

Squeeze-out of minority shareholders in listed companies

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Basically, under Swiss law, there are two possibilities of squeezing-out minority shareholders in a Swiss listed company domiciled in Switzerland upon completion of a public tender or exchange offer: a squeeze-out of the minority shareholders pursuant to Art. 33 of the Federal Act on Stock Exchanges and Securities Trading (SESTA) or a squeeze-out merger pursuant to Art. 8(2) of the Swiss Merger Act (SMA).



In 2009, the following Swiss target companies listed in Switzerland have been confronted to a squeeze-out procedure of minority shareholders pursuant to Art. 33 SESTA: Jelmoli Holding AG, Canon (Switzerland) AG, LO Holding Lausanne-Ouchy SA, Métraux Services SA and Quadrant AG. Other Swiss target companies listed in Switzerland, such as BB Medtech AG, Harwanne Compagnie de participations industrielles et financières SA and Athris Holding AG, have been or may be confronted to (possible) squeeze-out mergers pursuant to Art. 8(2) MA.



This article intends to give an overview of both squeeze-out proceedings from a legal and tax perspective and some recommendation on when either proceeding should be used.

Squeeze-out pursuant to Art. 33 SESTA

A public tender offer to purchase or exchange equity securities is subject to the SESTA if it is made publicly to the holders of equity securities of Swiss companies whose equity securities are, in whole or in part, listed on an exchange in Switzerland (Art. 2(e) SESTA). An offer is deemed to be made publicly if the offer is addressed to the holders of the equity securities by means of readily accessible media carriers such as newspapers and the like. While creeping tender offers are generally believed not to constitute a public offering, standing in the market activities needs to be carefully analysed as it may tend to be construed as public offering activities.

Art. 33 SESTA provides an offeror with the right to squeeze-out the remaining minority shareholders of the target company after a public tender offer resulting in the holding of more than 98% of the voting rights in the target company.

In order to determine whether the threshold of 98% is exceeded, the shares with suspended voting rights, i.e., treasury shares of the target company, and shares held by the offeror or in concert with third parties at the time of the squeeze-out request are

allocated to the offeror.

The squeeze-out procedure requires the offeror to file a claim against the target company at the competent court (Art. 33(1) SESTA).

The offeror can petition the court to cancel the outstanding minority equity securities of the target company within three months following the end of the tender offer period. Such equity securities must be re-issued by the target company and allotted to the offeror either against payment of the offer price or against delivery of the offered shares, each for the benefit of the holders of the cancelled securities (Art. 33(2) SESTA).

The court will inform the public and the remaining shareholders that they may participate in the proceedings.

The predominant view of legal doctrine suggests that the shares of the target company do not necessary have to be or remain listed at the time the minority shareholders are squeezed out. However, certain scholars propose that the shares of the target company must still be listed on the stock exchange at the time the court judgment, with respect to the squeeze-out of the minority shareholders, becomes final.

The SESTA contains no provisions with respect to a (voluntary or mandatory) delisting of issuers. Applicable regulations are contained in the Listing Rules (LR) and the "Directive for the Delisting of Securities" (Directive) issued by the SIX Swiss Exchange (SIX).

Pursuant to Art. 58 LR, the regulatory board of the SIX (Regulatory Board) may delist securities on the basis of a justified request by the issuer. In principle, this request can be submitted at any time and outside a take-over situation. In its assessment of the delisting request, the Regulatory Board considers market's, issuer's and shareholders' interests, it being understood that a delisting request following a takeover of the issuer is usually deemed to constitute a valid reason for the delisting request.

The delisting has to be announced at least three

months before the last trading day. The Regulatory Board may grant exceptions to this rule if the delisting is the result of a takeover in which the intention to delist has already been published in the offer prospectus. Pursuant to Art. 23 of the Ordinance of the Takeover Board on Public Takeover Offers (TOO), an offer prospectus must contain the basic intentions of the offeror with respect to the target company, including, as the case may be, the intention to have the target delisted upon completion of the offer. It is market practice to include such delisting intention in the offer prospectus. In such case, a period of one month upon the delisting announcement in the offer prospectus is usually deemed appropriate. Accordingly, the delisting publication period may run in parallel to the offering period to the effect that a delisting may occur within a few days following the end of the offer period and the publication of the results.

If at the time of delisting, the free float of securities outstanding is higher than 5%, the issuer will be responsible to maintain or procure the maintenance of an 'over the counter' market for such securities for a period of up to six months (Art. 5 Directive). Market practice of the Regulatory Board recognises shorter periods.

Swiss corporate law does not provide for statutory provisions as to which corporate body should resolve on a delisting request, i.e., board of directors vs. shareholders' resolution. Based on general principles of corporate law, it is established practice that the board of directors is the responsible corporate body to resolve on a delisting.

Although the board of directors is not subject to specific obligations under SESTA, a listing provides shareholders with certain additional rights such as extended information, reporting or disclosure requirements or minimum guarantees with respect to public tender offers. Some legal scholars suggest that these rights as accrued shareholders' rights (*wohlerworbene Rechte*). As a consequence, a delisting may be construed as a violation of accrued shareholders rights that may trigger issues of directors' liability.

Squeeze-out merger pursuant to Art. 8(2) SMA

The SMA provides mechanics for a compulsory squeeze-out of minority shareholders, when the buyer (or rather the offeror) holds more than 90%. The SMA does not explicitly require any objective reason for the squeeze-out merger. However, some legal scholars argue that a squeeze-out merger without any economical or organisational reason constitutes an abuse of rights by the majority shareholder.

For purposes of the merger, the offeror needs to

incorporate a legal company serving as acquisition vehicle.

Initially, the board of directors of both the acquisition vehicle and the target company must enter into a written merger agreement (Art. 12 SMA).¹ One of the essential elements of a merger agreement providing for a squeeze-out is the amount of compensation to the minority shareholders of the target company, which in a squeeze-out merger can consist of either cash or shares in the offeror (so-called triangular squeeze-out merger).

Based on the merger agreement, the boards of directors of both merging companies must prepare, either individually or jointly, a merger report for the attention of the shareholders (Art. 14 SMA). The merger report must *inter alia* explain and substantiate the purpose and the consequences of the merger; in particular, the principal motivations for the merger and the business and other consequences for the merging companies, as well as the amount of the compensation to the minority shareholders and the reasons why only compensation is provided instead of participation or membership rights.

The merger agreement, the merger report and the merger balance sheet must be reviewed by an admitted audit expert that has to provide a written report on the findings of the audit. The audit report must confirm that the cash compensation for the minority shareholders is reasonable (Art. 15 SMA).

During a period of 30 days prior to the shareholders' meeting, each merging company must allow the shareholders to inspect the main merger documents at its registered office (Art. 16 SMA).

The merger agreement must be approved by at least 90% of the shareholders of the acquired company, i.e., the target company (Art. 18(5) SMA). It is disputed in legal doctrine whether the 90% quorum is calculated based on the number of voting rights or the number of shareholders. The SMA does not settle the issue of whether the number of voting rights represented at the shareholders' meeting or the total number of votes is relevant. For the time-being, the Register of Commerce of the Canton of Zurich accepts resolutions taken, (i) by 90% of all existing shareholders; or (ii) by 90% of all voting rights.

The merger resolution, i.e., the resolution of the shareholders approving the merger agreement, needs to be incorporated in a notarised deed (Art. 20(1) SMA).

The board of directors of the merging companies are obliged to promptly register the approved merger with the Register of Commerce, and the merger becomes effective (completion) upon its registration. Upon registration, all assets and liabilities of the acquired company will be transferred to the surviving company by operation of law. The acquired company

is dissolved and cancelled from the Register of Commerce (Art. 21 and 22 SMA).

The SMA requires the surviving company to secure the claims of the creditors of the acquired companies if the creditors request this within a period of three months following completion of the merger. Creditors must be informed on their rights by a notice published three times in the Swiss Official Gazette of Commerce. However, the publication notice is not required if an admitted audit expert confirms that no claims are known or to be expected that could not be satisfied through the disposable assets of the companies involved (Art. 25 SMA).

Prior to the merger resolution, both companies are obliged to inform their employees on the consequences of the merger with respect to their employment relationship, their right to refuse the transfer of the employment relationships and the right to request security for their claims. If, as a consequence of the merger, measures are planned that affect the employees, they must be timely consulted prior to the merger resolution. The board of directors of the respective companies must provide information at the shareholders' meeting on the result of the consultation process. If the statutory provisions on consultation rights are not observed, the employees' representatives are entitled to request a court order that prohibits the registration of the merger in the Register of Commerce (Art. 28 SMA).

Upon registration of the merger with the Commercial Register, the employment relationships of the acquired company are transferred to the surviving company by operation of law. However, an employee of the acquired company may reject the transfer of the employment relationship, in which case the employment relationship transfers anyhow, but ends in accordance with the legal notice period. Any employee of the surviving company may, like any other creditor, demand security for his or her claims arising from the employment relationship (Art. 27 SMA).

The compensation to be paid to the squeezed-out shareholders must be appropriate. The currently prevailing opinion assumes that the compensation must correspond to the fair value of the previous participation. In this context, the best price rule² has to be considered during a period of six months after the expiration of the supplementary acceptance period of a public tender or exchange offer.

As legal remedies, a minority shareholder may file a claim for appropriate compensation before competent court if the compensation for its shares is deemed inadequate. Such action must be filed within two months upon publication of the merger in the Swiss Official Commercial Gazette. The claim does not affect the legal effectiveness of the merger. As a rule, the

costs of proceedings must be assumed by the surviving company, and the court's decision applies to all minority shareholders being squeezed-out (Art. 105 SMA).

Shareholders that have not approved the merger resolution are entitled to challenge such resolution within two months upon the publication of the resolution in the Swiss Official Commercial Gazette. For instance, the minority shareholders may assert that the necessary quorum of 90% has not been met or that the squeeze-out would constitute an abuse of rights.

Furthermore, the merger resolution may also be challenged by a shareholder if the resolution is in breach of law or the articles of association.

As long as the merger is not registered with the Register of Commerce, a challenging shareholder may request the court to prohibit the registration of the merger prior to the final decision on the merits of the case. If the claim is approved and the defect cannot be remedied, the court will annul the merger resolution (Art. 106 and 107 SMA).

Free choice of squeeze-out procedure?

The relation between a squeeze-out of minority shareholders pursuant to Art. 33 SESTA on the one hand and a squeeze-out merger under Art. 8(2) SMA on the other hand is controversial. Some legal scholars argue that Art. 33 SESTA constitutes a special rule (*lex specialis*) in relation to the squeeze-out by merger. According to these scholars, if the threshold of 98% is not reached in course of a public tender offer, the execution of a squeeze-out merger would constitute an abuse of rights to the extent the sole purpose of the merger was to exclude the minority shareholders. However, the prevailing legal doctrine states that the provisions on the squeeze-out merger are also applicable after execution of a tender offer.

Tax implications

As the two squeeze-out procedures are quite different as to the conditions to be satisfied and the steps to follow, not surprisingly also the tax consequences in the hands of the companies involved and their shareholders may depart quite significantly depending on the procedure chosen and the compensation offered to the squeezed-out minority shareholders.

What is of particular interest for the tax analysis is in the context of an Art. 33 SESTA squeeze-out the fact that the shares held by the minority shareholders are cancelled by a court ruling and then re-issued by the target company to the majority shareholders in exchange for the compensation to be paid by the offeror to the minority shareholders. In the context of

a squeeze-out merger; this is the fact that the compensation to be paid to the minority shareholders may be shares or cash (or a combination hereof) from the majority shareholder or may be cash from the dissolved or the surviving company in case of a triangular merger.

Tax implications of an Art. 33 SESTA squeeze-out

On the level of the target company, the cancellation of existing (minority) shares and the subsequent reissuance of new shares to the offeror have no impact on the income tax basis and are considered to be tax neutral for purposes of the withholding tax on dividend and liquidation proceeds distributions and the stamp duty on capital contributions. Accordingly, the cancellation and reissuance of shares is disregarded for tax purposes.

On the level of the minority shareholders, the squeeze-out against cash or shares of the offeror is considered as a disposal. Hence, a Swiss resident taxpayer holding the minority shares as a private asset (i.e., non-business asset) will realise a tax exempt capital gain (or a non-deductible capital loss) and a Swiss resident taxpayer holding the minority shares as a business asset will realise a taxable gain (or a deductible loss). However, if instead of cash, shares in the offeror are offered as compensation for the minority shares cancelled, a taxpayer holding the minority shares as a business asset may claim a roll-over of tax basis within a corporate reorganisation. Hence, the tax consequences to the Swiss resident shareholders accepting the tender offer on a voluntary basis and the minority shareholders being squeezed-out against their will under Art. 33 SESTA are identical.

Tax implications of a squeeze-out merger

Compensation offered by the dissolved or surviving company. Under Art. 8(2) SMA, target can be either merged into the offeror or into a subsidiary of the offeror. In both cases, a roll-over of tax basis within a corporate reorganisation applies and no income taxes will be triggered on the level of the two merged entities. Furthermore, such merger is also exempt from the stamp duty on capital contributions. If a cash (or in kind) compensation to the squeezed-out minority shareholders is paid by the surviving company (offeror or its subsidiary) or the dissolved company (target), a distribution of reserves occurs that triggers the 35% dividend withholding tax on the net amount of reserves distributed (i.e., the difference between the gross amount of compensation offered and the amount of nominal share capital forfeited). On the minority shareholder level, any compensation received from the surviving or acquired company will trigger the income tax: for a Swiss resident minority shareholder holding the minority shares as a private (i.e., non-business) asset, the income tax will be triggered on the portion of the

compensation received that exceeds the amount of nominal share capital forfeited. For a Swiss resident minority shareholder holding the minority shares as a business asset, the income tax will be triggered on the gain realised. A loss would be fully deductible.

Compensation offered by the parent of the surviving company.

If the target company is merged into a subsidiary of the offeror, compensation to the squeezed-out minority shareholders can be offered by the offeror (instead of the subsidiary as the company surviving the merger with target – so-called triangular merger situation). Again, a roll-over of tax basis within a corporate reorganisation applies and no income taxes will be triggered on the level of the two merged entities. Furthermore, such merger is also exempt from the stamp duty on capital contributions and, as no distribution of reserves occurs on the level of the surviving and dissolved company, no dividend withholding tax is triggered. As a result of this so-called triangular merger, on a consolidated basis, the offeror will own through its participation in subsidiary 100% of the assets of target and subsidiary. Such exchange of compensation between the majority and minority shareholders in order to allow the majority shareholder to get a 100% interest in the surviving company will not lead to a distribution of the offeror's reserves. Accordingly, exchange (and no dividend) treatment will apply on a (minority) share for cash or (minority) share for new shares exchange as long as compensation is offered by the offeror (and not by the surviving or dissolved company). As a consequence hereof, no withholding tax is triggered on the level of the offeror and minority shareholders holding the Swiss resident minority shares as a private (i.e., non-business asset) will realise a capital gain (and no dividend income), which will be exempt from income taxation.

Tax as an additional measure of coercion to minority shareholders

Depending on the procedure chosen by the majority shareholder to squeeze-out minority shareholders, the offeror and the minority shareholders could benefit from exchange treatment (leading to no withholdings on the level of the offeror and its subsidiaries) and a tax exempt capital gain in the hands of Swiss resident minority shareholders holding their shares as a private (i.e., non-business asset) or would have to accept dividend treatment (leading to dividend withholdings on the level of the surviving or dissolved company and income taxation in the hands of the minority shareholders holding their shares as a private asset).

Even if the offeror is choosing a squeeze-out procedure, that would preserve exchange treatment for the shareholders accepting the offer or being squeezed-out, such exchange can be re-characterised

retroactively into dividend treatment if target or the surviving subsidiary were merged into the offeror. If such post-acquisition merger occurs within the five-year claw-back period, minority shareholders holding target shares as a private (i.e., non-business) asset would have to recognise income to the extent the cash compensation received exceeds the amount of nominal share capital cancelled or, in case of a share for share exchange, the nominal share capital of the shares received is exceeding the nominal share capital of the shares cancelled.

Which form of squeeze-out is then to be recommended?

If the threshold of 98% of the shares in a Swiss target company whose equity securities are, in whole or in part, listed on an exchange in Switzerland is reached in the course of a tender or exchange offer, we would normally recommend a squeeze-out of the minority shareholders pursuant to Art. 33 SESTA. Tax wise such squeeze-out procedure would put the minority shareholders on the same footing as the shareholders that have already accepted the tender or exchange offer (same tax treatment). Furthermore, as exchange treatment would be granted, Swiss resident minority shareholders holding target shares as a private (i.e., non-business) asset would recognise a tax exempt capital gain (or non-deductible loss).

If, however, the threshold of 98% of the shares in a Swiss target company whose equity securities are, in whole or in part, listed on an exchange in Switzerland is not reached in the course of a tender or exchange offer, but more than 90% of the shares are tendered, we would normally recommend delisting the target company's shares first, and then contemplate a squeeze-out merger. In such a squeeze-out, depending on the compensation offered to the minority shareholders and the source of such compensation, income tax neutral exchange treatment or a taxable dividend may result.

It remains to be noted that, if the equity securities of a public Swiss company are not listed on an

exchange in Switzerland, be it because they are listed only abroad or OTC traded, the SESTA does not apply even if an offer is publicly made. Accordingly, even if the 98% threshold is reached, the minority shareholders could only be squeezed-out through the means of a squeeze-out merger:

Notes:

- ¹ It is not decided, yet, whether the mother company of the acquisition vehicle (i.e., the offeror) has to become a party to the merger agreement, as well, if the compensation to the minority shareholders consists of shares in the offeror:
- ² According to the 'best price rule', the offeror and persons acting in concert with the offeror may not, after the publication of the offer prospectus, acquire securities or financial instruments of the target company at a price higher than the offer price unless this price is offered to everyone else.

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