Switzerland - Experiences with the Merger Act

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After coming into effect on July 1, 2004, around 1,350 mergers, 120 demergers/spin-offs, 1,200 conversions and 670 transfers of assets and liabilities have been carried out until February 2006 pursuant to the new Swiss Merger Act ("MA").

In daily business, the merger can easily be seen as the most prevalent form of reorganisation. So-called conversions also take place frequently. With regard to the other restructuring forms, one must note that that the demerger and the transfer of assets and liabilities have not appeared as much in daily business as previously expected.

The merger

The "regular" merger

Art. 7 para. 1 MA states that the partners of the acquired company are entitled to participation and membership rights in the acquiring company which, after considering the assets of the companies involved, the allocation of voting rights and all other relevant circumstances, must be equivalent to their current participation and membership rights. Based on article 7 para. 2 MA, it is permitted to combine the exchange ratio for the participation rights with compensation in cash. This payment is limited to 10% of the real value of the participation rights granted.

A private or public limited company cannot offer fractional amounts of a share (less than at least one share) for compensation. An adjustment of the exchange ratio can only be reached through the increase or the reduction of the shares' value. Any increase in value will likely result in the consolidation or the cancellation of shares. A value reduction can be accomplished through a capital reduction or a dividend payout. In the merger between the Swiss real estate companies Swiss Prime Site AG (SPS) and Maag Holding AG (Maag), the parties adjusted the exchange ratio through a share split by reducing the nominal value of the shares and increasing the number of shares in return. The stock split allowed for the allotment of at least one SPS share to each Maag shareholder as a result of the merger.

Art. 9 para. 1 MA states that the acquiring company must increase its share capital to the extent necessary to protect the rights of the shareholders of the acquired company. The exclusion of the subscription right for the shareholders of the acquiring company is mandatory pursuant to Art. 9 MA and, consequently, permitted without any constraints.

According to the Commercial Registry of Zurich, a capital increase report must be provided for in each capital increase linked to a merger. However, if a merger report already exists, the registry only asks for additional information on the exclusion of the subscription rights pursuant to Art. 652e No. 4 CO. Today, the Federal Commercial Registry Office considers acceptable not to issue a separate capital increase report and audit confirmation in the event of a capital increase linked to a "regular" merger process.

Establishment and verification of interim balance sheets

By virtue of Art. 11 para. 1 MA, an interim balance sheet must be prepared in two cases:

First, an interim balance sheet must be prepared in the event that there were more than six months between the last closing date for financial statements and the signing date of the merger agreement. The signing of the merger agreement shall be the relevant day for the calculation of the six-month term (Art. 11 para. 1 MA).

Second, if important changes have occurred in the assets and liabilities of the merging companies since the last balance sheet date, the companies shall prepare an interim balance sheet. The "important changes" refer to material changes with regard to the function of the balance sheet used for the merger. Hence, a material change must have a material impact on the exchange ratio (and the amount of a potential compensation) as well as on warranties relating to the transfer of capital, unless the changes can be determined objectively with absolute precision. If a dividend is paid out prior to the signing of the merger agreement, it is most likely that no interim balance sheet needs to be prepared as the changes in the financial situation can be determined objectively. The same applies to an ordinary and authorised capital increase. However, the acquisition of certain goods or securities for instance may result in substantial financial alterations. In such a situation, one must always examine whether an interim balance sheet must be prepared or not.

Pursuant to article 11 para. 1 MA, "the companies which are merging" are required to prepare an interim balance sheet. This provision requests the preparation of an interim balance sheet from all companies involved in the merger. However, only the balance sheet of the acquired company has to be delivered to the relevant commercial registry.

According to Art. 15 para. 1 MA, the balance sheet issued for the merger in the "ordinary" process is subject to verification by a specially qualified auditor. The same applies to the interim balance sheet, meaning that it must also be audited. If a company is required to have its accounts audited pursuant to a statutory or legal obligation, such interim reporting is also subject to verification.

The squeeze-out merger

According to Art. 8 para. 2 MA, the companies involved in a merger may set out in the merger agreement that the execution of the merger shall be carried out through a compensation payment exclusively. This allows for the exclusion of minority shareholders as a result of the merger of two or more companies.

The compensation does not necessarily have to be paid in cash, but can also be settled with other marketable assets, such as securities of an associated company (the parent company in relation to a so-called triangular merger).

Legal authors agree that limited companies – in contrast to the wording of Art. 18 para. 5 MA – should not be affected by decisions taken by the majority of persons, but rather by majority based on the number of shares. However, it is unclear to which extent the quorum shall be calculated in detail (90% of the shares represented at the general meeting of shareholders? Some 90% of the shares represented at the general meeting of shareholders and 90% of the represented nominal share capital? 90% of all share votes? or 90% of all share votes and 90% of the entire nominal share capital?).

Squeeze-out pursuant to SESTA/Squeeze-out pursuant to MA

The Federal Act on Stock Exchanges and Securities Trading (SESTA) provides for a possibility to squeeze-out minority shareholders upon a tender offer in case the offeror holds more than 98% of the voting rights in a listed company upon completion of the offer.

If the offering party does not reach such a level, but does manage to acquire 90% of all voting rights, it may then finalise the execution of the transaction as a so-called squeeze-out merger with one of its subsidiaries pursuant to the Merger Act.

Accordingly, with regard to listed companies, there exists the alternative to follow a squeeze out process pursuant to Art. 33 SESTA or carry out the process as a squeeze-out merger by virtue of Art. 8 para. 2 MA.

Demerger

Demerger pursuant to the Merger Act vs. two-step demerger process

Despite certain examples in the daily practice, the demerger process pursuant to Art. 29 et seq. MA has only been seen sporadically. Most parties still prefer the so-called two-step demerger process. This process first includes the spin-off of certain assets into a wholly-owned subsidiary. In a second step, the shareholding in the subsidiary is transferred to the shareholders of the "parent" company as consideration. There are a number of reasons for the lack of using the one-step demerger, as set out below.

The companies involved in the demerger under the Merger Act are required to provide collateral for the creditors' claims provided that these creditors ask for such collateral within the legal period of two months and the companies cannot prove that the claims are not at risk as a result of the demerger (Art. 46 MA). Furthermore, all other companies involved in the demerger (companies with secondary liability) are jointly and severally liable for the creditors' claims of the company with primary liability (Art. 47 para. 1 MA).

The demerger process under the Merger Act requires the preparation of a demerger report (Art. 39 MA). Furthermore, all partners/shareholders are granted access to the most important documents (Art. 41 MA). Finally, the ultimate decision regarding a demerger can only succeed based on a qualified majority approval (Art. 43 MA).

One favourable aspect of the demerger pursuant to the Merger Act is the so-called (partial) universal succession. However, even within the scope of the Merger Act, it remains unclear whether the contractual relationships of the divesting company can be transferred to the acquiring company without the prior consent of all contractual parties. Although the majority of legal authors support this possibility, it is advisable to seek the prior consent of all counterparties at least in the case of a demerger.

Transfer of assets and liabilities

General

The Merger Act sets forth provisions on the transfer of assets and liabilities. The transfer of the assets and liabilities under the Merger Act takes place by operation of law in one act via partial universal succession (*partielle Universalsukzession*) upon the registration in the register of commerce of the divesting legal entity. This registration is necessary because a transfer of assets and liabilities may be carried out without complying with the usual requirements for the transfer of such assets and liabilities.

Consideration

In contrast to the merger and the demerger, a consideration shall not be paid to the partners of the involved companies, but rather to the divesting company itself.

The consideration may take place in the form of money or other assets. Consideration may also be performed by way of shareholding or membership rights of the acquiring company – as a typical step in the case of a spin-off – provided that the divesting company itself receives the consideration.

The wording of Art. 71 para. 1 lit. d MA only mentions a "potential" consideration. Consequently, a consideration is not absolutely necessary by law and a transfer of assets and liabilities may be carried out with or without compensation. In this respect however, one must always respect the prohibition to repay capital to shareholders (Art. 680 para. 2 CO) or the prohibition of hidden dividend payouts (Art. 678 para. 2 CO). Moreover, concerning the transfer of assets and liabilities in relation to a company in a distressed financial situation, the risks of the so-called "*paulianische Anfechtungsklage*" pursuant to Art. 285 et seq. of the Debt Enforcement and Bankruptcy Act must be taken into account.

Inventory

The assets and liabilities that are to be transferred must be identified easily. While general classifications and denominations are possible for certain assets, an adequate specification of the assets must still be ensured to respect legal security. A lot of time may lapse between the drafting of a transfer agreement and the subsequent execution of a transaction (the entry into the Commercial Register). During this period, the net working capital is likely to change constantly and payments in relation to receivables and payables as well as capital expenditures will most probably lead to numerous modifications in the account positions. In such events, the contract regulating the transfer of assets and liabilities should include an adjustment clause, based upon which all changes of the assets between the signing of the agreement and the execution thereof can be compensated through (additional) payment obligations.

Art. 72 MA (in conjunction with Art. 71 para. 1 lit. b MA and Art. 73 para. 2 MA) stipulates that the assets which cannot be determinable based on the inventory must remain with the divesting company. As a result, all assets that are not or not exactly specified will remain with the divesting legal entity. However, a specification is considered as adequate if both parties agree that all assets and liabilities of a certain business or business area are to be transferred. Hence, the assets belonging to such a business or business area should be nevertheless transferred to the acquiring company (if these assets were acquired between the signing of the agreement and the execution thereof).

The Merger Act does not contain any provision with regard to the treatment of liabilities of the divesting company. It does not set out whether the divesting company remains liable for claims that cannot be allocated specifically pursuant to the transfer agreement. Some legal authors argue that Art. 72 MA must be applied in analogy to Art. 73 para. 2 MA. Based thereupon, liabilities which are not specified as transferable liabilities in the inventory shall remain with the divesting company.

The transfer of assets and liabilities pursuant to the Merger Act vs. the ordinary asset deal

Although there have been a number of transfers of assets and liabilities pursuant to the Merger Act, this form of restructuring has not reached the importance expected. In many cases, assets are still transferred based on a traditional asset deal and, as a consequence, by way of a singular succession. The following paragraphs shall outline the different advantages and disadvantages and make clear that many disadvantages cannot be compensated with the advantages of the new Merger Act at the moment.

By virtue of Art. 75 para. 3 MA, all creditors may ask for adequate collateral. Art. 75 para. 2 MA sets out that a limitation period of three years shall govern the joint and several liability. Finally, Art. 108 MA stipulates a generally strong liability towards all creditors.

According to Art. 74 MA, the supreme management or administrative body of the divesting company must inform the partners/shareholders about the transfer of assets and liabilities in an appendix to the financial statements. In addition, Art. 106 et seq. MA sets out that all partners/shareholders may challenge any decisions of the supreme management body. One must also take into consideration that Art. 108 MA increases the scope of responsible persons substantially.

Art. 77 para. 1 MA not only provides for an information and consultation of the employees/employee representatives by the seller, but by the buyer as well. In this respect, one must take the possibility into account that any transaction can be stopped through a court order on behalf of the employees if the information and consultation requirements were not complied with.

The agreement on which the transfer of assets and liabilities is based upon must be handed to the commercial register. As a result, any third party may be able to consult the information pursuant to Art. 930 CO. However, with regard to contracts, all parties involved – and the contractual parties in particular – have a clear interest to keep certain information confidential. Consequently, one may question whether the parties may be permitted to specify certain assets in the inventory with acronyms or numbers. The Commercial Registry of Zurich has denied such a right.

The transfer entails that all assets and liabilities are transferred by law pursuant to a universal succession with the entry in the commercial register. As a result, the general transfer rules for the respective assets and liabilities do not have to be complied with (such as the transfer of ownership, the entry in the land register etc.). Just like in the case of the demerger however, it is unclear whether the transfer of contracts requires the prior consent of all contractual third parties. As long as this insecurity is not eliminated by case law, it is advisable to consult all third parties prior to transferring contracts as well.

The ordinary written form pursuant to Art. 70 para. 2 MA is also valid for assets that would require the public notarisation in the case of a singular succession. If a property is transferred, the relevant parts of a contract will need to be notarised nevertheless. However, one public notarisation is sufficient to execute a transaction with different properties in different cantons. As a result, the transfer of assets and liabilities pursuant to the Merger Act can be of advantage in the event that entire real estate portfolios need to be transferred.

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