The Acquisition and Leveraged Finance Review

Ninth Edition

Editor
Fernando Colomina

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THE ACQUISITION AND LEVERAGED FINANCE REVIEW

NINTH EDITION

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PREFACE

Market conditions have remained challenging through the past year. The post-pandemic recovery globally saw a significant setback as a result of the war in Ukraine, which exacerbated the pre-existing market issues and led to historic policy actions and moves across global markets. US inflation saw a cool-down from a second-quarter peak as the Fed turned to aggressive tightening on the market, risking triggering a recession in the US economy. Eurozone inflation accelerated through the year, reaching record double digits in the third quarter as power suppliers looked for alternative sources amidst soaring energy prices. Governments have been forced to intervene, with energy price caps announced to protect households through the winter. Further rate rises will be expected at European Central Bank policy meetings to tame inflation and restore price stability as recession risks grow.

In tandem with these challenges, the acquisition and leveraged finance industry saw primary issuance slow down significantly, with declines of almost 50 per cent in the first half of the year from record highs in the same period in 2021. Market conditions particularly deteriorated throughout the second quarter as we saw the credit markets take an early summer break. One bright spot, accounting for the largest portion of European buyout activity, was the volume of add-ons in popular defensive sectors such as B2B and IT, as financial sponsors looked to build up portfolio companies through the uncertainty.

Traditional lenders have been cautious about underwriting buyouts in this environment as spreads have widened. Financial sponsors across Europe have consequently considered private debt funds as a viable alternative to the syndicated markets. This year, they have played a more prominent role in larger buyout financings across sectors, with several funds sharing the risk. There are, however, signs that private debt funds are becoming more selective and looking to safer sectors that are less cyclical and protected from supply-chain issues. We would expect to see an increase in pricing on financing packages with less leverage and a demand in stronger protection and more-conservative terms.

As we enter 2023, macroeconomic conditions in Europe in a tighter policy environment are likely to remain challenging in the first half of the year. There will be an increase in liability management transactions, restructurings and distress-related M&A across more cyclical, capital-intensive sectors and highly indebted buyouts. But down markets and recessions provide good buying opportunities. With European equity prices likely to remain at relatively low and attractive levels, take-private transactions will continue to be an attractive source of deal flow. The strengthening US dollar also creates an opportunity for financial sponsors to take advantage of an attractive FX rate, particularly if the businesses are resistant to inflation or provide counter-cyclical business hedges.

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Many thanks to everybody who has participated in this publication, and a special thank you to Law Business Research.

We sincerely hope that this edition of *The Acquisition and Leveraged Finance Review* will be of assistance to you in this challenging era.

Fernando Colomina
Latham & Watkins
Madrid
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Chapter 9

SWITZERLAND

Lukas Wyss and Maurus Winzap[1]

I OVERVIEW

i The covid-19 pandemic

In Switzerland, as in many other jurisdictions, financial markets struggled in 2020 as a result of the covid-19 pandemic. In March 2020, the Swiss Federal Council (Bundesrat) declared the 'extraordinary situation' and introduced stringent measures, including the lockdown of schools, shops, restaurants, bars and entertainment and leisure facilities.

The Swiss Federal Council and the Swiss government passed various regulations in response to the covid-19 pandemic, including the set-up of the Swiss Covid-19 Loan Programme under an emergency ordinance (the Covid-19 Ordinance on Joint and Several Guarantees). Covid-19 loans with an aggregate volume of over 17 billion Swiss francs were granted under the programme. Covid-19 loans with an aggregate volume of approximately 6 billion Swiss francs were repaid by September 2022 and loans amounting to roughly 500 million Swiss francs have been honoured by the guarantee provided by the Swiss authorities. Hence, a significant number of covid-19 loans are still outstanding. While no further covid-19 loans were granted after July 2020, a number of important restrictions apply to companies that continue to be financed by covid-19 loans. This is because the purpose of such loans is, in short, limited to ensuring continuity of the business. While the restrictions under the Swiss Federal Act on Covid-19 Credits with Joint and Several Guarantee are more relaxed than under the original emergency ordinance, certain key restrictions still apply. Hence, a borrower of a covid-19 loan must not:

a pay dividends or bonuses to shareholders or repay equity capital to shareholders;
b grant loans or repay loans or other obligations to affiliated parties, unless such loan or other obligation was pre-existing;
c refinance intragroup loans, except for pre-existing obligations for the payment of interest and amortisations; or
d on-lend, or make otherwise available the proceeds of covid-19 loans to group companies outside Switzerland, except for pre-existing obligations for the payment of interest and amortisations.

These restrictions are problematic for operating entities that form part of a larger group of companies, where the group relies on cash flows generated by these operating entities. Debt servicing on the top level of a group becomes difficult where the operating entities are restricted to upstream cash flows. Also, there remains uncertainty over whether the sole

1 Lukas Wyss and Maurus Winzap are partners at Walder Wyss Ltd.

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granting of a guarantee, or the granting of security to guarantee or secure liabilities of a shareholder, could be considered as ;paying dividends;. If so, such a security or guarantee might be affected as to its validity by the provisions of the Swiss Federal Act on Covid-19 Credits with a Joint and Several Guarantee.

These restrictions affect the structuring of financing transactions and, accordingly, borrowers are incentivised to repay covid-19 loans sooner rather than later to rid themselves of such restrictions. Also, where group financing transactions have had to be renegotiated and covenant or even payment holidays have been granted by the lenders, the lenders have normally insisted on a clear road map towards early repayment of the covid-19 loans.

ii LIBOR cessation

Status

The London Interbank Offered Rate (LIBOR) for Swiss francs and other currencies was phased out on 31 December 2021 and has been replaced by alternative benchmarks in the form of risk-free rates. In Switzerland, the most comment risk-free rate used in the lending market is the Swiss Average Rate Overnight (SARON).

Hence, throughout the past year, banks have been intensively working on the transition of their loan portfolios from LIBOR to SARON and on updating the respective legal documentation. It seems that the Swiss lending market has adapted to this change quite well, and it appears that the transition process has been relatively smooth in most instances.

However, while the transition process is complete for some currencies (including Swiss francs), the process is ongoing, as other currencies (including the US dollar) are still to be phased out and replaced by alternative benchmarks. Most importantly for the Swiss market, EURIBOR continues to be used as a euro-based rate for now, but upcoming developments need to be closely monitored.

Calculation methodology used in the Swiss market

In Switzerland, during the initial phase of the transition, the calculation methodology 'cumulative compounded SARON' has been frequently used as an alternative benchmark for the new compounded SARON as recommended by the Swiss National Working Group on Swiss Franc Reference Rates. The legal documentation has been updated accordingly. This calculation methodology differs from the methodology applied by the Loan Market Association (LMA) as reflected in the LMA-recommended form rate switch documentation (i.e., daily non-cumulative compounded rate). It turned out that non-Swiss banks and lenders were not very familiar with the Swiss approach. As a consequence, during a later phase of the transition process and in situations where there are non-Swiss financial institutions in the syndicate of lenders, the LMA calculation methodology has typically been introduced in the legal documentation. Also, in multicurrency facilities agreements, in order to avoid different methodologies being implemented in relation to the different facilities, the daily non-cumulative compounded rate is used for calculating interest on a daily basis.

Running two different regimes in the same market is not very efficient and it seems that the market in Switzerland is now shifting away from the 'Swiss solution' to the more common international standard suggested by the LMA. Even in new lending transactions that are purely domestic, the calculation methodology used is now most often the daily non-cumulative compounded rate.

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Break costs

In transactions where LIBOR applies or applied, the borrower was under an obligation to pay break costs to the lenders upon prepayment of a loan during an interest period. The break cost concept assumes that each lender matches the funding of its loans to the actual term of the respective interest period of a loan and potentially suffers a loss if the interest that a lender should have received for the remainder of the interest period exceeds the actual amount that a lender would be able to obtain by redepositing the money for the period from prepayment of the loan until the last day of the interest period.

This rationale does not apply where a loan references risk-free rates, as risk- free rates accrue on a daily basis and are not an approximation of the cost to the bank of maintaining the loan over the interest period. Nevertheless, the agent and lenders may incur a loss if their funding arrangements for maintaining a loan are interrupted by a prepayment and for any administrative burdens. There are different ways to address this. A prepayment could trigger a one-time fee per prepayment or a portion of the margin could still be due for the remainder of the interest period. Alternatively, the number of voluntary prepayments could be limited during a year for purposes of avoiding revolving facilities being used almost as overdraft facilities. It now seems that a standard has evolved for the Swiss market, which is a combination of a limitation of the prepayments allowed and a one-time fee to be paid by the borrower upon prepayment, but it should be noted that there are still various options to play around with these elements.

iii Sanctions

Following the invasion of Ukraine by Russian military forces, the Swiss Federal Council enacted the ordinance on measures relating to the situation in the Ukraine on 4 March 2022 based on the powers assigned to it by the Swiss Federal Constitution and the Swiss Federal Embargo Act. Since 4 March 2022, the ordinance has been constantly revised and expanded.

Generally, the Swiss sanctions regime follows the sanctions regime enacted by the European Union. However, there are some deviations, in particular as regards the list of sanctioned persons. In addition, the Swiss State Secretariat for Economic Affairs (SECO), which is in charge of implementing the ordinance, has published certain FAQs thereby providing further guidance to the market.

The ordinance is applicable to all people and companies within Switzerland, but, other than the EU and the US sanctions rules, is not addressed to Swiss citizens living outside Switzerland.

Like the EU sanctions regime, the ordinance addresses and covers the following elements:

a commercial restrictions, preventing the sale of certain goods to Russia (e.g., weapons, dual-use goods, certain technology goods, goods related to the aerospace sector and the shipping sector (including the rendering of services), goods related to the oil and energy production sector, energy, luxury goods and gold);

b a general asset freeze of assets held by sanctioned persons;

c reporting obligations in relation to such assets held by sanctioned persons;

d a ban on taking deposits from Russian citizens and certain institutions;

e a ban on the rendering of financial, financing, trading and investment services to – and the financing of – certain counterparties;

f travel bans for sanctioned persons and a general ban on air traffic for aircraft registered in Russia;

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g limitations on dealing with certain counterparties, such as the Russian Central Bank and other government authorities;
h a ban on honouring and paying certain claims if they arise under an agreement that is otherwise limited by the Swiss sanction rules;
i a ban on establishing trusts if the beneficial owners are specific persons or entities; and
j a ban on rendering services in the areas of tax, accounting, auditing and certain other services to entities located in Russia.

Along with the sanction regimes of other countries, the Swiss regime will continue to evolve and expand. Also, the interpretation of the sanctions rules will continue to be highly dynamic. Hence close monitoring is key, in particular as the time periods in which such updates enter into force are normally extremely short.

iv ESG (environmental. social and governance)

The number of ESG-linked credit financing transactions is constantly increasing in the Swiss lending market. However, compared with the Swiss bond market, where a considerable number of sustainability-linked bonds, sustainable bonds, a large number of green bonds and even social bonds have been issued and listed on the SIX Swiss Exchange, the number of ESG-linked credit financing transactions is still relatively low and mostly limited to corporate credit financing transactions. Also, it seems that in private equity-sponsored Swiss leveraged finance transactions (that are mainly mid- or small-cap transactions), ESG is not (yet) a hot topic. It is, however, clear that the topic has more and more a high priority on the banks' agendas,

Typically, Swiss ESG-linked credit financing transactions do not provide for a 'use of proceeds' concept where the funds raised shall exclusively finance specific green, sustainable or social business transactions or assets. This provides the borrower with some flexibility, which is still important in revolving credit financing transactions where funds raised can be used for any corporate purposes. Rather, certain key performance indicators (KPIs) are defined in the documentation. The basis for such KPIs differs from industry to industry. Typically, there is no hard requirement to meet certain KPIs. Rather, the borrowers benefit from a reduction of the margin if the KPIs are met or even exceeded and are punished by an increase of the margin if the KPIs are not met. A challenging element of the ESG-linked transactions continues to be the monitoring, reporting and auditing of compliance with ESG criteria.

Clearly, the market for ESG-linked credit financings is rapidly growing and is becoming more and more sophisticated also in Switzerland.

II REGULATORY AND TAX MATTERS

i Regulatory matters

The mere provision of acquisition finance does not itself trigger a licensing requirement under Swiss laws. A licensing requirement would only be triggered if lenders would refinance themselves in Switzerland by means of accepting money from the public or via a number of unrelated banks. Lending into Switzerland on a strict cross-border basis is currently not subject to licensing and supervision by the Swiss Financial Market Supervisory Authority, FINMA.

Under the Swiss Financial Services Act (FinSA), financial advisers are required to register and accordingly, financial advisers of foreign financial institutions may only be active

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in the Swiss market once they are registered in the register of financial advisers. However, a person advising exclusively in the context of finance (lending) transaction will be out of scope of the registration requirement.

ii Tax matters

10/20 non-bank rules – political developments and the public vote of September 2022

Under the current Swiss withholding tax regime, 35 per cent Swiss Federal withholding tax is levied on interest paid to Swiss or foreign investors on bonds and similar collective debt. Any financing (including credit financings) may be subject to such a treatment in the event that the number of non-bank creditors under such a financing exceeds 10.

On 3 April 2020, the Swiss Federal Council initiated a consultation process (*Vernehmlassung*) regarding a planned reform of the Swiss federal withholding tax. The reform originally intended to replace the current debtor-based regime applicable to interest payments with a paying agent-based regime for Swiss federal withholding tax. As a consequence of the consultation process, the Swiss Federal Council, on 11 September 2020, decided to abolish Swiss withholding tax on interest payments (with the exception of interest payments on domestic bank accounts and deposits to Swiss resident individuals) without substitution and it submitted a corresponding legislative project to Parliament on 14 April 2021.

The abolition of Swiss withholding tax on bonds and other collective debt financings aimed to strengthen Switzerland's position as a financial market and treasury centre. All types of financing and refinancing activities in Switzerland (e.g., raising capital via bond issuances, crowdfunding platforms, ABS structures and other capital market transactions) would have been facilitated.

A referendum was initiated against such a legislative project (and the abolition of the Swiss withholding tax on interest payments) and the project therefore brought to a public vote by the people of Switzerland. On 25 September 2022, the Swiss people declined the new legislative project with 52 per cent of voters being against the reform.

Accordingly, the Swiss withholding tax regime remains unchanged and it is worth summarising the current regime again.

10/20 non-bank rules – Swiss withholding tax

Unlike most other countries, under the current Swiss withholding tax regime, Switzerland does not levy withholding tax on interest paid on private and commercial loans (including on arm's-length inter-company loans). Rather, 35 per cent Swiss federal withholding tax is levied on interest paid to Swiss or foreign investors on bonds and similar collective debt instruments issued by or on behalf of Swiss resident issuers. According to the Swiss Federal Tax Administration and the relevant regulations, credit facilities also qualify as collective debt instruments, if syndicated outside of the banking market and, as a result, there are more than 10 non-bank lenders in the syndicate.

International capital markets do not typically respond well to bonds subject to Swiss withholding tax. Therefore, the investor base is relatively often limited to Swiss investors, or, in the case of Swiss multinational groups, bonds are issued through a foreign subsidiary. However, the Swiss Federal Tax Administration reclassifies such foreign bonds into domestic bonds if the amount of proceeds used in Switzerland exceeds certain thresholds (i.e., the combined accounting equity of all non-Swiss subsidiaries of the Swiss parent company and the aggregate amount of loans granted by the Swiss parent and its Swiss subsidiaries to non-Swiss affiliates).

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In the context of syndicated credit financing transactions, it must be ensured that no Swiss federal withholding tax will be incurred, as this would simply not be acceptable to lenders, even in case the Swiss federal withholding tax could be recovered at some later point. In order to prevent Swiss federal withholding tax from being imposed on credit financing transactions (in contrast to bonds triggering such tax anyway), credit facility agreements entered into by a Swiss borrower, or a non-Swiss borrower under a guarantee from a Swiss parent company, must contractually restrict free transferability and syndication by invoking the '10/20 non-bank rules' and stating that (1) the lenders must ensure that while the loan in question is outstanding, no assignments, transfers or relevant sub-participations of loan tranches will be made, as a result of which the number of ten non-bank lenders would be exceeded and (2) the borrower must ensure that it will at no time have more than 20 non-bank lenders under any of its borrowings (in both cases generally disregarding any affiliated lenders).

As a result, credit financing transactions that must be broadly syndicated outside the banking market, because the banking market would not absorb such transaction, (such as TLB transactions) cannot provide for a Swiss borrower and it is necessary to structure around this.

In addition, the Swiss Federal Tax Administration may reclassify a syndicated credit financing transaction raised by a non-Swiss affiliate in the event that (1) the proceeds are (directly or indirectly) used in Switzerland and (2) a Swiss group entity provides security or a guarantee to secure such a credit financing. In the event that the security or guarantee provided by the Swiss group entity is only of an upstream or cross-stream nature, this doctrine of the Swiss Federal Tax Administration does not normally apply, but this must be confirmed by the Swiss Federal Tax Administration by way of a tax ruling confirmation on a case-by-case basis. Acquisition bonds issued for Swiss acquisitions will thus be issued abroad on a higher-tier level and on-lent through the acquisition structure down to the Swiss buying entities.

Deductibility of interest expense

Under Swiss tax law, interest incurred at the level of the acquisition vehicle is not available for set-off against income generated at the Swiss target company level for income tax purposes. This is because there is generally no tax consolidation under Swiss tax law (neither in Swiss domestic nor cross-border situations). However, there are means to (indirectly) 'push down' the acquisition debt portion, particularly if the existing debt can be refinanced at the target level. For the purposes of the Swiss 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, although that would result in a limitation of the number of non-banks to 10 for that portion of the debt in any event). However, since the proceeds of the acquisition debt may be lent on, the Swiss Non-Bank Rules have to be carefully addressed.

Alternatively, an (indirect) pushdown 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 converted into a downstream loan. In recent transactions, additional pushdown of debt potential has been created by some post-acquisition restructuring steps (such as group internal sales of assets generating additional earnings and the respective debt capacity).

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If such a pushdown can be achieved, some of the interest incurred on the acquisition debt may be brought to the target company level and become available for set-off against income generated at the target level. The security package structure may be improved in connection with such pushdown at the same time.

III SECURITY AND GUARANTEES

i Standard security package at closing

In leveraged acquisition finance transactions involving Swiss target companies, the acquisition debt portion usually benefits from the share pledge over the Swiss target company. In most cases, the security package is completed by other security provided by the acquisition vehicle, such as security over:

a claims and rights under the share purchase agreement;
b claims and rights under due diligence reports;
c claims and rights under intragroup loans;
d claims and rights under insurances (in particular, M&A insurances, if any); and
e bank accounts.

Share pledge

Under Swiss law, shares in stock corporations and limited liability companies may be pledged by written agreement and if share certificates have been issued by handing over the certificate to the pledgee (duly endorsed or assigned (as applicable) in blank in the case of registered shares). If certificates have been issued, the handover of such certificates is a perfection requirement for the pledge. While a pledge over shares can be perfected, even if no certificates have been issued, the issuance and handover of certificates it is generally considered to bring the pledgees into a factually stronger position in the event of enforcement. In addition, it is standard that any transfer restrictions in the target company's articles of association are removed. Provisions in the articles of association limiting the representation of shareholders at shareholders' meetings to other shareholders must also be lifted to ensure full flexibility once control over the shares has been gained. Given the lack of control over the target company pre-closing, the issuance of certificates and the amendment of the articles of association are generally accepted as (immediate) conditions subsequent.

Claims and receivables

Claims and receivables (claims under the share purchase agreement, insurance claims, claims under due diligence reports, etc.) may be assigned under Swiss law for security purposes by means of a written agreement between assignor and assignee. The agreement must specify the relevant claims and may cover future claims as well, provided claims are described in a manner that allows for clear identification once such claims come into existence. However, it must be noted that claims arising post-bankruptcy with a Swiss assignor would no longer be validly assigned and would be trapped in the bankrupt estate.

While assignability is generally given under Swiss law if the underlying agreement is tacit as regards or explicitly allows for an assignment, it is important that the underlying agreement does not contain a ban on assignment. 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, insurances, etc.) and, for the sake of clarity, it is even recommended that important agreements explicitly allow for an assignment for security

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purposes to financing parties. The same applies to any due diligence reports, although getting the benefit through reliance will also be satisfactory in most circumstances (either directly derived 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 recommended that these parties are notified of the assignment for security purposes and the transaction as a whole, even though, prior to an enforcement event, the security provider continues to be free to deal with these claims and rights.

Bank accounts

Security over Swiss bank accounts is typically provided by pledging the claims the account holder has against the account bank. An assignment for security purposes would also be possible (and would even be a slightly more direct security right), but account banks have become increasingly concerned in the past two years about 'know your customer' and beneficial owner identification issues, because the assignment is, legally, a full legal transfer, while the pledge only provides for a limited right *in rem*. As all account banks have priority rights in relation to the assets in the bank accounts, the pledge is, technically speaking and in the absence of a waiver of the account bank, second ranking. Therefore, to perfect the pledge, a notification of the account bank is mandatory. Also, the account bank is requested to waive all priority rights in relation to the relevant bank accounts on the basis of its general terms and conditions and otherwise, but account banks do not always grant such waiver.

Timing of providing security on closing

The security interest provided by the acquisition vehicle may be entered into and perfected pre-closing, except for the share pledge, which may only be perfected upon closing of the transaction, immediately after the acquisition of the shares by the acquisition vehicle. From a Swiss point of view, there is nothing that would make it overly burdensome or impossible to perfect the security interest as soon as the transaction is completed or closed. However, some items (such as the amendment of articles of association or notices) will have to become post-closing items, but, as described above, that does not prevent the perfection of the security interest as such.

ii Standard target-level security package

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, inter alia, security over:

a shares in subsidiaries;
b trade receivables;
c intercompany receivables;
d insurance claims;
e bank accounts;
f intellectual property; and
g real estate.

See above for a description of security over most of these assets.

However, in smaller transactions and depending on the level of leverage provided, sponsors are sometimes able to negotiate a slimmer security package for purposes of avoiding

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transaction costs. This is particularly true in pure Swiss domestic deals and in case the taking of security would require involvement of additional foreign counsel. In addition, in Swiss domestic finance transactions, borrowers often are successful in negotiating slim security packages as a consequence of the strong negotiation power that borrowers currently have in the finance market.

Real estate

Security over real estate is typically taken by way of taking security over mortgage certificates. A mortgage certificate is issued either in bearer or in registered form. Alternatively, since January 2012, a paperless version of a mortgage note can be created which is evidenced by electronic registration in the relevant land register. A mortgage note creates personal, non-accessory claim against the debtor, which is secured by a property lien. Unless preexisting mortgage certificates are available, the creation of new mortgage certificates requires a notarised deed and registration of the mortgage certificate in the land register. Once created, the mortgage certificates will be transferred for security purposes under a written security agreement without further notarisation or entry into the land register (except in the case of paperless mortgage certificates).

One important tax point has to be considered as interest payments to non-Swiss resident creditors of loans secured by Swiss real estate are subject to withholding tax at source, unless the lender is located in a jurisdiction that benefits from a double tax treaty with Switzerland providing for a zero rate and the lender qualifies for treaty protection. Accordingly, if a Swiss borrower is involved, it must be ensured that only 'Swiss treaty lenders' will be secured by real property to avoid the risk of withholding tax being applied to interest payments. Swiss treaty lenders are persons:

a having their corporate seat in Switzerland or are lending through a facility office (which qualifies as a permanent establishment for tax purposes) in Switzerland, and that are entitled to receive any payments of interest without any deduction under Swiss tax law; or

b lending in a jurisdiction having a double tax treaty with Switzerland providing for a zero per cent withholding tax rate on interest payments and the lender qualifies for treaty protection.

In particular, owing to these tax issues, security over real estate is normally only considered if there is substantial real estate located in Switzerland.

If a foreign borrower is involved (such as a foreign acquisition vehicle), the issue basically remains the same, but an application for an exemption through a tax ruling application may be considered. While such a tax ruling has been obtained very recently in a few cantons, the process of being granted such a ruling in other cantons might be quite lengthy and, therefore, costly (while the outcome is possibly vague). Without a satisfactory tax ruling, real estate located in Switzerland cannot be granted as security owing to the risk of potential withholding tax on interest payments.

Intellectual property

Under Swiss law, security over intellectual property is typically taken by way of pledge. A written pledge agreement is required, specifying the intellectual property right. As a matter of Swiss law, no registration is required for the valid perfection of the pledge over intellectual property. However, if not registered, the intellectual property may be acquired by a bona

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fide third-party acquirer, in which case the pledge would become extinct. While a Swiss law pledge over foreign intellectual property is valid as a matter of Swiss law, it should be double-checked whether the validity of the security interest would also be recognised under relevant foreign law, or whether – as an example – its registration would be a perfection requirement. Accordingly, with regard to foreign intellectual property of certain importance and value, it is advisable to register the pledge in the relevant register. Security agreements typically provide for a registration obligation for the pledge over important intellectual property on day one and for all other intellectual property upon the occurrence of an event of default.

Difficulties in taking security over movable assets

Owing to strict repossession requirements under Swiss law, taking of security over movable assets (such as an inventory or equipment) without substantially disturbing the daily business of the security provider is difficult. There are structuring solutions surrounding this issue (such as pledge holder structures or opco or propco structures), but these solutions are usually only implemented in situations where there is a specific focus on a specific asset (raw materials with substantial value, larger car fleets, aircraft parts, etc.).

Timing of providing target-level security

Unless there is some cooperation on the part of the seller to start preparing target-level security pre-closing (and depending on the exact release mechanisms 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.

iii Financial assistance and upstream and cross-stream security/guarantees

Standard upstream and cross-stream limitations will apply to Swiss target-level guarantees and security. Essentially, the amount of proceeds under upstream and cross-stream security or guarantees that is available to lenders is limited to the amount that the guarantor/security provider could distribute to its shareholders as dividends at the point in time of enforcement. In addition, certain formal requirements will have to be followed both, upon granting and enforcement of the security or guarantee. These limitations may affect the security substantially, particularly in situations of financial distress. However, if structured properly and if using all available mitigants, such limitations are generally accepted by investors and lenders.

In October 2014, the Swiss Federal Supreme Court ruled, that upstream and cross-stream loans that do not meet the at arm's-length test will also reduce the distributable amounts of the lender. However, at the same time, the Swiss Federal Supreme Court ruled that paid in surplus is generally available for distribution to shareholders. It would appear that parties have applied a more cautious approach around the granting of upstream and cross-stream loans since October 2014, but transaction structures generally remained unchanged. It remains to be seen whether further court rulings will be issued in this respect.

If the structure also includes a downstream loan from the acquisition vehicle to the Swiss target companies (often used for tax purposes as a pushdown of debt and for the repatriation of the cash flows), the Swiss target company may provide (unrestricted) security to secure such a downstream loan, because it would secure its own rather than parent debt. Accordingly, this would not qualify as upstream security. The acquisition vehicle in turn may provide security over the downstream loan, along with the (unrestricted) security package securing such a downstream loan. From a Swiss corporate law perspective, there is a good

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chance that upstream limitations will not apply to that security structure. However, such a security structure should be discussed with the Swiss Federal Tax Administration in the light of the Swiss Non-Bank Rules.

IV PRIORITY OF CLAIMS

i Statutory priority of claims

Upon bankruptcy over a Swiss entity, certain creditors would benefit from statutory priority:

a secured claims are satisfied with priority directly out of the enforcement proceeds; any surplus will be shared among (unsecured) creditors generally, and any shortfall would be treated as a third-class claim; and

b claims incurred by the bankruptcy or liquidation estate or during a debt restructuring moratorium with the administrator's consent rank above unsecured claims.

In relation to unsecured claims, there are three priority classes: the first class mainly consists of certain claims of employees as well as claims of pension funds; the second class consists of claims regarding various contributions to social insurances and tax claims; and the third class consists of all other unsecured claims.

ii Contractual structuring of priority of claims

Within the third class, creditors and the debtor are free to contract on the ranking of such claims among themselves. Typically, in Swiss acquisition finance transactions, the priority of claims among various debt investors is reflected on the basis of intercreditor arrangements rather than on the basis of structural subordination. It should be noted, however, that in larger transactions, the acquisition structure is most often set up outside Switzerland. In addition, where the investor base would expect a structural subordination, such a structure is implemented, but rather for marketing purposes.

Under Swiss law, intercreditor arrangements that provide for the priority of claims are generally binding on the parties involved and also on insolvency officials of an estate. However, given that there are hardly any relevant precedents, it cannot be ruled out that an insolvency official would treat all non-secured creditors indiscriminately as third-class creditors, and consider the priority of payments as a mere arrangement among creditors of the estate in relation to their respective claims in relation to the estate and pay them out on a pro rata and *pari passu* basis. Such being the case, the parties to the intercreditor arrangement may have to rely on the redistribution by the creditors among themselves.

iii Equitable subordination

The concept of equitable subordination is neither reflected in codified Swiss law nor well established in Switzerland. Even though there are no conclusive precedents, equitable subordination is generally only discussed in connection with shareholder loans. It is unclear whether the holding of a very small equity stake would be sufficient for a qualification of a loan as shareholder loan. It would appear that the terms of the loan and the circumstances under which it has been granted are more relevant than the specific percentage of shareholding. Against this background, it may be concluded that a loan granted in proportion to the shareholding of a small shareholder (together with all other shareholders) could be

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problematic, while the holding of a portion in a larger (syndicated) loan (at arm's length) by a bank seems to be unproblematic, even if that bank would hold an equity stake in the relevant Swiss company.

Basically, a parent company will be treated as any other third-party creditor of such Swiss subsidiary in the framework of a Swiss bankruptcy proceeding. The risk of a shareholder loan being deemed to be either subordinated against all other (non-subordinated) creditors, or to be treated like equity (in which case, the parent company would only be satisfied together with all other equity contributors), arises only under very specific circumstances.

Elements that could be relevant are:

a that the shareholder loan is granted in a situation where the Swiss subsidiary is already over-indebted;

b that the parent company had (or should have had) knowledge of the over-indebtedness of its Swiss subsidiary while granting the shareholder loan;

c that the granting of the shareholder loan resulted in the Swiss subsidiary having upheld its business activities, and accordingly in a deferral of the opening of bankruptcy proceedings over the Swiss subsidiary; and

d that the deferral of the opening of bankruptcy proceedings results in a (potential) damage of other creditors of the Swiss subsidiary.

A few scholars suggest applying a stricter regime (per se subordination of shareholder loans in bankruptcy; application to the concept to third-party loans, etc.), but it must be noted that court decisions where the concept of equitable subordination has been applied are fairly rare and, accordingly, that this concept cannot be regarded as well established as such. Therefore, we see little leeway for the application of such a concept, in particular, where loans are granted on an arm's-lengths basis and to Swiss companies that are not over-indebted.

V JURISDICTION

The submission by a Swiss company to the exclusive jurisdiction of the courts of any other non-Swiss forum is generally binding on such a Swiss company. It should be noted, however, that under Swiss law, jurisdiction clauses may have no effect as regards actions relating to, or in connection with, insolvency procedures that, as a rule, must be brought before the court at the place of such an insolvency procedure. Furthermore, contractual submissions to a particular jurisdiction are subject to the mandatory provisions on the protection of consumers, insured persons and employees pursuant to the Lugano Convention, the Swiss Federal Private International Law Act (PILA) and such other international treaties by which Switzerland is bound. Pursuant to the PILA and the Lugano Convention, Swiss courts may also order preliminary measures even if they do not have jurisdiction over the substance of the matter.

Until 31 December 2020, the Lugano Convention was applicable for jurisdiction and the recognition and enforcement of judgments in civil and commercial matters also in relation to England. Under the Lugano Convention, jurisdiction clauses referring to the 'courts of England' were valid since there is no specific requirement under the Lugano Convention to refer to a specific forum or a forum of a specific place. As a consequence of Brexit, the Lugano Convention no longer applies in matters involving England as from 1 January 2021 and any jurisdiction clause entered into by a Swiss company and to be reviewed by Swiss courts would be reviewed under the PILA. Other than under the Lugano Convention, under the

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PILA, a jurisdiction clause must at least determine a place or city, rather than just a country. If a jurisdiction clause does not meet these requirements and refers to the courts of a country only, there is some uncertainty about whether it would be held valid and enforceable in Switzerland. Therefore, it is advisable that such jurisdiction clauses refer to a specific city, rather than just to the courts of a country.

Enforceability in Switzerland of a foreign judgment rendered against a Swiss company is subject to certain limitations set forth in: (1) the Lugano Convention; (2) the other international treaties under which Switzerland is bound; and (3) the PILA. In particular, a judgment rendered by a foreign court may only be enforced in Switzerland if:

a in the case of (2) and (3) and, in certain exceptional cases, (1), the foreign court has jurisdiction;

b the judgment of such foreign court has become final and is non-appealable or, in the case of (1), has become enforceable at an earlier stage;

c the court procedures leading to the judgment followed the principles of due process of law, including proper service of process; and

d the judgment of the foreign court on its merits does not violate Swiss law principles of public policy.

In addition, enforceability of a judgment by a non-Swiss court in Switzerland may be limited if the Swiss company demonstrates that it has not been effectively served with process (a service of process on the Swiss company will have to be made in accordance with the Hague Convention).[2]

VI OUTLOOK

According to macro-economy experts, most countries are likely to fall into a recession in Q4 2022 until Q2 2023. Accordingly, it may be expected that acquisition and leveraged finance will go through a challenging time. In addition, it is expected that in Switzerland a fair number of transaction will have to be restructured.

2 The Hague Convention of 15 November 1965 on service of judicial or extrajudicial documents abroad in civil and commercial matters.

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Appendix 1

ABOUT THE AUTHORS

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Lukas Wyss is a partner in the Walder Wyss banking and finance team. He advises banks, insurers and other companies in connection with finance transactions and debt capital market transactions. In finance, he focuses on corporate debt finance, leveraged finance, asset finance (including real estate finance), acquisition finance and structured finance and securitisation. Lukas was educated at Zurich University and Lausanne University (lic iur 2000) and Columbia University, New York (LLM 2006, James Kent scholar). He was admitted to the Zurich Bar in 2002. Before joining Walder Wyss in 2007, he gained working experience as a district court law clerk (Meilen, ZH) and as attorney at major law firms in Zurich and New York.

Mr Wyss speaks German, English and French. He is member of the board and vice president of the Zurich Bar Association. He is admitted to practise in Switzerland.

MAURUS WINZAP

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Maurus Winzap is a partner and heads Walder Wyss's tax team. He focuses on domestic and international tax issues, particularly in corporate reorganisations, restructurings, structured finance, acquisitions and divestments. Other areas of expertise include tax planning for collective capital investments and cross-border relocations. He lectures and publishes regularly in the field of taxation. Mr Winzap is a lecturer in international tax at the Swiss Institute of Taxation. He was the chair of the organising committee of the 69th congress of the International Fiscal Association (IFA), which took place in Switzerland in 2015. In addition, he is a member of the executive board of the Swiss Tax Law Association (Swiss branch of the IFA). Mr Winzap was awarded his degree in law from the University of Zurich in 1997 and his Master of Law degree from the University of Virginia in 2002. He was admitted as a Swiss-certified tax expert in 2004.

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