange on the transfer of securities (transfer tax). Euro bonds denominated in non-Swiss currencies are exempt from transfer tax. A Swiss regulated bank, securities dealer or a Swiss company holding title to securities corresponding to an amount of at least CHF 10 million are deemed to be fiscal securities brokers for stamp duty purposes. The tax rate is one per cent with respect to issue tax for capital exceeding CHF 250,000 (CHF 1 million as from 1 January 2006), 0.15 per cent with respect to the transfer of Swiss securities and 0.3 per cent with respect to the transfer of foreign securities.

2.1.5 Other Taxes

Other than income and corporate income tax, individuals and corporations are taxed by the cantons and municipalities on their net wealth. Further cantonal taxes include real property taxes on the transfer and capital gains arising from the sale of real property (or the sale of shares in real estate companies).

2.1.6 International Tax Treaties

Switzerland has entered into international tax treaties to avoid double taxation in relation to income and corporate income (and withholding) taxes with more than 60 countries, including all OECD member states (except Turkey). The tax treaties are normally modelled on the OECD model convention.

2.1.7 Social Security Contributions

Social security contributions are levied on partnership income and income of employees. While those who are self-employed must contribute between 5.1 and 9.5 per cent of their annual income (depending on total earnings), the payroll deduction for employees is 5.05 plus 1.25 or 0.5 per cent (depending on the amount of unemployment insurance to be paid), with the same amount to be matched by the employer.

2.1.8 Corporate Re-Organizations

Various tax laws were revised in line with the goal of the Merger Act to increase the flexibility of Swiss companies re-organizing themselves. The main emphasis of the tax revision was placed on the principle that taxation of hidden reserves (i.e. the difference between book and market value) should not be triggered by a re-organization but be deferred until profits are actually realized on condition that (a) the assets and liabilities are transferred at their existing book value and (b) the parties concerned continue to be subject to taxation in Switzerland. In addition, depending on the type of transaction further conditions apply.

2.2 General Principles of Accounting

2.2.1 Sources of Reporting and Accounting Rules

Swiss company law prescribes the basic reporting and accounting principles (Articles 957 *et seq.* and 662 *et seq.* CO). The board of directors of a Swiss corporation must prepare a business report for each business year, including audited statutory accounts, an annual report of the directors and audited consolidated accounts if required. As a general rule, financial statements must be prepared in accordance with 'accepted accounting principles' such as completeness, clarity and materiality, prudence (conservatism), going-concern, and consistency. In addition, the law prohibits set-offs between assets and liabilities and between revenues and expenses. While Swiss company law contains rules governing statutory accounts in relation to format, valuation principles, reserves, and dividends, all it provides regarding consolidated accounts is that they must be prepared in accordance with generally accepted accounting principles and that the methods applied must be disclosed in the footnotes.

Switzerland, though not a member of the EU, is much influenced by EU Directives and therefore, in October 1998, an expert panel commissioned by the Swiss Government

proposed amendments modelled on the EU Directives to the existing law. A draft bill of a Federal Act on Financial Reporting and Auditing was produced. However, the goal of introducing a comprehensive bill was later dropped. Instead, in June 2004 a bill on the *Federal Act on the Admission and Supervision of Auditors* was presented for debate in parliament. The second part of the original draft bill, which related to financial reporting matters in general, got pigeon-holed in view of the uncertainty over international convergence of accounting rules.

Since Swiss company law does not provide a clear definition of what 'accepted accounting principles' are, the core of the accounting rules rests on recognised practices of the accounting profession. The Swiss Institute of Certified Accountants and Tax Experts ('Schweizerische Treuhand-Kammer') has published accounting and auditing standards and interpretations in the *Swiss Auditing Handbook* ('Schweizer Handbuch der Wirtschaftsprüfung'). Though not strictly legally binding, the Swiss Auditing Handbook reflects the accepted practices of the accounting profession in Switzerland. Moreover, The Swiss Foundation for Accounting and Reporting Recommendations ('Schweizerische Stiftung für Fachempfehlungen zur Rechnungslegung') has issued recommendations on valuation and presentation relating to both individual and group accounts (the emphasis being on the group accounts). This set of rules, the so-called *Swiss GAAP ARR/FER* (Accounting and Reporting Regulations) reflects to a large extent internationally accepted accounting standards and is applied mostly by small- to medium-sized companies.

By virtue of the SWX Swiss Exchange's Directive on Requirements for Financial Reporting, which came into effect on 1 January 2005, companies listed on the main segment may no longer use Swiss GAAP ARR/FER but have to apply either *IFRS* (International Financial Reporting Standards) or *US GAAP* (US Generally Accepted Accounting Principles) as from the financial year beginning on or after 1 January 2005.

2.2.2 Tax Relevance of Statutory Accounts

Swiss corporation tax is levied on the profits as evidenced by the statutory accounts (subject to certain adjustments). As a result, Swiss companies are encouraged to create hidden reserves by understating assets and overstating liabilities and keep disclosed profits low. This is in line with accepted accounting principles for statutory accounts, in particular the principles of prudence (conservatism) and realization as promulgated by the CO, and has so far been accepted by the Swiss tax authorities. Also, a conservative approach, which effectively understates profits, is underpinned by the fact that the major investors in Swiss companies are banks and financial institutions whose primary interest is in the security of their investment and the servicing of debt, rather than the disclosure of increases in profits and distribution of dividends.

2.2.3 Principal Users of Accounts

The pre-eminent users of financial statements are shareholders and creditors. Under Swiss law, there is no general requirement to publish accounts or file them for public

inspection with a governmental body. Exceptions apply to listed companies and companies with outstanding bonds (see Article 697 h CO) which must either publish the audited financial statements subsequent to the approval by the general meeting in the Swiss Commercial Gazette or provide a copy free of charge on request within a year of the shareholders' resolution. Investment funds are subject to strict supervision and must file accounts with the supervisory authorities. In addition, banks and insurance companies are required to publish accounts annually, six-monthly or quarterly, depending on the company's size, in the Swiss Commercial Gazette and further newspapers, as specified in the articles of incorporation.

Shareholders are generally entitled to receive or inspect the business report, including the financial statements, the directors' annual report, the audit report and the board's proposal for profit appropriation at the company's head offices and branches at least 20 days before the ordinary general meeting takes place, which must be held within six months of the balance sheet date. In practice, these documents are sent to the shareholders or made available on the internet.

Creditors may inspect the audited financial statements of Swiss corporations if they can demonstrate a valid ground. However, the company may deny a request for inspection due to overriding company interests or by settling the relevant debts. In practice, though, the banks as the most important providers of (debt) finance in Switzerland are in a position to require detailed financial information, irrespective of their limited legal rights, and in some cases (which are becoming increasingly rare, though) they will even insist on being directly represented on the board of directors.

2.2.4 Audit

Historically, prior to becoming independent through management buy-outs most of the major audit firms were owned by Swiss banks; nowadays, the profession is dominated by the big four (Deloitte Touche, Ernst and Young, KPMG and Pricewaterhouse Coopers).

Under Swiss law, audit requirements differ depending on the category into which a company falls:

- a) As a rule, Swiss corporations must have statutory auditors. The auditor's report for the statutory financial statements need not comment on whether these show 'a true and fair view'. However, a recommendation must be made to shareholders as to whether they should approve or reject the financial statements, which may be with or without qualification. The standard form of an audit report in relation to consolidated financial statements confirms that the accounts give a true and fair view of the company's financial position, the result of operations and the cash flow in accordance with the applied standard and that the statements comply with Swiss law.
- b) The involvement of specially qualified auditors is required for audit work relating to companies with total assets of more than CHF 20 million and/or revenues of

more than CHF 40 million and/or an average annual number of employees of more than 200 and those with bonds outstanding or with listed securities. In practice, Swiss certified public accountants are eligible for the position of 'specially qualified auditors', although some other qualifications are also sufficient, including qualifications obtained in foreign jurisdictions (e.g. UK chartered accountants) provided experience in and knowledge of Swiss law and accounting can be proven.

- c) Only specially authorized auditing firms may be appointed to undertake an audit required for a bank. Audit reports relating to banks are directly reported to the Federal Banking Commission and are not available for public inspection.

2.2.5 Role of Accountants in Acquisitions

Accountants often play an important role in the provision of detailed accounting and financial information on the target. The information is provided primarily to the management of the acquirer, but it is also frequently requested by sponsors and providers of finance in view of general appraisals in relation to particular transactions. Normally, the main purpose of the investigation is to assure that the financial statements are correct; sometimes, however, the auditing firms also produce valuations or work on a whole range of accounting and business issues, including the provision of cash projections or an analysis of the effects of an acquisition on the consolidated accounts of the acquirer.

2.2.6 International Comparability and Expected Revision of Swiss Law

Switzerland has traditionally based its accounting practices on minimal legal requirements and a largely tax driven presentation. Accordingly, there has been little compliance with international standards. However, the Swiss accounting profession has made a number of attempts to revise Swiss practices over recent years to harmonise the Swiss regime with internationally-accepted principles. The resulting ARR/FER standards are now widely accepted, and represented the minimum standard for listed companies until the end of 2004. ARR/FER in certain areas go beyond what the 4th and the 7th EU Directives require. Moreover, a large number of Swiss companies apply IFRS, and some of the multinational Swiss groups have introduced or are in the process of introducing US GAAP. As pointed out above, Swiss listed companies must now apply IFRS or US GAAP.

2.3 Statutory (Unconsolidated) Financial Statements

2.3.1 Contents and Format of Accounts

Statutory financial statements are prepared for an individual company on a stand-alone basis. They comprise a balance sheet, an income statement and the notes. A cash-flow statement is not required. Prior to 1992, there was no general accounts format. Since then, the disclosure in the statutory financial statements of all companies,

other than those covered by special legislation, have been standardised with a minimum classification of 26 items in the balance sheet and 15 in the profit and loss account.

2.3.2 Valuation Basis

As a general rule, companies are required to value their assets not in excess of the lower of cost and market value. In addition, the board of directors may value assets at amounts lower than the maximum value laid down by statutory law and thus create so-called "hidden reserves".

Tangible fixed assets are valued at historic cost. The revaluation of fixed assets above cost is prohibited by law with a few exceptions. Depreciation is strongly influenced by tax regulations. The tax authorities specify maximum depreciation rates for tax purposes which are often in excess of the true economic rate. As a result significant hidden reserves often exist against fixed assets.

Intangible assets, such as trademarks and goodwill, may be shown at cost, less appropriate amortisation. Purchased goodwill must be written off over a reasonable period, usually five to ten years. Where the goodwill relates to trade marks or long-term licences, a longer period may be used. Formation costs, such as legal fees and pre-incorporation costs, together with stamp duty, may be capitalised but must be amortised over a period of five years or less.

A provision for bad debts is usually five to ten per cent of the gross balance.

Details of contingent liabilities, guarantees and charges, for which no provision has been made, must be disclosed in a footnote to the balance sheet, although no details need be given.

As a consequence of the historical cost basis approach, statutory accounts usually show less equity than is actually existing. In addition, the equity and revenues situation may be distorted by the increase and decrease of hidden reserves and the realization principle according to which unrealized gains may be deferred and treated as corporate income only when they are realized.

2.3.3 Reserve Accounting

Swiss law provides that 5 per cent of the annual profit must be allocated to the general reserve until the latter has reached 20 per cent of the paid-in share capital. After having reached the 20 per cent limit, the following amounts must still be allocated to the general reserve:

- a) any share premium (also referred to as 'agio'), i.e. any surplus over the nominal value upon the issue of new shares after deduction of the issue cost to the extent such surplus is not used for depreciation or welfare purposes;

- b) the excess of the amount which was paid in on cancelled shares over any reduction on the issue price of replacement shares; and
- c) 10 per cent of the amounts which are distributed as a share of profits on top of a dividend of 5 per cent (calculated on the nominal value).

The portion of the general reserve exceeding an amount corresponding to half of the share capital may only be used to cover losses, support the company in times of financial distress and counteract or alleviate the consequences of unemployment; legal practice allows to convert the excess into distributable reserves based on a shareholders' resolution.

Exceptionally, holding companies are exempt from the obligation to build up reserves as set out in (c) above once they have reached the 20 per cent threshold and are not restricted in the use of the general reserve.

The remaining net profits are at the disposal of the shareholders' meeting.

2.4 Consolidated Financial Statements

2.4.1 Obligation to Prepare Consolidated Accounts

If a company controls other companies by a majority of votes or by other means, it must prepare consolidated accounts if the group during two consecutive years has had a balance sheet total exceeding CHF 10 million, net sales exceeding CHF 20 million, or more than 200 employees *per annum* on average. In addition, consolidated accounts have to be prepared in any case where a company has outstanding bonds or listed shares, or at the request of shareholders holding at least 10 percent of the share capital, or where it is necessary to produce such accounts to provide reliable information on the company's financial position and result of operations.

Any company included in the consolidated accounts of a parent company which is established and audited according to Swiss law or equivalent foreign standards is dispensed from preparing separate consolidated accounts if the parent's accounts are available to its shareholders and creditors. Such a company is, however, required to establish separate consolidated accounts if it must publish its individual company accounts because of outstanding bonds and shares quoted on stock exchanges or if consolidated accounts are requested by shareholders who hold at least 10 percent of the share capital.

Swiss company law requires the consolidated accounts to be prepared in accordance with generally accepted accounting principles and the consolidation and valuation principles to be disclosed in the footnotes. Today, the vast majority of the major Swiss companies present their accounts based on ARR/FER or IFRS. A few multinational Swiss groups prepare consolidated statements in accordance with US GAAP or the EU standards. This notwithstanding, based on current Swiss law unlisted Swiss companies are still allowed to present a view which is not true and fair, given that hidden reserves are generally permitted.

2.4.2 Accounting Treatment of Mergers and Acquisitions

Swiss company law remains silent on the accounting treatment of mergers and acquisitions. In practice, 'purchase accounting' is the method most commonly used, as opposed to 'pooling of interests', which has been applied in a few large Swiss combinations. From an accounting perspective, which may be different from the legal or tax viewpoint, a purchase is the acquisition of one company by another, whereas a pooling of interests involves the uniting of ownership interests by an exchange of shares. The choice between purchase and pooling accounting has an effect on the reported results because only purchase accounting leads to goodwill which reduces the return on equity due to amortization. Whether this finally affects stock prices is controversial, as it is unclear whether the markets always correctly adjust for the variation in reported results following the choice of either purchase or pooling of interest accounting.

Under the *purchase method*, if the purchaser pays more or less than the fair value of the net assets acquired, the difference between the purchase price and the book value of the purchased net assets will be reflected as positive or negative goodwill. Historically, there were generally two ways to treat goodwill. Either it could be written off immediately against retained earnings, which is still permissible under ARR/FER but prohibited under IFRS or US GAAP. Or goodwill could be capitalised and amortised over its useful life, i.e. over 5 to 20 years, as an expense through the income account. The results of the acquired company could be brought into the group accounts from the beginning of the year in which the acquisition was made and disposals eliminated from the beginning of the year in which the disposal was made. Under IFRS and US GAAP the target's assets and liabilities must now be measured at fair value as of the acquisition date such that if the purchase price is above the value of the revalued net assets, goodwill is created. Goodwill is not written off, but measured at cost on an ongoing basis and assessed for impairment. Any impairment is to be recognized immediately in profit or loss for the period.

Under the *pooling of interest method* the existing book values for assets and liabilities of the merging entities are combined by adding up each of the items on the balance sheets. As a consequence, no goodwill arises and the acquired assets and liabilities are not restated to fair values. Since the return on equity is therefore not affected, businesses used to show a strong preference for the application of pooling of interests accounting. Nowadays, under IFRS and US GAAP combinations must be accounted for using the purchase method.

In any event, it is important to bear in mind that neither the purchase nor the pooling of interests method and the ensuing differences in treatment of goodwill has any effect on distributable assets. A group's ability to make distributions to its shareholders depends on the amount of reserves and profits on a company's statutory balance sheet, irrespective of the goodwill arising on consolidation.

3 Corporate and Commercial Law

3.1 Corporate Law Matters

In the event of an acquisition or restructuring, approval by the shareholders of the transferee corporation ('acquirer') will be required if:

- the business of the target company is outside the statutory purpose of the acquirer – the shareholders must then approve an amendment to the articles of incorporation of the acquirer, which requires a resolution to be passed with a quorum of at least two-thirds of the shares represented and an absolute majority of the share capital represented (see Article 704 I.1 CO);
- the consideration for the acquisition takes the form of shares (or equity linked bonds) – the shareholders must then approve an increase in the share capital with a two-thirds quorum in order to issue the shares, unless sufficient authorized capital is available;
- a restructuring under the new Merger Act is contemplated – the shareholders must then approve the merger agreement, or the spin-off agreement, as the case may be, again with a two-thirds quorum.

The shareholders of the target will have to approve the transaction:

- indirectly by selling their shares; or
- in the case of a merger, conversion or spin-off to an existing company, or a sale of all assets followed by a liquidation of the company, by a resolution in the shareholders' meeting.

Special disclosure requirements apply if the transaction is financed by an increase in the share capital of the acquirer, irrespective of whether the subscribers pay cash or in kind (Articles 650 II.4, 628, 634, 652e, 652f CO). The board will have to issue a report detailing how the valuation of the target company was made, and the auditors of the acquiring corporation will have to confirm that the valuation meets accepted standards (Article 652f CO). Moreover, a prospectus will be required if the shares are offered to the public (Article 652a CO).

A shareholder, or a group of shareholders, holding ten per cent or more of the share capital of a corporation may at any time request that the board of directors call a shareholders' meeting with a specific agenda (Article 699 III CO) – for instance, the election of new directors who may have indicated that they will enter into a merger agreement or enter the acquirer into the shareholders' register.

The acquirer is neither entitled to request information about the target from the target directly nor has the acquirer, even after the purchase of a majority of the target's shares, a right to inspect the shareholders' register to be able to identify and contact other shareholders. Rather, the acquirer will have to inform the shareholders about his offer through the press or other media (potentially subjecting the offer to the takeover rules). If the target has issued bearer shares, not even the target will be

able, at least theoretically, to contact its shareholders and will have to respond by public announcement as well.

Basic information on a Swiss company may be obtained from the commercial register, including:

- the contents of the articles of incorporation;
- the share capital;
- the number and types of shares; and
- the names of directors, managers and officers.

Except for listed companies and companies with listed bonds, there is no requirement to publish financial statements. However, shareholders and creditors are entitled to receive a balance sheet and a profit and loss statement (Article 697h CO). Under the new Merger Act, the shareholders of a Swiss company involved in a merger, de-merger, or conversion are entitled to inspect the financial statements of all the companies concerned covering the last three business years. Although the accounting rules introduced in 1992 improved the quality of financial information, many companies voluntarily comply with international accounting standards or the standards imposed by the fourth and seventh EU directives.

In this context, it should be noted that statutory balance sheets of Swiss companies often do not reflect the true and fair value of a company, for the board has an incentive to form hidden reserves by undervaluing assets and making unnecessary provisions. The main reason for creating hidden reserves is that Swiss corporate taxes are levied on profits shown on statutory (unconsolidated) accounts; depreciating assets to values below market or creating provisions are thus means to reduce tax liabilities. In addition, as a corporation usually allocates part of the reported earnings to free reserves, the pay-out ratio of Swiss companies is often small in relation to their actual revenues.

Since July 1992, corporations with listed shares must disclose their major shareholders in a footnote (see Article 663c CO). Since 1998 shareholders holding more than 5 per cent of the shares in a Swiss listed company have to disclose their holdings to the company concerned and the stock exchange on which the shares are listed.

If securities are publicly issued, the CO requires the production of an 'issue prospectus' which is limited in scope (see Article 652a CO) compared with a 'listing prospectus' as per the Listing Rules of the SWX Swiss Exchange.

3.2 Commercial Law Matters

The acquisition of a corporation's stock is governed by Articles 184–215 CO relating to the sale of movable goods. Many of the rules contained in these Articles may be derogated by oral or written consent. In particular, Articles 190 and 214 (default by either party), Article 185 (passing of risks and benefits with regard to the purchased shares

or assets), and Article 192 *et seq.* (breaches of representations and warranties) form the cornerstones to be considered when drafting a share purchase agreement.

In the event of a sale of a controlling block of shares, the Swiss Supreme Court has held that statutory law does not imply terms into the agreement as to the state and condition of the underlying business and that the buyer will have to seek express representations and warranties to be legally protected. However, on various occasions the Court has allowed an acquirer to rescind the contract even in the absence of a warranty clause if the net value of the business turned out to be considerably lower than expected on the ground of 'material error'.

Article 201 CO requires the buyer to examine the purchased goods without delay and to object immediately if defects are uncovered. This also applies to the purchase of shares with respect to debts in the underlying business. Article 210 CO provides that all claims for defects of the purchased goods (or breaches of warranty) are time-barred unless the acquirer instigates court proceedings within one year of completion of the sale. Neither of Articles 201 or 210 CO is mandatory, and legal counsel of the acquirer will often insist on adapting these rules to the special circumstances of an acquisition.

Based on Article 205 CO the acquirer may rescind the contract if representations and warranties prove to be untrue. However, in many cases the seller will want the acquirer to waive this right (at least for the period subsequent to completion of the agreement) and confine himself to damages or indemnities for breach of contract by the seller. Finally, Article 200 CO stipulates that the seller shall not be liable for a breach of warranty if the acquirer knew the defects of the purchased good (or the underlying business), unless specific warranties as to the absence of such defects were given. Especially where an extensive due diligence has been carried out prior to signing the agreement, the acquirer will want the applicability of this clause to be excluded.

4 Insolvency, Bankruptcy, Composition with Creditors

4.1 Insolvency and Bankruptcy

If debts are not paid when they become due, a normal *debt collection procedure* is commenced by filing an enforcement request to the debt enforcement and bankruptcy office. The debt enforcement office issues and serves a summons to pay upon the debtor, containing the order either to pay the sum specified by the creditor within 20 days or to file an objection within 10 days. The filing of an objection has the effect of bringing the proceedings to a halt. In case an objection is raised, the creditor must set it aside by proving that his claim is justified in an ordinary or a summary court procedure.

After the end of the introductory stage, the process is continued – if the creditor is a company – through the filing of a request for continuation of proceedings. Then, a

bankruptcy warning is issued and served upon the creditor. In the event that the creditor is not paid within 20 days upon service of the bankruptcy warning, he may file a request for declaration of bankruptcy with the competent bankruptcy court. The declaration of bankruptcy is issued by the court within a short delay, after a bankruptcy hearing. The declaration of bankruptcy results in the acceleration of all debts; further, the bankruptcy court appoints a liquidator.

In the following events a request for declaration of bankruptcy may or must be filed *without previous enforcement proceedings*:

- If the debtor's whereabouts are unknown, or if the debtor has escaped in order to avoid his obligations, or has acted fraudulently, or is attempting to act fraudulently to the detriment of his creditors, or has concealed assets in enforcement proceedings;
- if a debtor who is subject to enforcement proceedings by bankruptcy has ceased payments;
- in case of rejection of a composition agreement or revocation of a moratorium (see below);
- in the event of over-indebtedness of the company, i.e. when its assets do not cover its liabilities;
- a debtor himself may also at any time request the opening of bankruptcy proceedings by declaring to the court that he is insolvent (declaration of insolvency).

In the event of bankruptcy, all sizable assets owned by the debtor constitute the bankruptcy estate. The opening of the bankruptcy proceedings entails that all obligations of the debtor become due against the bankruptcy estate with the exception of those which are secured by mortgages on real estate. The creditor may claim the amount of debt, interest up until the date of the opening of the bankruptcy proceedings as well as the costs of enforcement. Unmatured non-interest bearing claims are discounted at a rate of five percent. There is a fixed order of distribution to the creditors. Creditors of the same class are equal among themselves. Yet creditors of a class only receive proceeds once the creditors of the preceding class or classes have been satisfied.

A creditor has to submit its claim to the bankruptcy administrator who examines the claim, makes the necessary inquiries for verification and decides whether or not to admit the claim. A creditor whose claim has been entirely or partially rejected may bring an action against the bankruptcy estate.

The proceeds of the bankruptcy estate are applied to cover:

1. the costs of the proceedings;
2. the debts of the bankruptcy estate (i.e. debts arising after the opening of the bankruptcy proceedings);
3. the secured claims (being satisfied directly out of the proceeds from the realization of the collateral);

4. the unsecured claims and the uncovered part of secured claims; these are satisfied in the following order:
 - First class: claims of employees derived from the employment relationship; claims derived from the Federal Statute on Accident Insurance, claims from discretionary pension schemes, and claims of pension funds against employers; claims for maintenance and assistance derived from family law;
 - Second class: claims of persons whose assets were entrusted to the debtor acting as holder of parental power;
 - Third class: all other claims.

4.2 Composition with Creditors

Swiss bankruptcy law provides a legal procedure which enables a financially unsound debtor to reach a composition agreement with his creditors without having to file for bankruptcy. A composition agreement may have advantages over bankruptcy proceedings in certain cases. *Inter alia*, it may facilitate a reorganization of the debtor (as opposed to a liquidation in the case of bankruptcy), achieve a higher liquidation return for the creditors, grant more flexibility in the liquidation or sale of the debtor's assets or permit the current management (as opposed to a receiver in the case of bankruptcy) to continue, within certain limitations, to run the business of the debtor.

In essence, the competent court, to the extent it holds the view that prospects for the recovery of unsatisfied claims exist, will grant the debtor a debt moratorium for a period of up to 24 months, during which time the debtor must agree on a composition agreement with his creditors (except for certain privileged creditors as defined under Swiss bankruptcy law). The composition agreement also requires court approval. The debt moratorium has the effect that no debt enforcement action against the debtor may be initiated or pursued; furthermore, although the debtor remains 'in charge', i.e., continues to manage his affairs, he is subject to supervision as regards the conduct of his day-to-day business through a court-appointed composition commissioner and may only dispose of assets with the approval of the competent court.

Failing the execution of a composition agreement, or if a debt moratorium is revoked by the competent court, creditors may demand the opening of bankruptcy proceedings. Alternatively, the debtor may also file for bankruptcy if he meets the requirements in this regard.

4.3 Avoidance Actions

Swiss law provides creditors in composition and bankruptcy proceedings with the legal tools to challenge transactions entered into by a debtor prior to the confirmation of a composition agreement by assignment of assets or the opening of bankruptcy proceedings if these transactions impair the realization of assets in favour of the creditors. The critical interval is 1 or 5 years prior to the composition or bankruptcy

depending on the type of avoidance action. The legal tools to invalidate transactions because of their preferential character reach not only payments of money, gifts and sales, but also security transfers. Legal commentators have generally held avoidance claims to encompass all actions of a debtor which harm the creditors if the debtor's counter-party acted in bad faith or gained an unjustified enrichment.

5 Listed Companies

5.1 Regulatory Regime

The Federal Act on Stock Exchanges and Securities Trading of 24 March 1995 ('Stock Exchange Act', 'SESTA') regulates stock exchanges, securities dealers, and insofar as listed companies are concerned, mandatory disclosures of shareholdings and public offers. While the provisions relating to disclosure of shareholdings and public offers came into force on 1 January 1998, the remainder of SESTA's provisions entered into effect on 1 February 1997. Since the coming into force of SESTA, listed companies and their shareholders must comply with a comprehensive regime regarding disclosure of shareholdings and public offers.

SESTA makes *disclosure of shareholdings* mandatory if shares of a company which is incorporated in Switzerland and whose equity securities are listed are purchased or sold and if, as a result of a purchase or sale, certain thresholds are exceeded, irrespective of whether or not voting rights are exercisable. The relevant percentages are 5, 10, 20, $33\frac{1}{3}$, 50 and $66\frac{2}{3}$ per cent of the voting rights. The notification must be made both to the stock exchange and the company concerned within four trading days after the disclosure obligation arises. Non-observance of these reporting duties is an offence which can result in a (large) fine.

Furthermore, in the context of a public offer, each person who holds at least 5 per cent of the voting rights in the target company or in the company whose shares are offered as consideration must notify both the Takeover Board and the stock exchange of each transaction in these shares by midday on the trading day following the transaction.

5.2 SWX Swiss Exchange, EUREX, and virt-x

SESTA, besides regulating securities dealers, notifications of significant shareholdings, and tender offers, sets forth the general requirements to be met by stock exchanges seeking authorization from the Federal Banking Commission. The system is basically one of self regulation, leaving the production of rules for listing and trading to the exchanges. The most important stock exchange authorized under SESTA is the SWX Swiss Exchange, which is one of the leading stock exchanges in Europe.

The SWX Swiss Exchange became the world's first fully integrated electronic trading, clearing and settlement operation in August 1996. At the end of 2004, 378 shares,

20 investment funds, 26 exchange traded funds, 1265 bonds, and 4148 derivatives were quoted on the SWX. Measured on the basis of trading turnover, the SWX operates Europe's largest market segment for listed and exchange-traded warrants. The shares traded on the SWX are mainly held in the Swiss-based deposit accounts of domestic and international investors.

Over the past years, a number of large listed corporations have opted for a single share structure consisting of registered shares with deferred or no printing of certificates. Where a company still has more than one class of shares, bearer shares sometimes trade at a premium over registered shares owing to their free transferability and because registered shares trade on a smaller market (as they are often owned by Swiss investors). Participation certificates, in general, trade at a discount due to their lack of voting power.

The SWX Swiss Exchange offers a range of listing segments, including the Main Segment (equity securities, bonds and derivatives), SWX Local Caps, Investment Companies, Real Estate Companies, and Investment Funds, each of which are governed by special rules. A company applying for listing on the Main Segment of the SWX Swiss Exchange must:

- have presented accounts for at least three complete financial years, unless an exemption is granted;
- have a consolidated capital ('Eigenkapital') of at least CHF 25 million;
- show that if equity securities are listed for the first time, the capitalisation is at least CHF 25 million, or, if debt securities are listed, the total nominal amount is at least CHF 20 million, or, if derivatives are quoted, the relevant capitalization requirements are satisfied, which vary depending upon the kind of the underlying securities;
- show that a sufficient number of shares, corresponding to 25 per cent of the share capital, has been distributed to the public by the time of admission of the securities for which listing is sought or that proper market trading can be expected if a lower percentage is traded.

The listing application must include, among other things, a prospectus containing the information set forth by the Listing Rules of the SWX Swiss Exchange. In addition, under the Listing Rules, quoted companies have certain continuing disclosure obligations.

Trading in domestic securities on the SWX Swiss Exchange is settled within three business days. Exchange members enter purchase and sale orders directly into the electronic books of the SWX, where they are automatically matched. Historically, off-the-floor trading has been a special feature of the Swiss securities market. There is still a large number of registered broker/dealers in Switzerland who are not members of the SWX Swiss Exchange and are therefore under no obligation to process orders by means of the electronic SWX matcher. Banks which are licensed to act as broker/dealers often offset their customers' purchase and sale orders at market rates. However,

securities dealers who are subject to SESTA must report all on- and off-exchange transactions in Swiss and foreign securities listed on a Swiss exchange, with a few exceptions. Thanks to the national clearing and depository system, SIS SegInterSettle AG, physical delivery of the shares can be avoided provided the purchaser and the seller are both customers of a member bank.

EUREX – the EUROpean EXchange – was set up as a joint venture between the SWX Swiss Exchange and Deutsche Börse AG through the merger of DTB Deutsche Terminbörse and SOFFEX (Swiss Options and Financial Futures Exchange). EUREX is a fully computerized exchange where standardized options are traded. It is today's leading derivatives trading platform (based on total trading volume).

In 2001, a UK based joint venture called virt-x was formed by the SWX Swiss Exchange and Tradepoint Financial Networks PLC with the aim to create the top trading platform for Europe's biggest 600 blue chip stocks. Although this aim has clearly been missed, virt-x is now the home market for the Swiss blue chip companies which are included in the Swiss Market Index (SMI®). As a Recognised Investment Exchange (RIE), virt-x is subject to UK law and the supervision of the UK regulator, the Financial Services Authority (FSA). Since virt-x has been created, a distinction has to be made between the listing of securities and their admission to trading. Shares traded on virt-x continue to be listed by the home regulator, such as the SWX Swiss Exchange, the UK Listing Authority (UKLA) and other recognised listing authorities based on the relevant listing requirements, and, separately, will be admitted to trading by virt-x on certain conditions (capitalisation, trading volume, et cetera). As to the Swiss jurisdiction, the procedure for listing and the continuing obligations of listed companies continue to be subject to Swiss law. In addition, virt-x maintains an ongoing dialogue with the UK regulator which in turn interacts with the Swiss supervisory authority.

5.3 Insider Dealing, Market Manipulation and Market Abuse

In 1988 the enactment of Article 161 of the Swiss Penal Code made insider trading a criminal offence. Prior to 1988, insider dealing was prohibited under special circumstances only – for instance if a tippee received inside information qualifying as a business secret.

A person who has information as an insider with respect to a listed company is liable to a fine and/or imprisonment if he (a) abuses a confidential fact (by dealing) or makes such confidential fact known to a third party, (b) foresees that the dissemination of the confidential fact will have a significant effect on the share price, and (c) realizes a profit for himself or another person. Furthermore, a tippee who learns a confidential fact from an insider who is acting intentionally commits an offence if he abuses the information as specified above. Insiders can be directors, managers, auditors, agents, and any of their auxiliaries. A fact is 'confidential' if it involves the issuance of securities, a merger or an event of similar significance. Hence, the definition of a 'confidential fact' is narrower than that of a 'price sensitive fact', which is

relevant in the context of the ad hoc publicity requirements imposed by the Listing Rules of the SWX Swiss Exchange.

Since the insider trading article entered into force in 1988 convictions for insider dealing have been rare. The reasons are twofold. First, the term 'confidential fact' is narrowly defined, effectively excluding much price sensitive information from the Article's field of application. Secondly, it has proven very difficult in practice for the prosecution to establish beyond a reasonable doubt that a confidential fact was brought to a tippee's attention by an insider acting intentionally.

Criminal sanctions for insider trading are applied *ex officio*, the maximum penalty amounting to imprisonment of three years or a fine of CHF 40,000 (or more in certain circumstances, as far as insiders are concerned). Tippees may be fined for the same amounts or be imprisoned for up to one year. Profits deriving from insider transactions are seized by the authorities. Sellers who have suffered a loss may also bring a claim in tort and may rescind the purchase if they were induced to sell their shares to the insider.

Furthermore, together with the entering into force of the Stock Exchange Act, Article 161bis SPC relating to the prohibition of market manipulation was adopted. This Article forbids any attempt to significantly influence the price of securities traded on a Swiss stock exchange by spreading misleading factual information or by entering into fictitious purchases and sales. Article 161bis SPC does not penalise legitimate market stabilisation activities.

In light of recent developments in the EU, the Swiss Federal Banking Commission has decided to issue guidelines on market abuse. These guidelines contain detailed rules on the abuse of confidential information, market manipulation, market abuse and other abusive behaviour. However, contrary to the market abuse regulations in the UK and other jurisdictions, the Swiss regime will not apply to issuers, but only to banks, securities dealers, stock exchanges, depository banks, investment funds and their representatives.

III Regulatory Approval Conditions

1 Merger Control

The Federal Act on Cartels and other Restraints on Competition of 6 October 1995 as amended on 1 April 2004 ('Cartel Act') introduced preventive merger control in Switzerland when it entered into effect on 1 July 1996.

Article 9 of the Cartel Act provides that the Competition Commission must be notified of concentrations which have an effect in Switzerland if in the business year preceding the concentration (a) the undertakings concerned have reached a combined worldwide turnover of at least CHF 2 billion, or combined sales in Switzerland amounting to at least CHF 500 million, and (b) the turnover of at least two of the undertakings concerned in Switzerland was CHF 100 million or more. It is generally the latter requirement that determines in practice whether or not a notification must be made. Besides, notification is required if one of the undertakings concerned has been held in previous proceedings to benefit from a dominant position in a relevant market and the concentration affects the same market.

The 'undertakings concerned' include the merging companies as well as the controlling and the controlled enterprises. The term 'concentration' is broadly defined to include not only statutory mergers but also an acquisition of control and the establishment of what is called a 'concentrative' joint venture. A joint venture is deemed to be concentrative if it performs all functions of an autonomous enterprise on a lasting basis (3 to 5 years) and continues the business activities of at least one of the controlling undertakings.

Merger control procedures commence by a notification to the Competition Commission, which must occur prior to completion of the agreement leading to the concentration. The Competition Commission decides within one month whether to instigate proceedings to further examine the concentration or whether to clear the transaction. If further proceedings are instigated, the examination must be finalised within 4 months, resulting either in the approval of the concentration or its (partial) prohibition. An appeal may be taken from the decision of the Competition Commission to the Appeal Competition Commission and then to the Federal Supreme Court.

The Competition Commission may prohibit a concentration if its examination reveals that (a) the concentration creates or strengthens a dominant position as a result of which effective competition can be eliminated in a given market, and (b) conditions in another market are not concurrently improved so as to outweigh the disadvantages of the dominant position.

Concentrations falling within the ambit of Swiss merger control will often also be subject to EU competition rules if they are likely to have an impact on the European market or to other jurisdictions depending on the relevant merger control regimes.

2 Lex Koller (Acquisition of Real Estate)

The Federal Law on the Acquisition of Real Property by Foreigners of 16 December 1983, as amended on 1 October 1997 and 1 April 2005 (referred to as Lex Koller), provides that the acquisition of real property and the acquisition of shares in companies or businesses owning real property requires authorization from the cantonal authorities, unless the property is used as a permanent business establishment. In particular, Lex Koller applies to a purchase of shares in a company owning real property which is not used for business purposes if:

- a) the acquirer is a foreigner, a foreign corporation or a Swiss corporation controlled by a foreigner;
- b) the acquirer obtains or reinforces a controlling position – the test being, *inter alia*, whether foreign ownership is in excess of one-third of the share capital; and
- c) the market value of the real property (exclusive of real estate used as a permanent business establishment) is more than a certain percentage of the market value of the total assets of the company. As the law is silent on what that percentage is, there is some controversy among legal writers as to whether the relevant threshold should be set at $33\frac{1}{3}$ or 50 per cent.

If the value of the real property that is not used as a permanent business establishment is not clearly below the relevant threshold, the acquirer must seek confirmation by the competent authorities that Lex Koller will not apply. Where the value of such property exceeds the relevant threshold, the foreign purchaser must seek the approval of the competent authorities to acquire a controlling interest, which will be given on certain grounds only.

It is of particular importance to ensure compliance with the obligations imposed by Lex Koller because a purchase of shares in a company holding non-business related Swiss real estate without the necessary authorization will be deemed to be null and void.

3 Employment of Foreign Nationals

Switzerland imposes limitations on the possibility of foreign nationals working in Switzerland. Each canton has an annual quota of working permits in proportion to the size of its economy. If a Swiss company is acquired, a non-Swiss purchaser therefore cannot expect to be able to staff the newly-acquired company exclusively with non-Swiss managers. However, working permits for top executives, skilled technicians and specialists who are essential for the operation of a business will usually be granted – subject to the availability of permits under the cantonal quota.

The bilateral agreements between Switzerland and the EU relating to the free movement of persons provide for a gradual opening of the labour markets by introducing the freedom of movement for EU citizens in several stages during a transitory period of 12 years. The freedom of movement includes the right of entry, the right of resi-

dence and the right of access to an economic activity. As from 1 June 2004 the Swiss benefit from all the advantages of free movement in the EU whilst EU citizens must wait until 2014 to enjoy the full set of privileges. On 1 June 2004, anyhow, Switzerland eliminated priority treatment in the labour market for Swiss nationals. In addition, controls of wage and working conditions for EU citizens of the old Member States (Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, United Kingdom) and the EFTA countries have been abolished. In order to take up work in Switzerland, citizens from these EU and EFTA countries will have to prove that a Swiss employer is willing to employ them and will be subject to the annual quotas for Swiss work permits. These quotas will be applied until 2007 and amount to 115,500 for workers with short-term contracts of up to 1 year and 15,300 for workers with long-term contracts. No permit is required for citizens of the EU states mentioned above as well as EFTA nationals taking up employment in Switzerland for up to three months. The rules with respect to citizens of countries not forming part of the EU basically remain unchanged, and special regulations continue to apply to certain jurisdictions, including the US.

4 Foreign Investment

There are currently no restrictions on capital transactions between Switzerland and other developed countries. However, the Swiss National Bank may regulate the country's money supply and implement credit and currency policies.

Under certain circumstances the Swiss government may prohibit the sale of securities of Swiss companies as it did in 1978 in order to control the exchange rate of the Swiss franc. Currently, no such rules are in force.

Foreigners may acquire all types of domestic assets or shares in domestic companies without requiring authorization, with the exception of (a) companies engaged in certain regulated businesses, such as banks, and (b) real property or companies holding real property (see III.2 above).

Until 1992 many Swiss corporations had limited the transferability of registered shares to foreigners in their articles of incorporation. The revised company law confines these limitations to certain regulated businesses and to companies owning real property not used for business operations.

The sale of an ongoing business that requires a licence or concession for its operation (e.g. the transport business, certain activities in the health sector and the importation of certain agricultural products) may be subject to approval by the competent authorities. However, licenses will usually not have to be renewed if shares of a licensed company are sold.

Generally, investment incentives are available only to new enterprises or new investments of existing businesses. Therefore, the purchase of an existing business normal-

ly will not entitle the acquirer to investment incentives, except if the business becomes engaged in new projects. Even then, it will often prove helpful to incorporate a new entity in order to take full advantage of incentives offered to newly-established companies.

Incentives vary considerably from one canton to another, sometimes even from one municipality to another. As a general rule, they fall into one of the following categories:

- a) tax incentives – reduction of income and capital taxes for up to ten years (in some areas even on the federal level) or extraordinary depreciation allowances;
- b) finance incentives – subsidies for interest payments or guarantees for loans;
- c) administrative incentives – help in locating adequate premises (possibly also sale of land below market value) and ease in obtaining work permits.

Areas such as Zurich, Basel or Geneva will offer fewer incentives than regions with ailing industrial sectors. Federal incentives are generally limited to less developed areas, albeit the Federal Act on Venture Capital of 1 May 2000 introduced general tax incentives for venture capitalists.

IV Private Acquisitions

1 Share or Business Purchase?

In purchasing an incorporated business an acquirer can opt for an asset purchase or a share purchase. The decision will depend on whether or not:

- the target is organized as a corporation;
- the acquirer wants to purchase the entire business;
- there is a risk of hidden liabilities;
- the assets are easily transferable;
- tax and accounting considerations favour one approach over the other;
- assets must be pledged in order to finance the transaction.

In the past Swiss parties usually opted for selling shares rather than assets and liabilities, for the transfer of shares was much easier in practice than the transfer of a business where title for every asset, contract and governmental authorization had to be individually transferred. In addition, business transfers often required the consent of third parties or governmental agencies. Where real property was involved, a registration of the new owner was required, which could trigger special taxes. While the new Merger Act simplifies the acquisition of business assets by providing for a transfer by operation of law, the procedure to sell a business is still more burdensome than a sale of shares, entailing the production of a detailed inventory, a registration in the commercial register, information of the shareholders, joint and several liability of the seller for a certain interval and other measures to protect the interests of creditors and employees.

In addition, a share deal will be preferable for an individual vendor who generally realizes a tax free capital gain on the disposal of shares (see IV.5.1 below). For the acquirer, the purchase of assets offers two advantages from a tax viewpoint: (i) he may set off financing costs directly against income of the purchased business (since the costs and the income will arise in the same legal entity) and (ii) the acquirer may furthermore write off assets of the purchased business in the future and therefore benefit from tax savings, given that book values may be written up on completion of the acquisition. These advantages, however, usually do not measure up to the benefits a seller derives from a share transaction. Therefore, more often than not the parties will agree to a share deal if the seller somewhat lowers the purchase price in order to compensate the purchaser for agreeing to the seller's preferred structure.

Where there is a purchase of shares, certain other advantages may arise. For instance, the target company will become a subsidiary of the acquirer. This not only leads to limited liability of the parent but also facilitates a future re-sale. If the busi-

ness of the target should be combined with that of the acquirer, the two entities can merge after the acquisition. The necessity to pledge assets in connection with the transaction (e.g. as a security for financing by a third party) will also favour a purchase of shares over the purchase of a business because under Swiss law a pledge is valid only if collateral is actually transferred to the pledgee, which effectively rules out pledges of business assets.

The acquisition is structured as an asset deal if a share purchase is not feasible due to the legal organization of the enterprise concerned or because the acquirer wants to purchase only part of the business, or if there is a danger of a considerable amount of hidden liabilities that cannot be dealt with by warranties of the selling shareholder(s). In these cases, the acquirer will purchase all, or part, of the assets of the target and assume all, or part, of the (known) liabilities.

2 Acquisition Process

2.1 Negotiations/Letter of Intent

Private acquisition agreements are generally negotiated by the senior management, assisted by lawyers who normally become involved when one party, usually the acquirer, wishes to draft certain ancillary documents, e.g. a letter of intent.

The seller will often insist that the letter of intent contain confidentiality undertakings, which, together with provisions regarding exclusivity (if any), are meant to be legally binding, whereas there is normally no right to enforce the execution of a definitive agreement. The parties generally should not fix the purchase price in a letter of intent without appropriate reservations because many aspects of the transaction, in particular taxes or unknown liabilities, that will have a bearing on the price, are rarely considered during the first stages.

If a party does not negotiate in good faith and eventually refuses to sign the contract, the other party may have a claim based on *culpa in contrahendo* to be compensated for the costs incurred in connection with the negotiations (e.g. legal fees, travel expenses) or as a result of arrangements made in view of the execution of the contract (e.g. hiring of a manager for the new subsidiary). The seller may have a claim for damages against an acquirer acting in bad faith if the seller turned down other prospective purchasers who no longer wish to purchase the business when the acquirer aborts negotiations. However, *culpa in contrahendo* does not give rise to a claim for lost profits.

If the basic structure for the transaction has been agreed, it is usually legal counsel of the acquirer who prepares a first draft of the purchase agreement (except if the seller is conducting an auction). Although this draft normally favours the position of the acquirer, it should not be extremely one-sided so as to be acceptable as a basis

for further negotiations and to avoid a counter-proposal by seller's counsel or a request for a more balanced new draft.

After the signing of the letter of intent, the parties sometimes agree to a timetable, which quite often proves to be optimistic. Nevertheless, it is a useful tool for addressing the issues the parties will have to consider before, and after, the execution of the agreement.

2.2 Public Announcement

Under Swiss corporate law an acquirer is under no general duty to disclose his shareholdings in the target or to publicly announce his intentions to purchase a business. However, since July 1992 the target company is obliged to disclose its major shareholders. Reporting requirements furthermore arise under the Stock Exchange Act if one of the parties involved is a listed company. Sometimes, the so-called 'ad hoc publicity' rules force a listed company to disclose negotiations if there are rumours in the market. Once a contract is signed, the transaction is generally publicly announced, but quite often without specification of the purchase price.

2.3 Investigating the Target Company

A prospective buyer is invariably faced with the problem that the seller is reluctant to disclose details about the target for as long as it is uncertain whether the acquirer is willing to purchase the business at an acceptable price. Therefore, on the one hand, the seller will want to sign the agreement before giving the acquirer full access to data regarding the business. On the other hand, the acquirer will not want to be bound until he knows that the proposed acquisition represents a sound commercial investment. A variety of techniques have been developed in order to mitigate this problem:

- a) The acquirer can be given only limited access to the business until the signing of the agreement and instead be offered contractual protection in the form of detailed warranties. The acquirer may then freely inspect the target's business after signing, knowing that he will have the right to rescind the agreement prior to completion if the warranties prove to be materially incorrect. After completion, indemnity payments will be due if the acquirer discovers a breach of warranty. The procedural advantage of this technique is that information is given by the party which can most easily produce it. It is much more efficient if the seller represents and warrants that it has full title to the real property and that the buildings are in compliance with the applicable laws rather than if the buyer's attorneys look into these issues. Verification of the information is still possible after completion for as long as the warranties and indemnities survive.

Yet, this technique is not suitable when damages or indemnity payments would be an insufficient remedy for the acquirer – for example, where title to certain assets or certain earnings data is of such importance to the acquirer that the possibility of a rescission or an indemnity payment will not afford adequate protection.

- b) According to another method, which is popular in the context of auctions, an inspection is carried out by a third party on behalf of the Seller ('Vendor Due Diligence'), generally by an accounting or law firm also acting on behalf of the Purchaser and signing a confidentiality agreement regarding information obtained during the audit. Such a due diligence will not only cover the financial and legal aspects of the target business, but also business matters, such as markets in which the business operates, competitors, production, sales, research and development, et cetera. The accounting or law firm is often commissioned to pass on only information of 'deal killer' quality.
- c) Yet another alternative is to give the acquirer full access to the business of the target even prior to the signing of the agreement against the potential acquirer's undertaking to treat all information confidentially, particularly if the transaction is not completed. This procedure is often not suitable if the acquirer is a competitor of the target (or the seller). It is most often used when private equity houses purchase companies in Switzerland.

2.4 Signing and Completion (Closing)

Normal practice is for the purchase agreement to provide for an interval between signing and completion. The interim period will be used to obtain third party consents or governmental authorizations. It will also allow the acquirer to arrange for the financing of the transaction and possibly to further inspect the business of the target.

On completion, the parties exchange the shares (or transfer the business) against payment of the purchase price. As the warranties will usually be given either as at the date of the most recent balance sheet, or as at the signing of the agreement, the period pending completion must be regulated by contract. Normally the seller will promise that the target company will not enter into contracts outside the ordinary course of business without the prior written consent of the acquirer; often, certain representations and warranties are confirmed to be correct as at completion.

Simultaneous signing and completion is possible where no interim period is necessary.

3 Share Purchase

The nature and length of a sale and purchase agreement depends on the business of the target, the method by which information is exchanged and the bargaining power of the parties. These elements have a bearing on the amount of warranties to be given by the seller. The agreement usually contains the clauses set forth below.

3.1 Recitals

The agreement generally contains recitals which summarize the understanding between the parties of the basic structure and describe the transaction in summary. The

parties sometimes expressly state that the recitals shall have no binding effect and represent declarative statements only.

3.2 Sale of Shares

The agreement usually provides that a certain number of shares is to be sold free from all liens and encumbrances. It may be worth noting here that if share certificates have been issued the transfer by virtue of statutory law excludes a transfer of liens or encumbrances provided the acquirer acts in good faith (see Article 935 CC for bearer shares, and Article 968 and 1006 CO for registered shares).

The wording of the clause often refers to the number, type and nominal value of the shares issued. If not all of the shares are purchased, the serial numbers of the certificates will be enumerated.

The agreement further provides for the duty of the seller to deliver the shares on completion and specify, according to the type of shares, whether they must be simply handed over (bearer shares) or also need to be endorsed (registered shares) and/or whether the board of directors of the target company must approve the transfer (registered shares with transfer restrictions). In the latter case, minutes of the respective board decision must be delivered at completion.

If no share certificates have been issued, title is transferred by written assignment.

Finally, the agreement often provides for the acquirer's duty to accept delivery of the shares on completion. This makes clear that acceptance of the shares is a contractual duty of the acquirer, allowing the seller to withdraw from the contract (in accordance with Article 102 *et seq.* CO) if the acquirer defaults (see also Article 211 I CO).

3.3 Purchase Price

The agreement also provides for the acquirer's obligation to pay the purchase price on completion either to the seller or (at least in part) into an escrow account. The consideration may take the form of cash or shares or a combination of cash, debt or equity securities of the buyer and possibly a contingent component based on future performance. If the parties have agreed on cash, a money transfer or the delivery of a banker's draft will be arranged. The delivery of shares against payment of the purchase price takes place at the completion meeting, where each party can verify whether the other is able to perform its main obligations under the agreement.

Acquisitions in Switzerland tend to be settled in cash. In general, if an acquirer offers shares, the seller will accept consideration in this form only if the shares are readily marketable (possibly after a back-up period). More often than not, this rules out share-for-share deals involving private companies as buyers.

In a situation where the buyer and the seller disagree on the method of payment, in that the buyer wishes to offer shares whereas the seller wishes to receive cash, a ven-

door-placing could be envisaged. Though rare in practice, this type of placing involves the buyer transferring its shares to the seller and organizing through its financial advisers a placing of these shares with institutional investors while promising the seller a certain amount of proceeds out of such placing.

Swiss acquirers will often finance a transaction by issuing equity in spite of the fact that Swiss law treats an increase of the share capital made in view of an acquisition similar to a contribution-in-kind (Article 652c and 628 CO), entailing special disclosure obligations. A shareholder of a Swiss corporation has a statutory right to subscribe newly-issued shares in proportion to his holding ('pre-emption right'). A Swiss acquirer, when raising cash to finance the purchase will therefore either have to issue shares to its shareholders, or seek shareholders' approval to waive the pre-emption rights, a decision requiring not only a majority of two-thirds of the shares represented (Article 704) but also what is called 'valid grounds'. These are normally deemed to exist if the shares are either issued to the seller or to the public in order to finance an acquisition.

The amount a buyer is willing to pay for the target company will depend on the valuation of the business, which is more of an art than a science. Over the last two decades, the *discounted cash flow* method has gained widespread acceptance. The DCF method operates by discounting forecasted free cash flows (operating profit + depreciation + amortization of goodwill – capital expenditures – cash taxes – changes in working capital) to a present value using the target company's weighted average costs of capital as the discount factor. Another (short-hand) valuation technique involves the use of *comparative ratios*, such as the P/E ratio. Here the purchase price is calculated as a multiple of the (historical, but sometimes also estimated future) earnings a target company is producing based on the P/E for the stocks within the target group's industry. Finally, the net assets method can be applied where the book values are adjusted to reflect the *market value of the net assets*. The parties usually agree that a certain amount will have to be paid in excess of the value of the net assets of the company in order to compensate the seller for goodwill. This excess amount generally depends on:

- synergy effects the acquirer intends to realize;
- the earning power of the target;
- hidden reserves in the balance sheet;
- the target's goodwill (in the strict sense of the word);
- tax consequences of the transaction; and
- the bargaining power of the acquirer and the seller.

An alternative to setting the price based on historic figures, market multiples, or projected free cash flows is to determine the consideration by reference to the results of the target for a certain period after completion. *Earn-out formulas* are used especially where the seller continues to manage the target company after selling his shares. Such formulae are quite common in the professional services sector – involving public

relations, accounting or consultancy firms – where the parties intend to retain the services of the founders and key employees of the company. A seller might – if such formula is used – be willing to accept a low salary for his future services for tax reasons, because he may realize a tax-free capital gain from a higher purchase price, whereas his income as an employed manager will be taxed at ordinary rates and, furthermore, will be subject to social security payments. From the point of view of the acquirer, an earn-out formula may also be advantageous as it ties the consideration to the performance of the business.

The employment contract to be agreed with the seller will have to include, *inter alia*:

- provisions regarding the management of the target company;
- a list of transactions for which the seller will need the approval of the acquirer;
- a provision that the seller may not renounce his salary (which he might be tempted to do in order to reach profit targets);
- a non-competition clause for a certain period of time after termination of the employment relationship.

In addition, the purchase agreement will contain rules for the computation of profits, defining, for example:

- interest rates on inter-company loans;
- rates of depreciation and amortization of good-will;
- research and development expenditures;
- creation of reserves (e.g. for taxes, warranty claims);
- treatment of work in progress, et cetera.

Often, and irrespective of the way the purchase price is determined, the question of deferred taxation is addressed by the purchaser at some point in time. To a large extent Swiss companies are allowed to write off assets for accounting and tax purposes. Consequently, Swiss companies may incur considerable tax liabilities when their operations are sold or liquidated. Therefore, the acquirer will argue that part of that tax burden must be borne indirectly by the seller and that the purchase price must be lowered accordingly. The seller will take the position, however, that in an on-going business deferred taxes are of minor importance and would become due only if the acquirer liquidated the business – something the seller would not expect the acquirer to do.

Even if the parties agree on a fixed price and not a formula, the contract should specify how the price was calculated. This will facilitate the computation of reduction payments if warranties prove to be untrue.

If the seller has granted loans to the target company, it should be specified whether the loans will be assigned to the acquirer, and if such transfer is contemplated,

whether payment of the purchase price includes consideration for the assignment. If the seller owes money to the target, the parties will usually agree that the acquirer assumes the debt of the seller against an appropriate deduction of the purchase price.

Sometimes it is agreed that the acquirer shall pay part of the consideration into an escrow account – for example until the inspection of the business can be completed or until a settlement is reached in a major dispute in which the target company is involved. Similarly, the acquirer may seek to delay the payment of part of the consideration for a variety of reasons.

3.4 Warranties and Indemnities

3.4.1 General

The parties usually devote much time during negotiations to the 'reps and warranties' section of the agreement. In contrast to other jurisdictions, Swiss warranties are usually included in the main document and not listed in a separate schedule.

The Swiss Federal Supreme Court has held in a number of cases (see e.g. BGE 79 (1953) II 155; 97 (1971) II 43; 107 (1981) II 419; 108 (1982) II 102) that the statutory remedies for defects in purchased goods (Article 197 *et seq.* CO – see II.1 above) apply only to the share certificates and not to the business as such. Consequently, the purchaser will want to ensure that contractual warranties are given by the seller with respect to the business. The relevant court decisions have been heavily criticised by legal writers, yet to no avail.

Warranties given by the acquirer are usually of minor importance. In practical terms, parties sometimes annex an extract of the commercial register evidencing that the acquirer's representatives have authority to sign the agreement.

Where Swiss courts had to adjudicate claims on the grounds of material defects of acquired businesses, they on various occasions allowed the aggrieved party to have recourse to Article 24 I.4 CO, which provides that a contract may be rescinded based on a material error at the time when the agreement was made. The courts have expanded this rule to also allow price reductions within certain limits. Since a rescission of the contract often does not prove to be an adequate solution, it is common for the parties to waive the right to rescind the agreement due to a breach of representations and warranties or a material error. One reason for the scarcity of published court decisions in this area is that many private acquisition agreements contain an arbitration clause.

A number of customary warranties given by the seller are enumerated in IV.3.4.11. below.

3.4.2 Who should give Warranties

Normally only controlling shareholders will be able and prepared to give warranties on the condition of the business. Minority shareholders, however, will sometimes also be required to assume liability in proportion to their share of the sale proceeds.

Under Swiss law it is unusual for the target company itself to give warranties as is sometimes the case in other jurisdictions. This is because a payment under such a warranty:

- a) would in fact economically be made by the acquirer; and
- b) could be considered as a constructive dividend to the selling shareholder, subject to withholding tax.

From the acquirer's viewpoint, it makes sense, though, to obtain warranties from the target relating to the period prior to completion if a breach of warranties discovered during a pre-completion due diligence allows the acquirer to rescind the contract.

3.4.3 Remedies for Breach

The legal remedies for a breach of warranties are derived from general principles of contract law and the law relating to the sale of movable goods. These principles do not always provide an adequate solution in the context of an acquisition. Therefore, the parties usually seek to vary the operation of statutory law by defining specific terms with respect to remedies.

The agreement will often provide that the purchaser is not required to complete the transaction if a material breach of warranty is discovered before completion. However, the parties usually exclude any right to rescind the agreement after completion, thus in effect waiving actions for rescission on the grounds of Article 205 CO relating to grave defects and Article 24 I.4 CO relating to material errors. Furthermore, Article 207 III CO restricts the right to rescind the agreement where the acquirer has modified the purchased goods.

If a breach of warranty is discovered after completion (or prior to it, but the acquirer decides to complete the deal anyway), the acquirer may seek a *reduction of the purchase price*. Generally, Swiss courts apply the relative method to determine the appropriate reduction. This operates by reducing the purchase price, say CHF 72, in proportion to the ratio of the 'true value' of the goods without the defects, say CHF 60, to the 'true value' of the goods with the defects, say CHF 40, so that in this instance the relevant proportion would be 3:2, meaning that the reduced purchase price would amount to 48. In practical terms, it will hardly be possible to establish 'true values' in M&A transactions. Therefore (and absent a rule in the agreement) a judge is likely to ask: 'What would the parties have agreed in good faith had they both known of the existence of the breach of warranties when entering into the contract?' The liability will amount to the difference between the purchase price and the value so found by the judge.

As a general rule, the purchaser will prefer *indemnities* over reps and warranties, stating in the agreement that the seller will keep the buyer harmless from a specific loss in relation to certain matters, for example in relation to pending litigation. Where there are indemnities, it is unnecessary to ask what the value of the shares is or would be. The seller will simply have to discharge his payment obligation and may not argue that the acquirer would have purchased the shares for the same consideration even if he had known of the breach when signing the agreement. Technically, such a clause qualifies as a guarantee as per Article 111 CO. Indemnities are usually given in favour of the target company itself, although agreements sometimes provide that the acquirer may elect to directly receive the compensation. Reduction payments are always paid to the acquirer.

Swiss law provides for additional *damages* for breaches of the seller's representations or covenants under certain circumstances – for example if the acquirer suffers a damage that is not covered by either an indemnity or a reduction of the purchase price or if the parties agree that the appropriate remedy should be damages rather than a reduction of the purchase price.

3.4.4 Limitations on Liability

Often the seller will seek to limit his responsibility for warranties by asking for a maximum liability to be stated in the agreement (possibly amounting to the purchase price or a certain percentage of the purchase price). In addition, the parties may agree minimum limits to be reached before a claim can be brought. On the one hand, typically no claims may be made unless the aggregate of all claims exceeds a certain threshold (for example one per cent of the purchase price). On the other hand, a *de minimis* limit may be agreed on individual claims, which means that a claim may not be counted towards the *threshold* unless it is worth a certain minimum amount, say CHF 5,000. If the minimum limit is exceeded, the buyer will want to ensure that the full amount to the first Swiss franc can be recovered, in which case the minimum limit is often referred to as a threshold, whereas the seller's desire is to become liable only to the extent the limit is exceeded, in which case it is called a *deductible*. In this context, it should be noted that under Swiss law a maximum limit is ineffective insofar as the seller has caused a damage by gross negligence (Article 100 I CO).

3.4.5 Notification of Breach

Article 201 CO provides that the buyer must examine the 'purchased goods' (i.e. in the present context the business) as soon as practicable in the ordinary course of business and that the seller must be notified forthwith of any defects for which he is liable under the warranty. Should the purchaser fail to comply with this notification duty, the sale and the sold products are deemed to have been approved, except where there are defects which could not have been discovered in the course of a normal examination. Where such hidden defects are later uncovered, immediate notice must be given, failing which the hidden defects are deemed to have been accepted.

The duty to immediately examine the business and notify the seller of any breach is usually relaxed in a share purchase agreement by allowing the acquirer to notify the seller of any breach discovered at any time during a stated period.

3.4.6 Limitation of Actions

Article 210 CO provides for a time limit of one year from the date of delivery for bringing a claim for breach of warranties. The parties sometimes extend this survival period to two or three years, and often agree longer intervals for claims involving tax and environmental matters.

3.4.7 Joint and Several Liability

Pursuant to Article 143 CO, there is no joint liability of debtors (i.e., the selling shareholders) unless it is so stated in the contract.

3.4.8 Qualification of Warranties as to Knowledge

Warranties are often qualified as being given to the best knowledge and belief of the seller. This will not always protect a buyer who either knew, or should have known, of a defect had he applied due care or made reasonable enquiries. Under certain circumstances, the knowledge of directors, managers and officers of the target will be imputed to the seller. The knowledge clause is often the subject of considerable debate, as the buyer will not want to accept a limitation on its claims based on its knowledge.

Warranties are sometimes also qualified in terms of materiality. The seller may be requested to state for example that there are no 'material' proceedings pending, or threatened, against the target. Normally, though it would be advisable to expressly define what 'materiality' means, it will be difficult in practice to craft a definition.

3.4.9 Structure of Warranty Clauses

The following areas are generally covered by warranty clauses:

- a) the target as a legal entity (incorporation, shares, ownership, assets);
- b) the target's accounts;
- c) the target's business and contracts; and
- d) dealings of the target since the date of the most recent balance sheet and the signing of the agreement or even until completion.

Statements relating to the conduct of business until completion are strictly speaking undertakings by the seller to conduct the business in a certain manner, rather than warranties confirming a given state of affairs.

3.4.10 Disclosures

Warranties are usually given subject to matters disclosed either in the agreement itself or in a separate disclosure letter, which is annexed to the agreement.

3.4.11 Typical Warranties

Typical warranties may cover the following areas:

a) Warranties as to the target

- The buyer will usually require warranties giving it comfort that the target is duly incorporated and existing in accordance with Swiss law, as evidenced by an extract from the commercial register. The extract informs the acquirer about the number, type and nominal value of the outstanding shares, the dates of amendments in the articles of incorporation, and lists all persons entitled to sign on behalf of the target.
- The parties sometimes also agree to refer to the articles of incorporation and important resolutions by the board of directors – especially the resolution regarding the entering of the acquirer in the shareholders' register. The seller will warrant that these are valid documents and resolutions.
- A further warranty in this context will assure the acquirer that all other corporate documents are in good order, including the minutes of the shareholders' meetings and the meetings of the board of directors.

b) Warranties as to the accounts presented to the acquirer

- The buyer will want to seek confirmation that the balance sheet, the profit and loss statement as well as the cash flow statement (if existing) have been drawn up in accordance with generally accepted accounting principles. Also, the warranty may state that the assets are neither individually nor collectively overvalued and that the liabilities are not undervalued or unaccounted for. This general warranty is often specified by detailed warranties for certain assets (e.g. real property or patents) or liabilities (e.g. taxes or social security contributions). That is especially important where the accounts do not give a true and fair view, which is normally the case in Switzerland in relation to statutory accounts. Furthermore, the seller will be asked to warrant that there are no contingent liabilities (to be accounted for in the notes to the balance sheet) and no other threatened or possible debts for which reserves should have been provided.
- Because leased or rented property does not appear in the balance sheet, the acquirer will often want the seller to warrant that such property is at the disposal of the target and that it is in good working condition.
- The purchaser may also seek to obtain a warranty stating that the target has conducted its business in the ordinary course since the date of the most recent balance sheet and has not, and will not pending completion, enter into any

transaction outside the ordinary course of business. This clause may also be inserted as a 'covenant' of the seller.

- Sometimes, the buyer will furthermore wish to include a warranty dealing with the inventory and its saleability within a certain period of time.

c) Warranties as to compliance with contracts and law

- It is common for a seller to warrant that the target, its business and the production sites are in compliance with all applicable laws and regulations. Compliance with building and construction laws, environmental regulations and statutes relating to safety standards of certain equipment is of particular importance in this context. With regard to regulated businesses, this clause will assure the acquirer that the business is operated in accordance with the applicable regulations.
- Furthermore, the purchaser will usually want the seller to warrant that there are (i) no defaults under any material contract, (ii) no claims against the target in relation to existing contracts, unless provided for, and (iii) no notices, threats or indications as to the termination of material contracts because of the transaction (for instance due to a change of control clause).
- The seller will also have to warrant that there is no litigation or administrative proceeding, pending or threatened, against the target unless disclosed.
- Sometimes, the buyer seeks a warranty that the assets are adequately insured.
- In addition, the seller will normally have to warrant that the target has not entered into (material) agreements and contracts other than those disclosed in an annex. The relevant contracts can be defined with respect to the contractual commitment (e.g. contracts creating an expenditure in excess of a certain amount, or contracts binding the target for a period of more than a certain number of years), or may contain a list of generically important agreements (e.g. licensing agreements, lease agreements, credit or loan agreements, consulting and joint venture agreements).
- Further clauses typically deal with taxes and obligations towards employees (including pension funds).

3.4.12 Conduct Pending Completion

As to the target's conduct pending completion, technically, two interim periods should be distinguished: (a) the period between the date of the most recent balance sheets and the signing of the agreement, and (b) the period between signing and completion. During the latter, the seller will still control the business but will do so on behalf of the acquirer, at least in those cases where the purchase price is not fixed as at closing only. Therefore, the seller usually will undertake to cause the target to transact business only in the ordinary course and to seek written approval from the acquirer for certain important transactions. Often this clause can refer to the warranty clause enumerating important contracts.

3.5 Covenants and Undertakings

This clause may contain, *inter alia*:

- a) A non-competition clause which prevents the seller not only from directly competing with the target but also from participating in competing enterprises, sometimes supported by a penalty payment obligation (Article 160 CO) on the part of the seller. The non-competition clause should be reasonably limited as to the restricted activities, the geographical area of the restraint and its duration because courts may apply the relatively strict standards for non-competition clauses of employees by analogy (Article 340 *et seq.* CO). Furthermore, competition law considerations also necessitate a limitation of restrictive covenants.
- b) An undertaking from the seller to enter into certain agreements with the target, particularly where prior to the sale the target was a subsidiary of the seller and where it will continue to provide certain services to its former parent in future (or procure services from the former parent). Similarly, it may become necessary upon the sale to formalize oral agreements with former group companies. If, to take an example, the target holds patents, it may request the acquirer to procure that the target enters into a licence agreement with the seller.

A seller in a service business will often undertake to enter into an employment or consulting agreement with the target. Frequently, tax considerations will have a bearing on whether the seller prefers low compensation for his services as employee or consultant in view of a higher purchase price for the shares, as the latter might lead to a tax-free capital gain. This undertaking is often given additional weight by a clause specifying that signing of the employment contract is a condition precedent to completion of the purchase agreement.

- c) An undertaking by the acquirer that for a certain period of time the target will not terminate any of its employment contracts and the acquirer will not liquidate the company. The latter is sometimes also important for tax reasons.
- d) An undertaking by the parties to treat the purchase agreement and its contents confidentially during a certain interval. In certain circumstances, however, the parties must be able to disclose confidential information due to legal requirements for either the acquirer or the seller to report an acquisition. If the acquirer is a listed company and if officers of the acquirer (or seller) intend to trade in the shares of the acquirer, an announcement will be inevitable, as such trading may amount to insider dealing in the absence of adequate information given to the public (see Article 161 of the Swiss Penal Code).
- e) Sometimes the conditions for conducting the business of the target pending completion will be spelled out here as well.

3.6 Conditions

The agreement may contain a number of conditions that must be fulfilled prior to completion, including:

- a) Approval from third parties, such as key employees, customers, suppliers, landlords and banks. An approval condition is necessary when contracts with third parties contain a change of control clause, or when contracts may be terminated at short notice – for example credit agreements with banks, employment contracts and possibly lease agreements.

Instead of insisting on certain undertakings, the parties may prefer to make the signing of certain agreements a condition precedent to completion. It is useful to specify the exact form of the consent or agreement required in order to avoid uncertainty at the completion meeting.

- b) Governmental authorizations, for example clearance from competition or tax authorities.
- c) Shareholders' approval, where necessary.

In general, the parties should be aware of Article 156 CO, which provides that a condition is deemed 'fulfilled' where one of the parties has attempted in bad faith to prevent it from being satisfied.

3.7 Completion (Closing)

This clause specifies when and where completion will take place. In case payment will not be made by wire transfer (which is the usual form) but by delivery of a cheque, the seller will often seek assurance that the cheque received is credited to his account for value on the day when the shares are transferred, i.e. on completion.

Furthermore, the agreement will enumerate the documents to be exchanged on completion, such as:

- a) Letters of resignation from the members of the board of the target.
- b) Consents and authorizations by third parties and a board resolution agreeing to the transfer of registered shares to the acquirer and the entering of the acquirer in the shareholders' register.
- c) Assignment of a shareholders' loan and signed copies of the target's agreements with the seller.

3.8 Other Provisions

Other provisions in a typical share purchase agreement may cover the following topics:

- a) Employees and pensions: Swiss employers may either set up their own pension fund or ensure employees with an existing fund, as set out in the Federal Act on Compulsory Pension Plans of 25 June 1982. Pension funds are legal entities distinct from the employer. An acquirer will therefore not enter into a direct legal relationship with the target's pension fund upon the acquisition.

A surplus in the fund does not accrue directly to the target, but can sometimes be used for a contribution holiday. Technically, the target is not liable for underfunding provided it has always made the required contributions, although the target will often have a 'moral obligation' to fill existing gaps. Specific terms in the purchase contract are necessary in case new pension arrangements must be made; for example, where employees used to be members of a pension fund of the seller's group, there must be provisions for a split of the fund (see also Article 23 of the Federal Act on Vested Benefits of 17 December 1993). If the pension fund must be terminated, amended and/or partially distributed, governmental authorities must approve the arrangement. In other cases, the employees will remain beneficiaries of the target's existing pension fund.

- b) Insurance coverage: insurance arrangements must sometimes be re-considered, especially where the target is a group company insured under an umbrella policy.
- c) Entire agreement: this clause will specify that the signed agreement, together with its annexes, contains the entire agreement of the parties and supersedes any previous understanding or contract.
- d) Modifications: modifications will usually have to be made in writing.
- e) Costs: it is usual to provide that each party bears its own costs (i.e. lawyers' and accountants' fees); if a security turnover tax is levied on the transaction, the parties should specify who will have to bear it.
- f) Notices: This clause will specify the manner in which any notices are required to be given, e.g. whether communications by fax or e-mail constitute valid notices under the agreement.
- g) Applicable substantive law: Swiss law is generally agreed to be the governing law if the target is a Swiss company. Foreign law might be chosen if, for example, both the seller and the acquirer are nationals of the same non-Swiss jurisdiction.
- h) Jurisdiction: parties often agree that disputes will be submitted to an arbitral tribunal or a specific Swiss court, or possibly – as a compromise – to the courts at the domicile of the target. The latter choice is only possible if at least one of the parties is a foreign resident and if Swiss law is applicable to the contract (Article 5 III. b of the Federal Act on Private International Law) since *forum non conveniens* rules may apply to domestic cases (i.e. where both the seller and the acquirer are Swiss companies and/or Swiss nationals).

3.9 Signatures

No notarisation or filing of the acquisition agreement is necessary in order to make the document binding. A Swiss party's authorized signatories (as evidenced by an extract of the commercial register) may sign the agreement; no corporate seal need be affixed or stamped onto the document. It is common for the parties to initial all pages of the agreement, although this is not a legal pre-requisite.

4 Asset Purchase

4.1 In General

The main difference between an asset and a share purchase agreement lies in the fact that the former must specifically enumerate the assets sold and the liabilities transferred. With respect to the liabilities, sellers that are not registered in the commercial register can agree on a public notice of the transfer in order to avoid the necessity of creditors' approval. Otherwise, the business purchase agreement will look similar to the share purchase agreement, with the exceptions referred to below.

Swiss law generally requires consent by the creditors to the assumption of debts by a new debtor (Article 176 CO). However, where an entire business is transferred by a seller who is not registered in the commercial register and where the transfer is publicly announced, Article 181 CO dispenses with such consent. Instead, in order to protect the creditors, the seller remains jointly liable with the acquirer for two years after the transfer; for unmatured claims the two year period commences on the day the claim becomes due. Where a seller is registered in the commercial register, the parties may agree that the assets and liabilities will be transferred in one step by operation of law based on an *asset transfer* as provided for in Article 69 of the Merger Act (see IX below).

4.2 Breach of Warranties

It is usual to contractually specify the consequences of a breach of warranties because Swiss statutory remedies may be (a) generally inadequate for a particular acquisition and (b) specifically unclear on whether a reduction in the purchase price is to be made based on the effect a breach has with respect to the business as a whole or with respect to the value of the respective asset.

4.3 Employees

Employees may terminate their employment where there is a business transfer if they do not agree to be taken over (Article 333 CO). In addition, Article 333a CO provides for an information duty of the employer. However, employees must respect the legal notice period of one to three months depending on the duration of their employment (Article 336a and 336b CO). Therefore, Article 333 CO is of practical relevance only where important employees of the target have long-term contracts or contracts with notice periods exceeding three months.

4.4 Consent of Third Parties

Often, consents from third parties or governmental authorizations will be required for a business transfer. Non-assignment clauses in agreements with third parties will have to be waived by the third parties concerned.

4.5 Completion

The clause regulating completion activities usually contains a detailed list of the documents to be produced in order to evidence the transfers.

5 Tax Considerations

5.1 Taxation of the Seller

Capital gains arising from the sale of privately owned shares by individuals are tax free, making share transactions very attractive for individual sellers. Majority shareholders who are employed by the company therefore often prefer to pay themselves low salaries (thus increasing corporate taxes), accumulate profits and then sell the company, so that they can realize a non-taxable capital gain.

In some instances, the federal and some cantonal tax authorities have counteracted such tax advantage imposing an income and withholding tax liability either by virtue of a broad interpretation of the provisions defining income or based on anti-avoidance provisions. The tax authorities' practice rests on the doctrines of 'transposition' ('Transponierung') and 'indirect partial liquidation' ('Indirekte Teilliquidation'), which have been upheld by the Swiss Supreme Court.

More specifically, the following situations can arise where an income tax liability is imposed on capital gains realized by individuals on privately held assets:

- a) An individual sells the shares for a price exceeding the nominal value to a holding company which he controls. Here, income tax will usually be levied, both on the federal and the cantonal level, on the difference between the purchase price and the nominal value. The reasoning is that upon liquidation of a corporation shareholders have to pay income tax on the difference between the liquidation proceeds and the nominal value of the shares. If the target were liquidated after the transfer of the shares to a holding company, this tax could be avoided because the holding company – which pays only a reduced income tax – would not realize a gain (or a reduced gain if the liquidation proceeds exceeded the book value of the shares) and the liquidation proceeds it receives would be virtually tax free as well.
- b) An individual may also be taxed on a sale of shares to an unrelated corporate acquirer if the target company holds large amounts of cash or other non-business related assets provided (a) this cash is indirectly used to finance the acquisition and (b) there is some sort of co-operation between the seller and the purchaser. The tax authorities have argued that this is justified because a seller would normally pay out the cash as a dividend before transferring the shares (or sell non-business-related assets and distribute the proceeds), i.e. convert what he would normally receive as taxable income into a tax free capital sum paid for shares. In

practice, this theory of indirect partial liquidation is applied where the purchaser must finance the acquisition by loans and refinances the purchase price through the target company, for example by causing it to pay out dividends after the acquisition or by merging with the target after the purchase. The tax authorities have been heavily criticised by the legal doctrine, and some cantons have reconsidered their position. The canton of Zurich, for instance, will tax the imputed income of the seller only in cases of tax avoidance (where there is an unusual structure of the transaction), but a very recent ruling of the Federal Supreme Court has again expanded the applicability of the indirect partial liquidation doctrine. Since the risk of income tax being levied increases in the event that the acquirer finances the purchase out of current assets of the target, the seller often insists on covenants in the purchase agreement restricting the purchaser's ability to make use of current assets for up to 5 years after the acquisition.

Withholding tax may also be levied on the corporation in alternatives (a) and (b), as the imputed income of the seller can be regarded as a constructive dividend.

A partner selling his share in a partnership is liable for income tax (and social security contributions) on the difference between the sales price and the base cost of his quota (usually equivalent to his contribution to the partnership plus already taxed retained earnings).

Subject to certain exemptions, the sale of shares or a business by a Swiss resident corporation will be taxed as corporate income on the amount of the difference between the purchase price and the book value of the shares (respectively the assets minus liabilities in the case of a sale of a business). In some cantons, holding companies are exempt from corporation tax and, therefore, not taxed on corporate income derived from a sale of their participation. But income tax at a flat rate will be levied on such sales at the federal level, save where the participation relief applies.

5.2 Taxation of the Acquirer

The acquirer will account for the purchased shares in the target company as a participation on its balance sheet (there being no consolidation for tax purposes). Tax authorities generally do not allow the purchaser to write off the value in the new shares, unless the subsidiary concerned encounters serious financial difficulties. Also, the acquirer will not be able to use losses carried forward by the new subsidiary unless it merges with it. In the absence of group taxation members of a Swiss group cannot surrender trading losses to each other.

In the event of a business purchase, the acquirer may step up the book value of the assets in order to reflect the purchase price. It may also post an account for the purchased goodwill, or add it into a previously established goodwill account. In future years, assets may be written off and goodwill may be amortized. Losses carried forward by the acquirer may be offset by future gains of the target, although certain restrictions apply.

The acquirer will be liable to pay security turnover tax if he is a fiscal securities dealer. If the acquirer issues shares in order to finance the acquisition, the issuance of shares will attract a stamp duty of one per cent of the issue price (provided the share capital exceeds CHF 250,000 or CHF 1,000,000 as from 1 January 2006). No stamp tax is due if shares are given as consideration to the seller where the transaction qualifies as a merger or a re-organization for tax purposes.

Normally, transfers of assets and liabilities, or shares of a third company, between members of an 80 per cent group are treated on a no gain / no loss basis so that there is no change to income tax, subject to a 5 year holding period (Articles 61 para 3 DFTA and 24 para 3 DFTHA).

6 Joint Venture

6.1 General

Companies can be combined not only by an acquisition or merger but also by a joint venture where each party transfers assets to a new enterprise in exchange for membership rights. Joint ventures may be formed as partnerships (Article 530 *et seq.* CO), although more commonly they are organized as corporations. In any event the organization of the joint venture and the relationship between its members is governed by a joint venture agreement.

A typical agreement will contain clauses covering the following topics:

- a) Contributions of each partner to the joint venture, share capital of the entity, domicile and name of the company, its purpose and an agreement to elect an auditor acceptable to both parties.
- b) Composition of the board of directors and the competencies of the board. Each of the parties usually undertakes to vote its shares in favour of an agreed number of directors designated by the other party. Rules on decision-making of the board, and the presidency of the board are also included. Generally, the shareholders' meeting will have more competencies than is typical in a public company. Often the parties agree that certain transactions can only be entered into with the approval of all the parties involved or based on unanimous written consent of all the board members, whereas for other transactions a majority vote in the shareholders' or board meeting will be sufficient. If both parties hold 50 per cent, deadlock devices will have to be agreed (casting vote of the chairman, appointment of an expert arbitrator, etc.).
- c) Rules regulating transactions between the joint venture and the parties as well as duties of the parties to provide additional finance if necessary.
- d) Dividend policy.
- e) Put and call options, rights of first refusal, pre-emption rights, and 'drag and tag along' clauses in the event of a transfer of the shares to a third party.

- f) Non-competition clause; confidentiality clause.
- g) Termination of the joint venture agreement and liquidation of the joint venture company.
- h) Applicable law and jurisdiction.

6.2 Special Features of Swiss Law

The following points are noteworthy in structuring a Swiss joint venture:

- a) A Swiss *joint venture corporation* ('JVC') cannot legally bind itself by entering into a contractual agreement when it comes to subject matters falling within the competency of the shareholders' meeting (like a share capital increase) or the board of directors (e.g. with respect to board majority requirements, delegation of business to management, or the approval of a share transfer). In consequence, a Swiss corporation should normally abstain from executing a joint venture agreement, except with regard to a specified list of rights and obligations involving non-corporate issues, such as e.g. the entering into of a licence, loan, lease or purchase agreement with one of the joint venture partners acting as a counterparty (matters like these are sometimes also addressed in separate satellite agreements).

In instances related to corporate matters, only the (future) shareholders can assume contractual obligations in the joint venture agreement where they will usually agree that the necessary steps must be taken to implement the contractual arrangements at the corporate level, e.g. by exercising shareholders' rights to achieve a share capital increase or to instruct the board members to draft internal rules of organisation containing the agreed arrangements or to appoint specified managers, etc. Unfortunately, not all contractual arrangements can be exactly mirrored by the corporate documents.

Where the contractual arrangements are not or cannot be translated into the corporate documents, each joint venture partner still has the possibility of suing the other party for specific performance. For instance, a party can be sued in its capacity as a shareholder of the JVC to exercise its voting right in a manner consistent with its contractual obligations under the joint venture agreement in a shareholders' meeting, which may have to be called again for the purpose of a new resolution. The same is true for board resolutions provided a shareholder is in a position to instruct a board member how to vote, given that a director is subject to non-transferable and inalienable fiduciary duties. If specific performance is impossible, the party who breached the joint venture agreement will be liable for damages.

- b) As a matter of principle, both shareholders' and board resolutions can be made subject to special *quorum and majority requirements*. Whilst the rules governing shareholders' resolutions must be laid down in the articles of association, which are on public display at the commercial registry, quorum and majority requirements related to board resolutions and matters involving the organisation and

decisions of management must be contained in the organisation rules, which are issued by the board. These organisation rules do not have to be filed and have to be disclosed in limited circumstances only.

Legal writers are unanimous in that veto rights of individual board members are illegal under Swiss corporate law, though the requirement of a unanimous consent for certain matters (where de facto all of the board members have a veto right) is thought to be permissible. Some controversy exists, however, as to what limits there are in relation to quorum or super-majority or unanimous consent requirements, particularly if they are excessively burdensome for the operation of the JVC.

- c) The *transferability of the shares* in the JVC can be restricted and made – at least to a certain extent – subject to the approval of the board of directors or the shareholders’ meeting.

Therefore, the parties to a joint venture agreement normally focus on a list of contractual rights and obligations governing the transfer of shares to a third party. Additional security measures to avoid a forbidden transfer to third parties (like the transfer of JVC shares to an escrow account, penalty payments, co-ownership, etc.) are hardly ever agreed.

- d) Joint ventures may not be entered into for an *indefinite period of time*. If the joint venture agreement does not specify a valid term, by operation of Swiss law each party will have a right of termination upon 6 months’ notice. Though the Swiss Supreme Court upheld the validity of a clause providing for the termination of the joint venture in the event of death of one of its individual members, such a provision would most probably be ineffective if the member were a legal person. Likewise, according to legal doctrine a valid term would not be agreed if the joint venture were entered into for the duration of the JVC. Yet, the majority view concedes that it would be permissible to provide that a joint venture should not be able to be terminated for as long as its members continue to be shareholders, provided that there are grounds for termination in the event of major occurrences, such as a repeated breach of the joint venture agreement by one of the parties, an IPO, a change of control in one of the parties, insolvency of the parties, et cetera.

6.3 Tax Considerations

Whilst a (concentrative) joint venture for competition law purposes is deemed to be a merger, the tax authorities used to qualify contributions to a joint venture as spin-offs before the Merger Act entered into force on 1 July 2004 with the result that asset transfers from the founding corporate members to the JVC were subject to a 5 year holding period in order to remain tax neutral. The Merger Act dispensed with the holding period requirement for spin-offs, but not for hive-downs. To fall within the regime of a tax-neutral re-organization, joint venture contributions have now to meet the requirements governing a hive-down (see IX.3.3 below), including the 5 year holding period.

7 Buyouts

7.1 Management Buyout

A management buyout is a transaction by which the target's managers and additional equity and debt investors, such as banks or private equity funds, jointly acquire the shares of the target company. The buyers normally seek to finance the acquisition through the company's assets and to service the company's loans from future earnings. This is achieved usually by the formation of an acquisition company, which purchases the shares and is merged into the target after a certain period of time, although tax authorities have become increasingly reluctant to accept interest as financing expenses which can be offset against operating income. While debt investors expect a regular interest payment and a (partial) repayment of the loans and sometimes an option to purchase shares (in the event of mezzanine facilities), equity investors hope to achieve an appropriate return in view of the company's expected development and the prospects of a share sale.

As a rule, arrangements between a closely-held corporation and its managers or directors do not have to be disclosed, in contrast with other jurisdictions. However, a breach of the general duty of care and loyalty of managers and directors may result in the transactions being declared void if they are not in the best interests of the corporation. If in the light of third party interests these transactions are not declared null and void, it may at least expose the incumbent managers and directors to personal liability vis-à-vis the shareholders, the company or the creditors who have suffered a damage, provided that negligence or even intent can be proven by claimants.

There is no body of precedents clearly defining the duties of management if it purchases its own business. Again, the general duty of care and loyalty seems to indicate that managers should seek an independent valuation of the business in order to protect themselves against personal liability. No such valuation is necessary where all the shareholders approve the transaction provided they have been able to take an informed decision.

An additional layer of complexity arises sometimes if the seller is a private individual. Though private individuals are normally capable of realising a tax free capital gain by disposing of shares held in their private portfolios, the Swiss Supreme Court has recently taken the position in an *obiter dictum* that a management buyout may boil down to an indirect partial liquidation of the company. If this is the case, capital gains are requalified as taxable income (on the difference between sale price and nominal value, which can exceed the capital gain) even if they are made by a private seller. Since the criteria applied by the tax authorities vary and sometimes lead to unpredictable results, in practice, tax rulings should be sought to clarify the situation in each given case.

7.2 Leveraged Buyout

Leveraged buyouts basically operate like management buyouts. The main difference is that the initiative for the buyout is taken by debt and equity investors rather than by the management of the company. The formal purchaser will usually be a newly formed acquisition company that will be merged into the target after the share acquisition in order to ensure an efficient structure for tax purposes which allows for setting off interest payments with earnings and leads to an acceptable debt-equity ratio (see, however, above for the limits of such structure). The investors normally take an active part in the management of the company after the acquisition so as to make it ready to be floated in 2 to 5 years.

Where a bank finances an acquisition, it will want to take the shares of the target as a security. Business assets, with the exception of real estate, are usually unsuitable as collateral since under Swiss law a pledge of movables involves a transfer of possession. This is a further explanation as to why there usually is a preference to acquire shares rather than the on-going business of a corporation: shares can be pledged without affecting the day-to-day business.

Should the seller be prepared to provide debt finance to the acquirer, it is important to note that under Articles 717 and 884 CC the transfer of ownership in shares retained by the seller as security for his loan to the acquirer could be held invalid by a Swiss court. Furthermore, corporate law and tax considerations may exclude the possibility of the target granting a loan to the acquirer. In addition, the target's securing of the debt incurred by the acquirer to finance the acquisition might be considered *ultra vires*. Therefore, special measures will have to be taken to avoid legal problems arising from upstream or cross stream security transactions (financial assistance).

V Public Offers

1 Scope of Takeover Regulation

1.1 Public Offers

The tender offer rules embodied in the Stock Exchange Act and its implementing ordinances govern public offers for shares of a Swiss company of which at least one class of equity securities is listed on a Swiss stock exchange (Article 22 SESTA). The Federal Banking Commission ruled that offers for shares of foreign companies listed on the SWX Swiss Exchange are also subject to SESTA if they are managed in Switzerland. The Swiss takeover rules do not operate, however, if none of the target company's equity securities are listed.

Public takeover offers are widely defined to cover offers to purchase or exchange shares. Exactly what the term 'public' means is unclear and depends on the circumstances of a particular case, especially on whether the offerees are in a position to negotiate rather than merely accept or reject an offer. Creeping tender offers, where a stake is steadily built up by purchases on or off the exchange, do not fall within the ambit of the Swiss takeover rules (unless the threshold of 33.3 per cent is passed in which case the acquirer must make a mandatory public offer to the other shareholders); however, such a tactic is difficult to pursue due to the rules relating to the disclosure of important shareholdings.

Despite the fact that most public offers are made to acquire the entire share capital, SESTA also covers partial offers. Furthermore, companies carrying out a capital restructuring as a matter of principle must have regard to the takeover rules, though the Takeover Board has clarified that the rules must be applied with a certain flexibility if no change of control is involved, for instance in the event that the shareholders of an operating company are offered shares in a newly formed holding.

A bid which is supported by the board and management of the target company is generally referred to as a friendly offer, whereas an offer which does not carry the recommendation of the board is called hostile. SESTA regulates both friendly and hostile offers.

1.2 Purchase of Own Shares

Offers by a listed company to its shareholders to repurchase own shares representing more than two per cent of its capital are deemed to be public offers, albeit after review of the offer the Swiss Takeover Board may exempt the company from the obligation to comply with the takeover rules, provided:

- the buyback involves a maximum of 10 per cent of the votes and the share capital;

- there will be no delisting of the shares;
- the buyback relates to all categories of listed shares;
- the number of tendered shares will be reported to the Takeover Board and one of the principal electronic media on the trading day following the expiry of the offer;
- additional requirements will be met depending on whether the repurchase is made at a fixed price or at market value.

Further exemptions are available if the principles of equal treatment of shareholders, transparency, fairness and good faith are adhered to.

1.3 The Takeover Board

The Swiss Takeover Board is appointed by the Federal Banking Commission, which is the supervisory authority for stock exchanges and securities trading in Switzerland. It is the Takeover Board's responsibility to ensure compliance with the takeover rules. To this end, it may request all relevant information from an offeror or a target company. The Takeover Board issues recommendations to the parties involved in a takeover in each case and states whether the takeover rules are complied with. If the recommendations are rejected or disregarded, the Takeover Board informs the Federal Banking Commission. The Federal Banking Commission may then issue a binding order against which there is a right of appeal to the Federal Supreme Court.

In practice, it is customary for offerors to contact the Takeover Board at an early stage of the process, especially if it is doubtful whether a proposed course of action is in accordance with the takeover rules. Besides, offerors usually submit drafts of the pre-announcement, the offer prospectus and the summary of the offer to the Takeover Board for preliminary approval.

2 Procedure

2.1 Takeover Timetable

The dates in the left-hand column are given by reference to the day when the offer is published (P-Day).

P – six weeks	Voluntary pre-announcement of the offer in at least two national newspapers and through the electronic media
P-Day	Publication of the offer in at least two national newspapers and through the electronic media (including a reference to the prospectus)
P + 10	End of the cooling-off period, which may be waived in certain circumstances

P + 15	Publication of the position report by the target company's board of directors unless the report has been published in the prospectus
P + 30/50	End of offering period, having lasted at least 20 trading days (10 trading days in exceptional circumstances) and not more than 40 trading days
P + 31/51	Calculation of the shares tendered on a provisional basis and notification to the Takeover Board, the Swiss Exchange and through the electronic media
P + 34/64	Publication of the final interim result
P + 44/64	End of the additional offer period (which must be granted if the offer is successful)
P + 45/65	Notification of the provisional end result to the Takeover Board and the Swiss Exchange and through the electronic media
P + 48/68	Publication of the final end result
P + 54/74	Settlement

2.2 Pre-Announcement

Under the Swiss takeover rules, the offeror may inform the market of its intention to launch a tender offer in what is called a 'pre-announcement' ('Voranmeldung') before the offer is actually made (see Article 7 *et seq.* TO). This leaves the offeror an interval of six weeks to prepare the offer documents. If the offeror needs clearance from competition or other authorities prior to be able to launch the offer, the Takeover Board may extend the six week period.

Due to the offeror's obligation to proceed with the offer within six weeks, the decision to make a pre-announcement must not be taken lightly. A pre-announcement is particularly advisable in the event that (a) the SWX Swiss Exchange's ad hoc publicity rules would require disclosure to the markets anyway, for instance if there has been a leak of price-sensitive information concerning a contemplated offer, (b) a competing bid is being prepared of which the market should be advised as soon as possible, (c) clearance needs to be obtained from the Competition Authorities before an offer can be made, (d) the offeror wants to lock in the minimum offer price in case of a mandatory offer (see V.7), or (e) the offeror seeks to restrict the target's options concerning defensive measures.

The pre-announcement must contain:

- the offeror's name and registered office;
- the target company's name and registered office;
- the equity securities to which the offer relates;
- the price of the offer;

- the date of publication of the offer and its duration;
- conditions attached to the offer.

If a pre-announcement is made, as per Article 9 TO the main consequences are that

- a) the date of the pre-announcement, rather than the date of publication of the offer, is the time (i) when the offer price is determined in the event of a mandatory offer, (ii) when special notification duties arise for the offeror as well as for the target's important shareholders, and (iii) as from when certain defensive measures are prohibited; and
- b) the announced price of the offer may not be changed to the disadvantage of the persons to whom the offer is extended, unless the target company is subject to a due diligence investigation and the change can be justified on objective grounds or unless the announced offer price depends on the price the offeror will have to pay for an acquisition of a significant stake.

Since the offer price as published in the pre-announcement is generally binding, for all practical purposes the offeror must have arranged financing of the transaction at this stage already, albeit information on the type of financing and a confirmation by the special auditors that the necessary funds are available will only have to be provided in the final prospectus.

2.3 Publication of the Offer

The offer must be published in a prospectus containing information on the offeror, the financing, the offer price, the securities to which the offer relates and the target company (see V.4.1 below). Although the prospectus must be submitted to the Takeover Board not later than the date of publication, the offeror will normally provide the Board with a copy as early as possible to prevent it from asking for amendments after publication, which would have to be published again. Furthermore, the cooling-off period may be waived by the Takeover Board after review of the prospectus before publication provided that the prospectus includes the report of the board of directors of the target company.

A summary of the prospectus must be published in at least two national newspapers in German and French and must be made available to one of the electronic media specialised in disseminating stock market information (Telekurs, Reuters, Bloomberg, etc.). It must be clearly indicated where the prospectus can be obtained free of charge.

2.4 Offering Period and Publication of Results

The normal offer period of between 20 and 40 trading days may be reduced to 10 trading days provided that the offeror already holds the majority of the voting rights in the target company before the publication of the offer and the report of the target company's board has been included in the prospectus. Conversely, an offer period of

less than 40 trading days may be extended to the maximum period if the offeror has reserved the right to do so in the prospectus.

On the business day following the date on which an offer is due to expire the offeror must make an announcement through the electronic media and must simultaneously inform the SWX Swiss Exchange and the Takeover Board. The provisional interim announcement must state the number of equity securities acquired and held by the offeror and specify whether the conditions of the offer (if any) have been fulfilled. The definitive interim result must be published not later than four trading days after the expiry of the offer.

If the offer is successful, the offer period must be extended and the offer may be accepted during an additional period of 10 trading days after publication of the interim results. The final results will then be published again, first on a provisional basis and then in definitive form.

3 General Principles

The classical takeover situation involves an offer by a Swiss or a foreign company to acquire the whole or part of the equity capital of a listed Swiss company. The obligations and requirements arising in a takeover for the offeror, the target company and their respective boards of directors are numerous. The general principles which apply to all transactions can be summarised as follows:

3.1 True and Complete Information and Equal Treatment of Shareholders

The offeror must publish the offer in a prospectus, the contents of which are set out below. The prospectus must contain true and complete information so as to enable the shareholders of the target company to reach an informed decision. While this is not specifically spelled out in the Act, it may be assumed that the general prospectus liability will apply to an offer prospectus that contains false or misleading information.

In addition, the offeror must treat all shareholders of the target company equally (see Article 24 II SESTA and Article 10 TO). This has several implications. In relation to the offer price, while it may be fixed at the discretion of the offeror, provided the offer is not subject to the mandatory offer rules (see V.7 below), the principle of equal treatment requires that all shareholders of the target company are entitled to get the best price paid. If the offeror continues to buy shares of the target on and off the exchange during the offer period, the best price must be paid to all shareholders. The Takeover Board has decided that due to the best price rule the offeror may not buy target shares at a price higher than the offer price during a period of 6 months after the offer has expired.

Furthermore, equal treatment extends to different classes of equity instruments in that the offer must cover all classes of listed equity securities of the target company,

with the possible exception of options or warrants. If a partial offer is made, the acceptances are taken into account on a pro-rata, as opposed to a first-come-first-served, basis.

3.2 Conditions and Withdrawal of the Offer

Conditions may be attached to the offer. *Conditions precedent* are generally permissible, provided their satisfaction is outside the offeror's control (see Article 13 I TO). A general financing condition would therefore be impermissible, whereas the Takeover Board has accepted shareholders' approval of the contemplated transaction as a valid condition. Conditions precedent usually involve acceptances of a certain percentage of the securities to which the offer relates, official authorizations (competition commission, federal banking commission, etc.), or the registration of the offeror in the share register in case of registered shares. When the offer expires, it must be clearly stated whether the conditions have been fulfilled. The offeror may also reserve the right to waive certain conditions. *Conditions subsequent*, where the fulfilment or non-fulfilment can be ascertained only after the end of the offer period, require the approval of the Takeover Board (see Article 13 IV TO), which is normally granted where there are pending anti-trust clearances.

An offer may be withdrawn only if the offeror has expressly reserved the right to do so in the event that a condition is not fulfilled (see Article 16 TO). Withdrawals are permissible only if they are linked to the non-fulfilment of a condition.

3.3 Disclosure Obligations

The offeror and any other person holding at least 5 per cent of the voting rights of the target company must report all purchases and sales of equity securities of the target company to the Takeover Board and the SWX Swiss Exchange during the interval from publication until lapse of the offer (see Article 31 SESTA and Article 37 *et seq.* TO). The disclosure must be made not later than 12 noon on the business day following the day of the transaction. The Takeover Board may recommend publication of the disclosed transactions in certain circumstances.

3.4 Persons Acting in Concert

Persons are *acting in concert* when they co-ordinate their conduct by contract or any other methods to purchase or sell securities or exercise voting rights. As a general rule, persons acting in concert with the offeror must be disclosed in the prospectus and comply with the obligations incumbent upon the offeror, such as the obligation to treat shareholders equally, to notify transactions and to comply with transparency requirements. The shareholdings of persons acting in concert with the offeror are added to those of the offeror when calculating the offer's interim and final results. If the shares held by persons acting in concert in the aggregate exceed 33 1/3 per cent of the voting rights in a listed company and if these shares were acquired in view of

obtaining joint control, a mandatory offer must be launched for all outstanding shares.

3.5 Conduct of the Target Company

The board of directors of the target company normally advises its shareholders whether to accept or reject the bid in a special report, which is published either as part of the bidder's prospectus (in the event of a friendly offer) or separately not later than 15 trading days after publication of the offer (see Article 29 SESTA and Article 29 TO). Instead of making a recommendation, the board may merely enumerate advantages and disadvantages of the proposed offer. The directors must assure that no statements are made which could mislead shareholders or the market and must not have regard to their personal situation as directors of the target company. Directors should also be mindful that any commitments they enter into with an offeror may restrict their freedom to advise shareholders in the future. This may lead to conflicts of interest or to a breach of the directors' fiduciary duties. Besides, they may not take any frustrating action by employing defensive tactics intended to significantly alter the assets or liabilities of the target company (see V.5.2 below).

4 Takeover Documents

4.1 Offer Prospectus

The persons to whom the offer is made must be given sufficient information to be able to reach an informed decision (see Article 24 SESTA and Article 17 TO). More specifically, the following points have to be covered in the prospectus:

In relation to the offeror (see Article 19 TO):

- name, registered office, equity capital and main activities;
- identity of the shareholders or groups of shareholders holding more than 5 per cent of the voting rights, including the percentage of their shareholdings;
- the shareholders who directly or indirectly control the offeror insofar as this is significant for the recipients of the offer;
- person acting in concert with the offeror if this is significant for the recipients of the offer;
- the address where the offeror's latest published financial statements can be obtained;
- the offeror's shareholdings in the target company in relation to capital and voting rights, irrespective of whether or not these rights may be exercised;
- the number of equity securities in the target company that the offeror purchased and sold in the 12 months preceding the offer, including the highest purchase price paid.

In relation to the financing (see Article 20 TO):

- type of financing;
- confirmation by special auditors that the necessary funds are available;
- in the event of an exchange offer the offeror must confirm that all necessary measures have been taken for an exchange of shares.

In relation to the targeted securities and the offer price (see Article 21 TO):

- capital of the offeror;
- securities to which the offer relates and in the event of a partial offer, the maximum number of securities to which the offer relates;
- the price offered for each security, or in the event of an exchange offer, the exchange ratio.

In relation to the target company (see Article 23 TO):

- the offeror's general intentions in relation to the target company;
- existing agreements between the offeror and the target company, its shareholders or its key persons;
- confirmation by the offeror not to be privy to confidential information about the target company which the offeror received either directly or indirectly from the target company and which could be of material relevance to the decisions of the persons to whom the offer is extended; this requirement is of relevance where due diligence exercises have been carried out by the offeror prior to the offer.

Further disclosures are required in case of public exchange offers (see Article 24 TO), including information on the securities offered as consideration and the company whose securities are offered. If the offered securities are not listed, an auditor's valuation report must be included in the prospectus.

The offer prospectus must be reviewed prior to its publication by either an auditor authorized to audit Swiss securities dealers or by a securities dealer authorized under SESTA. The review covers the completeness and accuracy of the prospectus, compliance with the principle of equal treatment and the availability of funds to finance the offer. Its results are to be included in a written report in the offer prospectus.

4.2 Target's Board Report

The directors of the target company must publish a report whenever a public offer is made to the target's shareholders or when a previous offer has been revised (see Article 29 SESTA and Article 29 TO). When making its recommendation, the directors must be careful not to be swayed by personal interest since they have a fiduciary duty to act in the best interests of the company.

The report setting forth the position of the target's board must contain sufficient information and advice to enable the shareholders to reach an informed decision. The published information must be true and complete. In particular, the report must state the intentions of the shareholders who own more than 5 per cent of the voting rights, provided the board has knowledge thereof, and the intentions of the target with respect to defensive measures, including shareholders' resolutions planned in that respect. In addition, potential conflicts of interests involving directors and senior managers must be disclosed and the measures taken to prevent these conflicts from affecting the shareholders of the target must be highlighted in the report.

5 Defensive Measures

5.1 In general

During the course of an offer, the board of the target company may not enter into legal transactions which would have the effect of significantly altering the target's assets or liabilities without the approval of the shareholders in a shareholders' meeting (see Article 29 II SESTA). Although this means that in general the board of the target company may not take steps designed to make the company less attractive to the offeror or harder for it to acquire, there are permissible manoeuvres to defeat a hostile bidder, especially if they are put into place before a bid has surfaced and provided that the right corporate body is taking action.

5.2 Pre- and Post-Offer Techniques

A key question in takeover situations is whether the shareholders' meeting may deal with subject matters for which under general corporate law the board of directors is exclusively responsible. In the absence of a body of precedents, the answer is controversial. Legal commentators agree, however, that the shareholders' meeting may not simply re-delegate the general power it has in takeover situations to adopt defensive measures back to the board of directors, neither before nor after a tender offer is made, whereas it seems to be permissible for the shareholders' meeting to authorize the board in advance to take specific measures, should a hostile bid arise.

Transactions entered into by the board of a target company in violation of the restrictions on frustrating actions are null and void and may therefore be challenged by any person at any time.

Permissible pre-offer techniques include:

- a) *Restrictions of the transferability of registered shares* which can be achieved by Swiss companies through a clause in their articles of incorporation stipulating a maximum shareholding that no shareholder may exceed, generally expressed as a percentage of 2 to 5 per cent of the outstanding share capital. Yet, the articles of incorporation often make it clear that the board of directors may grant excep-

tions, thus entrusting the incumbent management with discretion to give preference to a white knight over a raider.

If the registration of a bidder is refused within 20 days after notification of the transfer, the bidder must still be registered as a shareholder without voting rights (Article 685f). As a consequence, a raider may increase his relative voting power even by acquiring shares without voting rights. If the articles of incorporation fix the maximum at 10 per cent, a raider could purchase that percentage plus a further 60 per cent of the shares, for which he will be registered as a non-voting shareholder. Still, among the shares carrying voting rights he will control 25 per cent, which is often sufficient to change the board of the company.

Acquirers have generally been successful in circumventing transfer restrictions by making their offer conditional upon a shareholders' meeting changing the articles of incorporation or by making the offering conditional upon the board of directors declaring that it will enter the acquirer in the share register.

- b) The creation of *super voting shares* and the placing of shares with '*friendly parties*' requires a qualified majority vote in the shareholders' meeting and valid grounds for the disapplication of pre-emption rights. This double hurdle will generally be difficult to pass.
- c) *Buybacks of own shares* of up to ten per cent of the share capital are generally permissible under certain circumstances as further specified by the Takeover Board (see V.1.2 above). Shares held by the target or by its subsidiaries cannot be voted (Article 659a and 659b CO).
- d) *Limitations of shareholders' voting rights* in accordance with Article 692 II CO. The articles of incorporation may further limit the number of shares any one person may represent (Article 689 II CO). Some Swiss companies have included clauses like that in their articles which have proven to be an effective anti-takeover device. Legal doctrine generally requires that there are justifiable reasons and that the shareholders be treated equally. If the board of directors is empowered to grant an exception, the – so far unresolved – question arises under what circumstances it may do so; recent court cases suggest that such clauses are invalid if they give full discretion to the board.
- e) *Staggered boards* where each year a certain percentage of all directors is elected for a defined period, though increasingly popular, are not a very effective anti-takeover device under Swiss law because the shareholders' meeting may force directors to step down at any time (Article 705 CO).

Defences adopted by Swiss companies were for a long time sustained by the practice of Swiss banks to vote the shares represented by them on behalf of their clients in favour of the management of the company (the total of such shares often constituted 30 to 50 per cent of all shares represented at a meeting). Because the banks' role has changed since Swiss company law was amended in 1992, requiring banks to seek specific instructions from their clients prior to voting shares (Article 689d CO), the outcome of shareholders' resolutions adopting frustrating actions is now less evident.

As opposed to the pre-offer techniques set out above, most post-offer manoeuvres are proscribed by the Swiss takeover rules (see Article 35 II TO), including:

- a *scorched earth policy* where the board either sells or buys business assets at a value or a price of more than 10 per cent of the balance sheet total;
- a *crown jewel option* whereby the target's management grants a third party a right to acquire a part of the company's most valuable business assets or intangibles if these are designated as crown jewels by the offeror;
- *golden parachutes*, i.e. agreements between the company and its directors or senior managers providing for unusually generous payments to be made in the event they resign from their position;
- the *issuance of new shares or bonds with conversion or option rights* based on authorized or contingent share capital without pre-emption rights or priority subscription rights of the existing shareholders, unless the shareholders' meeting which created the authorized or the contingent share capital expressly resolved that the board would be entitled to issue new shares in the event of a tender offer by a third party.

Still, there are some post-offer techniques that are permissible under the Swiss takeover rules, provided they do not substantially affect the company's assets, such as:

- *defensive lawsuits* against the bidder;
- finding a *white knight* willing to acquire the company and to enter into a competing bidding process;
- *re-capitalizations* to increase the company's short-term value to the shareholders, for instance by borrowing and paying out generous dividends;
- *greenmail* payments to the bidder by buying back shares at a price above market value and entering into a standstill agreement;
- *Pac Man defences*, i.e. a bid launched by the target company to acquire the hostile bidder.

6 Competing Offers

6.1 Procedure

Occasionally, a company attracts the attention of more than one bidder. The guiding principle in relation to competing offers is that the shareholders of the target company must be free to choose between the offers (see Article 30 II SESTA and Article 47 *et seq.* TO). A competing offer may be published at any time but not later than three trading days prior to the expiry of the initial offer. The offer period of the competing offer must equal that of the initial offer and may not be shorter than 10 trading days.

As a consequence, if the initial offer lapses before the end of the competing offer period, the initial offer is extended until the expiry of the competing offer, and the shareholders who have accepted the initial offer may withdraw that acceptance until the initial offer expires. After a competing offer is made, the initial offer may be revised or withdrawn until 5 trading days before the expiry of the (extended) initial offer. Revised offers are treated as new offers although the cooling-off period is reduced to three trading days and the offer period to 10 trading days.

6.2 Equality of Information

The target company must treat offerors equally, mainly by providing information given to one offeror or potential offeror promptly to another offeror or *bona fide* potential offeror even if the other offeror is less welcome. This should be kept in mind by the directors of a target company when being approached with a welcome bid, for any information divulged to a friendly suitor may subsequently have to be disclosed to an unwelcome raider. Still, unequal treatment of individual bidders may be permissible with the consent of the Takeover Board on the grounds of overriding company interests. Competitors may therefore find themselves in a position where they do not receive all the information supplied to other offerors.

The directors of the target company are personally liable for any contravention of the principle of equal treatment (Article 754 CO) and are well-advised to seek independent outside counsel to avoid the pitfalls of favouring one offeror over the other instead of creating a level playing field for all would-be bidders.

6.3 Shareholder Withdrawal Right

If a competing offer is made, each shareholder has a right to revoke the acceptance of an earlier offer. In a landmark decision in 2003, the Federal Banking Commission ruled that the withdrawal right in the event of a competing bid is mandatory and may not be contractually waived. As a result, lock-up agreements between a bidder and shareholders involving undertakings of the latter either to irrevocably tender their shares on the occasion of a public offer or to sell their shares on condition that the public offer is completed, are an ineffective means to achieve deal security for a bidder. However, where a share purchase is not conditional upon the completion of a public offer, it is still possible for a bidder to buy a majority stake and then launch an offer.

7 Mandatory Offers

7.1 General

Whilst the general takeover rules relate to voluntary offers, under SESTA a person may be required to make a public offer to buy all the equity capital of a company in certain circumstances. No such mandatory offer requirements exist for example un-

der US federal laws. What triggers a mandatory offer is an acquisition of equity securities resulting in a shareholding exceeding 33 $\frac{1}{3}$ per cent of the voting rights of a target company, irrespective of whether or not such voting rights may be exercised (Article 32 SESTA).

Though mandatory offers are generally governed by the same rules and regulations as voluntary bids, they differ insofar as the offer price and the offer conditions are concerned. The offer price may not be lower than the current market price and may not be more than 25 per cent below the highest price paid by the offeror in the preceding 12 months for equity securities of the target company. The offer price may be settled in cash or in exchange for equity securities. Except with the consent of the Takeover Board, mandatory offers – unlike normal tender offers – may not be made subject to conditions. Exemptions may be granted by the Takeover Board on important grounds, such as antitrust clearance, the transfer of all voting rights of the targeted securities, or the non-disposal of crown jewels by the target.

Moreover, the Swiss takeover rules provide that if a partial offer is made resulting in the offeror receiving shares in excess of 33 $\frac{1}{3}$ per cent of the voting rights of the target company, the terms applying to mandatory offers must be fulfilled from the beginning (see Article 10 V TO). On the one hand, this applies to the best price rule, even if the 33 $\frac{1}{3}$ per cent threshold is reached only at completion of the offer. On the other hand, with respect to conditions a strict application of this rule would have undesired effects for it would mean that an offer could not be made conditional on the offeror receiving acceptances in excess of a certain percentage of the voting rights of the target shares. The Takeover Board has therefore applied a relaxed standard as regards permissible conditions in the event of a partial offer if the 33 $\frac{1}{3}$ per cent threshold is exceeded during the offer process. The mandatory offer must be made not later than two months after the threshold has been reached.

7.2 Opting-Out, Opting-Up and other Exemptions

In contrast with the City Code, SESTA allows a Swiss target company to opt out of the mandatory offer rules by adopting an article to this effect in its articles of incorporation. A selective opting-out, which relates to specific persons only, is impermissible, and the Takeover Board has also refused to consent to deal-specific opt-outs and proposed a 5 year cooling period for such opt-out to take full effect. Furthermore, target companies may opt up the threshold triggering a mandatory offer requirement in their articles of incorporation from 33 $\frac{1}{3}$ to 49 per cent (Article 32 I SESTA).

In any event, the obligation to make a mandatory offer does not apply to (a) a financial restructuring involving a capital reduction immediately followed by a capital increase so as to offset a loss and (b) the underwriting of securities by banks or securities dealers provided the securities exceeding the relevant threshold are re-sold within three months.

Further, the Takeover Board may exempt offerors from the obligation to make an offer in justifiable cases, for example where

- voting rights are transferred within a group,
- the total voting rights of the target company are reduced and in consequence of such reduction the threshold is exceeded,
- the threshold is exceeded only temporarily,
- the shares are received without consideration,
- the purchaser is not in a position to control the company despite of his holding.

If an exemption is granted, the decision is published in the Swiss Commercial Gazette and the shareholders of the target company may raise objections with the Federal Banking Commission within ten trading days.

8 Freeze-Out and Going Private

8.1 Freeze-Out Conditions

The right to freeze out shareholders is triggered if (a) there has been a public offer involving the securities of the target company, and (b) the offeror has acquired more than 98 per cent of the voting rights upon expiry of the offer, including dormant voting rights and voting rights held in concert with third parties (see Article 33 SESTA). As regards the latter condition, the question has arisen whether in order to be able to invoke the squeeze-out provisions the 98 per cent threshold must be reached at the end of the offer period or whether voting rights acquired after the expiry of the offer but prior to the required court action (see below) will count towards the tally. The Takeover Board's view is that the courts should be allowed to decide this on the merits of each individual case.

In contrast with other jurisdictions, under the Swiss takeover rules no application can be made to a court to reduce the 98 per cent threshold. Conversely, there is no right on the part of the minority shareholders to be bought out by the offeror.

8.2 Procedure for Freeze-Out

Once 98 per cent of the target's voting rights have been acquired, the procedure for vesting the remaining 2 per cent in the offeror is rather burdensome. After the expiry of the offer, the offeror must bring a court action against the company within 3 months with a motion to cancel the outstanding shares (and possibly other equity securities). The court must then publish the action on three occasions and inform the remaining security holders that they may join in the proceedings within a time period of not less than 3 months after the first publication was made.

Once the offeror has shown that the conditions for a squeeze-out are fulfilled, the court officially cancels the outstanding shares (and possibly other equity securities). Subsequently, the target company, on the one hand, reissues the securities to the

offeror against payment of the offer price or exchange of the offered shares and, on the other hand, passes on the price paid by the offeror or the shares received from the offeror, as the case may be, to the holders of the securities which have been cancelled.

8.3 Merger Act

Under the Merger Act, an additional method is now available to cash out minority shareholders. It involves a cash-out merger between a Swiss offeror or – in case of a foreign offeror – wholly-owned Swiss subsidiary and the target company after the completion of the public offer, provided that the offeror holds at least 90 per cent of the voting rights in the target (see VI.1.7).

8.4 Delisting

According to a directive of the SWX Swiss Exchange a listed company is basically entitled to de-list its shares on request by submitting an application to the SWX. The admission board may decide on the day of announcement and the last trading day. In principle, there must be an interval of three months between the announcement and the delisting. In addition, if at the time of delisting more than five per cent of the shares are in public hands, off exchange trading must be maintained during six months after the delisting date. The application for delisting must be filed with the admission office of the SWX one month prior to the announcement. In the context of a merger or public offer exemptions may be granted with respect to the duration of the period between announcement and delisting.

VI Mergers

1 Statutory Long Form Mergers

1.1 Statutory Framework

The Merger Act provides for two methods of statutory mergers: mergers by *consolidation* and mergers by *absorption*. In a consolidation the assets and liabilities of the merging companies are amalgamated into a new legal entity by operation of law. Consolidations are rare in practice. The preferred method involves a merger of the target into the acquirer so that by operation of law the assets and liabilities of the target are transferred to the acquirer and the target's shareholders receive shares in the acquirer in exchange for the target shares (absorption). In both instances, the transferring companies will be dissolved without a formal liquidation process.

Prior to the enactment of the Merger Act, large mergers involving international companies were carried out mostly through the formation of a joint subsidiary into which the parent companies were merged. Such reverse absorptions facilitated the timing of shareholders' meetings while competition clearances were pending and was more acceptable to the parties where there was a merger of equals, as technically none of the two entities survived. It was used for example in the merger between Sandoz and Ciba-Geigy to form Novartis, and between Swiss Banking Corporation and Union Bank of Switzerland to create UBS. It remains to be seen whether the same *modus operandi* will continue to be applied under the Merger Act.

Mergers are permissible between most *types of Swiss companies*, although Article 4 MA imposes certain restrictions on the amalgamation of companies of different legal forms:

- Companies with a stated capital (corporations, corporations with unlimited partners and limited liability corporations) may merge with (i) other companies with a stated capital, (ii) cooperatives, (iii) as surviving companies with general and limited partnerships, and (iv) as surviving companies with associations registered in the commercial register.
- General and limited partnerships may merge with (i) other general and limited partnerships, (ii) as transferring companies with companies with a stated capital, (iii) and as transferring companies with cooperatives.
- Cooperatives may merge with (i) other cooperatives, (ii) with companies with a stated capital, (iii) as surviving companies with general and limited partnerships, (iv) as surviving companies with associations registered in the commercial register, and (v) if no cooperative shares exist, as transferring entities with associations registered in the commercial register.
- Associations may merge with (i) other associations and, provided they are registered in the commercial register (ii) as transferring companies with companies

with a stated capital, (iii) as transferring companies with cooperatives, and (iv) as surviving companies with cooperatives without shares.

Under-capitalized companies whose assets do not cover at least half of the equity capital stated in the articles of incorporation, or *over-indebted companies* whose liabilities (exclusive of equity) exceed the assets, may only merge with a company that has freely disposable reserves to cover the deficit in equity. No such restriction applies if creditors of the merging companies agree to subordinate their claims to all other creditors, provided the subordinated claims equal the amount of under-capitalization or over-indebtedness, as the case may be (Article 6 MA).

According to Article 7 MA the *exchange ratio* may be set in a way to provide for a cash compensation not exceeding 10 per cent of the shares' value. The merging companies may also agree in the merger agreement that their members will be entitled to elect between shares in the surviving company or a cash-out payment, or that only a cash-out payment will be made (Article 8 MA); tax law makes this option unattractive in practice, though.

If the most recent *statutory balance sheets* of the merging companies date back more than 6 months or a material change in the financial conditions of the merging companies has occurred, an interim balance sheet must be prepared (Article 11 MA). Whether or not the interim balance sheet needs to be audited by the statutory auditors is subject to controversy; in any event, it will be subject to review by the special auditors who must be appointed by the board specifically in connection with the merger. If the statutory 6 month period is accepted at face value (rather than interpreted to actually mean 9 months as some legal commentators argue), and if account is taken of the fact that it will usually take at least two months to prepare financial accounts, mergers can effectively only be carried out in the short intervals between February and June, and – based on an interim balance sheet – between August and December.

1.2 Merger Agreement

The top executive body of the companies involved must enter into a merger agreement. According to Article 13 MA, the agreement will have to include:

- the name, registered office and legal form of each of the merging companies;
- the exchange ratio for the shares and possibly the amount of the cash compensation, respectively, information on the membership in the surviving company;
- the process regarding the exchange of the shares;
- the time as from when the new membership rights entitle their holders to a share of the balance sheet profits;
- the point in time as from when the acts of the disappearing entity are deemed to be carried out for the account of the surviving company;
- the cash-out payment to be made in a squeeze-out (if any);

- special privileges and benefits granted to the top executive bodies, managers and auditors;
- the members with unlimited liability (if any).

In addition, the merger agreement will normally contain other provisions customary for the type of transaction, such as conditions precedent (the most important being shareholders' approvals), representations and warranties and indemnities (which will, unless given by shareholders, however not survive the merger), disclosure and confidentiality obligations, as well as governing law and jurisdiction clauses.

Break-up fees providing for a substantial penalty in the event of non-completion of a merger (e.g. if the target's shareholders refuse to approve the merger agreement in view of a higher offer from a third party) may not be binding if they are deemed to be *ultra vires*. However, payments to compensate the other party for costs and expenses incurred in connection with an aborted merger (including for lost management time) are thought to be permissible and can be quite substantial.

1.3 Merger and Special Auditor's Reports

The members of the highest executive body of the merging companies must furthermore prepare a *report on the merger* setting out and explaining, from a legal and an economic point of view, the purpose and the consequences of the merger, the merger agreement, the exchange ratio and possibly the amount of any compensation, the reasons why a cash-out payment (if any) is to be made in lieu of an exchange of shares, special considerations in connection with the valuation of the shares in light of the exchange ratio, the amount of the capital increase of the surviving company (if any), possible personal obligations and liabilities arising for the members of the disappearing entity as a result of the merger, consequences of the merger for the employees and the contents of a social plan (if any), consequences of the merger for the creditors of the merging companies, and information on the authorizations received and to be obtained from supervisory and state authorities (Article 14 MA).

Specially qualified auditors must review the merger agreement, the merger report and the balance sheet on which the merger is formally based and confirm the fulfilment of certain requirements in a written *auditor's report* (Article 15 MA). The shareholders of the merging companies are entitled to inspect the merger agreement, the merger report, the special auditors' merger report as well as the financial statements of the last three business years.

1.4 Shareholders' Resolutions

By virtue of Article 16 MA, each merging company must during a period starting 30 days prior to the date of the shareholders' resolutions make the following *documents* available for *inspection* by its members:

- the merger agreement or plan;

- the merger report;
- the special auditor's report;
- the annual financial statements of the three most recent business years, as well as the interim statement (if any).

The merger must be approved by the general meetings of the companies in accordance with special *majority requirements*, which vary depending on the type of company (see Article 18 MA). If the agreement provides for a cash-out payment only, the merger must be approved by at least 90 per cent of the shareholders of the transferring company who are entitled to vote. The interpretation of this requirement is subject to debate when it comes to companies with a stated capital. In that instance, the majority view construes it as meaning 90 per cent of the votes (rather than the members), though whether the votes represented or all of the existing votes should be the benchmark is unresolved.

As a general rule, the shareholders of the surviving company will not only have to approve the merger agreement but also resolve to increase the share capital to create the required merger consideration. For technical reasons, authorized share capital will be created for that purpose, given that under the regime of the Merger Act there is no limitation on the number of shares which can be issued based on authorized capital; and ordinary share capital increases continue to be subject to a three month time limitation, which can pose a problem when regulatory approvals or clearances must be obtained. In addition, the Merger Act provides exemptions with respect to the corporate requirement for certain disclosures in connection with contributions in kind.

1.5 Registration in the Commercial Register

The resolutions of the members of the general meetings must be registered with the commercial register. The merger becomes effective when the entries in the commercial registers are made (Article 22 MA). It is at the time of registration when by operation of law (a) all the assets and liabilities of the disappearing company are transferred to the surviving company, (b) the shareholders of the transferring company become members of the surviving entity, and (c) the transferring company is dissolved without liquidation.

1.6 Protection of Creditors and Employees

At the request of the merging companies' creditors the surviving company must secure outstanding claims within *three months after the effective date* of the merger (Article 25 MA). The creditors must be advised of this by three publications in the Swiss Commercial Gazette. No publication is required if a special auditor confirms that no claims are known or expected to arise which the surviving entity would not be able to satisfy by freely disposable assets. There is generally no duty to provide security if the surviving company proves that the merger will not jeopardize the satisfaction of

the claims. Instead of providing security, the company may also discharge individual claims provided that other creditors will not suffer a damage as a result thereof.

Employees of the transferring company may refuse to be taken over with the effect that their employment will be terminated upon the statutory notice period. In addition, each of the transferring and the surviving companies must consult the employees' representative body before the shareholders' resolve to approve the merger. In the event of breach of these requirements by the merging companies, the employees' representative body may request in court that the entry of the merger into the commercial register be prohibited.

1.7 Cash-Out Mergers

The Merger Act contains a novelty under Swiss law by dealing with what is called a 'cash-out merger'. A cash-out merger is subject to the approval by the shareholders of the transferring company in a general meeting with a *90 per cent majority* of the voting rights (Article 18 MA). In a cash-out merger the acquiring company buys the shares of the target for cash, in effect freezing out the shares of the company being absorbed. This is a variation of a traditional merger in which shareholders of the transferring company exchange shares for shares. By paying cash, the surviving company reduces its capital by the amount of the cash-out, but gains the assets of the transferring company. A cash-out merger effectively creates a compulsory freeze-out of minority shareholders.

1.8 Cross Border Combinations

Together with the Merger Act the Federal Act on Private International Law has been revised to expressly deal with cross-border statutory mergers.

An 'immigrant merger' of a foreign company into a Swiss company is now permissible if the applicable foreign law allows the foreign (disappearing) entity to merge into a Swiss company and if the requirements arising under foreign law are satisfied. Besides this, the merger will be subject to Swiss law.

Conversely, in an 'emigrant merger' a Swiss company will be able to be merged into a company domiciled abroad provided the Swiss company can prove that (a) with the merger its assets and liabilities are transferred to the foreign company and (b) the rights of its shareholders in the foreign company will be adequately maintained. The emigrant Swiss company is subject to Swiss law applying to a transferring entity in a Swiss merger, which means, among other things, that the creditors of the Swiss company must be advised of the merger and their right to be secured. Apart from that, the merger is subject to foreign law. A company which is registered in the Swiss commercial register may be deleted only based on a report by specially qualified auditors confirming that the creditors' claims have been secured or satisfied or that the creditors have agreed to the dissolution of the company. In addition, if the Swiss company is the disappearing and a foreign company the surviving entity, it must be shown that

the merger has become effective under the applicable foreign law, and a specially qualified auditor must confirm the vesting of new rights in the members of the disappearing Swiss company or the receipt of adequate compensation or cash-out payments. In any event, due to prohibitive tax consequences, an emigrant merger will continue to be rare in practice.

1.9 Appraisal Rights and Triangular Mergers

Contrary to other jurisdictions where there are *appraisal rights*, Swiss merger law does not provide for a compulsory buyout right of the minority shareholders who vote against the merger.

In a *triangular merger*, the target company merges into a subsidiary of the acquiring company with the target shareholders receiving as merger consideration shares in the acquiring company. A (forward) triangular merger would theoretically be possible under the new Merger Act if in a squeeze-out merger the consideration consisted of shares in the surviving entity's parent company. However, as the super-majority requirement for shareholders' resolutions approving a squeeze-out merger is 90 per cent of all the voting rights of the transferring company, triangular mergers will be rare in practice.

2 Statutory Short Form Mergers

2.1 General

There are two types of short form mergers under the Merger Act: mergers within a group of companies (see 2.2 and 2.3 below), and mergers involving a small or medium-sized company (see 2.4 below).

2.2 Upstream and Sideways Mergers

According to Article 23 MA companies with a stated capital may be combined by a short form merger if the surviving company holds title to all of the transferring company's shares with voting rights. Based on the letter of the law, legal commentators have pointed out that the short form privileges are available for upstream mergers only, as opposed to downstream or reverse mergers where a parent company is merged into a wholly-owned subsidiary. In addition, sideways mergers may be effected by the same simplified procedure. Sideways mergers involve companies whose shares are held by the same parent or one or several persons who form a group either on legal grounds (e.g. a community of joint heirs) or through a contractual arrangement (like a general partnership).

The *short form privileges* for upstream and sideways mergers are as follows:

- the merger agreement may contain less information than is required for a long form merger (particularly, there is no need to provide information on the exchange ratio);
- neither a merger report nor an auditor's report will have to be produced;
- there is no right of inspection; and
- no shareholders' resolutions will have to be taken.

In the absence of a body of precedents, according to most legal writers short form mergers should also be permissible where the shares of the transferring subsidiary are held by the surviving company only indirectly, and where the merging sister companies' shares are held by a company through one or several intermediate entities.

2.3 Upstream Mergers Involving less than 10 per cent Minority Shareholdings

Where a parent company holds title to 90 per cent of the transferring company's stock, certain exemptions are available from the long form merger requirements, provided the minority shareholders have a right to opt for cash or shares in the surviving company and will not be subject to personal liability. The exemptions are less extensive than those applying to an upstream merger involving a wholly owned subsidiary:

- no merger report will have to be produced; and
- no shareholders' resolutions will have to be taken.

Squeeze-out mergers where there is a compulsory freeze-out are not eligible for a short form merger.

2.4 SME Exemptions

The shareholders of a *small or medium-sized entity (SME)* may by unanimous consent waive the requirements of (a) a merger report, (b) an auditor's review of the merger agreement, the merger report and the balance sheet on which the merger is based, as well as (c) the right of inspection.

By definition, a small or medium-sized company is a company that

- is not listed or has no outstanding bonds, and
- during the two business years prior to the merger has not exceeded two of the following thresholds: (i) a balance sheet total of CHF 20 million, (ii) a turnover of CHF 40 million, (iii) 200 full-time employees (annual average).

3 Merger Alternatives

3.1 Unauthentic Merger or Merger-like Combination (Quasi-Merger)

A 'normal' merger involves the dissolution of the transferring company without liquidation. An *unauthentic merger* is characterized by a disappearing entity transferring its business to the surviving company by way of a contribution in kind (usually in the context of a share capital increase of the surviving entity) and the subsequent liquidation of the transferring entity.

A *merger-like transaction*, also referred to as a quasi-merger, involves an acquisition of shares in a target company where the consideration consists of shares in the acquiring company and possibly additional cash. A quasi-merger will typically not result in the dissolution of the transferring company; rather, the transferring company will become a subsidiary of the offering entity.

3.2 Special Structures

3.2.1 Single Headed Structure

Another possibility of combining businesses is for two entities to form a common holding company. With respect to *privately held firms*, this is achieved through a transfer of the shares in the combining entities to a (newly) formed company by a contribution in kind. The transferring shareholders will be receiving shares in the newly formed company and the transferred entities will continue to exist as subsidiaries of the new holding company.

Single headed structures involving *public companies* can be accomplished in several ways. One technique involves as a first step the combination under a holding company of the businesses of the combining companies (identical to the dual headed structure as set out under 3.2.2 below). In a second step, one of the parent companies launches a public (exchange) offer to the shareholders of the other company, thus becoming the ultimate parent. Another technique presupposes the formation of a new company initially held by a trustee. Subsequently, a public exchange offer is launched by Newco to the shareholders of the combining companies, as a result of which Newco will acquire the shares of the combining entities in exchange of issuing Newco Shares and thus become the new parent. This technique emphasizes the idea of a partnership of equals. In a second step, Newco can absorb the company domiciled in the same jurisdiction as Newco by way of a merger, thus allowing for a squeeze-out of the minority shareholders who have not tendered their shares.

3.2.2 Dual Listed Company Structure

Under the dual headed joint venture structure the shareholdings of the members in the combining listed companies remain unchanged, whereas the businesses of the

combining companies are brought under the roof of a jointly held entity based on a shareholders' agreement between the parent companies.

A dual headed joint venture which attracted considerable attention in the past was the 'merger' between ASEA and Brown Boveri (BBC) to form ABB. Each of ASEA and BBC transferred its business and subsidiaries into a newly-formed corporation called Asea Brown Boveri, and each received 50 per cent of the shares in the new company. The shareholders of ASEA and BBC kept their shares in ASEA and BBC respectively, but the two companies were transformed into holding companies, each with the main asset consisting of a 50 per cent interest in the joint venture. The same structure was originally used in the combination between Zurich Insurance and Allied plc. However, none of these double headed structures passed the test of time. They were transformed into single headed structures again so as to have one shareholders base on which to build in view of future acquisitions and the goal to maintain sufficient liquidity in the market.

3.2.3 Synthetic Merger

Another form of a dual headed structure is what is called a *synthetic merger*. A synthetic merger is not a merger in the legal sense but a pooling in an agreed manner of future income generated in the businesses of the companies concerned (generally in proportion to their valuation). Technically, this can be achieved by a swap of minority equity stakes in the parties' subsidiaries and an allocation of preference shares to the other entity to equalize profits. The pooling agreement will require the parties to pay out dividends up to the parent level if necessary. A synthetic merger does not require a combination of the businesses under a holding structure as described above. The pooling can cover both operating income and extraordinary income, arising for example as a result of a spin-off or a sale of a part of the business to a third party (or even a liquidation).

From a Swiss tax perspective, the minority participation should be worth at least CHF 2 million (market value) or represent at least 20 per cent of the share capital. If this is the case, the dividend paid to a Swiss parent qualifies for the participation exemption from Swiss income taxes. However, such payments may still lead to (unrecoverable) withholding taxes. To avoid withholding taxes, distributions to the other party may possibly be altogether avoided, except in the event of extraordinary revenues as a result of spin-offs or a sale of part of the business.

A synthetic merger in many instances may prove to be too complicated in the long run and lack the required flexibility in the event of necessary reorganizations. In practice, as of yet no synthetic merger has survived for a substantial period of time.

4 Tax Considerations

4.1 Tax Consequences for Shareholders of Merging Companies with a Stated Capital

Capital gains of a Swiss resident individual arising from the disposition of privately owned shares are tax-free. Consequently, the exchange of shares in a merger will not be subject to income or withholding tax, except if the individual shareholder receives shares in the surviving entity with an increased nominal value (the additional nominal value being taxable) or a compensation or cash-out payment.

If shares in the transferring company are business assets, no tax consequences will arise due to the merger, provided the book value of the shares remains unchanged. Differences in nominal value are irrelevant for income tax purposes when it comes to business assets, whereas cash payments in the context of a merger will attract income and withholding tax.

Special rules apply in the event of a merger involving an insolvent company.

4.2 Tax Consequences for Merging Companies with a Stated Capital

As a general rule, if the assets and liabilities of the disappearing company are transferred to the surviving entity at their existing book values, no profits or withholding taxes will be incurred on open or hidden reserves, provided the surviving company will remain subject to taxation in Switzerland (Articles 61 para 1 DFTA and 24 para 3 DFTHA). In the event of a merger, no stamp duty will be levied on the issuance of new shares by the surviving entity. Losses carried forward by one of the merging entities may be used to offset future income of the surviving company.

4.2.1 Upstream Merger

If a subsidiary is merged into the parent company, the book value of the subsidiary's assets and liabilities will rarely equal the value of the shares on the parent's balance sheet. Because of that, there will often be either a merger gain or a merger loss.

A merger loss is tax-deductible if it represents a genuine loss. A loss is 'genuine' if the value of the subsidiary shares is overstated, which is the case if the book value exceeds the value of the subsidiary's net assets (taking into account hidden reserves). A non-deductible 'artificial' merger loss may either be immediately written off against the surviving company's equity or activated as goodwill and written off over a five year period against freely disposable reserves (without, however, any positive impact on taxes). By writing off an artificial merger loss, hidden reserves will be created.

A merger gain is subject to corporate income tax, which, however, will normally be reduced due to the availability of the participation relief.

4.2.2 Downstream/Reverse Merger

In the event of a downstream or reverse merger, the parent company is merged into a wholly owned subsidiary. As a result of the merger, the subsidiary receives the parent's assets, including subsidiary shares. These can be delivered to the shareholders of the parent company in exchange for the parent shares. In consequence, the surviving subsidiary will normally not have to increase its share capital.

On the part of the transferring parent company, a downstream merger is tax neutral, provided the surviving entity will continue to be subject to Swiss taxation and the assets and liabilities are transferred on the basis of their existing book values. As far as the surviving subsidiary is concerned, any surplus in assets amounts to a shareholders' contribution, which in the context of a downstream merger is tax neutral as well.

4.2.3 Sideways Merger

Sister companies can be merged on a tax neutral basis provided the surviving entity continues to be subject to Swiss taxation and there is no increase in the book values of the transferred assets and liabilities. If there is a difference between the amount by which the capital of the surviving entity is increased and the stated equity capital of the transferring company, capital surplus will be created which is not subject to taxation.

4.3 Retroactive Effective Date for Tax Purposes

The effective date of a merger may be agreed in the merger agreement to be retroactive as of the date of the most recent financial statements. While the Merger Act provides that a merger agreement must be entered into not later than six months after the date of the most recent annual financial statements (lest an interim balance sheet must be prepared), the tax authorities' point of reference is the filing of the registration with the commercial register, rather than the signing of the merger agreement. In other words, if the registration of the merger is filed more than six months after the date of the latest financial statements, the retroactivity of the merger will be rejected by the tax authorities.

4.4 Merger-like Combinations of Companies with a Stated Capital

The Merger Act is not concerned with merger-like combinations. In practice, in order for a transaction to qualify as a merger-like combination the tax authorities require the acquiring company (a) to own at least 50 per cent of the voting rights of the acquired company following completion of the transaction and (b) not to have made cash payments or granted loans in an amount exceeding 50 per cent of the value of the acquired company. A merger-like combination does not result in the dissolution of the acquired company.

A merger-like combination is tax neutral for the companies involved. There is no holding period requirement. A (partial) exchange of shares held by an individual as private property will result in a tax-free capital gain (or loss), just as cash payments received in exchange for the shares. If the shares are business assets, the quasi-merger will be tax neutral as well provided the new shares are taken up in the books at a value corresponding to the book value of the transferred shares. However, cash payments will be subject to taxation when the shares are business assets. Increases in nominal value are irrelevant, irrespective of whether the shares are private or business property.

4.5 Statutory Mergers Following a Share Purchase/Quasi-Merger

In the event of a merger-like combination followed by an absorption, there will be no tax consequences for the merging companies, provided the general tax neutrality requirements are met (i.e. continued liability to Swiss taxation; transfer at book value). Individuals, however, will be subject to the merger tax regime, with the consequence that nominal value increases and cash payments will attract income and withholding taxes. No such requalification of a share-for-share deal into a merger transaction will occur if there is an interval of 5 years between the merger-like combination and the statutory merger. However, a requalification will be likely also where as a first step shares are purchased for cash and a statutory merger is made as a second step if the tax authorities view the transaction as an indirect partial liquidation (see above V.5.).

VII De-Mergers

1 Statutory Framework

The Merger Act has introduced a legal procedure for a de-merger to be effected by operation of law such that a concurrent transfer occurs of both (a) the assets and liabilities to be conveyed to a (newly formed or existing) company and (b) the shares in the transferee company to the shareholders of the transferring entity ('spin-off'). In addition, the Merger Act is concerned with de-mergers by which a company is split up, meaning that (a) its business is transferred to separate (newly formed or existing) companies, (b) the shareholders of the original company receive shares in the transferee companies, and (c) the original company, after the bifurcation, will be dissolved and deleted from the commercial register ('split-up').

Spin-offs and split-ups are herein referred to as 'de-mergers'. In contrast, a *hive-down* involves a 'down-stream separation' by virtue of a push-down of assets and liabilities into a (newly formed or existing) subsidiary. Technically, a hive-down is usually made by way of a share capital increase where the consideration for the shares issued to the parent consists of the net assets contributed to the subsidiary. Because a hive-down does not affect the shareholders of the transferring company, it falls outside the scope of the de-merger regime. The same is true for an 'upstream separation' in the form of an asset transfer by a company to its shareholders, which can nevertheless qualify as a tax-privileged re-organization if it occurs within a group of companies.

Businesses may be de-merged *symmetrically*, such that the new membership rights will be proportional to their original shareholdings, or *asymmetrically* where the shareholders' participations in one or several of the companies will differ from the percentage originally held. De-mergers are only available for companies with stated capital and cooperatives.

Whilst the provision of a cash compensation not exceeding 10 per cent of the value of the newly allocated shares is clearly permissible, squeeze-out de-mergers resulting in a shareholder being bought out from all the companies involved would be a violation of the requirement of membership continuity. This notwithstanding, some legal commentators think that partial squeeze-out payments are in line with the Merger Act, provided that following the de-merger all the shareholders still hold title to shares in at least one of the companies involved.

The *de-merger balance sheet* can be based on the most recent statutory balance sheet of the transferring company, provided it dates back a maximum of 6 months and no material changes in the financial conditions have occurred. If either of these conditions fails to be satisfied, interim balance sheets of all the companies involved must be prepared. Whether the interim balance sheet of the transferring company will be subject to the audit of the statutory auditors and the special appointed de-merger auditors is subject to controversy.

2 De-Merger Steps

2.1 De-Merger Agreement

The de-merger will be agreed between the boards of the companies in (a) a *de-merger agreement* if the de-merger involves a transfer of assets and liabilities to an existing company or (b) a *de-merger plan* if the transfer is made to a newly formed company. According to Article 37 MA the de-merger agreement or plan must include:

- the name, registered office and legal form of the companies involved;
- an inventory listing and allocating the items of the business to be transferred (real property, securities and intangible assets having to be itemised);
- the exchange ratio in relation to shares and cash compensations (if any);
- the procedure for the exchange of shares;
- the date as of which new membership rights entitle to a share of the balance sheet profits;
- the point in time as from when actions by the transferring company are deemed to be taken for the account of the receiving company;
- special privileges and benefits granted to the members of the top executive bodies, senior management or auditors;
- a list of the employment relationships to be transferred.

In the event of a spin-off, assets or liabilities which based on the de-merger agreement or plan cannot be clearly assigned to either of the parties, will be deemed to be allocated to the transferring company (Article 38 MA).

2.2 De-Merger and Special Auditor's Reports

The board of directors is responsible for the preparation of the de-merger report which must set out and explain, from a legal and an economic point of view:

- the purpose and consequences of the de-merger;
- the de-merger agreement or plan;
- the exchange ratio for shares and the amount of cash payments (if any);
- special considerations regarding the valuation of the shares in view of the determination of the exchange ratio;
- personal obligations and liabilities possibly arising for members of the company as a result of the de-merger;
- consequences of the de-merger for the employees of the companies involved as well as the contents of a possible social plan;
- the effects of the de-merger on the creditors of the companies involved in the de-merger.

The de-merger agreement or plan and the de-merger report must be reviewed by special auditors to be appointed by the board who, in a written report, must set out whether the intended share capital increase (if any) of the receiving company suffices to safeguard the rights of the members, whether the exchange ratio or the cash payment is justifiable, which method was used for what reasons to determine the exchange ratio, and how, if several methods were used, they were applied in order to determine the exchange ratio and what special circumstances were taken into consideration when determining the value of the shares in view of the determination of the exchange ratio.

2.3 Protection of Creditors and Employees

Prior to the shareholders' meetings the creditors of the companies involved in the de-merger must on three occasions be publicly advised of their right to request *within 2 months* that they be secured (Article 45 MA). The right to be secured does not apply, however, if a company can prove that the de-merger will not jeopardize the creditors' claims. Instead of providing security, the company may also satisfy a claim provided that other creditors will not suffer a damage as a result thereof. The provision of the requested security (if any) must occur before the shareholders' resolutions are taken. In the context of a de-merger the timing is therefore different from a merger where creditor protection is afforded only after the shareholders' meetings have approved the transaction agreement.

If the claims of a creditor are not satisfied by the company to which the respective debts were allocated, the other companies involved in the de-merger will become jointly and severally liable. However, joint and several liability materialises only if the claims are not secured and if the company which is primarily liable is subject to bankruptcy or debt collection proceedings (issuance of a certificate of loss) or if it has transferred its domicile abroad with the effect that the enforcement of claims is substantially hindered.

Employees are protected by virtue of Article 333 CO, which provides that employees of the transferring company may refuse to be taken over and thus effectively terminate their employment upon the statutory notice period. In addition, each company must consult the employees' representative body before the shareholders resolve to approve the de-merger. In the event of breach of these requirements, the employees' representative body may request in court that the entry of the de-merger into the commercial register be prohibited.

2.4 Shareholders' Resolutions

During a period starting two months prior to the date of the shareholders' resolutions, each company involved in the de-merger must make the following documents available for *inspection* by its members (Article 41 MA):

- the de-merger agreement or plan;

- the de-merger report;
- the special auditor's report;
- the annual financial statements of the three most recent business years, as well as the interim statement (if any).

The shareholders' meetings of all the companies involved must approve the de-merger agreement (Article 43 MA). If a corporation resolves to approve a de-merger agreement the *majority requirement* is two-thirds of the votes represented and an absolute majority of the share capital represented. In the event of an asymmetrical spin-off or split-up at least 90 per cent of the members of the company who are entitled to vote must approve the agreement. When it comes to companies with stated capital, the majority view is that the 90 per cent requirement is met if 90 per cent of the votes (rather than the members) approve the transaction, albeit legal writers are divided as to whether the reference to 'votes' relates to all of the existing votes or the votes represented at the meeting.

In the event of a spin-off, to avoid negative tax consequences the shareholders of the transferring company will also have to resolve a *share capital reduction* in an amount corresponding to the nominal value of the newly created shares of the transferee company. Furthermore, spin-offs to an existing company will often require the transferee company to increase its share capital to create the necessary spin-off consideration. Under the Merger Act certain exemptions from corporate disclosure requirements relating to contributions in kind are available in this connection.

If the de-merger is made to a newly formed company, the public deed required for the formation of the transferee company can be taken up in the public deed on the shareholders' resolution to approve the de-merger agreement, it being understood that the transferee company is formed by the transferring company on behalf of the future shareholders.

2.5 Registration in the Commercial Register

Finally, the board of directors of the transferring company must file the shareholders' resolution in relation to the de-merger with the commercial registry. If the transferee company had to increase its share capital, an application for registration must be filed by the transferee company as well. The de-merger becomes effective upon registration in the commercial register (Article 52 MA). At this point in time by operation of law the assets and liabilities listed in the inventory are transferred to the receiving companies and the shareholders of the transferring company become members of the receiving companies (unless an asymmetrical allocation of shares has been agreed).

2.6 Cross-Border De-Mergers

An 'immigrant de-merger', which involves a foreign transferring company and a newly formed or existing Swiss transferee company, is generally subject to foreign law,

save for those provisions of the Merger Act which protect legitimate Swiss interests and must therefore be cumulatively applied, such as provisions on creditor protection, inspection rights of shareholders, a capital increase or the formation of a Swiss company.

In an 'emigrant de-merger', where the transfer is made from a Swiss company to a newly formed or existing foreign entity, as a matter of principle Swiss law is applicable to the transferring company. In addition, the parties must have regard to any applicable foreign law provisions. In practice, emigration de-mergers will most probably remain out of favour due to prohibitive tax consequences.

2.7 SME Exemptions

The shareholders of a small or medium-sized enterprise (see for SME definition above VI.2.5) may waive by unanimous consent the requirements of (a) the de-merger report, (b) an auditor's review of the de-merger agreement, the de-merger report and the balance sheet on which the de-merger is based, as well as (c) the right of inspection.

3 De-Merger Alternatives

3.1 Asset Transfer

Legal entities other than companies with stated capital and co-operatives are disallowed from effecting de-mergers under the Merger Act. Alternatively, these legal entities can employ a device called 'asset transfer' to achieve the same economic result (see VIII below).

3.2 Traditional Two Step Spin-off

Whilst Swiss corporate law traditionally was not concerned with de-mergers whose essential feature is to cause the transfer by operation of law of (a) assets and liabilities to a separate legal entity and (b) shares in the receiving entity to the shareholders of the transferring company. Rather, to accomplish these effects Swiss companies had first to hive down the assets and liabilities to be spun off to a subsidiary, either by a sale or by a contribution in kind, and secondly to procure the transfer of shares in the transferee company to the shareholders of the transferring company.

As to the second step, the ties between the parent company and its subsidiary were severed by means of a *dividend in specie* consisting of the entire share capital of the newly formed subsidiary paid to the shareholders of the parent company (used e.g. when Givaudan was created). Alternatively, the parent company in its capacity as the sole shareholder of the subsidiary resolved a *rights issue* where the subscription price was considerably less than the market value of the shares. The parent then waived

its pre-emption rights for the benefit of its shareholders who had the option of exercising the rights against payment of the reduced subscription price. This was usually combined with a rights trading which enabled private individuals to realize a tax-free capital gain on the sale of the subscription rights (used e.g. in relation to Ciba Specialty Chemicals, Lonza and Syngenta). In either event, the spin-off normally required not only the shareholders' approval of the parent company but also a formal shareholders' meeting of the newly formed company resolving to distribute a dividend in specie or to transfer the rights in a rights issue. Finally, as a third alternative the transferring parent fully capitalised the hived-down subsidiary and then resolved to *decrease the parent's share capital* such that the reduced amount was repaid to the shareholders in the form of shares in the hived-down subsidiary (used e.g. in Sulzer-Medica).

As a matter of principle, traditional two step de-mergers continue to be available as an alternative to a fully-fledged de-merger as defined by the Merger Act.

4 Tax Considerations

The requirements for a tax-neutral spin-off or split-up are as follows (Articles 61 para 1 DFTA and 24 para 3 DFTHA):

- the transferee company must continue to be subject to Swiss taxation;
- the assets and liabilities must be transferred on the basis of existing book values;
- the transfer must involve (part of) a business, and each of the transferring and the receiving companies must continue to operate at least one business unit (dual continuing businesses requirement).

Prior to the enactment of the Merger Act, there was an additional 5 year holding period requirement. As this was abolished, shares in the transferring or the spun-off entities can now be sold immediately following completion of the spin-off without the danger of triggering the tax effects of a liquidation.

Theoretically, the transferring entity can write down the net value of the spun-off business against a share capital reduction or against open reserves. In order to avoid the creation of additional nominal share value (as the transferee company will normally have to issue new transferee shares), which would result in withholding tax duties for the transferring entity and income taxes for Swiss resident individuals, the transferring company will normally opt for a share capital reduction. Alternatively, negative tax consequences can be avoided if the shareholders make an equity contribution to the transferee company corresponding to the newly created nominal value of the transferee shares.

Where the shareholders receive not only shares in the de-merged company but also compensation or cash-out payments, such payments will attract withholding and (corporate) income tax.

VIII Conversions

1 Statutory Framework

1.1 General Situation

Under the Merger Act a company may change its form while maintaining its legal and economic identity ('conversion'). Since a conversion is a purely internal corporate occurrence, the converted company's legal relationships with third parties will not be affected.

With respect to a company with stated capital a conversion does not result in its dissolution or the formation of a new company, and will not involve a transfer of assets or liabilities. When it comes to the conversion of a general or limited partnership into a company with stated capital, a new company will be established, though technically only the entry in the commercial register will be amended. Conversions of general into limited partnerships and vice versa are not subject to the Merger Act, but are governed by the contractual arrangements of the parties.

Though conversions are permissible for almost any type of company, in certain cases they will be disallowed because of fundamental differences in the legal or business organization of the companies involved. For example, a corporation cannot be converted into a general or limited partnership. Likewise, it will not be possible to convert a company into a foundation. Yet based on Article 54 MA it is permissible for

- a company with stated capital (corporations, corporations with unlimited partners and limited liability corporations) to convert into (i) a company with stated capital under a different legal form or a cooperative;
- a general partnership to convert into (i) a company with stated capital, (ii) a cooperative, or (iii) a limited partnership;
- a limited partnership to convert into (i) a company with stated capital, (ii) a cooperative, or (iii) a general partnership;
- a cooperative to convert into (i) a company with stated capital, or (ii) an association provided the cooperative has not issued certificates and provided the association will be entered into the commercial register
- an association which is entered into the commercial register to convert into a company with stated capital or a cooperative.

Generally, the rights of the shareholders on conversion must be maintained and safeguarded (Article 56 MA). This is obviously subject to the general – and possibly quite fundamental – mandatory changes occurring to the memberships rights as a consequence of the newly adopted legal form. Members of entities without membership certificates have the right to receive at least one share if the company is converted

into a company with stated capital. Whether the principle of continued membership generally rules out the possibility of squeeze-out or compensation payments – even with the affected members' consent – is subject to debate among legal commentators. In any event, where all the partners or shareholders agree on a given plan, the parties are basically free to structure the migration of their membership rights as they please.

When on the occasion of a conversion a new company must be formed, the mandatory provisions of the Civil Code and the Code of Obligations governing the new company will apply, save for the provisions regulating the formation of a company with stated capital and the provisions on contributions in kind.

If the balance sheet on which the conversion report is based dates back more than 6 months or if the financial conditions have materially changed, an interim balance sheet must be produced. Whether the interim balance sheet needs to be audited by the company's statutory auditors is controversial; in any event, the interim balance sheet will be subject to review by the special auditors who need to be appointed by the top executive body in connection with the conversion.

1.2 Practically Important Conversions

The most common conversions involve the following practical issues:

- *Conversion of a partnership into a company with stated capital:* as such a conversion normally requires the consent of all the partners, the parties are free to agree the structuring and allocation of shareholders' rights relating to the company with stated capital.
- *Conversion of a corporation with limited liability (GmbH/LLC) into a corporation:* Since the minimum nominal value of corporation shares is lower than that of LLC shares, the conversion process will not pose any problems. If the LLC's total share capital is less than the minimum capital of a corporation (CHF 100,000), the conversion will only be feasible if the share capital is increased prior to or concurrently with the conversion. This cannot be avoided by only partially paying up the corporation shares, if the LLC shares were fully paid-up.
- *Conversion of a corporation into a corporation with limited liability (GmbH/LLC):* Given that each shareholder of an LLC may hold only one share, any number of shares in the corporation will be converted into one LLC share. In addition, as each LLC share's nominal value must be CHF 1,000 or multiples thereof (whereas the corresponding amount for a corporation is CHF 0.01), a compensation or a contribution payment may become necessary (the latter requiring consent of the concerned shareholder). Squeeze-outs of shareholders holding in aggregate the equivalent of less than CHF 1,000 in nominal share value are impermissible. Whether these minority shareholders could voluntarily agree to a cash-out payment, is controversial. If the corporation's share capital exceeds the maximum LLC capital of CHF 2,000,000, a share capital reduction will furthermore be required.

2 Conversion Steps

2.1 Conversion Plan

The top executive body of the entity concerned must prepare a conversion plan, which needs to be approved by the general meeting. According to Article 60 MA the conversion plan must at least contain

- information on the name, registered office and legal form before and after the conversion,
- the new articles of incorporation, as well as
- the number, type and amount of shares the members of the entity will receive after the conversion, respectively information on the membership in the company after the conversion.

2.2 Conversion and Special Auditor's Reports

Furthermore, the top executive body of the company must prepare a written conversion report (Article 61 MA). The report must set out and explain, from a legal and an economic point of view,

- the purpose and the consequences of the conversion,
- compliance with the mandatory requirements in relation to a newly formed legal entity,
- the new articles of incorporation,
- the conversion ratio of shares or membership details effective as of conversion,
- personal obligations and liabilities which might arise for the members due to the conversion, as well as
- the obligations that can be imposed on the members under the new legal form of the company.

Specially qualified auditors who must be appointed by the top executive body in connection with the conversion must review the conversion plan, the conversion report, as well as the conversion balance sheet. Furthermore, members of the company have a right of inspection of the conversion plan, conversion report, special audit report as well as the financial statements of the last three business years.

2.3 Approval by the General Meeting

During a 30 day period, ending on the day when the general meeting's resolutions are taken, the entity to be converted must make the following documents available for inspection by its members (Article 63 MA):

- the conversion plan;

- the conversion report;
- the special auditor's report;
- the annual financial statements of the three most recent business years, as well as the interim statement (if any).

Conversions of corporations ('AG'), corporations with unlimited partners ('Kommandit-AG'), limited liability corporations ('GmbH'), co-operatives ('Genossenschaft') and associations ('Verein') require the approval of the general meeting of the members of the company (Article 64 MA). Depending on the type of company involved, different super majority voting requirements apply, such as for

- *a corporation and corporation with unlimited partners*: at least two thirds of the votes represented and the absolute majority of the nominal value of the shares represented; if an obligation to make supplementary financial contributions or other personal contributions is introduced on the conversion into a limited liability corporation, all the shareholders concerned must consent;
- a conversion of a company with stated capital into a co-operative: the consent of all the shareholders;
- *a limited liability corporation*: at least three quarters of the shareholders who represent at least three quarters of the company capital;
- *a co-operative*: at least two thirds of the votes cast, or at three quarters of all members in the event that supplementary financial contributions, personal contributions or a personal liability is introduced or extended;
- *an association*: at least three quarters of the members present at the general meeting.
- *a general or limited partnership*: the consent by all the partners, except if agreed that the consent of three quarters of the partners shall be sufficient.

2.4 Registration in the Commercial Register

The conversion will become effective at the time when it is entered into the commercial register (Article 67 MA).

2.5 Protection of Creditors and Employees

Given that a converted company maintains its legal and economic identity, a conversion normally will not affect creditors. In any event, the Merger Act provides that persons liable for the company's obligations prior to the conversion will continue to be liable during a period of three years for due obligations created prior to the publication of the conversion. Further, as the conversion has no impact on the employees, Article 333 of the Code of Obligations will not apply.

2.6 Cross-Border Conversion

There are no provisions under the Federal Act on Private International Law providing for a direct conversion across the borders. A cross-border conversion therefore must be effected by a two step transaction where a company's domicile is first transferred abroad and the conversion is then made under the foreign jurisdiction's legal regime, or vice versa.

2.7 SME Exemptions

The members of a small or medium-sized enterprise (see for SME definition VI.2.5 above) may waive by unanimous consent the requirements of (a) a conversion report, (b) an auditor's review of the conversion plan, the conversion report and the conversion balance sheet, as well as (c) the right of inspection.

3 Conversion Alternatives

Where a conversion cannot be effected in accordance with the Merger Act, the persons or entities involved may decide to incorporate the new legal form and to use the mechanics of an asset transfer (see VIII below) as an alternative to achieve the same economic results.

4 Tax Considerations

For tax purposes, the term conversion is broader than that used in the Merger Act.

4.1 Conversion from a Partnership into a Company with Stated Capital

The requirements for a tax-neutral conversion from a partnership into a company with stated capital are as follows (Articles 19 para 1 and 2 DFTA and 8 para 3 and 3bis DFTHA):

- the converted company must continue to be subject to Swiss taxation;
- the assets and liabilities must be brought into the converted company at their previous book value;
- a business unit or part of a business unit must be transferred; and
- shares in the converted company which are the private property of an individual shareholder are subject to a 5 year holding period.

4.2 Conversion from a Company with Stated Capital into another Company with Stated Capital or a Cooperative and vice versa

A conversion from a company with stated capital into another company with stated capital or a cooperative, and vice versa, will not be subject to taxation, provided that the following circumstances exist (Articles 61 para 1 DFTA and 24 para 3 DFTHA):

- the converted company continues to be subject to Swiss taxation;
- the assets and liabilities are migrated into the converted company at their previous book value.

Unlike for a conversion from a partnership into a company with stated capital, no holding period requirement applies.

On the part of the shareholders who own shares in the converted company as part of their private property, a conversion will not trigger income tax provided there will be no nominal share value increase. If the shares of a converted company are part of the business property, a conversion will not result in income taxes for private individuals if the book value remains unaltered, irrespective of whether or not there is an increase in nominal values. The same principle applies for legal entities owning shares in a converted company with respect to corporate income tax.

IX Asset Transfers

1 Statutory Framework

When the Merger Act came into force, its crown jewels were said to be the provisions on a new transactional tool called 'asset transfer'. Registered companies and registered sole proprietorships may now avail themselves of the opportunity to transfer assets and liabilities without the need to have regard to the various requirements governing the conveyance of different types of assets and liabilities. In practical terms, all that is required for an integral and simultaneous transfer of a number of assets and liabilities is (a) a contract and (b) the entry of the asset transfer into the commercial register. In principle, there is no need for a shareholders' resolution, and the assets and liabilities to be transferred can be lumped together arbitrarily. Even a single item of an asset can be transferred by way of an asset transfer. In addition, the parties are generally free to agree that the transfer is to be made against consideration or free of charge. If no consideration is paid, the corporate law limitations on capital distributions and liquidations apply.

Technically speaking the asset transfer is different from

- a merger and a split-up in that none of the parties involved in an asset transfer will be dissolved by operation of law;
- a spin-off because the consideration (if any) will be paid to the transferring company as opposed to the company's shareholders (if the shareholders of the transferring entity receive membership rights in the transferee company, the transaction is deemed to be a de-merger); and
- a conversion, given that an asset transfer necessarily involves at least two parties.

The range of application for an asset transfer is extremely broad. It may be used to effect a corporate restructuring (economically similar to a merger, de-merger or conversion), a liquidation, a sale of assets or shares, a contribution-in-kind in the context of a hive-down or a share capital increase, a distribution in kind (dividend or a capital reduction), etc. The asset transfer mechanism is like an empty vessel which can be filled with any substance. Whether in practice that empty vessel will make the loudest noise, as they say, remains to be seen. The disadvantages associated with an asset transfer are the need to draw up a detailed inventory and the disclosure of information due to the registration of the asset transfer with the commercial register where the transfer agreement is on public display.

2 Asset Transfer Steps

2.1 Asset Transfer Agreement

In accordance with Article 71 MA, the top executive bodies will have to enter into an asset transfer agreement containing

- the name, domicile and legal form of the entities involved,
- an inventory with the precise listing of assets and liabilities to be transferred; real property, securities and intangible assets having to be listed piece by piece,
- the total value of the assets and liabilities to be transferred,
- the consideration (if any),
- a list of the employment relationships to be transferred.

An asset transfer is only permissible if the inventory shows a surplus of assets. Assets and liabilities that cannot be allocated based on the inventory, will remain with the transferring company (Article 72 MA).

2.2 Registration in the Commercial Register

The asset transfer needs to be entered into the commercial register. At the time of registration, the assets and liabilities listed in the inventory are transferred to the receiving company by operation of law (Article 73 MA). The traditional forms of transfer, which vary depending on the type of asset or liability involved (transfer of possession for chattel, assignments for claims, endorsements for share certificates, registration in the land registry for real property, consent of creditors for transfer of debts, etc.) are redundant when it comes to the effectiveness of the asset transfer.

However, when debating the bill on the Merger Act the legislator concluded that there should be one exception to that rule. It was thought that contractual arrangements should not be able to be transferred by operation of law without the contract partner's consent. That orthodoxy has been challenged of late. Commentators are now almost unanimous in advocating that the asset transfer should be able to comprise contractual arrangements, at least where the contractual arrangement does not exclude a transfer, given that individual claims and individual debts can be transferred without the need for creditors' or debtors' consents, as the case may be.

2.3 Information of Members

The top executive body of the transferring company must inform its members of the asset transfer in the footnotes of the annual accounts, except if the assets involved represent less than 5 per cent of the balance sheet total of the transferring company (Article 74 MA). In the absence of a duty to prepare annual accounts, the asset transfer must be communicated to the transferor's next general meeting.

The following points must be explained and justified from a legal and an economic viewpoint:

- the purpose and consequences of the asset transfer,
- the transfer agreement,
- the consideration for the transfer, and
- the consequences for the employees and the contents of a social plan (if any).

2.4 Protection of Creditors and Employees

If the transferring company assigns debts, it will nevertheless during a period of three years remain severally liable with the transferee for liabilities incurred before the asset transfer was entered into the commercial register (Article 75 MA). In addition, there is a duty for the companies concerned to secure claims of creditors if the joint and several liability either ceases to exist during the three year period (e.g. because one of the companies is liquidated) or if there is *prima facie* evidence that it will be insufficient to afford adequate protection to the creditors. Instead of providing security, the companies may satisfy individual claims, provided other creditors will not suffer a damage as a result thereof.

Transfers of employees are subject to the requirements set out in articles 333 and 333a CO (see above VII 2.3).

2.5 Cross-Border Asset Transfers

The situation is basically similar to that of a cross-border de-merger (see VII.2.6 above).

3 Tax Considerations

3.1 Restructuring versus Realizations

Swiss tax law does not expressly deal with the asset transfer as a transactional mechanism. So far as it is used to achieve the economic effects of a merger, de-merger or conversion, it will be tax-neutral assuming it complies with the requirements for a tax-neutral merger, de-merger or conversion, as the case may be. If, however, an asset transfer is employed within the ambit of a sales transaction, income will normally be realized and tax liabilities will arise. In consequence, whether or not a transaction involving an asset transfer is tax-neutral, hinges on its qualification either as a reorganisation (tax-neutral) or a realization of income (tax relevant).

3.2 Intra Group Transfer (Restructuring)

Concurrently with the enactment of the Merger Act, Swiss tax law was revised to broaden the definition of transactions qualifying as tax-neutral reorganisations. Further to the traditional corporate restructurings (merger, de-merger, conversion), the definition now includes the transfer of shares (assuming at least 20 per cent of the share capital is involved, which must be owned directly or indirectly), a business, part of a business or other operating fixed assets (such as real property, production facilities, machines, means of transportation, patents, licences and concessions) within a group of companies, provided the transfer occurs between Swiss companies and the companies concerned are under the common management of a company with stated capital or a cooperative (Articles 61 para 3 DFTA and 24 para 3 DFTHA).

These types of intra-group transfer are tax-neutral if as a general rule (to which there are exceptions)

- the receiving company continues to be subject to taxation in Switzerland,
- the assets and liabilities are transferred at book value, and
- the 5 year holding period requirement is complied with.

The permissibility of tax-neutral transfers of shares, businesses, business parts or operating fixed assets at book value is a first step towards group taxation. It will for example concern upstream and side stream asset transfers within a group. The difficulty in practice will be to bring upstream and side stream transactions in line with the corporate law prohibitions to make hidden profit distributions or repay equity capital. As an alternative to an asset transfer to a sister company, a business or part of a business could also be transferred with the same economic effect by means of a spin-off (where the holding period requirement does not apply).

3.3 Hive-Downs (Restructuring)

A business, part of a business and operating fixed assets can be hived down to a Swiss subsidiary on a tax-neutral basis (see Articles 61 para 1 DFTA and 24 para 3 DFTHA) if:

- Swiss taxation continues,
- the assets and liabilities are transferred at book value, and
- the 5 year holding period condition is met.

About the Authors

Ralph Malacrida is a partner with Bär & Karrer. He is a graduate of the University of Zurich (Dr.iur.) and the University of Pennsylvania Law School (LL.M.). Ralph Malacrida is the author of a number of publications on corporate and securities law and has contributed the section on asset transfers to a leading publication on the New Merger Act.

Contact address: r.malacrida@baerkarrer.ch

Rolf Watter is a partner with Bär & Karrer. He is a graduate of the University of Zurich (Dr.iur.) and Georgetown University (LL.M.) and a professor (Titularprofessor) at the Zurich Faculty of Law. Rolf Watter is the author of books and articles on corporate and securities law and editor of a leading publication on the New Merger Act.

Contact address: r.watter@baerkarrer.ch

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Zurich	Brandschenkestrasse 90, CH-8002 Zurich Tel. +41 (0)58 261 50 00, Fax +41 (0)58 261 50 01 zuerich@baerkarrer.ch
Geneva	12, quai de la Poste, CH-1211 Genève 11 Tel. +41 (0)58 261 57 00, Fax +41 (0)58 261 57 01 geneva@baerkarrer.ch
Zug	Baarerstrasse 8, CH-6301 Zug Tel. +41 (0)58 261 59 00, Fax +41 (0)58 261 59 01 zug@baerkarrer.ch
Lugano	Via Vegezzi 6, CH-6901 Lugano Tel. +41 (0)58 261 58 00, Fax +41 (0)58 261 58 01 lugano@baerkarrer.ch
London	1 Pemberton Row, Fetter Lane, London EC4A 3BG Tel. +44 20 7583 1940, Fax +44 20 7583 1941 london@baerkarrer.ch

Further details on the offices as well as all publications of the Swiss Commercial Law Series in PDF format are available at www.baerkarrer.ch. General Emails: zuerich@baerkarrer.ch