Swiss Commercial Law Series

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Mergers & Acquisitions in Switzerland

Second Edition

Helbing & Lichtenhahn
Mergers & Acquisitions in Switzerland

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1 Introduction

1.1 Political and economic background

Switzerland is a *confederation* of 26 *Cantons* (States). Only matters enumerated in the constitution fall within the competence of the Confederation. While the federal legislature is, for example, empowered to enact a civil code and rules on corporations, the court organization and the judicial procedure for claims based on such federal laws is reserved to the cantonal legislatures.

Despite the different cultural backgrounds of its population of 7.01 million at the end of 1994, (one of the highest population densities in the world) the political situation in Switzerland is very stable. Switzerland’s four major political parties have shared power in the Federal Council – the Federal executive body – for more than thirty years.

The gross national product reached CHF 359 billion (which equals US$ 300 billion) in 1993 (up 1.9% from 1992, but down 1.4% in real terms, taking into account inflation), which represents the highest per capita of all industrialised countries. Although, goods valued at CHF 93 billion (which is US$ 77 billion) were exported in that year, imports led to a trade deficit of CHF 3.5 billion (US$ 3 billion). However, this trade deficit was balanced by the service sector and by capital investments abroad, leaving a surplus of CHF 27.6 billion in the national current account balance, representing 8.9% of gross domestic product.

Switzerland had for years an unemployment rate of below one per cent but the rate stood at 4.5% at the end of 1993. Today 61.2% of the workforce is employed in the service sector.

Switzerland’s international relations were marked for a long time by a policy of armed neutrality. A change appears to be taking place, however, as Switzerland has recently started to participate in UN sanctions, e.g. during the Gulf crisis. The Swiss never intended for this policy of neutrality to mean that they sought isolation. 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. It joined 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 assure a common market between the EU and EFTA countries. Switzerland applied for EU membership in May 1992 but it is uncertain at this point in time when negotiations will start. Negotiations are taking place in order to obtain bilateral treaties with the EU and areas covered include transportation, working permits (free movement of persons) and rules of origin for goods. Despite this somewhat ambiguous relationship towards the EU there is a clear trend towards making Swiss laws and regulations compatible to the EU directives, which is especially true in the field of commercial law.

A total of CHF 81 billion was raised on the Swiss capital market in 1993 (up from 52 billion in 1992) and foreign issuers accounted for 55% of this sum. Interest rates for treasury bonds were on average 5% in 1993 and stood at about 4% at the beginning of 1995.

In 1993 the Swiss equity market ranked ninth worldwide in terms of capitalization. The volume of securities traded reached CHF 343 billion in that year. The Swiss stock market index (SPI) moved from 1238 points to 1867 points and presently stands (summer 1995) at 1700.

1.2 Switzerland’s legal system

1.2.1 In general

As Switzerland is a confederation, the federal and cantonal legislatures each have power to enact laws on certain matters, as defined in the Swiss Constitution. Article 64 of this Constitution grants the federal parliament a general power to legislate in the field of private law. This provision has been interpreted to allow the enactment of rules governing take-overs by the Federation. The court organization and the rules on civil procedure are, however, a domain of Cantonal law even if the courts hear cases on claims made under a Federal statute.
In 1881, the Swiss federal legislature enacted the first Swiss Code of Obligations (‘CO’). Major revisions occurred in 1911, 1936 and in 1992 regarding Swiss company law. In 1907, the Swiss Civil Code (‘CC’) was enacted and entered into full force in 1912. Together these codes contain virtually all applicable norms concerning family and inheritance law, property, contracts, torts, restitution, partnerships, corporations and securities.

Most rules regarding the acquisition of Swiss offeree companies and their organizations may be found in the CO, namely in:

(a) Article 620–763, CO regarding the organization of a corporation (in German, Aktiengesellschaft – AG, or in French, Société Anonyme – SA see 1.2.2 and 1.4 below);
(b) Article 748–751 CO on mergers of such corporations;
(c) Article 184–215 CO regarding the purchase of movables – these rules apply to the purchase of shares and, by analogy, to the acquisition of a corporation;
(d) Article 181 CO concerning the transfer of a business.

Also in the CO are rules regarding:

(i) the formation, performance and breach of a contract;
(ii) the rescission of contracts based on material error or fraud;
(iii) the employer/employee relationship;
(iv) the assignments of claims and liabilities; and
(v) provisions regarding promissory notes.

The CC contains rules relating to movable property, real property and the pledging of property including shares.

The Federal Stock Exchange and Securities Trading Act which is now enacted by parliament and which is likely to enter into force in 1996 will contain rules on mandatory disclosure of share ownership, on take-overs and on mandatory offers. This new law will replace Cantonal rules which cover the securities markets and stock exchanges. These rules, however, do not cover take-overs (see 6.2 below on currently applicable rules).
Other relevant rules enacted by the Swiss federal legislature are regulations relating to the banking sector, competition rules (see 3 below) and rules for the acquisition of real property by foreign residents (see 2.5 below).

Federal and Cantonal tax laws in most cases will determine the structure of a transaction (see 8 below).

1.2.2 Company law

Swiss company law (Article 530 et seq. CO) regulates the organization of a Swiss offeree company (see 1.4 below). The following comments will be confined to corporations (Article 620–763 CO), since this type of company is predominant in Switzerland.

Swiss company law also contains rules concerning the transferability of shares (see 1.4.1 and 6.5.2 below) and defines the corporate action required to transfer shares or a business.

Approval by the shareholders of the acquiring corporation (‘acquirer’) is necessary if:

(a) the business of the offeree company is outside the statutory purpose of the acquirer – the shareholders must then approve changes in the Articles of Association of the acquirer, which requires a resolution passed with a quorum of at least two-thirds of the shares represented, combined with an absolute majority of the total share capital voted (see 1.4.1 below and Article 704 I.l CO);

(b) the consideration is to be given in shares (or in the form of equity linked bonds) – the shareholders must then approve an increase in the share capital in order to issue the shares, unless sufficient authorized share capital was created prior to the transaction.

The shareholders of the offeree will have to approve the transaction either by:

(i) selling their shares; or

(ii) in the case of a merger or a sale of all assets followed by a liquidation of the company, by a vote in the shareholders’ meeting.
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(see Article 704 CO again requiring a quorum of two thirds of the votes represented in the meeting).

Special disclosure requirements apply if the transaction is financed by an increase in the share capital of the acquirer, irrespective of whether the newly-issued shares will be used as consideration to the seller, or whether existing shareholders (or the public) subscribe to these shares for cash which in turn is used to pay the purchase price (Articles 650 II.4, 628, 634, 652e, 652f CO – see 4.5.3 below). The board will have to issue a report detailing how the valuation of the offeree was made and the auditors of the acquiring corporation will have to confirm that this valuation meets accepted accounting standards (Article 652f CO). Finally a prospectus will be required if the shares are offered to the public (Article 652a CO).

1.2.3 Rules regulating private acquisitions

The acquisition of shares (including controlling blocks) of a corporation is regulated by Article 184–215 CO, relating to the sale of movable goods. Many of these rules are non-mandatory and may be waived by tacit understanding or by oral or written agreement. The most important rules are found in Article 190 and 214 CO – concerning default by either party – in Article 185 – regulating the passing of risk (and benefit) with regard to the purchased shares or assets – and in Article 192 et seq. CO – concerning breaches of representations and warranties.

In the case of the sale of a controlling block of shares, the Swiss Federal Supreme Court, so far, has refused to apply Article 192 et seq. CO with regard to the state and condition of the underlying business, unless the seller has given express representations and warranties. However, the Court has allowed the acquirer to rescind the contract even in the absence of a warranty clause (see 5.5.4 below) if the net value of the business was considerably lower than expected.

Article 201 CO requires the acquirer to examine the purchased goods as soon as possible and to object immediately if any defects are discovered. This rule also applies to the purchase of shares. Article 210 CO provides that all claims for defects of the purchased goods (or breaches of warranty) are time-barred unless the acquirer starts court
Neither Article 201 nor Article 210 CO is mandatory, and legal counsel of the acquirer should insist on indemnity clauses clearly providing for another mechanism in the event of a breach of warranty (see 5.6.4 and 5.6.5 below).

Article 205 CO allows the acquirer to rescind the contract if representations and warranties prove to be false. However, in many cases the seller will request the acquirer to waive this right (at least for the period subsequent to the completion of the agreement) and confine himself to merely damages or indemnity payments for breach of contract by the seller (see 5.6.2 below).

Finally, Article 200 CO stipulates that the seller is not liable for a breach of warranty if the acquirer knew the defects of the purchased good (or in this case in the underlying business) unless specific warranties as to the absence of such defects have been given. Especially in cases, where an extensive due diligence is conducted prior to signing the agreement, the acquirer should insist that the applicability of this clause is excluded in the contract.

1.3 Merger and acquisition activity in Switzerland

Merger and acquisition activity in Switzerland has been growing steadily over the past few years, the number of publicly announced transactions having risen from 139 in 1980, to 194 in 1985 and 410 in 1990. The number then dropped to 266 in 1994 due to the recession that started at the end of 1991. Some acquisitions of controlling interests were followed by tender offers to public shareholders, an example being the acquisition of Jacobs Suchard by Philip Morris in 1990. Since many of Switzerland’s corporations are either privately-held or – even if listed on the Swiss Stock Exchanges – controlled by one shareholder or one family, all acquisitions were made either by private agreement, by a merger or by a tender offer supported by the management of the offeree company.

However, several unsolicited bids to take over a company have been made over the past few years, involving such well-known companies as Hero, Usego, Georg Fischer, Hoffmann-LaRoche, La Suisse, Rinsoz & Ormond, Gewerbebank Baden, Publicitas, Sulzer,
Saurer and Konsumverein Zurich. Only the last of these was successful, some of the others ending with a ‘white knight’ acquiring the offeree and/or the shares held by the raider, often at a considerable premium. The most recent example, still pending at the moment (April 1995) concerns Holvis. The number of management buy-outs is still rather low, although the buy-outs of such firms as Juvena and Kardex have attracted considerable attention.

1.4 Business organization of a possible offeree

1.4.1 The company limited by shares (‘corporation’)

Most businesses in Switzerland are organized as corporations – AG or SA (see 1.2.2 above). The minimum share capital requirement is CHF 100,000. Prior to July 1992 it was CHF 50,000 and roughly 50% of Switzerland’s 170,000 corporations are established with such minimum capital. A transitory period of five years until the end of June 1997 has been granted to companies incorporated after 1985 to increase their capital; older companies are unaffected and are permitted to maintain a share capital of CHF 50,000.

In general shareholders are not liable for obligations of the corporation beyond their contribution to the share capital. The share capital may be increased by a majority vote of the shareholders either as a so-called ordinary increase, or in the form of or conditional capital. The availability of conditional capital, however, allows to create shares in connection with convertible bonds or option rights.

A reduction of share capital is also possible but requires, inter alia, a notice to the creditors.

For tax purposes, the maximum debt-equity ratio is generally six to one.

The Articles of Association define organizational requirements further. The corporation must have a board of directors and auditors. A shareholders’ meeting must be held at least annually. The board of directors may manage the company itself but many companies have chosen a two-tier system with a management that runs the day-to-day business and a board of directors with supervisory functions. If such a structure is chosen, the board must issue so-called organization
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rules which define the competency of the board and of management. The majority of the directors of a Swiss corporation must be Swiss citizens residing in Switzerland.

The company may issue bearer or registered shares:

(a) In the case of bearer shares, possession of the certificate is sufficient evidence of title, the transfer of such shares being made by simple delivery.

(b) Registered shares are transferred by endorsement. In addition, the name of the purchaser must be entered in the corporation’s share register. Under the provisions applicable prior to July 1992 and – by virtue of the transitory provisions applicable until June 1997 – the transferability of registered shares can be limited by a provision in the Articles of Association allowing the board of directors to refuse to enter a purchaser into the share register without disclosing the grounds for such refusal. The consequence of such refusal under the old rules was that voting rights remained with the seller of the shares, whilst the purchaser only acquired dividend rights and an entitlement to liquidation proceeds.

Since July 1992 the following rules apply with regard to registered shares: If the shares are not listed on a stock exchange, the corporation can withhold its consent and thus hinder a transfer of all rights attached to the shares (Article 685c III CO) by asserting a ground for refusal, which must be defined in the Articles of Association, within three months of a proposed transfer. It may also refuse consent 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 oppose the transfer if the acquirer refuses 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, etc. see Articles 685b IV, 685c II CO).

If the shares are listed on a stock exchange the company can only refuse to consent to a transfer based on a provision in the Articles of Association which states that the interest of any single shareholder may not exceed a certain percentage. Many of the listed companies have adopted a 3% level which also applies to shareholders acting in
concert. Other possible grounds for refusal are enumerated in Article 4 of the Transitory Provisions to the CO for companies owning real estate due to restrictions on foreign ownership of interests in such entities (see 2.5 on the so-called Lex Friedrich). For the purposes of registration the acquirer must declare that he is holding the shares for his own account; furthermore there are special rules applying to transfers made by operation of law (Article 685d III CO). Although the acquirer immediately becomes a shareholder upon purchase of the shares, his voting rights are suspended until he is approved as a shareholder by the company (Article 685f III CO). Notice of refusal must be furnished by the company within 20 days, failing which the acquirer is deemed to have been accepted as shareholder (Article 685g CO). A shareholder refused under these rules must still be registered, however, only as a non-voting shareholder.

Furthermore, transferability of all types of shares may be affected indirectly by limiting, in the Articles of Association, the number of votes which one shareholder may cast in the shareholder’s meeting (see 6.4.5 below). For example, Nestlé AG provided in its Articles of Association, prior to May 1989, that the board of directors could refuse to register a shareholder without stating any reasons. Until the Articles of Association were amended to give the board of directors the right to refuse registration of a shareholder who, directly or indirectly, holds more than three per cent of the registered share capital, foreigners were only permitted to purchase bearer shares. Moreover, a provision was inserted that no shareholder may represent more than three per cent of the entire share capital (i.e. including bearer shares) in a shareholders’ meeting; subsequently, bearer shares were abolished and Nestlé has now only a single class of registered shares outstanding. Another example is UBS, Switzerland’s largest bank, which had a clause in its articles limiting to 5% the number of votes a shareholder (or several shareholders acting in concert) may cast in a shareholders’ meeting. This provision was abolished in November 1994 when shareholders voted to abolish registered shares (which also had super voting rights, see below); however, the respective shareholders’ decision was attacked in court by BK Vision – a substantial shareholder – and the old Articles will remain in force until a court decision is rendered.
The company may issue bearer and registered shares, or, for example, registered shares type ‘A’ and ‘B’ with different nominal values. As the Articles of Association may provide that every share carries one vote irrespective of its nominal value, super voting shares may be created by issuing, for example, registered shares with a nominal value of CHF 10 and bearer shares with a nominal value of CHF 50 (or any multiple of the nominal value of registered shares up to tenfold, see Article 693 CO), meaning that holders of registered shares will hold more voting rights relative to a given investment. Since July 1992 Swiss company law limits the voting power of such shares for certain important decisions (see Article 693 III and 703 CO), requiring that a majority of the capital represented approves such decisions.

1.4.2 Other types of corporations
The limited liability corporation (Gesellschaft mit beschränkter Haftung – GmbH in German) and the co-operative (Genossenschaft) are of minor practical importance. They number approx. 3,000 and 14,000 respectively as of the end of 1994. Since 1992, when the minimum capital contribution for the AG was raised to CHF 100,000 and when such entities were required to appoint qualified auditors, the number of newly formed limited liability corporations has increased somewhat because the minimum capital of such entities is only to CHF 20,000 and auditors are in certain circumstances not required at all.

1.4.3 Partnerships and limited partnerships
Comparatively few business in Switzerland are organized as partnerships. At the end of 1994, approx. 14,000 partnerships (Kollektivgesellschaft) and limited partnerships (Kommanditgesellschaft) were registered. Members of such partnerships will often transform their business into a corporation before selling it to an acquirer, because:

(a) an acquiring corporation may only become a limited partner;

(b) the transfer of the shares of a company is technically much simpler than the transfer of a business; and
(c) the seller may realise a tax-free capital gain from the sale of shares, while a gain resulting from the sale of a share in a partnership will generally be taxed as income.

Tax authorities will only accept a tax-free transfer of the business from the partnership to the corporation, provided that:

(i) each partner retains the same proportion of control over the corporation as previously in the partnership; and

(ii) each partner does not sell his shares for a period of at least five years.

Therefore, if partners intend to sell their business in the future, they are well advised to transform their business into a corporation at least five years before an intended sale. This remains true even though company income – as opposed to a partnership income – is taxed at two levels, namely, at the corporate level and on a personal level, when individual shareholders receive distributed dividends. In order to minimize their tax burden, shareholders in a closely-held corporation should abstain from drawing dividends during the last years before the sale, and then sell their shares for a higher and (tax-free) consideration (see 8.2.1 below the limitations on this type of tax planning).

1.5 Switzerland’s securities markets

At present, 240 Swiss corporations are listed on the Swiss Stock Exchanges in Zurich, Geneva and Basel. Many of these corporations have both bearer and registered shares listed. Also, some corporations have issued, and listed, participation certificates – a type of non-voting stock (see 4.5.5 below). There is also pre-market trading on the major exchanges, involving securities of medium and smaller sized companies, which do not comply with the listing requirements of the Stock Exchanges or which have not yet applied for listing.

The Stock Exchanges in Lausanne, Berne, St. Gall and Neuchatel disappeared between 1989 and 1991, but a number of over-the-counter markets organized by specialized banks remain.
The Cantons (States) are empowered to enact laws regarding security trading. The various Stock Exchanges, to a varying extent, are self-regulated. Listing requirements, however, are uniform. This regime will change in 1996 when the Federal Stock Exchange and Securities Trading Act (see 1.2.1 above) will enter into force. This Act will set basic requirements for recognized stock exchanges, which will have to adopt self regulated rules for listing and trading. The Act will furthermore regulate brokers who are presently only regulated in certain Cantons. It is expected that in 1996 (under the regulation of the competent authorities of the Canton of Zurich) the Swiss Electronic Exchange will open for trading. This fully automated trading system will start a new era in Swiss securities trading as the present stock exchanges, in which trading is still made on the floor, will gradually disappear.

A Swiss company which applies for listing must:

(a) as a rule, have been in business for at least five years. (However, certain exceptions apply and the present draft for listing on the new Swiss Electronic Exchange shortens this period to three years);

(b) publish its audited balance sheet and profit and loss statement, as well as its business report. The listing rules of the Swiss Electronic Exchange will – if the present draft is adopted – provide for accounting principles which assure a fair view of the company’s financial situation which is not the case at present, see 9 below;

(c) be capitalized with at least CHF 5,000,000. (this sum is expected to be raised to CHF 25,000,000 under the new listing rules); and

(d) publish (or make available) a prospectus. Under the listing rules of the Swiss Exchange (which presently only exist in draft form) companies will also have certain continuous disclosure obligations.

The securities to be listed must have achieved a sufficiently broad market. A member of the Stock Exchange has to act as a sponsor for the new applicant.

The majority of trading in domestic securities on Swiss Stock Exchanges is done by cash transactions settled within three days.
Trading information is transmitted to banks and brokers through a telequote system. Once the Swiss Electronic Exchange opens, members will enter orders directly into the trading system which will match purchase and sale orders automatically.

A special feature of the Swiss securities market is off-the-floor trading, in which anyone licensed to deal professionally in securities may freely engage: there are 170 registered broker/dealers in Zurich not represented on the floor of the exchange. It is estimated that off-the-floor trading is at least as important as the reported trading on the exchanges. Banks which are licensed to act as broker/dealers often offset their customers’ purchase and sale orders at the current market rates. This market is expected to change, however, once the Swiss Electronic Exchange is in full operation. Exchange members will be under a duty in the new regime to report all trades. Furthermore, there is a requirement to pass all orders through the exchange system unless a certain volume per trade is exceeded.

The national clearing and depositary system (SEGA) bypasses the need for physical delivery of the shares if the purchaser and the seller are both customers of a member bank. At present, registered shares are being introduced gradually into this system.

The Swiss Options and Financial Futures Exchange (SOFFEX) is a fully computerized exchange for trading in standardized options on shares of a number of major Swiss companies.

Disclosure requirements at the time of listing of a new class of shares are limited compared with other jurisdictions. There is also no stringent requirement for continuing disclosure by a listed company. As mentioned above, this will be different under the rules of the Swiss Electronic Exchange.

Bearer shares often trade at a premium over registered shares because of their free transferability and because registered shares trade in a smaller market (as they are often reserved for Swiss investors). Participation certificates, in general, trade at a discount because of their lack of voting power.
1.6 Information available on Swiss companies

Basic information may be obtained from the Commercial Register, such as:

(a) the contents of the Articles of Association of a corporation;
(b) its share capital;
(c) the number and types of shares; and
(d) the names of directors, managers and officers.

The records kept with the office of debt collection might give further indications as to the financial strength of the offeree company.

Except for listed companies and companies with listed bond issues, there is no requirement to publish balance sheets (see, however, 9.1.2 below). Shareholders and creditors are entitled to receive a balance sheet, however, and a profit and loss statement (Article 697h CO). The accounting rules introduced in the CO in 1992 will generally improve the quality of financial information that can be derived from this reporting. Furthermore, many companies voluntarily comply with international accounting standards or the standards imposed by the fourth and seventh EU directives. A recent study has shown that out of the 40 leading companies 18 applied IAS standards, 17 the rules of the EC-directives and 1 company US-GAAP. Further improvements may be expected from the new listing rules of the Swiss Electronic Exchange which will also set accounting standards.

It should be noted that balance sheets of Swiss companies often do not reflect the fair value of the company, because the board of directors may create hidden reserves, by undervaluing assets or creating unnecessary provisions (see 9 below, but also 1.5 above for new listing rules). The possibility of creating such reserves reduces the earnings to be declared for tax purposes. As a corporation usually will allocate part of the reported earnings to open reserves, the payout ratio of Swiss corporations compared to their real earnings is very small. Low dividends also have led to a general undervaluation of Swiss stock.

Beginning July 1992, corporations with listed shares must
disclose their major shareholders in a note appended to the balance sheet (see Article 663c CO).

The prospectus rules currently in force are not very detailed (see Article 652a CO). Only those prospectus rules pertaining to the Swiss Electronic Exchange and coming into force in fall 1995 will meet international standards.

1.7 The role of advisors and financial institutions

Major Swiss banks and a number of specialized companies offer services in the merger and acquisition area – e.g. searching for possible offeree companies, evaluating the merits of a transaction, or arranging the financing of a transaction.

The drafting of the necessary documents will usually be done by specialized law firms which will often also advise on the tax issues involved. Accounting firms, which are usually involved in auditing the financial statements of offeree and/or acquirer, are often also consulted on tax issues. Tax considerations greatly influence the structuring of a transaction as well as the drafting of certain clauses in an acquisition agreement. Thus it often proves helpful if there is either close co-operation between tax advisors and legal counsel, or if specialized lawyers acquainted with and able to counsel on tax issues, draft the documents.

1.8 Trends and outlook

There is a clear trend towards importing Anglo-American practices in the merger and acquisition field into Switzerland. This also applies to hostile takeovers where expressions such as raider (see 1.3 above), white knight, poison pill, golden parachute (see 6.4.6 below) are now commonly used. The Anglo-American influence also can be perceived from private acquisition agreements which increasingly reflect American-style clauses.

Further changes in the merger and acquisition field in Switzerland may be expected from the revised company law, from the future regulation of the Swiss security markets (see 1.5 above), and from Switzerland’s adoption of EU directives (see 1.1 above).
2 Regulatory framework

2.1 No regulations with respect to tender offers

There are presently no rules in Switzerland concerning tender offers. The Association of Swiss Stock Exchanges has, however, issued a Swiss Take-over Code which is limited in scope compared to regulations in other countries (see 6.2 below); it is furthermore only binding to banks but it has been observed in all tender offers made so far in Switzerland. The Federal Stock Exchange and Securities Trading Act which is likely to come into force in 1996 (see 1.2.1 above) will regulate tender offers and will even contain rules on mandatory offers.

2.2 No disclosure rules for the acquirer

At present there are no rules requiring the disclosure of the acquirer’s initial share holdings (see, however, Article 663c CO) or of his intention to purchase shares of a company exceeding a certain percentage. The Federal Stock Exchange and Securities Trading Act will make disclosure mandatory; the thresholds triggering reporting requirements are 10, 25, 33 1/3, 50 and 66 2/3%. Non-observance of these reporting requirements will constitute an offence (see also 6.3 below).

The Swiss Take-over Code (see 6.2 below) does provide for a rule that share holdings must be disclosed in the case where a tender is made.

2.3 No exchange control restrictions

There are currently no restrictions on capital transactions between Switzerland and other countries. However, the Swiss National Bank may regulate the country’s money supply and implement credit and currency policies. Foreign-based entities wishing to raise capital on
the Swiss market must report the transaction to the Swiss National Bank.

Under certain circumstances the Swiss government may prohibit the sale of securities of Swiss companies. Such a prohibition came into force in 1978 in order to control the rate of exchange for the Swiss franc (Article 16i I.3 Federal Law on the National Bank). Currently, no such rules are in force.

2.4 No restrictions on foreign investment

Foreigners may acquire all types of domestic assets or shares in domestic companies without obtaining special approval, with the exception of:

(a) companies engaged in certain regulated businesses, such as banks; and

(b) real property or companies holding real property (see 2.5 below).

Until 1992, many Swiss corporations had limited the transfer of their registered shares to foreigners in their Articles of Association. The revised company law confines these limitations to certain regulated businesses or to companies owning real property (see 1.4.1 above and also 10.1 below with regard to investment incentives). The old restrictions hitherto applicable under the previous rules remain in force during a transitory period of five years, during which the Articles of Association must be adopted so as to conform to the revised company law.

The sale of an ongoing business which requires a licence, or a concession, to operate (i.e. in the transport business, in the health sector and with regard to the importation of certain agricultural products) may be subject to approval by the competent authorities. However, the sale of shares of a corporation which has been granted a particular licence in many cases will not necessitate renewal of this licence.
2.5 Rules regarding the acquisition of real property by foreigners (Lex Friedrich)

The Federal Law on the Acquisition of Real Property by Foreigners of 16 December 1983 (usually referred to as Lex Friedrich) limits not only the acquisition of real property, but also the purchase of shares in companies (or mergers with such companies) or of a business that owns real property (as further defined in Article 4 Lex Friedrich and Article 1 of the implementing ordinance). Parliament intended to change the rules with respect to M&A transactions in 1994. However, a referendum held in summer 1995 rejected these changes. The Lex Friedrich applies to a purchase of shares in a company that owns real property only if:

(a) the acquirer is a foreigner, a foreign corporation or a Swiss corporation which is controlled by foreigners;

(b) such acquirer obtains or reinforces a controlling position – the test for such control is, inter alia, met, if foreign ownership exceeds one-third of all shares; and

(c) the market value of the real property is more than one-third of the market value of the total assets of the company. If the value is clearly below this threshold, the acquirer must seek to obtain a declaration by the competent authorities that the Lex Friedrich does not apply to the case in point.

If the value of the real property exceeds one-third of the total assets, the foreign purchaser must seek the approval of the competent authorities to acquire a controlling interest, which is generally granted if the real property is indispensable for the conduct of the corporation’s business (e.g. for a plant, as office space). The authorization will often only be granted subject to certain conditions, such as a prohibition of re-sale or a requirement that the shares be deposited with the competent cantonal authorities or agencies (see Article 14 Lex Friedrich and Article 11 of the implementing ordinance). No authorization will be granted if the real property is near a military installation, or if the acquisition is considered contrary to the public interest.
A purchase of shares in a company holding Swiss real estate without the necessary approval is considered null and void under the *Lex Friedrich*.

### 2.6 Rules on the employment of foreign nationals

Switzerland imposes strict limitations with regard to working permits granted to foreign employees. Each canton has an annual quota of working permits in proportion to the size of its economy. If a foreign group purchases a Swiss corporation, the acquirer therefore cannot expect to staff the newly-acquired corporation entirely with non-Swiss management. However, working permits for top executives, skilled technicians and specialists essential to the smooth operation of a business will usually be granted – subject, of course, to the availability of such permits under the quota of that Canton.

The currently ongoing negotiations between Switzerland and the EU are likely to grant to EU-nationals some type of privilege over residents of other countries. Rules with respect to nationals of other countries basically remain unchanged; exceptions apply, however, to certain countries with which long established relations exist, such as the USA.
3 Competition rules

Switzerland does not have such extensive and strict rules regarding competition as do other countries such as the USA, or the EU.

Article 30 of the Federal Law on Cartels of 20 December 1985 provides that the Federal Commission on Cartels may investigate mergers, acquisitions and joint ventures if such transactions lead to, or enforce, a dominant position in a market which could have either economically or socially detrimental consequences. However, there is no duty imposed on the parties to seek authorization from the Commission prior to completing a transaction. Furthermore, the Commission has no power to order a divestiture if it considers that a merger has detrimental consequences; it may merely issue orders – which need confirmation by the Federal Department for the Economy if contested – regulating the market behaviour of the new entity or the new group (see Article 33 Federal Law on Cartels).

If the latter has a market position allowing it to influence the pricing of goods or services to a large extent, price increases may fall under the examination of the federal price supervisor who, under certain circumstances, may prohibit the increases.

The Federal Law on Cartels is presently being revised. The draft presently discussed in Parliament provides for a notification duty of important mergers; the thresholds that the merged entity would need to reach are, however, very high, requiring either a combined turnover of CHF 2 million or a turnover in Switzerland of CHF 500 million, the turnover of the smaller entity must amount to at least CHF 100 million in Switzerland. Mergers of such a magnitude may also fall under the competition rules of the EU, because they are likely to have an impact on the European market. There would therefore be a notification duty to two authorities in such a scenario.

The Federal Law on Unfair Competition may apply to certain practices in a contested take-over situation, especially if the ‘raider’ is a competitor of the offeree and tries, for example, to influence business decisions of the offeree’s management.
4 Methods of acquiring a company or its business

4.1 Private agreement

4.1.1 In general

Control over the offeree company (or its business) may be obtained pursuant to a private agreement by:

(a) purchasing a controlling block of shares from the shareholder(s) of the offeree;

(b) purchasing the assets and liabilities (collectively the business) of the offeree by entering into a contract with the offeree being represented by its board of directors;

(c) agreeing that the offeree will increase its share capital (possibly by creating super voting stock) and that the acquirer will subscribe for all newly-issued shares; or

(d) a merger agreement between two privately-controlled companies.

The purchase of a controlling block of shares is the technique most commonly used in Switzerland.

However, it is quite common to merge the offeree company into the acquirer after a purchase of all the shares and in cases where a foreign acquirer uses a Swiss acquisition vehicle to purchase the shares of the offeree, financed by loans granted from third parties or from the foreign parent company (see 8.4.5 below for tax details).

4.1.2 Sale of shares or of a business

Whether the acquirer purchases the business or the shares of the offeree company will depend primarily upon whether:

(a) the offeree is organized as a corporation or in another legal form;

(b) the acquirer wants to purchase the entire business of the offeree or only part of it – e.g. a branch;
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(c) there is a likelihood of hidden liabilities;
(d) the assets are easily transferable;
(e) tax and accounting considerations favor one technique over the other;
(f) there is a necessity to pledge assets in order to finance the transaction.

Swiss parties usually choose the sale of shares, the transfer of shares being a much more practical transaction compared to the transfer of a business where title for every asset and every contract and governmental authorization must be transferred, or assigned, individually. In addition such transfers may require the consent of third parties or the relevant governmental agencies. Where real property is involved, such transfer requires a registration of the new owner which may trigger special taxes (see 8.2.5 below).

Corporation tax will be levied on the offeree selling its business with respect to the amount by which consideration received exceeds the book value. In addition, the individual shareholders will be taxed upon distribution of dividends (or liquidation proceeds) which are taxed as ordinary income. In contrast, an individual shareholder generally will realize a tax free capital gain, by selling his shares (see 8.2.1 below). The seller will therefore in most cases insist on a share deal. For the acquirer, the purchase of a business offers from a tax viewpoint two advantages: (i) the acquirer may set off financing costs directly against income of the purchased business (since these 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 (because a step-up of assets is generally possible) and therefore realize in the future tax savings. These advantages are, however, comparatively small to the advantages of the seller if a share transaction is made. Most parties agree therefore to a share transaction, whereby the seller will often be ready to somewhat lower the purchase price in order to reflect the fact that he profits from this structure of transaction.

In the case of a purchase of shares the offeree company will become a subsidiary of the acquirer, which not only leads to limited
liability of the parent company but also facilitates a future re-sale of
the subsidiary. If the business of the offeree 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 bank) will also favor a purchase of
shares (which can be easily pledged) over the purchase of a business
because Swiss law requires the transfer of property for a valid pledge
which is in most cases not feasible with business assets.

The acquisition is structured as a purchase of a business if a share
purchase is not feasible (see (a) and (b) above), or if there is a danger
of a considerable amount of hidden liabilities that cannot be dealt
with by warranties given by the selling shareholder(s). In such a case,
the acquirer will purchase all, or part, of the assets of the offeree and
assume all, or part, of the (known) liabilities.

4.1.3 Negotiations/letter of intent

Private acquisition agreements will often be negotiated by senior
management of the seller (or of the offeree company) and the
acquirer. The parties often agree on the basic structure of the transac-
tion and the purchase price prior to consulting their advisors.

Often lawyers become involved in a transaction when one party,
usually the acquirer, wishes to draft a letter of intent. Because many
aspects of the transaction, in particular taxes or unknown liabilities,
are rarely considered during the first stages of negotiations, a subse-
quent adjustment of the purchase price may be necessary. Therefore
parties should not fix the definite price in a letter of intent without
appropriate reservations.

The seller will usually insist that the letter of intent contain a
confidentiality clause. While this clause and the provisions regarding
exclusive negotiations are meant to be legally binding, it is usually
understood that the letter of intent is not binding with respect to the
conclusion of a definitive agreement.

If one party does not negotiate in good faith and finally refuses to
sign the contract, the other party may have a claim based on culpa in
contrahendo – i.e. for its costs arising out of the negotiations (e.g.
legal fees, travel expenses) or costs incurred on the assumption that
the contract will be concluded (e.g. the hiring of a manager for the
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new subsidiary). The seller may have a claim for damages against an acquirer acting in bad faith if the seller had turned down other prospective purchasers who no longer wish to purchase the business after the termination of the negotiations by the acquirer. However, *culpa in contrahendo* does not give rise to a claim for lost profits.

4.1.4 Typical contents of a private agreement

In recent years it has become increasingly common in Switzerland to draft rather detailed agreements along Anglo-American lines. A typical structure (*see* 5.5 below for details) would be the following:

(a) Definition of what is purchased (i.e. shares or the business, *see* 4.1.2 above);

(b) purchase price and method of its payment (*see* 4.5 and 5.2 below);

(c) representations and warranties (*see* 5.5.4 and 5.6 below);

(d) covenants and undertakings (*see* 5.5.5 below);

(e) conditions (*see* 5.5.6 below);

(f) employer/employee relationship and pension fund issues (*see* 5.5.8 below);

(g) closing obligations (*see* 5.5.7 below);

(h) clauses on notification, changes in the agreement, jurisdiction and similar matters (*see* 5.5.8 below).

4.1.5 Change of control by means of an increase in the share capital

If a company increases its share capital by more than 100% (or if the company creates stock with super voting rights in a sufficient amount), control over this company will change if the acquirer, rather than the present shareholders, subscribes to the newly-issued shares. The current shareholders must, however, waive their subscription rights with a special quorum of two-thirds of all shares represented in the shareholders’ meeting (Articles 652b and 704 CO).

This method is also used in order to acquire companies which are in financial difficulty where the largest creditor may agree to
renounce his claim against shares in the company provided that he obtains control.

Article 680 CO prohibits the repayment of the consideration furnished by the shareholders for their shares, which precludes the company from giving any warranty with regard to the newly-issued shares.

4.1.6 Public announcement

Under Swiss law an acquirer is under no duty to disclose his shareholdings in the offeree nor to publicly announce his intention of acquiring the offeree, even if the acquirer is listed on a Swiss Stock Exchange. However, since July 1992 the offeree company is obliged to disclose its major shareholders (see 1.6 above). Reporting requirements also arise under the Federal Stock Exchange and Securities Trading Act (see 2.2 above).

4.2 Public offers

4.2.1 In general

The only rules regarding public offers, which have hitherto played a minor role in Switzerland (see 1.3 above), may be found in the Swiss Take-over Code (see 6.2 below). New draft legislation on public offers is likely to become applicable in 1996, however (see 1.2.1 above).

4.2.2 Friendly offers

An offer of an acquirer to public shareholders which is supported by the board and management of the offeree is generally referred to as a friendly offer. Such support, consisting in a recommendation of the management of the offeree to its shareholders to accept the offer, is often obtained when the acquirer enters into an agreement with the offeree regarding future cooperation between the two companies. Present managers often seek to secure their position within the offeree in such an agreement as well. However, the board of the
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offeree must be careful to treat all shareholders equally (Article 717 CO) and it may not engage in any acts favoring the acquirer over other shareholders. A further consequence of this duty of the board is that it must give the necessary information to shareholders in order to allow them to make a considered choice with regard to the offer. This duty to inform shareholders – derived so far from general principles of law – will be stipulated in the Federal Stock Exchange and Securities Trading Act (see 1.2.1 above and 6.3 below).

Unlike a merger, there is no need for a shareholders’ meeting to approve the offer; on the other hand, shareholders are not obliged to tender their shares. The draft of the Federal Stock Exchange and Securities Trading Act (see 1.2.1 above and 6.3 below) will provide for a squeeze-out mechanism if the acquirer has purchased more than 98% of the shares of the offeree.

In many instances, a change of control effected by a private agreement (e.g. the purchase of a controlling block) is followed up by a public offer addressed to the remaining minority shareholders.

4.2.3 Unfriendly offers

Only a few unfriendly offers have been made in Switzerland to date (see 1.3 above). At present there are no court judgments defining the duty or the right of the board of directors to oppose a public offer (see, however, 6.4 below). There are no regulations requiring the management of the offeree to refrain from defensive tactics; but the general duty of care of directors and/or managers towards their company (and their personal liability in the event of a breach of such duty) will offer some guidance (see 6.4. below). The Federal Stock Exchange and Securities Trading Act (see 1.2.1 above) will prohibit the board from issuing or purchasing shares once an offer has been announced. The board may not dispose of any important assets after such announcement.

4.3 Merger

Swiss company law provides for two types of merger. In a consolidation (Article 749 CO) two or more companies are amalgamated into
a new entity, their assets and liabilities being vested in this new company by operation of law. This method was rarely used because of negative stamp tax implications (see 8.3.3 below); despite the fact that the relevant rules changed in 1993, now offering a consolidation free from stamp tax, this method has not been used since.

The generally practised method is to merge the offeree into the acquirer, the assets and liabilities of the offeree being transferred by operation of law to the acquirer and the offeree shareholders receiving shares in the acquirer in exchange for their shares.

A well-known merger was that of Ciba AG with JR Geigy AG, in which for tax reasons the latter was merged into the former, which was subsequently renamed CIBA-GEIGY AG.

Sometimes the acquirer is merged into the offeree, especially in cases where the offeree is listed on a Stock Exchange, while the larger acquirer is not. The offeree then has to increase its share capital by more than 100% and the shareholders of the acquirer becomes the major shareholders of the offeree (a reverse take-over, see 4.1.5 above).

Technically a merger requires an agreement negotiated by the boards of directors of both companies (see 7.2 below) and the necessary approval of the shareholders.

It is uncertain whether, under Swiss law, the shareholders of the acquirer must expressly approve the merger. In practical terms, they often have to give their approval, at least indirectly, as they must approve the increase in the share capital of the acquirer (see also 1.2.2 above) which is necessary when the amount of authorized capital is insufficient.

Mergers are also a means by which a parent company may acquire the assets and liabilities of subsidiaries. In such a case, no shares are exchanged, and the assets and liabilities of the subsidiary take the place of the shares on the balance sheet of the parent company. The difference between the book value of these shares and the book value of the net assets of the subsidiary is accounted for as a merger loss or gain (see 8.4.5 below). This merger of the subsidiary sometimes is fiscally advisable after the purchase of all the shares of the offeree, since Swiss tax law does not allow for the consolidation of income and expenditures arising within a group of companies.
4.4 Joint ventures

Enterprises can also be linked by an agreement between two or more parties, each transferring certain assets to a new corporation in exchange for shares.

A recent joint venture which attracted a lot of attention was the ‘merger’ between ASEA and Brown Boveri (BBC). ASEA and BBC each transferred their business and subsidiaries into a newly-formed corporation – Asea Brown Boveri – and received 50% each of the shares in the latter. The shareholders of ASEA and BBC kept their shares, but the two companies were transformed into two holding companies each of whose main asset consists of a 50% interest in the joint venture.

Joint ventures also may be organized as partnerships (Article 530 et seq. CO). If, as is common, a joint venture is organized as a corporation, the relationship between the shareholders (and to some extent the organization of the joint venture) is usually governed by a shareholders’ agreement (see 7.1 below).

4.5 Consideration

4.5.1 In general

Acquisitions in Switzerland tend to be settled by cash payment. Tax planning and accounting aspects invariably reduce the possibilities of using alternative methods of financing (see 8.2 below).

4.5.2 Loan financing

Where a bank finances an acquisition, usually it will take the shares of the offeree as collateral. Similarly, the seller might also grant a loan to the acquirer. However, it is important to note that, under Article 717 and 884 CC, the transfer of ownership in the shares which have been retained by the seller as collateral for his loan to the acquirer might be held invalid by a court.

Business assets, with the exception of real estate, are usually unsuitable as collateral since the pledging of movable goods is not
possible under Swiss law without the transfer of possession. This is a further explanation as to why in general there is a preference to acquire shares rather than the on-going business of a corporation (see 4.1.2 above), since shares can be pledged without effecting the day-to-day business of the offeree.

Tax considerations might exclude the possibility of the offeree making a loan to the acquirer. In addition, the offeree’s securing of the debt incurred by the acquirer to finance the acquisition might be considered void as an *ultra vires* act. Therefore the acquirer may have to cause the offeree to sell assets not required for the running of the business and to declare a dividend in the amount necessary to finance the transaction.

### 4.5.3 Shares of the acquirer

If an acquirer offers its shares to the seller, in general the seller will accept this consideration only if there is a functioning market for the shares of the acquirer. If the acquirer is a foreign company, the seller will furthermore have to take into consideration potential foreign withholding and other taxes.

The issuance of an acquirer’s shares as consideration was possible, but rarely utilized prior to 1992 by Swiss acquirers, because authorized share capital was not provided for under these old rules and the holding of treasury stock was restricted. Authorized share capital has been introduced to Swiss company law as of July 1992 (*see* Article 651 CO). The amount of such authorized capital must not exceed 50% of the outstanding capital and the authorization to the board of directors can only be given for a period of two years. The limited possibility of excluding the subscription rights of existing shareholders (*see* Articles 652b and 704 CO, requiring a special quorum) make it uncertain whether financing by an exchange of shares will become more frequent.

Treasury shares are now permitted, but the holding must not exceed 10% of the share capital (20% in exceptional cases, *see* Article 659 CO).

If new shares are issued for consideration, the exchange of acquirer shares for offeree shares will be considered a contribution-in-kind to the acquirer; therefore the increase is further complicated
by the requirement of: (a) a special report to be made by the board of directors, assessing the value of the offeree on the basis of this valuation and (b) an auditors’ report confirming the accuracy of such a report (Articles 652e, 652f CO). The shareholders must approve the capital increase by a special quorum of two-thirds of the shares represented at the meeting (Article 704).

4.5.4 Payment with proceeds of an increase in the share capital

Swiss acquirers will often finance a transaction by raising the necessary cash for the purchase by increasing their share capital.

Although 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), meaning compliance with complicated requirements of the respective rules (see 4.5.3 above), it appears that many acquirers do not abide by the respective rules.

A shareholder of a Swiss corporation has a statutory option to subscribe to newly-issued shares in proportion to his holding prior to the new issue. A Swiss acquirer therefore will either have to raise the cash to finance the purchase by issuing the shares to the present shareholders, or by seeking shareholders’ approval to waive their subscription right and offering the shares to a third party, or to the public, a decision requiring a quorum of two-thirds of the shares represented (Article 704). Furthermore – at least according to a decision of the Zurich Commercial Court which is presently (April 1995) under review by the Federal Supreme Court – dissenting shareholders may attack such a decision on the grounds that suppressing the statutory option requires notification (Article 652b CO) which does not exist if the purpose of the suppression is to raise cash to finance an acquisition, because present shareholders could also provide the necessary cash.

4.5.5 Financing by participation certificates of the acquirer

Participation certificates are a type of non-voting stock that came into use in the early 1960’s. The CO only introduced explicit rules on participation certificates in 1992. Previous participation certificates had been a very flexible instrument regulated by the Articles of Asso-
cation, which varied considerably from company to company. By virtue of Articles 656a et seq., the revised rules on issuing shares apply by analogy, which means inter alia that to create or authorize participation certificates a formal procedure must be followed. Rules on the disclosure of acquisitions paid for with shares (see 4.5.3 and 4.5.4 above) also apply. The total nominal value of participation certificates must not exceed 200% of the share capital.

4.5.6 Earn-out

Especially in cases where the seller retains management of the offeree company after selling his shares to the acquirer, the parties might agree on an earn-out formula, under which the purchase price of the shares is increased if certain targets are attained during the subsequent years. Such formulae are quite common in the tertiary sector – i.e. public relations, accounting or consulting firms – where the parties intend to retain the services of the founders and key employees of the company.

A seller might be willing to accept a comparatively low salary for his future services under such a formula for tax reasons, since 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, is subject to social security payments.

The employment contract concluded with the seller will have to include, inter alia:

(a) clauses regarding the management of the offeree company;

(b) a list of transactions for which the seller will need the approval of the acquirer;

(c) a provision that the seller may not waive his salary (which he might be tempted to do in order to reach profit targets);

(d) usually a non-competition clause for a period of time after termination of the employment relationship.

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

(i) interest rates on inter-company loans;
(ii) rates of depreciation and amortization of good-will;
(iii) amount for research and development expenditures;
(iv) creation of reserves (e.g. for taxes, warranty claims);
(v) treatment of work in progress, etc.

From the point of view of the acquirer, the earn-out has the advantage of the purchase price being tied to the performance of the business. The acquirer furthermore will be able to finance the purchase price partially from a distribution of dividends from the offeree company.

4.5.7 Consideration in escrow, consideration to be paid at a later date

Parties sometimes will agree that the acquirer pays part of the consideration into an escrow account – e.g. until final inspection of the business to be acquired, or until a settlement is reached in a major dispute in which the offeree company is involved. Similarly, the parties may provide that the acquirer will pay a part of the purchase price only at a later date while still guaranteeing payment of this sum.
5 Private agreement

5.1 Negotiations

Negotiations up to the time of a possible drafting of a letter of intent have already been described above (see 4.1.3 above). If the basic structure of the transaction has been agreed upon, it is usually up to the legal counsel of the acquirer to prepare a first draft of the purchase agreement. Although this draft of course will favor the position of the acquirer, it is usually not extremely one-sided in order to serve as an effective basis for further negotiations and to avoid a counter-proposal by the seller’s attorney, or a demand for a re-draft.

Parties sometimes agree to a timetable after the signing of the letter of intent. Very often this timetable proves to be too optimistic; nevertheless, it is a useful tool for addressing the issues each party must deal with before, and after, the signing of the agreement.

Major differences are best dealt with in a meeting between the two principals, with their professional advisors present. The presence of the senior executives of each party will facilitate an agreement on open issues which have been pointed out by the professional advisors. Pure drafting questions will be dealt with efficiently in one or more meetings between the lawyers.

5.2 Defining the purchase price

Parties will usually base their price negotiations on the offeree’s last available balance sheet. As balance sheets of non-listed Swiss companies rarely reflect a fair value of the company – due to hidden reserves – (see 9.4 and 9.5 below), the parties sometimes base their negotiations on internal accounts, or management accounts.

The parties often will agree that a certain amount of money 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 sum will depend on:
(a) the earning power of the offeree;
(b) hidden reserves in the balance sheet;
(c) the goodwill (in the strict sense of the word) of the offeree;
(d) synergy effects the acquirer intends to realise;
(e) tax consequences of the transaction; and
(f) the bargaining power of the acquirer and the seller.

The parties sometimes will agree on a goodwill payment and provide
in the contract that an accounting firm shall establish a balance sheet
as per a certain date – which is usually the completion date –
according to accounting rules defined in the agreement, accordingly
the exact purchase price is not known at the moment the parties sign
the agreement.

An alternative to setting the price in relation to the balance sheet
is an earn-out formula (see 4.5.6 above). Of course, a balance sheet
based approach can be combined with an earn-out.

A further possible basis for determining the purchase price is the
earnings of a company (for example the parties agreeing that the
purchase price would be ten times earnings before taxes) or the value
of the principal asset of the offeree (e.g. a patent or real property).

Often the question of deferred taxation becomes a major issue
towards the end of negotiations. To a large extent Swiss companies
are allowed to write off assets for accounting and tax purposes; such
companies are liable therefore for considerable taxes once their oper-
ations or the respective assets are sold or liquidated. The acquirer
often will argue that part of this tax burden must be borne indirectly
by the seller and that the purchase price must consequently be
lowered. The seller will take the position that, in an on-going busi-
ness, such deferred taxes are of minor importance and would become
due only if the acquirer liquidates the business – something the seller
would not expect the acquirer to do (see also 5.5.5 below for contrac-
tual clauses in this respect).
5.3 Obtaining information

Parties to a private acquisition agreement almost inevitably encounter the problem of the seller not wanting to disclose details about the offeree company until he is certain that the acquirer is willing to purchase the business at a price acceptable to the seller. Therefore the seller would prefer to sign the agreement before the acquirer has full access to all data regarding the business. On the other hand, the acquirer does not want to be bound until it knows exactly whether the business meets its expectations.

A variety of techniques have been developed in order to mitigate this problem:

**Technique 1**
The acquirer has only very limited access to the business of the seller until the signing of the agreement, but the seller guarantees the state of the business by detailed warranties in the contract, which should give the acquirer the necessary comfort as to the condition of the business. The acquirer may then freely inspect the offeree’s business after the signing of the agreement and has a right to rescind the agreement prior to completion if the warranties prove to be materially wrong. After completion, indemnity payments will be due if the acquirer discovers a breach of warranty. This technique has the advantage 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 legal provisions rather than requiring the acquirer’s attorneys to check into all these questions). Verification of this information is possible, as long as the warranties remain in force and as long as indemnity payments may be claimed.

This contractual solution is not feasible when it is not sufficient that the acquirer be entitled to damage or indemnity payments under the agreement – e.g. where title to certain assets or patents is of such importance to the acquirer that the possibility to rescind the contract or to seek indemnity payments will not protect him adequately.
Technique 2
The inspection is conducted by a third party acceptable to the seller, generally an accounting firm which undertakes to treat all information obtained during the audit confidentially. Such an audit will not only cover the question whether the last balance sheet fairly reflects the financial situation of the offeree, but will also extend to such issues as the validity of contracts with key employees.

Technique 3
The acquirer has full access to the business of the offeree, even prior to the signing of the agreement, but signs an undertaking that he will treat all information acquired as confidential, in case the transaction is not completed. This procedure is usually not possible if the acquirer is a competitor of the offeree (or seller).

The tendency in Swiss share purchase agreements is to use a combination of the possibilities described as Techniques 1 and 3.

5.4 Signing and completion (Closing)

Usually the purchase agreement will provide for an interval between the signing of the agreement and its completion. This interim period will be used to obtain third parties’ consent, or governmental authorizations. It will also allow the acquirer to arrange for the financing of the transaction and possibly to inspect the business of the offeree (see 5.3 above).

On completion, the parties will exchange the shares (or transfer the business) against payment of the purchase price. As the warranties will usually be given either as per the date of the last balance sheet, or as per the signing of the agreement, the period pending completion must also be regulated by contract: usually the seller will promise that the offeree company will not enter into any contracts outside the ordinary course of business (or exceeding a certain amount) without the written consent of the acquirer (see also 5.6.11 below).

Simultaneous signing and completion is possible where no interim period is necessary.
5.5 The share purchase agreement

The nature and length of a sale and purchase agreement depends on the business of the offeree, the method by which information is exchanged (see 5.3 above) and the bargaining power of the seller and acquirer. These three elements influence the number of warranties to be given by the seller.

The agreement usually contains the following clauses.

5.5.1 Recitals

The agreement will usually start with recitals which summarize the basis of the understanding between both parties.

The parties sometimes explicitly state that the recitals shall have no binding effect, although this is usually unnecessary because the recitals will not contain any duties of either party.

5.5.2 Sale of shares

This clause provides for the shares to be sold free from all liens and encumbrances. If share certificates have been issued, their transfer usually excludes the transfer of any liens or encumbrances if the acquirer deals in good faith with respect to third parties’ rights (see Article 935 CC for bearer shares, and Article 968 and 1006 CO for registered shares).

The wording of the clause will often refer to an extract from the Commercial Register which evidences the number, type and nominal value of shares issued. If not all of the shares are to be purchased, the serial numbers of the shares to be transferred will be enumerated.

The clause will further provide for the duty of the seller to deliver the shares on completion and specify, according to the type of shares (see 1.4.1 above), whether the shares must be simply handed over – bearer shares – whether they also need to be endorsed – registered shares – or whether the board of directors of the offeree company must approve the transfer. In the latter case, minutes of the respective board decision must be delivered upon completion.

If no share certificates have been issued, title is transferred by written assignment.
Finally, the clause will provide for the acquirer’s duty to accept delivery of the shares on completion. This provision makes it 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).

### 5.5.3 Purchase price

This clause will provide for the acquirer’s duty to pay the purchase price on completion to the seller, or possibly into an escrow account (see 4.5.7 above). If the parties agree on cash, a money transfer or the delivery of a banker’s cheque on completion will be specified. An exchange of shares against consideration takes place at the completion meeting, and each party is able to check whether the other has performed its main obligation under the agreement.

Possibilities for defining the purchase price have been set out above (see 5.2 above). Even if the parties agree on a certain amount, and not a formula, the contract should specify how the parties arrived at the purchase price. This will facilitate the computation of reduction payments (see 5.6.2 below) to be made by the seller if warranties prove to be false.

If the seller has granted loans to the offeree company, it should be specified further whether the seller will assign this loan to the acquirer, and, if such transfer is contemplated, whether payment of the purchase price includes consideration for the assignment. If the seller has borrowed money from the offeree, the parties will usually agree that the acquirer assumes the debt of the seller against an appropriate deduction of the purchase price.

### 5.5.4 Warranties and indemnities

Parties usually devote much of their negotiations to drafting this section of the agreement. In contrast to other countries, Swiss warranties are usually included in the main agreement and are not listed in a separate schedule.

Due to a number of court decisions rendered by the Swiss Federal Supreme Court (see e.g. in BGE (Bundesgerichtsentscheid) 79 (1953)
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II 155; 97 (1971) II 43; 107 (1981) II 419; 108 (1982) II 102), it has become important for the acquirer to receive warranties from the seller with respect to the business itself, because the statutory remedies for defects in purchased goods (Article 197 et seq. CO – see 1.2.3 above) according to the courts only apply to the shares as such and not to the business represented by these shares. These court decisions have been heavily criticised by legal writers.

Warranties given by the acquirer usually are of minor importance. In practical terms, parties often annex an extract from the Commercial Register that evidences that the acquirer’s representatives have authority to sign the agreement.

In the few cases in which Swiss courts have dealt with material defects in the business, judges have so far always resolved these cases by applying the rule articulated in Article 24 I.4 CO, providing that a contract is not binding if there was material error of one party at the time of the conclusion of the agreement. Because of this rule, the party which relied on the material error in general has the right to rescind the contract. However, this is often not an adequate solution and therefore parties will usually stipulate that a breach of representations and warranties in the contract (which will result in claims for defects in the goods purchased, see 5.6.2 below) will be compensated by indemnity payments.

One main reason for the scarcity of published court decisions in this field might be due to the fact that many private acquisition agreements contain an arbitration clause (see 5.5.8 below).

Usual warranties given by the seller are enumerated in 5.6 below.

5.5.5 Covenants and undertakings

This clause may contain, inter alia:

(a) A non-competition clause, which restricts the seller not only from directly competing but also from participating in competing firms. This clause will usually be linked to a penalty payment (Article 160 CO) and should also provide for the possibility of the acquirer seeking an injunction. Although there are no court decisions on this question, the non-competition clause should be reasonably limited as to location, time and subject, because courts
could apply the relatively strict rules regarding the non-competition clauses for employees (Article 340 et seq. CO) by analogy. Furthermore, competition law considerations (see 3 above) also render it necessary to limit the clause as to scope, time and territory.

(b) An undertaking from the seller to enter into certain agreements with the offeree. Such undertakings are rather frequent if, prior to the sale, the offeree was a subsidiary of the seller and will henceforth continue to provide certain services for its former parent company; similarly, it may become necessary upon the sale to formalize agreements which have so far only been concluded orally. If, e.g., the offeree holds patents, it may be necessary that the acquirer agrees that the offeree will enter into a licence agreement with the seller.

A seller in a service business will often undertake to enter into employment or consulting agreements with the offeree. Frequently tax considerations will influence the question of whether the seller prefers comparatively low compensation for his services as employee or consultant in exchange for a high purchase price for the shares, as the latter variation might lead to a tax-free capital gain (see 8.2 below).

The undertaking to enter into certain contracts is often ‘enforced’ by a clause in the contract specifying that the signing of the contract is a condition precedent to the completion of the agreement: a draft of the contract may be attached to the agreement. A party may not unreasonably refuse to sign such agreement in order to avoid completion of the purchase agreement (see Article 156 CO and 5.5.6 below).

(c) An undertaking by the acquirer that the offeree will not terminate any of its employment contracts for a certain period of time. Such a duty might be imposed by the seller, who would like to demonstrate to other employees in this group that he still is a ‘secure’ employer. The seller often also insists on an undertaking by the acquirer not to liquidate the company for a certain period of time.

(d) An undertaking by the parties to keep the agreement secret until a certain date. There is no legal requirement for either the acquirer
or the seller to announce an acquisition (see 2.2 above). 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 necessary, as such trading would be considered insider dealing in the absence of adequate information given to the public (see Article 161 of the Swiss Penal Code and 10.3 below).

(e) Sometimes the conditions for conducting the business of the offeree pending completion will be inserted into this clause (see 5.6.11 below).

5.5.6 Conditions

The agreement may contain a number of conditions that must be fulfilled in order to complete the agreement. Such conditions can include, but are not limited to:

(a) Approval from third parties, including key employees. Such approval generally is necessary when contracts with such third parties contain a change of ownership clause, or when such contracts may be terminated on relatively short notice – i.e. credit agreements with banks, employment contracts and possibly lease agreements.

Instead of providing for certain undertakings of the seller or acquirer (see 5.5.5 above), the parties may prefer to make the signing of certain agreements a condition precedent to the completion of the agreement.

Often it is useful to specify the exact form of the consent or agreement to be made, in order to avoid confusion. The parties may also agree on an approval which is ‘satisfactory’ to the acquirer.

(b) Governmental authorizations, obtaining of tax clearance.

(c) Shareholders’ approval, where necessary (see 1.2.2. above).

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 its fulfilment.
5.5.7 Completion (Closing)

This clause will specify when and where completion will take place. The seller will often want an assurance that the cheque received on completion will be credited to his account on the same day.

Furthermore, the agreement will enumerate what documents will be exchanged on completion. Apart from the shares and the purchase price, such documents might include:

(a) Letters of resignation from the members of the board of the offeree.

(b) Consent by third parties and authorizations – a board resolution agreeing to the transfer of the shares to the acquirer and the entering of the acquirer in the shareholders’ register.

(c) Assignment of a shareholders’ loan, signed copies of the offeree’s agreements with the seller.

(d) A report to be prepared by the accountants who have examined the books and inventories of the offeree.

5.5.8 Other provisions

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

(a) Employees and pensions: Swiss employers may chose to either set up their own pension fund or to insure employees with an existing fund under the Federal Law on Compulsory Pension Plans of 25 June 1982. Pension funds are legal entities distinct from the employer and an acquirer will therefore not enter into any direct relationship with the offeree’s pension fund upon the acquisition. A surplus in the fund does not accrue directly to the offeree. The offeree is not liable for underfunding provided it has always transferred to the fund its portion of the contributions due. Specific terms in the contract are necessary in cases where new arrangements must be made, e.g. where employees used to be members of a pension fund of the seller’s group, there must be provisions for new arrangements by the acquirer see, also Article 23 of the new Law on Vested Benefits of December 17,
1993. If the pension fund must be terminated, amended and/or partially distributed to a new pension fund, governmental authorities must approve the arrangement (Article 89bis CC and Articles 52, 53, 61, 62 Federal Law on Compulsory Pension Plans of 25 June 1982). In all other cases employees will simply remain beneficiaries of the offeree’s pension fund.

(b) Insurance coverage must sometimes be changed, again namely in cases where the offeree is a group company that was insured under an umbrella insurance 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 to be made only in writing.

(e) Costs: usually each party bears its own transaction costs (i.e. lawyers’ and accountants’ fees). If a security turnover tax is levied on the transaction (see 8.2.4 below), the parties should specify who bears this tax.

(f) Notices.

(g) Applicable substantive law: Swiss law will usually be designated if the offeree is a Swiss company. A foreign law might be chosen if, for example, both the seller and the acquirer are nationals of a third country.

(h) Jurisdiction: parties often specify that disputes will be submitted to arbitration, or may agree to submit themselves to the jurisdiction of a court in Switzerland, or possibly – as a compromise – to the courts in the domicile of the offeree. 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 International Private Law Statute) 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).
5.5.9 Signatures

No notarization or filing of the agreement is necessary in order to make the document binding. In the case of a Swiss acquirer or offeree, authorized signatories (as evidenced by an extract by the Commercial Register) will sign the agreement. No corporate seal need be affixed or stamped onto the agreement. Parties will often initial all pages of the agreement, although this is not a legal pre-requisite.

5.6 Seller’s warranties and indemnities in detail

5.6.1 Who should give warranties

Usually only controlling shareholders will be able, and prepared, to give warranties as to the condition of the business (see also 5.3 above on the relationship between warranties and information). Minority shareholders, however, will sometimes also have to undertake to contribute to indemnity payments on a pro rata basis.

Under Swiss law it is unusual for the offeree company itself to give warranties, as is sometimes done in other jurisdictions. This is because:

(a) a payment under such a warranty would in fact economically be made by the acquirer; and

(b) such a payment could be considered as a constructive dividend to the shareholder, subject to withholding tax.

Warranties of the offeree make sense, however, from the acquirer’s viewpoint for the period prior to completion: a breach of the warranties discovered during a pre-completion due diligence allows the acquirer to rescind the contract (see 5.3 and 5.6.2), it may also want to claim damages for a breach from the offeree, and not only from the seller.

5.6.2 Remedies for breach

Remedies for breaches of warranties which are provided for by law have already been mentioned (see 1.2.3 above on reduction of the
purchase price, and 5.5.4 above, for rescission of the contract based on material error). These legal remedies are deduced from general principles of contract law and the law of sale of movable goods, and they do not always provide an adequate solution of a conflict between the parties with regard to an acquisition agreement: therefore the parties usually will specify remedies for a breach of warranty in the agreement.

The agreement will often contain a provision that the acquirer is not required to complete the transaction if a material breach of a warranty is discovered before completion (see 5.3 above).

However the parties usually wish to exclude the possibility of a rescission after completion. If this is the case, the contract must explicitly state this, since Article 205 CO, as it stands, gives the acquirer the right to elect either rescission of the agreement or a reduction of the purchase price if there is a breach of warranty. Assuming that there is no such clause, the judge may grant only a reduction even if the acquirer seeks a rescission (see Article 205 II CO). Furthermore, Article 207 III CO limits the possibility of rescission in cases where the acquirer has modified the purchased goods.

If a breach of a warranty is discovered after completion (or beforehand, but the acquirer chooses to complete the deal anyway), the acquirer may seek a reduction of the purchase price equal to the difference between the purchase price and the actual value of the shares in view of the breach.

Generally, Swiss courts apply the relative method to determine the indemnity payment. This operates by reducing the purchase price proportionally to the ratio of the ‘true value’ that the goods would have if there was no breach. In practical terms, it will hardly be possible to establish these true values. Therefore a judge is likely to ask the question: ‘What would the parties have agreed to in good faith had they both known of the existence of the breach of the warranty when entering into the contract?’ The indemnity payment will amount to the difference between the purchase price and the value so found by the judge.

The parties sometimes prefer to agree on indemnity payments, in the strict sense of the word, providing, for instance, that the seller will pay to the offeree all amounts which cannot be collected from the offeree’s debtors. In such cases, it is not necessary to ask what the
value of the shares is in view of the breach. The seller simply will have to repay the amount guaranteed (to the offeree) and may not argue that the acquirer would have purchased the shares for the same consideration even if the acquirer had known of the breach at the time of signing the agreement. Technically, such a warranty clause would be considered a guarantee in the sense of Article 111 CO.

Indemnity payments will usually be paid to the offeree company, although agreements often provide that the acquirer may elect to receive the payments directly. Reduction payments will always be paid to the acquirer.

Swiss law also provides for damage payments under certain circumstances – e.g. if a breach of a warranty entails additional damages by the acquirer not covered by either an indemnity payment or a reduction of the purchase price.

5.6.3 Limitations on liability

Often the parties will agree on limitations for reduction, damage or indemnity payments, stating that payment is only due if breaches of warranties amount to a certain minimum level (various small defects then being aggregated), and that payments may not exceed the purchase price.

The lower limit exempts the seller from liability for minor defects. The upper limit does not apply if the seller has caused damage by gross negligence (Article 100 I CO).

5.6.4 Notification of breach

Article 201 CO provides that the purchaser must examine the ‘purchased goods’ (i.e. in the present context, the business) as soon as is feasible in the customary course of business; the seller must be notified forthwith of any defects for which the seller is liable under the warranty. Should the purchaser fail to notify forthwith so, the sale and condition of the sold products is deemed to have been accepted, except where there are defects which could not be discovered in the course of a normal examination. Where defects of this kind are later found, immediate notice must be given on their discovery, failing which there is deemed acceptance even with regard to these defects.
This duty to immediately examine the business and notify the seller of any breach is usually changed in a share purchase agreement by requiring the acquirer to notify the seller at any time during a stated period of any breach discovered.

5.6.5 Limitation of actions
Article 210 CO provides for a time limit of one year from the date of delivery for actions based on a warranty. Parties usually will extend this limit to two or three years, or sometimes longer for warranties regarding taxes.

5.6.6 Joint and several liability
Pursuant to Article 143 CO, there is no joint liability of debtors (i.e. in the present case; the selling shareholders) unless it is so stated in the contract.

5.6.7 Qualification of warranties as to knowledge
Warranties are often qualified as being to the best knowledge and belief of the seller. This will not protect a seller who either knew, or should have known, of a defect had the seller applied due diligence or made reasonable enquiries (Article 3 CC). Under certain circumstances, the knowledge of directors, managers and officers of the offeree will be imputed to the seller.

Warranties are sometimes also qualified, especially in terms of materiality. The seller might, for example, state that there are no ‘material’ proceedings pending, or threatened, against the offeree. Usually, it will be advisable to define the expression material – e.g. by stating that no proceedings with a value in litigation in excess of a certain amount are pending or threatened against the offeree.

5.6.8 Structure of warranty clauses
In general it is useful to group warranty clauses, for example:
(a) as to the offeree;
(b) to the offeree’s accounts;
(c) to the offeree’s business and contracts; and
(d) as to dealings of the offeree since the date of the most recent balance sheet and the signing of the agreement or even until completion (see 5.6.10 below).

Declarations as to the conduct of business up to the time of completion are, strictly speaking, not warranties but are undertakings by the seller to conduct the business in a certain manner.

5.6.9 Disclosures

Warranties will often include the qualification ‘unless disclosed by the seller, there are …’ whereby such disclosures are often included in a separate disclosure letter or made an annex to the agreement.

5.6.10 Text of warranties

Typical warranties may cover the following points:

(a) Warranties as to the offeree

• The acquirer will usually require a warranty that the offeree is organized and existing in accordance with Swiss law, as evidenced by an extract from the Commercial Register, which will usually be annexed to the agreement. This extract will inform the acquirer about the number, type and nominal value of all outstanding shares, the dates of changes in the Articles of Association and will list all persons entitled to sign on behalf of the offeree.

• The parties generally also agree to annex a copy of the Articles of Association, and of important resolutions by the board of directors – especially the resolution regarding the entering of the acquirer in the shareholders’ register – to the contract. The seller will warrant that these are true copies of the documents presently in force.

• A further warranty in this context will assure the acquirer that all
corporate documents are in order: namely minutes of the shareholders’ meetings and meetings of the board of directors.

(b) **Warranties as to the accounts presented to the acquirer**

- If the parties have conducted their price negotiations based on a balance sheet (see 5.2 above), this warranty will be of utmost importance. A standard text might state that the balance sheet and profit and loss statement (usually annexed to the agreement) have been drawn up in accordance with generally accepted accounting principles. Also it may state that assets are neither individually nor collectively overvalued, nor are liabilities undervalued or not accounted for. This general warranty is often detailed for certain assets (e.g. real property or patents, where extracts of the respective registers may be annexed to the contract) or certain liabilities (e.g. taxes or social security contributions). This is especially important where the balance sheet does not adequately reflect the financial status of the business, which is rather frequently the case in Switzerland (see 5.2 above and 9 below). Furthermore, the seller will have to warrant that there are no contingent liabilities (accounted for in the notes to the balance sheet) and no other threatened or possible liabilities for which reserves should have been provided.

- Leased or rented property does not appear in the balance sheet, so the acquirer will often require a warranty that such property is at the disposal of the offeree and that it is in good working condition.

- There may be an additional warranty by the seller that the offeree has conducted its business in the ordinary manner since the date of the last balance sheet and has not, and will not pending completion, entered into any transaction outside the ordinary course of business. This clause may also be inserted under the ‘covenants’ of the seller (see 5.5.5 above).

- That the inventory is saleable within a certain period of time.

(c) **Warranties as to contracts and compliance with law**

- That the offeree, its business and the buildings are in compliance with all applicable legal provisions and regulations. Compliance
with building and construction laws, environmental regulations and provisions regulating the safety standards of certain equipment is of 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.

- That the offeree is not in default of any material contract. Materiality may be defined – e.g. as contracts entailing payments in excess of a certain amount.

- That, to the best knowledge and belief of the seller, there are no claims against the seller derived from existing contracts.

- That there is no litigation or administrative proceeding, pending or threatened against the offeree unless disclosed.

- That no termination of material contracts has been announced or threatened, and the contractual parties in these contracts are not in default of their respective obligations.

- That the assets are adequately insured.

- Depending on the nature of the business, there will be an additional warranty that the offeree has not entered into certain categories of contracts, with the exception of the contracts listed in an annex to the agreement. These contracts again can be defined with respect to the commitment of the offeree (e.g. contracts creating an expenditure in excess of a certain amount, or contracts binding the offeree for a period of more than a certain number of years), or could contain a list of important agreements (e.g. licensing agreements, lease agreements, credit or loan agreements, consulting and joint venture agreements). Furthermore, the acquirer may wish to include in this list all contracts between the offeree and the seller.

5.6.11 Conduct pending completion

A clause regulating the offeree’s conduct pending completion sometimes will be inserted either in the covenants section (see 5.5.5 above), or in the section of the agreement dealing with warranties. Technically, two interim periods should be distinguished: the period
between the date of the last balance sheets and the signing of the agreement (see 5.6.10 above), and 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. The seller usually will undertake, therefore, to cause the offeree to act only within the ordinary course of business, and the seller will furthermore undertake to seek written approval from the acquirer for certain important transactions. Often this clause can refer to the warranty clause that enumerates these important contracts (see 5.6.10 above).

5.7 The business purchase agreement

5.7.1 In general

The main difference between a business purchase agreement and a share purchase agreement consists in the necessity in the former to define the assets sold and the liabilities to be transferred. The warranty clauses will specify the condition of the assets. With respect to the transfer of the liabilities, parties will usually agree on a public notice of the transfer in order to avoid the necessity of approval from all creditors (see below). Otherwise, the business purchase agreement will be similar to the share purchase agreement with the exceptions enumerated in paragraphs 5.7.2–5.7.5 below.

Swiss law generally requires consent by the creditors to the assumption of a debt (Article 176 CO). However, where an entire business is transferred and the transfer publicly announced, Article 181 CO dispenses with such consent. In order to protect the creditors, the seller remains jointly liable with the acquirer for two years after the transfer; for unmatured claims such two year period commences on maturity.

5.7.2 Breach of warranties

The contract should specify the exact consequences of breaches of warranties, because Swiss law is unclear on the question as to whether a reduction in the purchase price is to be made based on the effect the breach of the warranty has with respect to the business as a
whole, or whether the basis for a reduction should be the diminished value of the respective asset.

5.7.3 Employees

Employees may terminate their contracts where there is a transfer of the business if they do not agree with the transfer (Article 333 CO). The new Article 333a CO provides furthermore for an information duty that the employer must comply with. However, employees must respect the legal notice period of one to three months (depending on the duration of their employment) for termination of employment (Article 336a and 336b CO). Therefore, Article 333 is only of practical importance to the extent that important employees of the offeree have long-term contracts, or contracts with longer notice periods.

5.7.4 Consent of third parties

Often, consent from third parties (see 5.5.6 and 5.5.7 above) or governmental authorizations (see 2.4 above) will be necessary in the case of a transfer of a business. Non-assignment clauses in agreements with third parties will have to be waived by these third parties.

5.7.5 Completion

As each asset, contract and liability must be transferred individually according to the respective rules, the clause regulating the completion will usually list in detail what documents must be produced in order to evidence the transfer.
6 Public offers

6.1 In general

There are presently no rules or regulations in force regarding public offers in Switzerland (see 2.1 and 4.2 above), but the Federal Stock Exchange and Securities Trading Act, which does contain rules on offers, is likely to become applicable in 1996.

Some general rules may be inferred from the directors’ duty of care and loyalty towards the company and its shareholders. These apply to friendly offers, which directors may only accept if they are in the best interest of the shareholders, as well as to unfriendly takeovers, where the directors’ duty may exclude certain defensive tactics.

At present a prospectus is required only if the acquirer offers shares, or bonds, in exchange for the shares of the offeree (Article 652a and 1156 CO). These rules hardly ever apply, as most tender offers are made against a cash payment.

6.2 The Swiss Take-over Code

6.2.1 In general

The Association of Swiss Stock Exchanges issued a Swiss Take-over Code (‘the Code’) on 30 August 1989 (amended 1 May 1991). This Code regulates offers in a way comparable to the UK City Code, although the Swiss Code is much narrower in its proposed field of application and in its attempt to restrict certain of the acquirer’s and offeree’s practices. The general reaction to the Code has been that it favors too heavily the interests of the management of the offeree.

The Code provides, inter alia, for a take-over panel, which monitors take-overs. The Code neither includes the duty of the acquirer to disclose a shareholding prior to making an offer (there is, however, a requirement to make certain disclosures in the offer), nor the duty of the offeree’s management to issue statements that would allow the shareholder to make a well-considered choice. Professional advisers
and outsiders seem to abide by the rules of the Code, although only members of the Stock Exchanges (namely banks) are bound by it. The main purposes of the Code are to provide shareholders with adequate information, to avoid market manipulation and, generally, to define what is fair behaviour of all parties involved. Shareholders of the offeree should have the opportunity to accept an offer even if the offeree management rejects it.

6.2.2 Duties of the acquirer under the Code

According to the Code, duties of the acquirer include:

(a) Equal treatment of the offeree shareholders. There is no specific rule, however, that would exclude purchases outside the offer at lower prices; it is also permissible to pay a premium to the seller of a controlling block of shares. All payments made during three months prior to the offer must be disclosed.

(b) No withdrawal of an offer unless the offeree takes defensive steps or unless a competing offer is launched.

(c) Partial offers are permitted, but the acquirer must accept the tendered shares on a pro rata basis.

(d) The acquirer must grant an additional period for shareholders to tender their shares after the offer has become unconditional. The Code furthermore provides for a mandatory offer for all shares if the acquirer purchases more than 50% of all outstanding voting rights.

(e) The offer must remain open for at least two weeks but not more than two months; offers can only be accepted after a cooling-off period of ten days.

(f) The filing of a report with the take-over panel prepared by an accounting firm confirming that the acquirer has abided by the rules of the Code.

(g) No market manipulation (e.g. by selling shares into the market during the offer).

(h) A prospectus requirement.
6.2.3 Duties of the management of the offeree under the Code

Once the offer has been made, the management of the offeree has the following duties:

(a) If the offeree has issued registered shares with limited transferability, a shareholders’ meeting must be called to vote on the restriction – even if the Articles of Association give the board of directors full discretion to refuse to record the purchasing shareholder (see 1.4.1 above) – provided that the acquirer holds ten per cent of the share capital (regardless of whether these shares are registered or not).

(b) No manipulation of the share price. It is still uncertain how this provision will be interpreted, because the draft of the Code contained a clause that prohibited any change in the capital structure after the announcement of the offer (e.g. by an increase in the share capital), or the incurring of extraordinary financial liabilities (e.g. the promise of ‘golden parachutes’ see 6.4.6 below) – these explicit prohibitions have been dropped in the final version of the Code.

It is uncertain (and not resolved by decisions of the take-over panel published so far) whether the duties imposed on the management of the offeree fulfil the purpose of allowing the shareholders to make a well-considered choice, since they usually will not be able to assess the value of their shares under the existing management.

Furthermore, the necessity for a report on the offer by an audit firm will make it virtually impossible to launch a surprise attack on the offeree. There is also considerable danger of insider dealing during the preparation of such a report.

6.3 The Rules of the Federal Stock Exchange and Securities Trading Act

The Federal Stock Exchange and Securities Trading Act will most likely have a significant impact on public offers in Switzerland.

Starting most likely in July 1996, the acquirer will have to announce to the offeree company his shareholdings if he – by
acquiring or disposing of shares – reaches or passes (in either direction) the thresholds of 5, 10, 20, 33 \( \frac{1}{3} \), 50 or 66 \( \frac{2}{3} \) % of the voting rights, irrespective of whether the acquirer can exercise these votes or not. This duty also applies to groups acting in concert. The period within which the acquirer must notify the company is yet to be defined by the Federal Banking and Stock Exchange Commission. The notification will have to be published by the company. Sneak attacks will therefore be excluded in the future.

More importantly, the Federal Stock Exchange and Securities Trading Act aims at regulating public offers for the shares of all companies listed on the Swiss Exchange. The main elements of this regulation are the following:

(a) A take-over panel supervises public offers; it may issue recommendations to the parties; if these recommendations are disregarded, the Federal Banking and Stock Exchange Commission may issue binding rulings. The panel may issue rules on the conditions that an offer may be subjected to, and more generally rules that assure fair treatment, including the period during which an offer must be open and under which conditions it may be revoked. The panel will also have to issue rules on competing bids.

(b) The acquirer must treat shareholders equally and must publish a prospectus (the contents of which will be detailed by the panel) on the offer which may not contain any false or misleading statements. While this is not specifically spelled out in the Act, it may be assumed that the general prospectus liability provisions will apply to this prospectus, providing a claim for damages to everybody harmed by the wrong prospectus.

(c) The offer must be checked by either an auditing firm or a recognized securities dealer for its compliance with all rules and regulations on take-overs.

(d) The target company must issue and publish a report in which it either recommends or rejects the offer. This report may not contain any untrue statement. Between the launch of the bid and its completion, the board may not dispose of any material assets or incur major liabilities unless such transactions are approved by
a shareholders’ meeting. The panel will have to issue rules further detailing these provisions.

(e) Notice of Transactions in the shares of a major shareholder (defined as owning more than 5%) must be to the target company; this also applies to persons acting in concert.

(f) If 98% of the shares are acquired in the offer, the acquirer may squeeze out the remaining shareholders.

(g) Probably the most controversial rule is the one on mandatory offers contained in Article 32 of the Act. The rule provides that whoever acquires more than 33 1/3% of the voting shares of a company (whether the shares actually confer voting rights or not) must make a public offer to all remaining shareholders for all listed shares. The price offered to the minorities may not be lower than 75% of the highest price that the acquirer has paid during the twelve months preceding his passing of the threshold. These rules will have to be detailed by the panel. The Federal Banking and Stock Exchange Commission is empowered to grant exceptions to the rule on mandatory offers, *inter alia* because of an acquisition of shares in connection with a financial restructuring, if transfers are made within a group of shareholders, or if the threshold is only passed temporarily.

Listed companies can avoid this rule by opting out of it by amending their articles of association accordingly. They may also decide – again by a change in the articles – to submit themselves to the rules but to raise the threshold from 33 1/3 % to 49%.

The new rules will therefore have a significant impact on public offers, mainly by assuring better disclosure from all parties involved and by the legally enforceable powers that the panel and the Federal Banking and Stock Exchange Commission will have.

### 6.4 Duty of management faced with an offer

As yet there are no court decisions in Switzerland that define the duties of the board of directors or of management faced with an unsolicited tender offer; neither are there any clear guidelines as to the
conditions an offer must first fulfill before management is allowed to accept it. Also it is uncertain, under Swiss law, to what extent the management of the offeree may claim that a tender offer is detrimental to the interests of employees and creditors of the company.

Generally, the board of directors must treat shareholders equally (Article 717 CO) and should ensure by its actions that outsiders do so as well. The board should therefore try to ensure that shareholders have sufficient time to consider an offer; in the case of a partial offer, the board may (and should) resist it if offers from shareholders are not accepted on a pro rata basis. In addition, the board should gather information about the acquirer specifically with respect to his ability to pay the purchase price and as to his intentions for the offeree. These duties of management which are derived from general principles of corporate law (fiduciary duty and duty of equal treatment) are therefore similar to the duties spelled out in the Federal Exchange and Securities Act (see 6.3 above). A breach of these duties may lead to personal liability of the board members.

Even if the offer meets the aforementioned standards, the directors may reject and fight it, if they believe in good faith that the offer is not in the best interest of the shareholders. It is uncertain to what extent other parties, such as creditors, employees or clients, are to be considered.

The board of directors of the insurance company ‘La Suisse’ preferred, for instance, an offer (after an auction for their company) of Rentenanstalt of CHF 12,000 per share over an offer by a ‘raider’ of CHF 14,000, and refused to declare that the latter would be recorded in the shareholders’ register. Possible Lex Friedrich problems (see 2.5 above) and uncertain financing of the ‘raider’, as well as the interests of clients and employees were set forth as grounds. While the first two reasons seem justifiable, it is much less clear whether the interests of clients and employees would supersede the shareholders’ interest to receive an additional CHF 2,000 for every share they held.

It would be considered a breach of duty of the board of directors if their rejection of an offer were only based on their personal interest to safeguard their positions. Directors would become personally liable in this scenario for damages suffered by shareholders.
6.5. Defences adopted by Swiss companies against unfriendly offers

6.5.1 In general

Defences adopted by Swiss companies were for a long time supported by the practice of Swiss banks to vote the shares they represent on behalf of their clients (the total of such shares often constituted 30–50% of all shares present in a meeting) in favor of the management of the company. Banks became more and more aware, though, that their role as portfolio managers might be incompatible with supporting the offeree’s management under all circumstances.

The bank’s role furthermore changed due to a change in the company law which came into force in 1992; banks must now seek specific instructions from their clients prior to voting the shares (Article 689d CO); only if the client fails to give either specific instructions or general guidelines is the bank entitled to vote in favor of management.

A foreign acquirer should be aware especially of the fact that there are often close personal ties between Swiss companies – evidenced, for example, by seats on the board of directors being held by chief executive officers of other companies. Banks are particularly well represented on the board of their corporate clients and, naturally, such a bank will not be ready to assist in financing an unsolicited bid for such an offeree.

6.5.2 Registered shares with restricted transferability

Prior to 1992 (and due to transitory provisions during a further five years until the Articles are changed, see 1.4.1 above) even listed companies could (in their Articles of Association) vest in the board of directors the right to refuse registering an applicant without stating any reasons (see 1.4.1 for the example concerning Nestlé). In some event the board of directors had accepted registration of an acquirer provided he undertook to sign a shareholders’ agreement with existing major shareholders, which was the case for instance, with Gebrüder Sulzer AG and Werner K. Rey. Although originally tailored to protect a company to enable it to prove its Swiss ownership
in the case of war, Article 686 CO thus developed into a significant anti-take-over device. The transfer restriction was further supported by a (now abolished) ‘Gentlemen’s Agreement’ of the Swiss Banking Association with Swiss companies, in which it was agreed that member banks would not execute orders by ‘unqualified buyers’ for registered shares on the Swiss Stock Exchanges.

Under the new rules, restricted transferability can still serve as a defensive measure, but the test is now more objective since the possibility of a refusal without giving any reasons is no longer possible. Listed companies may only define a maximum shareholding (generally expressed as a percentage of the outstanding share capital, often 3 or 5 percent) that any one shareholder may acquire; however, they generally state at the same time, in order to preserve some type of flexibility, that the board of directors may grant exceptions to this rule. Such a provision would give incumbent management the discretion to give a white knight preference over a raider.

If registration of the acquirer is refused according to such a rule within 20 days after notification of the transfer, he must still be registered as a shareholder without voting rights (Article 685f); dividend rights and subscription rights belong to the acquirer (see 1.4.1 above). Due to this rule, that an acquirer who has purchased more than the amount allowed by the articles of association must still be registered as a non-voting shareholder, a raider may increase his relative voting power by acquiring more shares. If the articles of association fix, e.g. the maximum at 10%, a raider could therefore purchase such amount, plus a further 60% of the shares, for which he will, however, only be registered as a non-voting shareholder. Still, among the shares carrying voting rights he will control 25% which will often be sufficient to change the board of the company.

Companies may also change their Articles of Association and restrict the transferability of shares which were in the past freely-transferable. However, such new restrictions may only be introduced with a two thirds majority.

Until now acquirers have tried to circumvent these transfer restrictions by making their offer conditional upon a shareholders’ meeting changing the Articles of Association, or conditional upon the board of directors declaring that it will enter the acquirer on the share register (see 6.4 above, for the La Suisse case).
6.5.3 Super voting shares, placing of shares with ‘friendly’ parties

The possibility of creating super voting shares and of placing such shares with ‘friendly shareholders’ has already been described (see 1.4.1 above); since 1992, this possibility is more limited because the total nominal value of the shares not privileged may not exceed by more than a factor of 10 the nominal value of the super voting shares.

The creation of these privileged registered shares or of new privileged shares (Article 693 II CO) requires the consent of two-thirds of the shares represented in the shareholders’ meeting and a majority of the capital represented (Article 704 CO); this quorum usually makes it impossible to create super voting stock once a tender offer is imminent.

Therefore Swiss companies have tried to increase the share capital and to place the shares thereby issued with friendly shareholders prior to any offer being announced. This tactic was more common prior to 1992; at present, it would require that the present shareholders waive their subscription rights with regard to the newly-issued shares (Article 652b CO), which also requires a qualified majority vote in the shareholders’ assembly and the presence of important grounds for the withdrawal of subscription rights. This double hurdle will generally be difficult to pass.

6.5.4 Redemption of shares

Prior to 1992, a Swiss company could not redeem its shares nor repay part of the stated capital (Article 680 II CO). The revised rules allow purchases of up to ten per cent of the share capital; in exceptional cases, such as a repurchase in connection with transfer restrictions (see 1.4.1 above), the limit is 20% (Article 659 CO).

Shares held by the offeree or by its subsidiaries cannot be voted (Article 659a and 659b CO).

6.5.5 Limitation of votes of shareholders

Article 692 II CO gives a company the possibility to provide in its Articles of Association that the votes of any one holder of shares may be limited (see 1.4.1 above).
The Articles of Association also may limit the number of shares any one person may represent (Article 689 II CO).

Many Swiss companies have included such clauses in their Articles which have proven to be a very effective anti-takeover device. Article 4c II of the Articles of Association of Ciba-Geigy AG reads, for example, as follows (free translation): ‘No shareholder may, in exercising his votes, represent more than five per cent of the share capital with respect to his own shares, or shares represented by him. Corporate shareholders under common control are deemed one shareholder under this rule. The board of directors may grant exceptions to this rule under special circumstances’.

Companies may create such rules by a majority vote in the shareholders’ meeting. Legal doctrine generally requires that there are justifiable reasons for such a measure, and that shareholders be treated equally.

If the board of directors is empowered to grant an exception to this rule, the – so far unresolved – question arises under what circumstances the board must grant such an exception. Where no such duty exists, an acquirer will have to make his offer conditional upon a shareholders’ assembly voting for a modification of the Articles of Association.

6.5.6 Golden parachutes
Severance payments to senior management in the case of a change of control (golden parachutes) are sometimes said to be a means to encourage take-overs, rather than to be an anti-take-over device, because the management will have a self-interest in accepting an offer.

Without entering into a discussion on the merits of this argument, it must be noted that these arrangements are almost always void because of the self-dealing aspect of the directors granting themselves such benefits.

6.5.7 Staggered board
The shareholders’ meeting may at any time recall directors, under the mandatory rule of Article 705 CO. A staggered board e.g. electing
each year only one third of all directors for a term of three years, is therefore not an effective anti-take-over device under Swiss law.

Nestlé has, however, recently introduced a clause in its Articles of Association requiring a special quorum (the presence of at least two-thirds of the capital and approval by 75% of the shares represented) if more than one-third of all directors are to be replaced. The Swiss Federal Supreme Court has upheld this clause. Nestlé introduced this clause in a meeting where only 50% of all shares were represented. Under the revised rules of Swiss company law this would not have been possible: decisions requiring a special quorum now have to be adopted by this same quorum (Article 704 II CO).

### 6.6 Proxy fights

A shareholder, or a group of shareholders, representing ten per cent or more of the share capital of a corporation may at any time request the board of directors to call a shareholders’ meeting (Article 699 III CO) with an agenda as requested by the shareholders – namely, an election of new directors who will agree to enter the acquirer on the shareholders’ register.

The offeree is not required to give information regarding itself to the acquirer nor has the acquirer, who has purchased some shares of the offeree, a right to inspect the shareholders’ register in order to contact other shareholders directly. The acquirer will have to try to inform the shareholders about his offer through the press or other media. If the offeree has issued bearer shares, not even the offeree will be able, at least theoretically, to contact its shareholders, and will have to respond by public announcement as well.
7 Joint ventures and mergers

7.1 Form of a joint venture agreement

A corporate joint venture is generally regulated by a shareholders’ agreement between the parties involved. A typical agreement will contain the following clauses:

(a) Contribution of each partner to the joint venture, share capital of the entity, domicile and name of the company, its purposes and an agreement to elect an auditor acceptable to both parties.

(b) Composition of the board of directors and the competence of such board. The parties usually will also undertake to vote their shares in favor of a candidate of the other party. Rules on decision-making within the board, and the presidency of the board are also included. Generally, the shareholders’ assembly will have more competence than in a public corporation. Often the parties will agree that certain transactions can only be entered into with the approval of all parties involved (or with the approval of all board members): for other transactions a majority vote in the shareholders’ (or board) meeting will be sufficient. If both parties hold 50%, there may be certain deadlock devices.

(c) Rules regulating transactions between the joint venture and the parties; duties of the parties to participate in future increases in the share capital.

(d) Dividend policy.

(e) Put and call options, right of first refusal and a ‘take me along’ clause in the event of transfer of the shares to a third party.

(f) Non-competition clause; confidentiality clause.

(g) Termination of the joint venture.

(h) Applicable law and jurisdiction.
7.2 Form of a merger agreement

7.2.1 In general

A merger may be understood to be a transfer of the assets and liabilities of the offeree to the acquirer whereby the offeree is automatically liquidated and the offeree shareholders receive shares of the acquirer (see 4.3 above).

The merger agreement is negotiated between the management of both companies, the agreement being subject to the offeree shareholders accepting the transaction in a shareholders’ meeting with a quorum of two-thirds of the shares represented and a majority of the represented capital (Article 704 CO). The acquirer’s shareholders must approve the merger, at least indirectly, since they must generally agree to an increase in the share capital in order to issue the necessary shares to the offeree shareholders unless the acquirer has sufficiently large authorized share capital (see 1.2.2 above). As yet no court has been called upon to decide whether the special rules regarding the issue of shares in the case of a contribution-in-kind also apply to a merger (see 4.5.3 above).

The law contains rules to protect the creditors of the offeree (Article 748 CO). Basically, similar rules as in a liquidation situation apply, the directors of the acquirer being responsible for assets of the offeree, which are kept separately, until all creditors are either secured or satisfied. Notice is then given to the Commercial Registrar, who will strike the offeree from the Register.

No shares are issued where a subsidiary is merged into its parent company. Also it is generally recognized that no approval of the parent’s shareholders is necessary (see 8.4.5 below, for tax consequences, and 4.3 above).

7.2.2 Form of a merger agreement

A typical merger agreement will contain the following clauses:

(a) Statement of the parties’ intention to merge the offeree into the acquirer.
(b) Exchange ratio and possible cash payment that would allow for a more practical ratio (i.e. for one offeree share, one acquirer share, plus CHF 100; in lieu of ten acquirer shares, for nine offeree shares). This clause will generally refer to a balance sheet of the offeree attached to the contract.

(c) Warranty clauses will only be possible if there is a majority shareholder, who must give the respective warranties personally, as the offeree company will cease to exist after the completion of the merger.

(d) Possibly a right of the acquirer to inspect the business of the offeree after signing but before completion, with a right to rescind the agreement in the event that a material breach is discovered (even after the merger has been approved by the shareholders).

(e) Covenants of the offeree – i.e. the right, or obligation, to pay out certain dividends in order to attain the planned ratio.

(f) Conditions – specifically shareholders’ approval and possible consents by third parties.

(g) Costs, applicable law, jurisdiction.

7.2.3 *Lock-up arrangements*

Lock-up arrangements that provide, for example, for high penalty payments in case the merger is not completed (i.e. because the offeree shareholders have refused to approve the transaction because a higher offer has been received from a third party) are not binding, because such a promise is an act *ultra vires* by the directors.
8 Tax considerations

8.1 General remarks on taxation and social security in Switzerland

8.1.1 Taxation of corporations and partnerships

The income of Swiss corporations and individuals is taxed on three levels:

(a) by the Federal Government;
(b) by the Cantons (i.e. States); and
(c) by the municipalities.

Cantonal taxes vary considerably with respect to the calculation of income and the overall tax burden.

A partnership is not taxed as an entity itself: instead, partners are taxed individually according to the income each receives.

In contrast, corporate income is taxed:

(i) as income of the corporation; and
(ii) as income of the shareholder, once the corporation distributes dividends.

Many Cantons do not tax dividend income of holding companies, in order to avoid creation of a third level of taxation. Both the Confederation and the Cantons furthermore levy a tax on the stated capital (plus reserves) of corporations.

The disadvantage of the corporate structure as compared to partnerships is partly compensated for by the fact that private capital gains of individual shareholders derived from the sale of shares are generally not taxed (see also 4.1.2 above and 8.2.1 below). As a consequence, many closely-held companies often will not distribute dividends, but will retain all earnings, as their shareholders may later realise these reserves in the form of a high, tax-free, capital gain.
8.1.2 Social security contributions

Social security contributions are levied on partnership income – at a rate of 9.5% – and on income of employees – 5.35% to be paid by the employee with the same amount to be matched by the employer. Shareholders in private companies who are also employed by the company may therefore prefer to draw a high income, as this will lower the taxable income of the corporation; on the other hand, such tax planning will increase the amount of social security to be paid.

8.1.3 Other taxes

Most other relevant taxes in this area are levied by the Federal government. Such taxes include:

(a) withholding tax, which is levied on the distribution of dividends (including constructive dividends);

(b) the securities issuance tax; and

(c) the securities turnover tax (stamp duties).

Other taxes levied at the Cantonal level include taxes on gains arising out of the sale of real property, or taxes on the transfer of this real property.

8.2 Taxation of the seller

8.2.1 Individual as selling shareholder

In most Cantons and on the Federal level, capital gains of individuals are tax free, unless the assets sold are considered to be a business asset (i.e. related to the business of an individual).

Majority shareholders working in their company will often prefer to pay themselves rather low salaries, accumulate profit within the company and then sell it, thereby realising a non-taxable capital gain (see 8.1 above).

The Federal, and some Cantonal, tax authorities have some years ago, begun to tax such capital gains either using a wide interpretation of the provisions defining income, or arguing that a sale of the offeree shares constituted a tax avoidance under the given circumstances.
Respective decisions by the tax administration have been upheld by the Swiss Federal Supreme Court.

Two situations must be distinguished in assessing the danger that the seller might have to pay income tax on his ‘capital gain’:

(a) A seller sells the shares to a holding company which he controls for a price exceeding the nominal value of these shares. Income tax will usually be levied, at the Federal and the Cantonal level, on the difference between purchase price and nominal value.

   The reasoning behind this taxation is the fact that, upon liquidation of the company, shareholders usually have to pay income tax on the difference between liquidation proceeds and the nominal value of the shares. If the company were liquidated after the transfer of the shares to a holding company, this tax could be avoided because the holding company – which pays only reduced income tax anyhow – would not realise any gain (or only a gain to the extent that the liquidation proceeds exceed the book value of the shares, respectively the purchase price). On the other hand the shareholder would receive the market value of the shares as the purchase price from the holding company, and realise a tax-free capital gain from these.

(b) An individual also may be taxed on a sale to an unrelated party if the offeree holds large amounts of cash, or other non-business related assets. The tax authorities’ reasoning is that a seller would usually pay out the cash as a dividend before transferring the shares (or sell non-business-related assets and distribute the proceeds). Such income tax on capital gains is levied in cases where the purchaser must finance the acquisition by loans and then cause the offeree to pay out high dividends after the purchase. This method of assessment of taxes has been criticised heavily by legal doctrine, and some Cantons have reconsidered their position. The Canton of Zurich will tax this imputed income of the seller only in cases of tax avoidance (a criteria of which is, inter alia, an unusual structure of the transaction).

Withholding tax (see 8.3.5 below) may be levied on the corporation in alternatives (a) and (b), as the imputed income of the seller can be regarded as a constructive dividend.
8.2.2 Individual as seller of share in a partnership

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

8.2.3 Corporation as seller of a business or of shares

The sale of shares or of a business will be taxed as income to the selling company on the amount of the difference between the purchase price and the tax basis of the shares (respectively the assets minus liabilities in the case of a sale of a business).

In some Cantons, holding companies are totally exempt from income tax and, therefore, not taxed on income derived from a sale of their participation, on the Cantonal level; but income tax at 9.8% is levied on such companies on the Federal level.

8.2.4 Security turnover tax

If either the seller or the acquirer qualifies as a dealer in securities – which is the case, inter alia, for holding companies with capital in excess of CHF 500,000 – or if a security dealer (such as a bank) acts as an intermediary in the transaction, there is a turnover tax of 0.15% on Swiss securities, to be paid by the dealer: the tax is shared if both parties are dealers.

8.2.5 Taxation on the transfer of real property

If real property is transferred, for example in an asset purchase, a tax on the transfer of real property and often a special tax on gains arising out of such transfer will become due. Many Cantons also tax the transfer of shares, on the basis of this same tax, if the offeree holds mainly real property. The tax on the transfer of real property is usually split between the parties; the tax on gains derived from such transfers is generally borne by the seller, although the parties may agree otherwise in the contract.
8.3 Taxation of the acquirer

8.3.1 In general

The acquirer will account for the offeree shares purchased as a participation in its balance sheet (see 4.3 above; there is no consolidation for tax purposes – see 8.4.1 below). Tax authorities generally will not allow the acquirer to write off the participation in the subsidiary, unless the subsidiary encounters serious financial difficulties.

The acquirer usually will not be able to use losses carried forward by the offeree unless it merges with the offeree. Losses carried forward by the acquirer may be offset by future gains of the offeree, in the case of a purchase of a business or in a merger.

In the case of a purchase of a business, the acquirer will step up the book value of the assets in order to reflect the purchase price. It also might post an account for the goodwill purchased, or add it into a previously established goodwill account. In future years, assets may be written off and goodwill amortized.

8.3.2 Security turnover tax

The acquirer must pay security turnover tax if it is deemed a security dealer (see 8.2.4 above).

8.3.3 Stamp duty and taxation of ‘Agio’

If the acquirer issues shares in order to finance the acquisition, there is a stamp duty of three per cent of the value received by the acquirer, if the shares are subscribed to by existing shareholders or the public in order to raise cash. No stamp tax is due if the shares are given as consideration to the seller, provided that the transaction does qualify as a merger for tax purposes.

Some Cantons tax as income the agio on the shares issued – i.e. the difference between the value received for the shares and nominal value of these shares. This tax is bound to disappear due to a law that forces Cantons to harmonize their tax laws.
8.3.4 Related acquirer

If the acquirer is a related party of the seller (e.g. a shareholder), a transfer below the fair market value will be deemed a constructive dividend from the seller to the acquirer, triggering a withholding tax of 35% and imposition of income tax on the seller (see 8.3.6 for refunding). No taxes normally are due if a parent company transfers assets and liabilities, or shares of a third company, to a Swiss subsidiary.

8.3.5 Income tax arising out of sale of the offeree’s assets

If the acquirer finances the purchase out of the sale of assets of the offeree, it will realise income to the extent that proceeds of the partial liquidation are distributed to it as dividends. Such tax may be subject to an inter-company dividend received exemption.

Tax authorities will also tax constructive dividends (i.e. loans bearing interest below rates fixed by the tax authorities; sale of assets by the offeree to the acquirer below market value). Furthermore, both declared and constructive dividends are subject to a 35% withholding tax that may be reclaimed by a Swiss acquirer, usually upon filing his tax return (see 8.3.6 for refunding by foreigners).

8.3.6 Withholding tax

Dividend payments generally are subject to a 35% withholding tax that can be fully reclaimed by a Swiss recipient upon filing his tax return (see 8.3.4 above). Foreign shareholders may reclaim withholding tax in accordance with applicable double tax treaties.

Withholding tax may not be reclaimed if the structure of a transaction is considered to be a tax avoidance scheme. The competent tax authorities tend to consider undistributed reserves of companies as potentially subject to withholding tax and often treat transactions avoiding withholding tax on these reserves as tax avoidance. An example of such a transaction is a sale of shares by a foreign resident (who would be subject to withholding tax) to a Swiss resident (who may reclaim this tax in full) who then immediately pays out all cash as dividends in order to finance the purchase. Because there is often...
uncertainty as to what the authorities will consider to be tax avoidance, a tax ruling often will be required if foreign residents are involved.

With regard to the drafting of a sale and purchase agreement, it is important to note that withholding tax paid by the offeree is borne economically by the acquirer.

8.4 Taxation in the case of a merger

8.4.1 In general

Currently Swiss tax law does not allow a company to consolidate different group companies’ balance sheets for tax purposes (see 8.3.1 above). If such consolidation is necessary (e.g. because of losses carried forward, or because of the necessity to offset interest payments of the acquirer with income generated by the offeree), the acquirer may prefer to:

(a) merge with the offeree;
(b) purchase the business of the offeree;
(c) purchase the shares of the offeree and merge with the new subsidiary.

The third possibility will have to be chosen if the acquirer does not want to issue shares as consideration (see 4.3 and 4.5.1 above).

8.4.2 Taxes on shareholders of the offeree

As capital gains of individual shareholders are tax-free (see 8.2.1 above), the question of whether an exchange of shares in a merger constitutes a sale is only of practical importance with regard to shares held by corporations. Generally, a merger will not be regarded as a sale and corporations will be allowed to take over the old tax basis of the shares.

Most Cantons levy income tax when the nominal value of the shares received exceeds the nominal value of the shares of the offeree
company held by the shareholder (see 8.2.1 above for the reasoning behind this tax).

**8.4.3 Tax consequences for the offeree company**

If assets and liabilities are transferred to the acquirer at their book value, no income tax or withholding tax is incurred by the transfer.

If the acquirer is incorporated in a different Canton from the offeree, the latter jurisdiction may provide in its tax code that hidden reserves of the offeree that are ‘leaving’ the Canton shall be taxed as income.

In most Cantons there is no tax on the transfer of real property in the case of a merger.

**8.4.4 Tax consequences for the acquirer**

No stamp duty is levied on the shares issued by the acquirer. In some Cantons, there is taxation of the *agio* (see 8.3.3 above) which, in reality, is almost always created in the case of a merger, because the difference between the book value of the assets minus the liabilities of the offeree will rarely equal the nominal value of the shares issued by the acquirer.

Income tax will be paid on the joint income of the two companies after the merger. Losses carried forward by one of the two entities may be used to offset future income of the combined entity.

**8.4.5 Merger of parent company with subsidiary**

Because the difference between the book value of the assets and the liabilities will rarely equal the value of the subsidiary as it appears in the balance sheet of the parent company, generally, there will either be a (taxable) merger gain or a merger loss (often accounted for as goodwill). Tax authorities will usually refuse to accept an amortization of this goodwill for tax purposes. The taxation of a merger gain is subject to the inter-company dividend received exemption.

If the acquirer has been established solely for the purchase of the offeree shares – the purchase price being financed by loans – and if the offeree is then merged into the acquirer in order to offset the
income of the offeree with interest payments on the loan, tax authorities may consider such structuring as tax avoidance, and refuse to honour claims for repayment of withholding taxes levied on future dividends.
9 Accounting aspects

9.1 Accounting standards and audit procedures

9.1.1 Overview
The approach to accounting in Switzerland is strongly influenced by tax considerations, because the published accounts, subject to certain adjustments, form the basis for levying taxes. This encourages a prudent approach and the creation of significant hidden reserves, which also have the effect of limiting employee and shareholder demands as the disclosed profits represent only a fraction of the real net income. This is underpinned by the fact that the major investors are banks and financial institutions, whose primary interest is in the security of their investments and the servicing of debt, rather than increasing profits.

Normally, published financial statements of Swiss companies include only balance sheet and profit and loss accounts, with a note disclosure. However, there is an increasing trend in larger companies, mainly those operating internationally, to present more comprehensive information; also, consolidated accounts are required if certain thresholds are reached (see 9.2 below). Often the consolidated accounts do reflect a true and fair view of the corporations’ financial standing because these accounts are not relevant for tax purposes.

As mentioned above (see 1.4) there are two major types of companies in Switzerland, the corporation (see 1.4.1) and the limited liability company (see 1.4.2). Corporations represent a considerable majority of Swiss companies, having advantages over limited liability companies. Most references here will be to corporations, but the regulations can be taken to apply to limited liability companies unless it is specifically stated otherwise.

9.1.2 Principal users of accounts
In general, users have restricted access to the accounts of non-listed Swiss companies, since there is no requirement to publish accounts
or file them with the Commercial Register (see, however, Article 697 h for the limited rights of creditors). The only exceptions are listed companies, companies with outstanding bonds (see Article 697 h CO), banks, insurance companies and mutual investment funds; the latter are subject to strict supervision and must file accounts with the respective regulatory authorities. In addition, banks and insurance companies are required to publish their balance sheets in *The Swiss Commercial Gazette* and further newspapers, as specified in the Articles of Association of the company. These must be published annually, six-monthly or quarterly, depending on the company’s size.

All companies, even those which are not required to publish accounts, have to make the following documents available for inspection by the shareholders:

(a) the balance sheet and (together with notes) auditor’s report;

(b) the profit and loss account;

(c) an annual report; and

(d) the board’s proposal for profit appropriation.

These must be available at head offices and branches at least 20 days before the ordinary general meeting, which must be held within six months of the balance sheet date.

The primary users of published accounts are shareholders. Banks, which supply the majority of external finance, frequently have seats on the board and access to more detailed management accounts. Theoretically any creditor who can demonstrate a legitimate interest may apply to the company to see the accounts and the company is required to disclose them. However the company may prevent access by settling the debt. Other outsiders are not regarded as being entitled to information concerning the performance and activities of the business.

The effect of the position of the banks is to incline accounting, access and disclosure towards the banks’ interests of conservatism, the protection of the security of their investments and the servicing of debt. Recently, the very largest companies have responded to pressures from international capital markets and published more
9.1.3 Accounting concepts and standards

In general, accounts must be prepared in accordance with ‘recognised accounting principles’, a term which is not legally defined. In practice, they are primarily determined by the accounting profession, the Swiss Institute of Certified Accountants, which has published comprehensive recommendations on valuation and presentation in both individual accounts and group accounts. However, this set of rules, the so-called FER, is not regarded as mandatory.

Although Switzerland is not a member of the EU, it is influenced by Directives which represent a new European standard for accounting rules. However, the CO does not extend to the full requirements of the EU Directives and a number of significant differences remain.

In particular, there are no proposals to introduce the concept of a ‘true and fair view’ contained in the Fourth Directive. There will also remain a number of significant differences, both in terms of practice and disclosure, compared with the position established by the Fourth Directive.

9.1.4 Form and content of accounts

Prior to 1992, there has been no standard accounts format for most Swiss companies.

Under the new law, the disclosure in the financial statements of all companies, other than those covered by existing special legislation, will be standardised with a minimum classification of 26 items being required in the balance sheet and 15 in the profit and loss account.

The accounts of companies are prepared on a basis consistent with that required by the taxation authorities. In order for deductions to be claimed they must be included in the accounts, which leads to a presentation which may not reflect the company’s commercial position.
9.1.5 Audit

Historically most of the major firms of auditors were owned by the larger Swiss banks. Through management buy-outs, all these firms have now become fully independent.

Under Swiss law there are different audit requirements with regard to Swiss companies:

(a) All public corporations must have statutory auditors, consisting of one or more persons or a professional firm who must be qualified to perform an audit (Article 727a CO) and be independent from the corporation (Article 727c CO). The auditor is required to examine the records to ensure that they have been kept properly. The certification need not comment on whether the financial statements show ‘a true and fair view’. However, a recommendation must be made to shareholders as to whether they should accept or reject the financial statements, which may be with or without qualification.

(b) 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 which are listed on the stock exchange, require an audit to be performed by specially qualified auditors. In practice, the auditors are usually members of the Swiss Institute of Certified Accountants, although some other qualifications are also sufficient.

(c) Only authorized auditing firms may be appointed to undertake an audit required by a bank. The audit reports go directly to the Swiss Banking Commission in Bern; they are not made public.

9.1.6 Role of accountants in acquisitions

The accounting profession often plays an important role in the provision of detailed accounting and general information relating to the offeree. The information is provided primarily to the management of the acquirer, but it is frequently also requested by sponsors and providers of finance as part of their appraisal of a transaction. The main purpose of the investigation is normally the production of a
valuation, but the work can be extended to cover comments on a
range of accounting and business matters. Calculations to eliminate
the effects of the creation and elimination of hidden reserves are
frequently undertaken.

9.1.7 International comparability
Switzerland has historically based its accounting practices on legal
requirements, using a presentation that is largely tax-driven. Accord-
ingly, there is little compliance with the international norm proposed
by the International Accounting Standards Committee (E32 –
Comparability of Financial Statements). The accounting profession
has made a number of attempts to revise Swiss practices over recent
years, to bring them more into line with internationally-accepted
principles. Additionally, the majority of larger companies now
produce consolidated accounts that conform more closely to interna-
tional standards.

9.2 Consolidation practices
9.2.1 Group accounts
Prior to 1992 companies were not obliged to prepare consolidated
financial statements, and consequently there were no formal rules.
The new law does not make group accounts mandatory if a company
together with its subsidiaries exceeds in two consecutive years two of
the following three thresholds: total assets exceeding CHF 10
million; turnover exceeding CHF 20 million, more than 200
employees. The law does not detail the consolidation rules but it
requires companies to disclose the rules they apply as well as the
principles of valuation upon which the accounts are presented. Most
listed companies present their accounts today based on IAS stand-
ards.

The term subsidiary undertaking covers those companies in
which the investing company has a majority of the voting power, in
which it controls the composition of the board of directors, or where
it controls it by other means.
9.2.2 Take-overs and acquisitions

The principle method of accounting for take-overs and acquisitions is the purchase method. The ‘pooling of interests method’ is rarely used, mainly because of the unfavorable tax implications of mergers.

9.2.3 The purchase method

Under the Swiss interpretation of the purchase method, the results of the acquired company may be brought into the group accounts from the beginning of the year in which the acquisition is made, and disposals eliminated from the beginning of the year in which the disposal is made. This may lead to a material distortion of trading performance.

Assets and liabilities in the acquired company are stated at their fair value to the acquiring group (calculated separately for each major asset), which may include the release of the more significant hidden reserves. Any difference between the aggregate fair values of the assets (and liabilities) and the consideration paid, represents positive, or negative, goodwill.

Accounting Standards permit two possible treatments:

(a) immediate write-off of the goodwill balance against reserves (not as a charge in the profit and loss account); or

(b) carrying the goodwill balance as an asset in the balance sheet, which is amortized over its useful economic life as an annual charge, through the profit and loss account.

Treatment (a), although not permitted anymore, was for a long time regarded in Switzerland as the preferred approach. Occasionally goodwill is eliminated against the share premium account. A growing number of companies adopt treatment (b).

The accounting impact of the two treatments may be characterised as follows: immediate write-off can cause a reduction in a group’s net assets and may create doubts about the adequacy of its resources: capitalization and amortization will maintain net assets, but will have the effect of reducing future reported earnings. A company is not precluded from using both methods in relation to
different acquisitions, provided that the notes to the accounts adequately describe the situation.

It is important to bear in mind that the effect of the varying treatments of goodwill in the consolidated accounts is to some extent more apparent than actual. A group’s ability to distribute profits to its shareholders is dependent on the distributable profits of the holding company, and since goodwill is a balance which arises on consolidation, its write-off in the consolidated accounts has no impact on the holding company’s own reserves.

If shares are issued, the premium on issue (being the difference between the nominal value and the market value of the shares issued) must be credited to legal reserves – a non-distributable reserve against which costs may be eliminated (including goodwill).

9.2.4 Accounting for related companies

Until recently equity accounting has not been widely used in Switzerland for accounting for investments in associated companies in group accounts. Previously, such investments were shown at cost. However, now the results of companies where the group has an interest in more than 20% of the share capital but does not exercise managerial control are usually incorporated into the group accounts under the equity method of accounting. This method presents the group’s share of the related company’s net assets and goodwill in the balance sheet and the group’s share of the related company’s profit for the period in the profit and loss account.

In the case of joint ventures, partial consolidation is frequently used. There is no formal definition of a joint venture and in practice a flexible definition is applied.

9.2.5 Outside shareholders’ interests

Where subsidiary undertakings in which the holding company has less than a 100% interest are consolidated into group accounts, it is normal to include 100% of the subsidiary undertakings’ net assets and post-acquisition profits, and to represent the extent to which these are attributable to outside shareholders as a separate balance described as ‘minority interests’. The balance is almost always meas-
ured by reference to the fair value of the subsidiary undertakings included in the group accounts.

9.3 Income and expense recognition

9.3.1 Accruals v. prudence

Prudence, encouraged by the tax laws and the interests of the major investors, is the dominant principle. This is intended to ensure the continued prosperity of the company in order that income may be smoothed and dividends distributed regularly.

Revenue and profits are not anticipated, but are sometimes realized when realised in the form of cash or near-cash assets. Provision is made for all known liabilities, whether the amount is known with certainty or is a best estimate in the light of available information.

9.3.2 Long-term contract work-in progress

Although accounting practices permit companies to take credit for ascertainable profit while contracts are in progress (e.g. percentage of completion method), such profits are rarely taken. Losses are recognized as soon as they become apparent.

9.3.3 Taxation

Profits of any one financial period are generally the basis for assessed tax only in a later year. It is general practice for companies to provide only for the taxes assessed in the accounting period.

Because the tax payable for the period is in general based on the profits assessable to tax by the taxation authorities – which is the same as the book profits (subject to any disallowable items) – provision is only made for the current tax liability, not deferred tax. In practice there may be some limited timing differences which arise as a result of differences between the tax basis and the accounts basis, but deferred tax is not provided on such items.

Deferred taxation is increasingly provided for in group accounts, although there is no obligation to do so. The full provision method is
most common, but sometimes the liability is restricted to 50% of the amount calculated under this method.

9.3.4 Foreign exchange

In practice two methods of translating foreign currency items are used in the group accounts:

(a) The monetary/non-monetary method requires that all debts and liabilities are translated at the year-end rate, while tangible assets (including stock) are translated at historic rates.

(b) The current rate method is the most common practice; under this the balance sheet is translated at the year-end rate, and the profit and loss account is translated at the average rate for the year.

Resulting differences are taken to reserves.

9.3.5 Research and development expenditure

In general, research and development costs are charged to the profit and loss account as incurred. Such costs are only rarely capitalized and matched against revenues in future periods. Some large companies disclose the amount of their expenditure on research and development as a note.

9.3.6 Pension liabilities

Most companies make contributions to a separate retirement benefits fund in the legal form of a foundation, which is usually reinsured. These funds are frequently overfunded and may themselves include hidden reserves. Contributions are charged to the profit and loss account when paid. Where a company does not have a benefits scheme it will pay the legally-required premium (defined contribution) to an insurance scheme.

9.3.7 Unusual items

Prior to 1992 there has been no requirement to disclose the gain on
unusual items, this has changed much Article 663 CO which requires corporations to disclose such items separately.

9.4 Valuation bases

9.4.1 General principles
The valuation basis used is a strict version of historical cost accounting. As a general rule, companies are required to value their assets at amounts not in excess of the lower of cost and market value. In addition, the law gives discretionary powers to the board of directors to value assets at amounts lower than the maximum carrying-value prescribed by law.

9.4.2 Tangible fixed assets
Tangible fixed assets are valued at historic cost. The revaluation of fixed assets above cost is prohibited by law with the exception of listed securities (see 9.4.7 below), real property and investments. The latter two may be valued higher than cost only in order to correct an overindebtedness. The surplus must be significant and established by means of a proper valuation and audit and must be made with the purpose of eliminating a remaining loss after the use of all hidden reserves. A special reserve must be established which assures that the distributions may subsequently be made until the revaluation has been written off. In addition, the revaluation must be disclosed in the profit and loss account and the audit report.

The fire insurance value of assets must be shown as a note to the accounts and is sometimes used to calculate the hidden reserve caused by excessive depreciation. This may, however, be misleading, as the disclosure does not take account of the value of land.

Depreciation is strongly influenced by tax regulations, which specify that only amounts charged in the books are available as tax deductions. Maximum rates for tax purposes are specified, and commonly used, which are usually considerably in excess of the true economic rate and accordingly significant hidden reserves may exist against fixed assets.
There is no requirement that cost and depreciation should be shown separately in the balance sheet.

### 9.4.3 Intangible assets

Intangible assets, such as trademarks and goodwill, may be shown but at a value restricted to their cost, less appropriate amortization. Purchased goodwill must be written off over a reasonable period, usually up to five 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 paid on shares, may be capitalized but must be amortized over a period of five years or less.

### 9.4.4 Leased assets

Leases are not widely used. Leased assets are occasionally capitalized, together with the corresponding liability, but there is no requirement to do so and most lessees use the operating method, under which the lease is treated as a rental agreement and a charge is made to the income statement equal to the rental payment. However, lease liabilities which are not included in the balance sheet have to be disclosed in the notes.

### 9.4.5 Stocks (inventory)

Stocks must be shown at the lower of cost and the generally prevailing prices at the balance sheet date. In applying the principle, although the comparison may be between individual items, it may also be based on product groups or stock as a whole. There is no requirement to differentiate between raw materials, work-in-progress and finished goods in the financial statements.

Purchase or production cost can be determined by any recognised method, including:

(a) LIFO (last in, first out);

(b) FIFO (first in, first out);
(c) average method; and

(d) selling price less estimated profit margin.

The most usual method is average direct cost (c) above.

Substantial provisions are often made against stock, the only limitation being established by tax laws – which state that, where sufficiently detailed stock records are maintained to identify individual prices and quantities, the minimum acceptable value is two-thirds of the lower of cost and market value.

9.4.6 Debtors (accounts receivable)

Non-paying accounts receivable are usually deducted directly from the total of accounts receivable, although the allowance is sometimes shown as a liability. There is no regulation regarding general provisions. Normally five to ten per cent of the gross balance is provided and is allowed as a deduction for tax purposes.

9.4.7 Investments

Quoted securities must not be valued at a price higher than their average Stock Exchange price during the month prior to the balance sheet date which can exceed acquisition cost. Unquoted securities must not be entered in the balance sheet at a value higher than cost. This would be reduced if the balance is impaired, based on an analysis of the shareholders’ equity, profits and cash flows generated by the investment. Separate regulations exist for life assurance companies.

9.5 Capital, reserves and liabilities

9.5.1 Reserve accounting

By law, a legal reserve must be created, with at least five per cent of annual profit being allocated to it until it reaches 20% of paid-up share capital. In addition, an allocation of ten per cent of the value of any dividend must be made to the extent that the dividend exceeds
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five per cent of the paid-up share capital. The legal reserve is not distributable and may be used only to cover losses. The use of legal and revenue reserves is sometimes also governed by the company’s Articles of Association.

The formation of hidden reserves is explicitly permitted in order to ensure the continued prosperity of the business (Article 669 CO). They are most likely to arise from the undervaluation of fixed assets, stock and investments, and the creation of excessive provisions. Although it is not necessary to disclose the existence of such reserves to the shareholders, the auditors must be kept informed because the notes to the balance sheet must disclose the dissolution of hidden reserves in certain circumstances (Article 663b para. 8 CO).

While profits and losses are recognized primarily through the profit and loss account, reserve accounting is occasionally used.

If accumulated losses exceed 50% of the nominal share capital and legal reserves, this must be brought to the attention of shareholders at a general meeting. If accumulated losses exceed 100% of the share capital and legal reserves, a balance sheet must be prepared at winding-up value and submitted to the court.

Swiss companies are not required to distinguish distributable and non-distributable reserves in the balance sheet. Thus the profit and loss account, for example, may contain reserves (normally legal reserves) which the company is not entitled to pay out to its shareholders.

9.5.2 Provisions

Excessive provisions are a common feature of Swiss accounts. Provision is made for all known liabilities and all diminutions in the value of assets.

9.5.3 Contingent liabilities

Article 663b CO requires that details of contingent liabilities, guarantees and charges, for which no provision has been made, must be disclosed as a footnote to the balance sheet, although no details need be given.
9.5.4 Discounted bonds and other innovative financial instruments

Under the Code of Obligations, the full repayment value of the bonds must be treated as a liability. The difference between the issue price and the amount repayable may be treated as an asset, but must be amortized over the period to redemption. However, discounted bonds are rare for tax reasons.
10 Other relevant provisions

10.1 Investment incentives

Generally investment incentives are only available for new enterprises or new investments within an existing business. The purchase of an existing business, will therefore, at least as a general rule, not entitle the new shareholder of the business to investment incentives unless the business pursues new projects after the acquisition. Even then it will often prove helpful to incorporate a new entity in order to take full advantage of all incentives offered to newly-established companies.

Incentives vary considerably from one Canton to another, sometimes even from one municipality to the other. As a general rule, available incentives can be outlined as follows:

(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 concessions than regions having industrial sectors which are in difficulty. Federal incentives also are limited to less developed areas.

10.2 Entities with tax privileges

Significant modifications to the general taxation rules apply to holding companies and domiciliary companies which are often virtually tax exempt on the Cantonal level.
This tax exemption sometimes makes it worthwhile to consider the establishment of a Swiss holding company as an acquisition vehicle for the purchase of Swiss, or foreign, businesses.

However, there are limitations as to capital, financing and distribution of dividends if the Swiss holding company seeks to take advantage of a double taxation treaty in order to minimise withholding taxes levied on the dividends distributed by foreign operations to the holding company.

10.3 Insider dealing and market manipulation

10.3.1 Meaning of insider dealing

Since an amendment was made to the Swiss Criminal Code, in 1988, insider trading is now a criminal offence. Prior to this new law, insider dealing was only prohibited under special circumstances – e.g. if a tippee received inside information that qualified as a business secret of the company in question.

An insider may be a director, a manager, an auditor or any person who has a mandate from a company, such as a lawyer or consultant. These persons also are deemed to be ‘insiders’ of a company controlled by, or in control of, the company with which they have a privileged relationship. Furthermore, ‘insiders’ may be auxiliary personnel of the aforementioned insiders, and members of governmental bodies or civil servants. Insiders may neither disclose their privileged information nor trade in securities based on such information; tippees are only prohibited from trading.

Disclosure and use of inside information is only prohibited if it concerns securities of companies listed on the official Stock Exchanges, or quoted on the pre-exchange market (see 1.5 above). Shares traded over the counter are not subject to the insider rule.

Only information regarding a planned rights issue, a merger or a transaction of comparable impact on share prices qualifies as relevant insider information.
10.3.2 Punishment of insiders and tippees

Criminal sanctions for insider trading are applied ex officio, the maximum penalty for insiders amounting to imprisonment of three years, or a fine of up to CHF 40,000 (unlimited in the case of greed, Article 48 Swiss Penal Code). Tippees may be fined for the same amounts, or imprisoned for up to one year. Gains deriving from insider transactions are seized by the authorities.

Sellers who have suffered a loss also may bring a claim in tort against the insider, or tippee, and may rescind the purchase if they were induced to sell their shares to the insider.

10.3.3 Market manipulation

Market manipulation has recently been held by the Swiss Federal Supreme Court to be a criminal offence (‘fraud’ as defined in Article 148 of the Swiss Penal Code). Because this judgment was rendered in a case of international judicial assistance, no exact definitions as to what constitutes market manipulation exist as yet.

Furthermore, the Federal Stock Exchange and Securities Trading Act will introduce an explicit provision prohibiting manipulations.

10.4 Restrictions on special deals with management

Arrangements between a corporation and its managers or directors need not be disclosed, in contrast with other jurisdictions. However, the general duty of care and loyalty of managers and directors (see also 6.3 above) may either render these transactions void – if they are not in the best interest of the corporation – or – if a transaction is not declared void with a view to protecting third parties’ interests – may expose the acting managers and directors to personal liability claims from shareholders, the company or creditor who have suffered damage.

There are no court decisions clearly defining the duty 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 claims for personal liability from their shareholders. No such valuation is necessary where all, fully informed, shareholders approve the transaction.
11 Summary

In some respects, the merger and acquisition field in Switzerland may be found to possess similarities with other countries, for example in:

(a) the rapid development in this area over recent years;
(b) incorporation of Anglo-American terminology in agreements;
(c) use of anti-take-over devices by corporations.

However, the political and legal framework in Switzerland differs considerably from other jurisdictions. Prospective acquirers, and offerees, must take into consideration the various particularities of Swiss tax and company law as well as other potential regulatory problems, such as the *Lex Friedrich*, when contemplating the acquisition of a Swiss corporation.
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