Practical Law™
MULTI-JURISDICTIONAL GUIDE 2013/14
FINANCE

ACC Association of Corporate Counsel

Leveraged acquisition finance in Switzerland: recent trends in structural features

Lukas Wyss and Maurus Winzap
Walder Wyss Ltd.

global.practicallaw.com/0-570-0124

INTRODUCTION

Although there have been signs of improvement, the Swiss market for leveraged acquisitions generally remained static during 2013 (source: surveys from Ernst & Young). However, there have recently been a number of remarkable transactions in Switzerland which either closed successfully or went through an intense bidding process or feasibility study phase. Such transactions included leveraged buyouts of large private and public Swiss targets, as well as a substantial number of smaller buyouts.

Large Swiss acquisition finance transactions are usually arranged through the London or US market and are placed with institutional investors. As a result, these transactions often depend on the availability of high-yield investors. Smaller Swiss domestic acquisition finance transactions, on the other hand, are often financed by Swiss banks, including Swiss Cantonal banks and smaller financial institutions. These financings are usually held by the banks on their balance sheet until full repayment. Also, such transactions are seen as a means of strengthening relationships.

LARGE LEVERAGED ACQUISITION FINANCE TRANSACTIONS

Almost all large leveraged acquisition financing transactions in the Swiss market during 2013 and the start of 2014 were structured in a similar way. Like many other jurisdictions, these structures included either or both:

- The placement of acquisition term-loan tranches with institutional investors (rather than banks).
- The issuance of high-yield notes.

In some transactions, bridge financing was provided to facilitate the acquisition process and the closing mechanics. This is generally taken out and refinanced by a high-yield notes financing as soon as possible after closing.

Debt packages for large leveraged acquisition finance transactions varied (among other things) depending on the volume and leverage required. The transactions consisted of either:

- Senior debt only.
- Senior debt and one or several layers of junior debt.

In most cases, the debt package was completed by a (revolving) working capital facility lent at the target level and structured as super senior debt. The super senior level derives from the structural preference and is usually also reflected in inter-creditor arrangements.

See Chart, *Typical acquisition finance structures in Switzerland*.

In these larger transactions, the acquisition debt portion is typically placed in the framework of a US or UK market transaction. Therefore, the documentation is usually not governed by Swiss law (except for the relevant security documentation).

In addition, since the borrower/issuer acquisition vehicle is typically structured as an intermediate holding company or a mere special purpose vehicle (SPV) within the acquisition structure (and considering that these transaction are usually structured as limited recourse transactions), there is always a strong focus on the cash flows generated by the Swiss target. Taking these factors into consideration:

- Swiss corporate law must to be carefully considered to ensure that there is proper access to cash flows.
- The structures must address the particulars of Swiss tax law.

Compliance with Swiss Non-Bank Rules

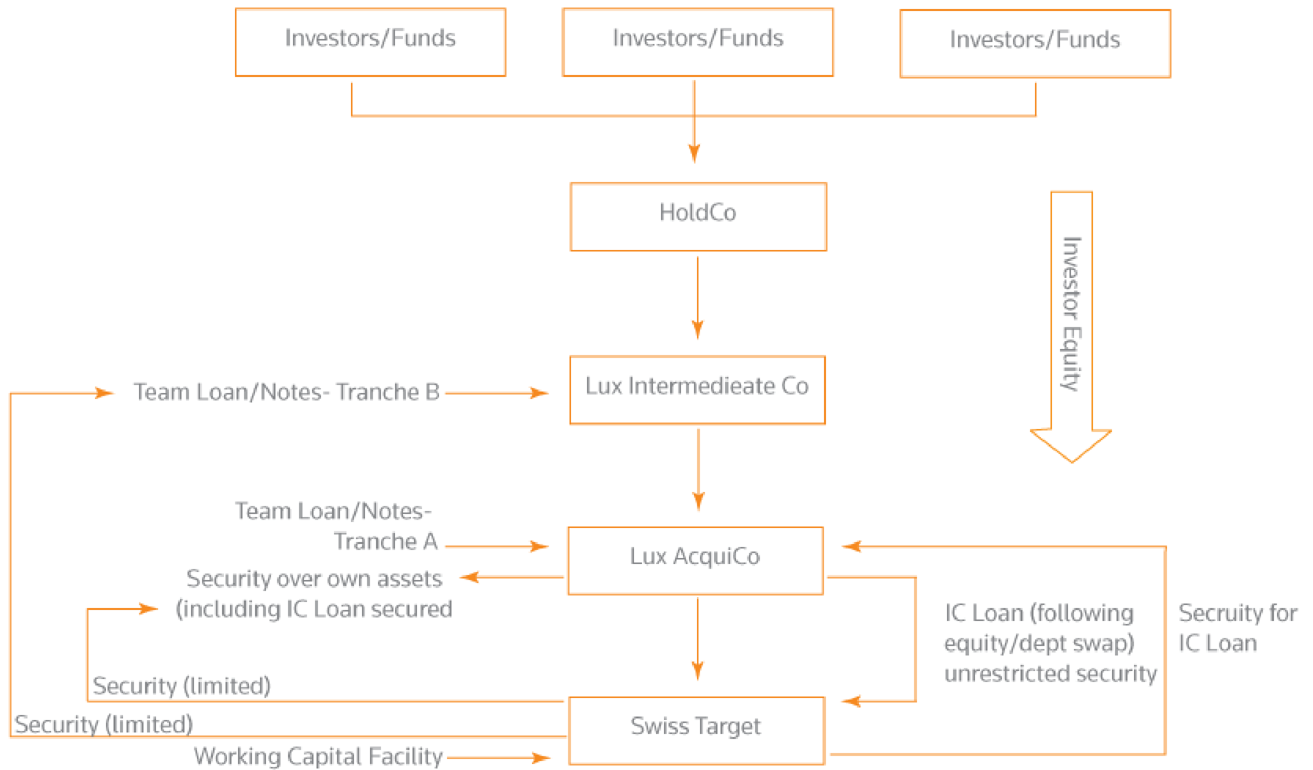
If senior and/or junior debt is to be placed with investors (rather than just banks), the transaction must be carefully structured to consider the Swiss Non-Bank Rules. This is to avoid Swiss withholding tax being incurred on interest payments (*see box, Swiss Non-Bank Rules)*.

When structuring a syndicated finance transaction involving Swiss borrowers to comply with the Non-Bank Rules, the usual approach is to limit the number of non-banks (investors) to ten. This approach is obviously not feasible in large leveraged acquisition finance transactions, where term-loan tranches or notes are placed outside of the banking market. Accordingly, funds under these kinds of transactions may not be raised by a Swiss borrower or issuer, but rather through a top-tier acquisition vehicle incorporated abroad in a jurisdiction which has a beneficial double tax treaty with Switzerland (for the purposes of up-streaming dividends without withholding). Given the generally beneficial double tax treaty between Switzerland and Luxembourg, typical structures often involve multi-level acquisition vehicles incorporated in Luxembourg.

In addition, if funds raised by a non-Swiss borrower are on-lent within the group to a Swiss target company, this may be regarded as circumvention by the Swiss Federal Tax Administration (SFTA). This is especially relevant if the Swiss target company guarantees and secures the acquisition financing. However, the SFTA has previously considered and approved structures that have included these structural elements by way of binding tax rulings. Nevertheless, the process must be carefully structured, with consideration of the time needed for the tax rulings.

© This article was first published in the Finance Multi-jurisdictional Guide 2014/15
and is reproduced with the permission of the publisher, Thomson Reuters. The law is stated as at 1 June 2014.

THOMSON REUTERS™



Swiss Non-Bank Rules

The Swiss Non-Bank Rules comprise two rules:

- Swiss 10 Non-Bank Rule.
- Swiss 20 Non-Bank Rule.

The Swiss 10 Non-Bank Rule defines (among other things) the circumstances in which a borrowing by a Swiss borrower/issuer will qualify as "collective fundraising" (similar to a bond). If the borrowing qualifies as collective fundraising, interest payments on the borrowing will be subject to Swiss withholding tax at 35%. Under these rules, withholding tax will be triggered when either:

- A lending syndicate consists of more than ten non-bank lenders (*Swiss 10 Non-Bank Rule*).
- A Swiss obligor has, on aggregate (that is, not in relation to a specific transaction only), more than 20 non-bank creditors (*Swiss 20 Non-Bank Rule*).

For the purposes of the Non-Bank Rules, a financial institution qualifies as bank (whether the financial institution is Swiss or non-Swiss) if both:

- It is licensed as a bank.
- It performs genuine banking activities with infrastructure and personnel of its own.

Breach of the Swiss Non-Bank Rules can result in Swiss withholding taxes becoming applicable. Such taxes would have to be withheld by the Swiss obligor and may (depending on any applicable double taxation treaty) be recoverable in full or partially by a lender..

Considerations for the security package

In these structures, the acquisition debt portion usually benefits from the share pledge over the top Swiss target company. In most cases, the security package is completed by other security provided by the acquisition vehicle, such as:

- Security over claims under the share purchase agreement.
- Any kind of due diligence reports.
- Insurances (if any).
- Bank accounts.

Under Swiss law, claims can be assigned for security purposes unless the underlying agreement contains a ban on assignment (*pactum de non cedendo*). Therefore, during the pre-signing phase the parties must ensure that all relevant documents do not contain any restrictions on assignment (particularly the share purchase agreement). The same applies for any due diligence reports, although getting the benefit through reliance will also be satisfactory in most circumstances (either directly deriving from the report or through additional reliance letters).

Although the requirement to notify third-party debtors (such as the sellers) is not a perfection requirement under Swiss law, it is strongly recommended that such parties are notified of the assignment and the transaction (for example, a third-party debtor might, pre-notification, validly discharge its obligation by paying to the assignor). The security provided by the acquisition vehicle is usually perfected on the closing of the transaction, immediately after the acquisition of the shares by the acquisition vehicle. Therefore, from a Swiss point of view, there is nothing that would make it overly burdensome or impossible to perfect the security as soon as the transaction is completed/closed.

In addition, security is typically granted by the Swiss target companies. The target-level security package is similar to fully-fledged security packages in other jurisdictions and may include (among others):

- Share security over subsidiaries.
- Trade receivables.
- Bank accounts.
- Intellectual property.
- Insurance claims.

However, due to strict de-possession requirements under Swiss law, it is difficult to get security over movable assets (such as inventory or equipment). There are structuring solutions around this issue (such as pledgeholder structures or OpCo/PropCo structures), but these solutions are usually only implemented in situations where there is a specific focus on such assets. Also, security over Swiss real property will require additional tax structuring in order to avoid withholding on interest payments.

Unless there is some co-operation from the seller to start preparing target-level security (and depending on exact release mechanics from existing financings), target-level security might only be available post-closing and it is usually agreed that target-level security might be completed as a condition subsequent to completion of the transaction.

Most importantly, standard up-stream limitations will apply to target-level security. This limitation might affect the security substantially, particularly in situations of financial distress.

If the structure also includes a down-stream loan from the acquisition vehicle to the Swiss target companies (often used for tax purposes as a push down of debt and for the repatriation of the cash flows) the Swiss target company can provide (unrestricted) security to secure such down-stream loan, because it would secure its own debt. Accordingly, this would not qualify as up-stream security. The acquisition vehicle in turn might provide security over the downstream loan, along with the (unrestricted) security package securing such downstream loan. From a Swiss corporate law perspective, there are good chances that up-stream limitations would not apply to that security structure. However, such a security structure should be discussed with the SFTA.

Access to target-level cash flows

Under Swiss tax law, for income tax purposes interest incurred at the level of the acquisition vehicle is not available for set-off against income generated at the Swiss target company level. This is because there is generally no tax consolidation under Swiss tax law (either in Swiss domestic or cross-border situations).

There are means to (indirectly) "push down" the acquisition debt portion, particularly if the existing debt can be refinanced at target level. For the purposes of the Non-Bank Rules, this would need to be structured as a downstream loan from the acquisition vehicle to the target level (or by refinancing the existing debt at the target level, though that would result in a limitation of the number of non-banks to ten for that portion of the debt in any event). However, given the on-lending of the proceeds of the acquisition debt, the Non-Bank Rules would have to be carefully addressed.

Alternatively, an (indirect) push down can be achieved by way of an equity-to-debt swap, where equity (freely distributable reserves or even share capital that can be reduced) is distributed (but not actually paid out) and then converted into a downstream loan. In recent transactions, additional push down of debt potential has been created by some post-acquisition restructuring steps (such as group internal sales of assets).

If such a push down can be achieved, the security package structure can be improved. In addition, some of the interest incurred on the acquisition debt can be brought to the target company level and may become available for set-off against income generated at the target level.

Additional direct Swiss target-level financing

If the transaction includes a (revolving) working capital facility lent directly to the (Swiss) target companies, compliance with the Non-Bank Rules can only be achieved by limiting the number of non-banks to ten (*see above, Compliance with Swiss Non-Bank Rules*). To ensure the acquisition debt portion of the financing (which might have more than ten non-banks as lenders/noteholders) does not affect the working capital facility, it is key to structure these facilities in a manner which ensures that they qualify as separate financings for purposes of the Non-Bank Rules. Behind this background, loss sharing provisions and similar (equalisation) provisions contained in inter-creditor arrangements must also be carefully structured or confirmed by the SFTA (by way of tax ruling) against the Non-Bank Rules.

LEVERAGED PUBLIC TAKEOVERS

The financing of public takeover transactions generally involves the same structural considerations as any other leveraged acquisition financing. However, certain elements arising from the public takeover must be considered. The process and the timeline for these transactions is summarised below (*see chart, Timeline for financing a leveraged public takeover*).

General considerations

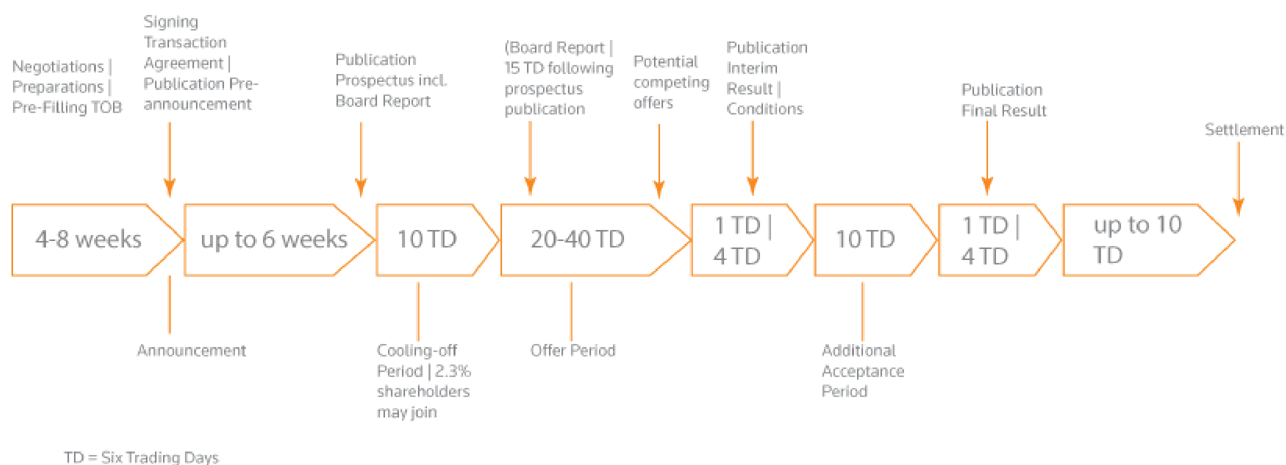
From a financing perspective generally, it would be important to know whether there is absolute certainty that the bidder will get 100% control over the Swiss target company. In the context of financing a leveraged public takeover, this is a challenge because there is a chance that the bidder will be stuck with a majority stake only (less than 100%).

Following the completion of a public tender offer (that is, after the lapse of the additional acceptance period), if a bidder holds 90% or more of the Swiss target's shares, there are two options available to get 100% control:

- **Squeeze-out merger.** Under Swiss merger law, a minority squeeze-out is available if the majority shareholder holds at least 90% of the Swiss target shares. A squeeze-out merger is usually perfected by merging the Swiss target company with a newly incorporated (and 100% owned) affiliated company (preferably a sister company incorporated for this purpose). The process for merging the two companies would take three to six months. However, minority shareholders have appraisal rights and can block the recording of the merger in the commercial register, which may delay the closing of the merger and, hence, the entire process.

  Also, given the appraisal rights of minority shareholders, it is important to kick-off the merger process (and the entering into of the merger agreement) only six months after the lapse of the additional acceptance period, in order to eliminate any risk of being in conflict with the "best price rule". Under the best price rule, if the bidder acquires target shares in the period from the publication of the offer until six months after the additional

TIMELINE FOR FINANCING A LEVERAGED PUBLIC TAKEOVER



acceptance period at a price that exceeds the offer price, this price must be offered to all shareholders; hence there is a risk that through the appraisal rights that shareholders have in the merger process, a higher price may be determined, which must then be offered to all shareholders (also retroactively).

- **Squeeze-out under Swiss takeover law.** If, following a public tender offer, the bidder holds 98% or more of the Swiss target shares, a squeeze-out of minority shareholders can be initiated. This process takes two to three months and involves a court ruling. The 98% level must be reached within three months after the additional acceptance period has expired. Contrary to a squeeze-out merger (as described above), minority shareholders have no appraisal rights, as they receive simply the offer price only. Similarly, blocking the recording in the commercial register is not possible, as the commercial register is not involved.

Following the completion of a public tender offer, if the bidder holds less than 90% of the Swiss target shares, there is no absolute certainty that the bidder will ever get to 100%. Although the bidder can try to buy additional shares over the market (the best price rules will have to be closely monitored), or an additional public tender offer may be launched, there is no absolute certainty that the bidder will get to 90%.

Once the 90% threshold is reached, a squeeze-out merger will become available again.

Structure of public tender offers

Under Swiss law, a public tender offer may contain certain conditions which, when satisfied, will oblige the bidder to complete the transaction. One of the permitted conditions is to include an acceptance threshold (that is, the requirement to complete the transaction when a certain percentage of shares are tendered to the bidder). However, an acceptance threshold of more than two-thirds (66.66%) will require approval from the Swiss takeover board. Although there are good chances that this threshold would be pushed to 75%, it is unlikely (though not impossible) that the takeover board will accept any threshold below 75%.

In addition, Swiss law provides for certain fund requirements in relation to the offer:

- Certain funds must be available on the launch of the offer and their availability must be confirmed by a special auditor.
- The offer prospectus must provide for financing details and confirmation from a special auditor.

Consequences on financing

Given the required structure of a public tender offer, the financing must be available and committed even though it is not absolutely certain that the bidder will ever get 100% control over the target (in particular, the financing will only be subject to conditions which essentially run in parallel to the conditions for the public tender offer). This situation is quite challenging from a financing perspective. This challenge could be approached in two ways:

- One approach could involve simply applying a more conservative overall leverage. However, this does affect the overall economics of the transaction considerably.
- Alternatively, two different financing structures could be prepared. However, the applicable structure would only be clear once the additional acceptance period has lapsed. However, this may be challenging for the arrangers and book-runners, as there will only be a limited amount of time available to market the transaction.

If the bidder does hold at least 90% of the Swiss target's shares, the period from the first drawdown to the point where the bidder would control 100% would still take a couple of months. In the squeeze-out merger scenario, it is prudent to wait until the best price rule has lapsed before entering into the merger agreement, as this would eliminate the risk of a successful appraisal action having retroactive effect on the offer price in the public tender offer (violation of the best price rule). Accordingly, it can be expected that the merger will be completed within eight to ten months after the lapse of the additional offer period, but it is prudent to add an additional two months, as a minority shareholder could potentially delay the process.

During the time period when minority shareholders are in the structure, access to target-level cash flows would be limited. First, it is difficult to structure up-stream loans for purpose of complying with the principle of "equal treatment of shareholders" (*see box, Equal treatment of shareholders*).

Second, any leakage of dividends to minority shareholders should be avoided. Therefore, the transaction will require some overfunding to ensure a proper debt servicing during the post-closing period, when target-level cash flows are not available.

Equal treatment of shareholders

The principle of equal treatment of shareholders is one of basic principles in Swiss corporate law. Under the principle, resolutions taken by the shareholders can be challenged if they give rise to unequal treatment or create a disadvantage to shareholders in a manner not justified by the company's objects.

Similarly, the board of directors is under a general duty to treat shareholders equally in the same circumstances. For example, granting a loan or providing security rights for the benefit of one shareholder (but not to the others) might be problematic under that principle and could lead to discussions around the validity of such agreement and board liability.

As long as minority shareholders are in the structure, it will be difficult to gain access to Swiss target-level security for purpose of securing the acquisition debt (given the principal of equal treatment of shareholders). However, during this period, it is still possible for the Swiss target company to grant security for the purposes of securing its own debt (such as downstream shareholder loans).

FINANCING OF ACQUISITION OF MINORITY STAKES

In recent years, there has been a very limited number of transactions where the acquisition of privately held minority stakes in Swiss target companies has been financed by banks with considerable leverage. The standard approach would rather be to apply the logics of a margin loan to such financing, where banks lend against the value of the shares and apply a relatively high haircut.

However, the Swiss market has recently seen some smaller transactions, where the logic of a leveraged acquisition financing has been applied (at least in part).To achieve this, a number of structural points must be addressed. Some of these structural points are set out in turn below.

Shareholder agreement

Since the minority shareholder/borrower has a lack of control over the Swiss target company on the basis of its shareholding, it is crucial for the shareholder/borrower to control certain decisions at the level of the Swiss target through a valid shareholder agreement (*see chart, shareholder agreement*). In the agreement, the minority shareholder (together with the other shareholders) should either:

- Make certain key decisions subject to all shareholders' consent.
- Increase the required quorum so that the minority shareholder has a right of veto.

In addition, the agreement must give the minority shareholder the right to:

- Appoint its representatives on the board.
- Provide for veto rights of the minority shareholder's representatives at the board level.

It is unlikely that, under the shareholder agreement, the minority shareholder will be in a position to initiate certain corporate action. However, the minority shareholder could have a right of veto if the other shareholders try to deviate from the pre-defined course of business. Therefore, the shareholder agreement should be drafted to ensure that any deviations from the default position must be subject to the consent of the minority shareholders.

Elements of shareholders' competences which should be addressed in the shareholders' agreement include:

- The obligation to declare and pay dividends to shareholders in an amount corresponding to a certain percentage of annual profit.
- Any change of capital structure being subject to minority shareholders' consent only.
- Any change of business being subject to minority shareholders' consent only.
- Any material disposals (in the Swiss target company and all subsidiaries) being subject to minority shareholders' consent only.
- Initiation of any liquidation procedure being subject to minority shareholders' consent only.

Elements of board competences which should be addressed in the shareholder agreement by making such actions subject to minority shareholders' representatives include:

- Any acquisition and/or corporate restructuring.
- Any incurrence of additional financial indebtedness.
- Any granting of security (negative pledge).
- Any granting of a loan or guarantee.
- Any disposal of assets.

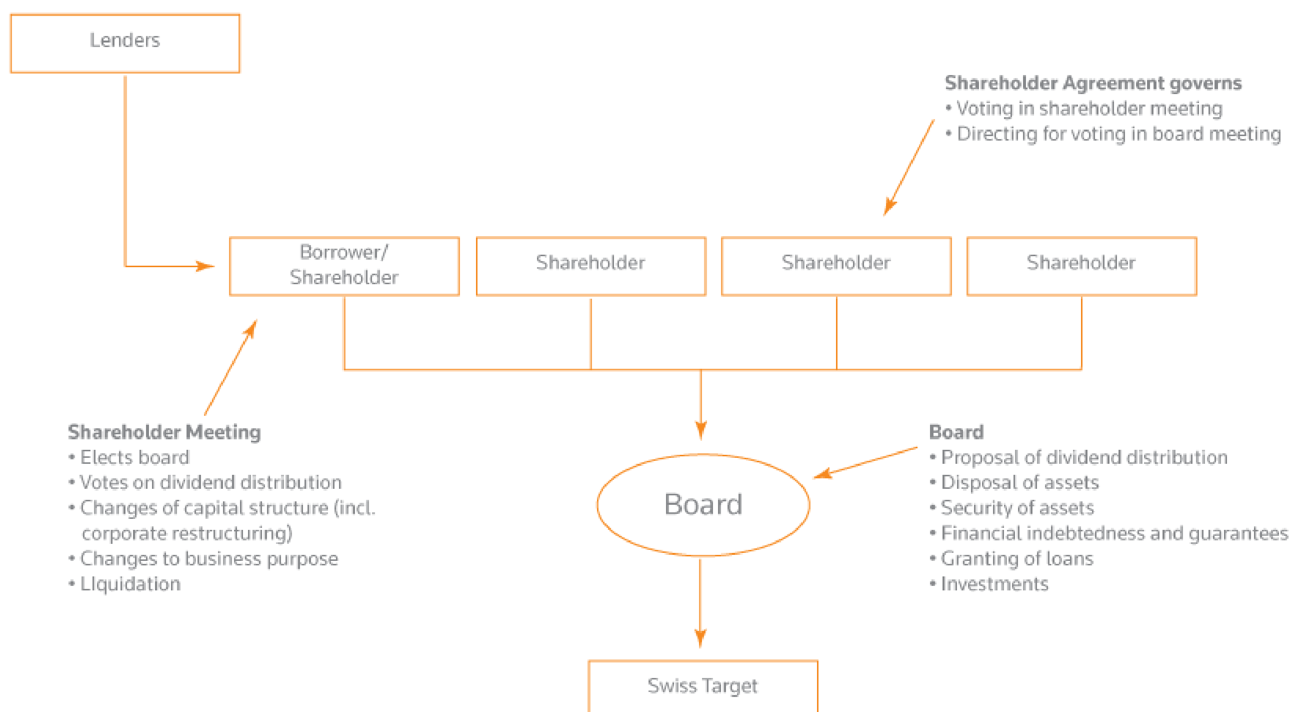
The finance documents should mirror the minimum requirements of the shareholder agreement and make any actions which require minority shareholder consent, subject to the finance parties' consent. In addition, any amendments to the shareholder agreement (such as the consent of the minority shareholder to such amendment) must be subject to finance parties' consent.

Under the shareholder arrangement, the minority shareholder will have control over the Swiss target company, and the finance parties will control the minority shareholder under the finance documents. However, it should be noted that the other shareholders will only have a contractual relationship with the minority shareholder (and not with the finance parties). Therefore, enforcement of the right of the finance parties is only possible through the minority shareholder. In addition, a breach of shareholder agreement by other shareholders will not result in the relevant action being held invalid.

In summary, in most circumstances the control that the finance parties have is indirect and not as robust as the contractual relationship the finance parties would normally have with the investor and the group entities, even though the control the minority shareholder has through the shareholder agreement is valid.

Limited access to cash flows of Swiss target company

Immediate access to cash flows is difficult to structure, even if the minority shareholder is in a position to direct the Swiss target company to grant loans to it. This is due to the principal of equal treatment of



shareholders, which makes it difficult to structure such loans. Therefore, the minority shareholder (and the finance parties accordingly) will usually rely exclusively on the dividend stream generated by the Swiss target company. The availability of the dividends must be ensured through the shareholder agreement.

Limited target-level security

Considering shareholders must be treated equally under the principal of equal treatment of shareholders, target-level security for the purpose of securing the acquisition debt is only available if all the other shareholders provide their explicit consent. Therefore, in these circumstances there is usually no target-level security at all. Even if the consent of all other shareholders is obtained, the target-level security must still be carefully structured (and limited, due to its upstream nature).

Security over Swiss target company's shares

If a handful of investors hold a Swiss target company, it is standard to have pre-emption rights and tag-along and drag-along rights in place.

However, the financing will require the minority shareholder to provide security over the Swiss target company's shares that it holds. This can typically result in a conflict for the following reasons (among others):

- It is standard for investors to require each other to sign up to non-disposal obligations, including an obligation not to provide security over the shares held by it.
- Investors want to make sure that they can control each other's shares through pre-emption rights. Finance parties meanwhile, want to be able to freely enforce into the share security without being required to first offer the shares to other investors at a pre-defined price.
- Investors want to make sure that they can drag along other investors in an exit scenario. At the same time, finance parties want to make sure that the minority shareholder will only dispose of and transfer the shares with their prior consent.

The above points would need to be fully negotiated. Otherwise, the finance parties' security right in the shares would be affected, or at least, the enforcement process could be substantially delayed.

CONCLUSION

The structuring of the financing of minority stake acquisitions is complex. Some important features, such as access to target-level cash flows and target-level security, will most likely not be available. Other elements of the structure, while available, will definitively be less robust than in a straightforward acquisition financing. All these elements must be carefully considered from a structuring and pricing perspective.

Given the positive overall outlook, the Swiss market for acquisition financing is expected to pick up even more during 2014, and larger transactions will depend heavily on the availability of an investor base for high-yield notes.

Practical Law Contributor Profiles

Lukas Wyss, Partner
Walder Wyss Ltd.
T +41 44 498 96 01
F +41 44 498 98 99
E lukas.wyss@walderwyss.com
W www.walderwyss.com

Professional qualifications. Zurich bar, 2002; District Court law clerk (Meilen, ZH) and as attorney at major law firms in Zurich and New York

Areas of practice. Advises banks, insurers and other companies in connection with a broad variety of finance transactions, capital market transactions and more generally, in regulatory, securities and corporate law matters. In finance, focuses on corporate debt finance, leveraged finance, asset finance (including real estate finance), acquisition finance and structured finance and securitisation.

Non-professional qualifications. Zurich University and Lausanne University (lic. iur. 2000); Columbia University, New York, USA (LL.M. 2006, James Kent Scholar).

Languages. English, German, French

Maurus Winzap, Partner
Walder Wyss Ltd.
T +41 44 498 96 05
F +41 44 498 98 99
E maurus.winzap@walderwyss.com
W www.walderwyss.com

Professional qualifications. Zurich bar, 2002; Swiss certified tax expert, 2004

Areas of practice. Advises a broad range of corporate and financial clients; particular expertise in advising on the tax aspects of M&A and private equity transactions, financings and corporate restructurings.

Non-professional qualifications. Degree in law, University of Zurich, 1997; master of laws, University of Virginia, 2002

Recent transactions

- Acting for Permira in the acquisition (and the respective acquisition financing) of CABB International.
- Acting for Credit Suisse Securities (USA) LLC and UBS Securities LLC in the acquisition financing in relation to the acquisition of VAT Holding AG.
- Acting regularly for all major Swiss banks in domestic and international credit finance transactions (including leveraged and corporate finance transactions).
- Acting for Swiss Life on the issuance and placement of two senior bonds (total of CHF425 million) and a convertible bond (CHF500 million).
- Acting for the arrangers/managers or the issuer in relation to all Swiss law aspects on numerous high yield bond transactions, such as issuances by Almirall SA, Boart Longyear, Constellium Group and others.
- Acting for arrangers and sellers on a large number of Swiss auto lease securitisation transactions, refinanced through ABCP platforms or privately placed.
- Acting for Cembra Money Bank (formerly GE Money Bank) in the first ever public Swiss auto lease securitisation and it's follow up transaction.
- Acting for Swisscard AECS AG in the first ever public Swiss Swiss credit card securitisation.

Languages. English, German.