

NEWSLETTER

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Transaction Agreements under Swiss Takeover Rules

Public Tender Offers for listed companies have lately increasingly been backed up also in Switzerland by transaction agreements between the bidder and the target company and/or its major shareholders of the target company. Although such agreements are shaped for the individual case at hand, standards begin to show, which differ from Anglo-Saxon structures due to the legal framework in Switzerland. This Newsletter exposes the typical areas of regulation of transaction agreements in Switzerland and illuminates them against the background of aspects of corporate and takeover law.

1 Transaction Agreements with the Target Company

By way of a transaction agreement, the bidder intends to ensure the support of the public offer by the board of directors of the target company, whereas the latter wishes the submission of an offer being of interest for the target company and its shareholders.

Transaction agreements typically set forth the following **duties of the bidder**:

- | Publication of the offer pursuant to the conditions previously discussed with the target company and consultation of the target company prior to all material changes to the offer
- | Execution of all acts in order to enable, to the possible extent, compliance with the terms of the offer, in particular soliciting official authorizations or, if applicable, approval of the shareholders' meeting of the bidder
- | On-going information to the board of directors of the target company regarding the status of the offer and the compliance with conditions

The **duties of the target company** generally include the following areas:

- | Recommendation to the shareholders of the target company to accept the public offer and publication of the report of the board of directors in the offering prospectus
- | Convening of a shareholders' meeting with the motion to abolish, if necessary, registration restrictions provided for by the articles of incorporation (restriction on transferability)

and to elect to the board of directors of the target company the persons recommended by the bidder – whereas certain of the existing members of the board of directors have to resign at the moment of the shareholders' meeting.

- | Support of the offer (to the extent legally allowed), in particular the obligation, not to seek or support competing offers, to terminate, if any, current discussions with other (potential) bidders and to inform the bidder on concrete intentions regarding competing offers
- | Subject to the existence of a better offer, no granting of a due diligence to a competing bidder
- | Except for outstanding options and conversion rights (including options of employees), omission of transactions with shares of the target company, in particular abstention from purchase or issuance of shares
- | Continuation of the target company's business within the ordinary course of business
- | Payment of a break-up fee to the bidder in case of failure of the offer

In a first step, the legal framework of such agreements will hereinafter be described.

2 Legal Framework

2.1 Takeover Rules

The provisions on takeover rules pursuant to the Federal Act on Stock Exchanges and Securities Trading do only apply as of publication of the public takeover offer (or its pre-announcement). Thus, transaction agreements concluded prior to the publication of the takeover offer resp. the pre-announcement, would generally not be subject to the takeover rules. Ever since the case "Centerpulse" in 2003, however, a **transaction agreement** is not considered being concluded separately from but rather as a part of an offer due to the fact that it is always entered into in view of a tender offer and, thus, **affects the offer**. Therefore, the takeover rules are also applicable to transaction agreements being concluded prior to the publication of the takeover offer resp. its pre-announcement.



Pursuant to the practice of the Swiss Takeover Board ("TOB"), persons are **acting in concert** with the bidder, when, in the context of the submission of a public tender offer and its terms, coordinating their behaviour resp. having agreed on the offer and the terms thereof. The conclusion of a transaction agreement regularly effects that the target company, the companies controlled directly or indirectly by it and the companies controlled directly or indirectly by the bidder, act in concert with the bidder in view of the offer. These persons have to be disclosed in the offering prospectus and are subject to certain duties under the takeover rules such as those on transparency or the reporting of transactions.

2.2 Corporate Law Provisions

From a corporate law perspective, it has first of all to be stated that the board of directors of a target company is generally under **no duty**, to **enter into a transaction agreement**. However, in case it comes to the conclusion that a takeover is in line with the interest of the company and of all shareholders, the entering into a transaction agreement can prove to be reasonable.

When assessing the admissibility of transaction agreements under corporate law, the **allocation of competences between the board of directors and the shareholders has to be observed**. Given that the acceptance of a takeover offer lies within the competence of the individual shareholders, the board of directors is neither allowed to impair the shareholders' decision-making authority, nor to enforce their approval.

Another aspect is the duty of the board of directors to observe the **purpose and interest of the company** and (within a takeover process) **all shareholders**. A transaction agreement can absolutely be in the interest of the company and the shareholders of the target company, for example in case it represents a condition of the submission of a takeover offer (thus actually rendering the offer possible) or in case a takeover offer provides a higher price than the last offer of a third party bidder.

However, given their character limiting the target company's room for maneuver, transaction agreements can aggravate another offer and, thus, potentially have an adverse impact on the interests of the shareholders of the target company. In case a transaction agreement does not contain an **"exit clause" in the event of a better offer**, this qualifies most probably as illegitimate pretension of competence by the board of directors. Even the board of director's obligation not to conduct discussions with third party bidders, has to be assessed critically in this context.

2.3 Aspects of unfair Competition

The Protection against Unfair Competition Act ("UC") covers all influences on the free coordination forces or mechanisms of a specific market by acts which disturb, tamper or prevent the competition on such market or which may have such effect. Public takeovers are transactions taking place in the

capital market, in particular the market of control of companies. A **transaction agreement which prevents the functioning of the competition with respect to the control of companies** and which prevents that because of the functioning competition the possible highest price for shares of the target is achieved, is unfair and **ineffective** pursuant to art. 2 UC, unless the transaction agreement may be terminated in case a substantially higher offer is received.

3 Admissibility of various Clauses of Transaction Agreements

In the following, the admissibility of various clauses of transaction agreements under Swiss law will be exposed.

3.1 Best Efforts-clauses

The duty to support an offer and to recommend it to the shareholders is generally allowed if such duties are dependent on the condition that no better offer is subsequently submitted by a third party or that the stock price of the target company does not develop favorably to a material extent due to other reasons.

3.2 No-Shop-clauses and Window Shop-clauses

No-Shop-clauses (pursuant to which the target company undertakes to neither consider prospective third parties nor to provide them with information) and Window-shop-clauses (pursuant to which the target company undertakes not to solicit actively other offers), are generally admitted on the condition that the board of directors comes to the conclusion that the bidder would not make an offer without such agreement.

From a corporate law perspective, the obligation of the board of directors in a takeover situation consists in negotiating, in the interest of all shareholders, the highest possible price and best possible terms, which may include soliciting alternative offers, but at least the consideration of interested third parties. However, there is no general duty of the board of directors to solicit other offers. **A duty not to consider third parties' offers at all**, would most probably **violate the company's interest** resp. the interest of all the shareholders and, hence, be inadmissible. Therefore, a caveat should at least be made for the case that a better offer is subsequently submitted by a third party.

In case the agreement has to be interpreted to the effect that after publication of the offer, prospective third party bidders are not to be provided with the same information than the contracting party, this generally violates the **duty of equal treatment of the bidders** set forth by the takeover rules. In case a target company has granted a due-diligence procedure to the contracting party, the same must, thus, be valid for competing bidders. This could sound a note of caution to the target companies, given that they might be willing to disclose their books to a financial investor, but not to a competitor seizing the opportunity in the context of a takeover offer to obtain confidential information regarding the target company.

3.3 Omission of Transactions with Shares of the Target Company

On the condition that they remain within the usual time frame in the context of takeover procedures and that the target company can meet its obligations resulting from options, conversion rights and participation plans, such clauses are generally allowed.

3.4 Continuation of the Target Company's Business within the ordinary Course of Business

On the condition that it is limited in time and that the target company does not limit itself to an extent leading to the failure of seizing business opportunities, the obligation to limit the continuation of the business of the target company to the ordinary course of business is uncritical.

3.5 Break-up Fees

On the condition that their amount is reasonable, break-up fees in case the takeover fails, are allowed. By means of a general guideline, it can be set forth that break-up fees are uncritical insofar as they compensate the third party for its costs (**lump sum** cost coverage), but they are problematic should the break-up fee have a punitive character (**false contractual penalty**).

Over the last months, the TOB has approved break-up fees in the amount of CHF 2,000,000 (Saia-Burgess), CHF 3,500,000 (Berna) and CHF 1,900,000 (Amazys), in essence based on the argument that the relevant amount is not suited to restrain a third party from submitting a competing offer and that the shareholders' freedom of choice is not restricted by the amount of the break-up fee. In all these cases, the break-up fee has been shaped in the relevant agreement as a lump sum cost coverage. Other than for example in the United Kingdom, where break-up fees of up to 1% of the transaction value are considered permissible, the TOB has not referred to the value of the transaction as (sole) criterion in its recommendations.

Up to now, the TOB has not opined on the question, whether a target company would be considered treating a **competing bidder** unequally in an inadmissible way when not offering the same break-up fee than to the contractual partner of the transaction agreement. Given that the break-up fee had been agreed upon with the White Knight and that the disagreeable first bidder had not raised its offer, this aspect has unfortunately not been clarified in the "Saia-Burgess" case despite the presence of a competing offer. It has to be assumed that an unequal treatment would be given and that target companies would have to face the situation of having to pay break-up fees also to the unwelcome competing bidder, towards whom the company has to furthermore open its books in the context of the due diligence.

In Switzerland, the sale of the **"crown jewel"** of the target company to the bidder is problematic in case the latter's offer

should not be successful. From a corporate law perspective, such an agreement generally qualifies as factual modification of the company's purpose or as factual liquidation, agreeing on which does not lie, as a matter of principles, in the competences of the board of directors of the target company. Furthermore, such a sale could hardly be justified by the company's interest, in particular against the background that this will render impossible the acceptance by the shareholders of a later and better offer. Finally, unless approved by the shareholders' meeting, agreements setting forth the sale of material assets on the condition of an ulterior takeover of the target company, violate the stock exchange law provisions on defense measures.

It is, furthermore, delicate under Swiss law to grant to the bidder **options on shares of the target company**. Such agreements are commonly used in the Anglo-Saxon area under the terms "Leg-Up Stock Options" (pursuant to which the beneficiary can generally acquire 10-20% of the target company's share capital) and "Lock-Up Stock Options" (which grant to the beneficiary the possibility to acquire a controlling share package). Such options can impede the shareholders' freedom of choice and be opposed to the interest of the target company. Furthermore, the issuance of shares with exclusion of the preferential subscription rights of shareholders would hardly be justifiable from a corporate law perspective and violate the stock exchange law provisions on defense measures.

4 Transaction Agreements with Major Shareholders of the Target Company

Provided that major shareholders hold participations in a target company, a bidder will try to ensure their support prior to the publication of the takeover offer. Transaction agreements with major shareholders can generally be classified into the following three types:

4.1 Irrevocable Tender Duty of the Major Shareholder

A type of transaction agreement between the bidder and a major shareholder of the target company consists in agreeing on the irrevocable tender of the shares held by the major shareholder to the bidder (Irrevocables). Such an agreement has been concluded for example in the "Centerpulse" case.

Given that they hamper or render impossible potential competing offers, such agreements are in conflict with the principle of Swiss takeover rules, pursuant to which all bidders shall have equal chances to acquire the target company and the shareholders of the target company shall be free to choose the best offer.

Therefore, a major shareholder is bound by a tender duty only (but still) to the extent that no competing offer is made. In case a competing offer is published, a major shareholder has the right to withdraw the tender obligation and to freely choose a competing offer.



4.2 Tender Agreements being conditional on the Success of the Offer

A transaction agreement between the bidder and a major shareholder of the target company can, furthermore, be shaped as purchase agreement for the shares which is conditional upon the success (closing) of the offer. This alternative can be reasonable in case major shareholders are holding very significant share packages and the offeror is only interested in the takeover if being able to achieve a 100% control over the target company.

When looking at the results, the effects of a purchase agreement conditional on the success of the offer are the same than the ones of an irrevocable tender. The bonding of a major shareholder to the conditional purchase agreement can lead to the creation of substantial access restrictions to the market for other bidders, reduce the chances of success of the latter and, thus, violate the interests of the minority shareholders given that they cannot at all or only to a limited extent benefit from a better offer. Therefore, in order to obtain a balance between the different interests, a major shareholder being bound by a conditional purchase agreement has to be able to withdraw the agreement and to freely opt for the competing offer, if any.

4.3 Unconditional Purchase Agreements

Finally, the bidder and the major shareholder of the target company can agree on concluding an unconditional share purchase agreement shortly prior to the pre-announcement or publication of the offer. Competing bidders are thereby excluded from the acquisition of these shares (unless the first bidder tenders these shares to the competing bidder in the latter's takeover offer) and possibly restrained from submitting a competing offer.

Given that it concerns a transaction being separate from the offer, the provisions of stock exchange law are not applicable in case of an irrevocable share purchase agreement concluded prior to the pre-announcement or publication of the offer. Thus, the admissibility of such an unconditional and irrevocable share purchase agreement gives generally raise to no concern.

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The content of this Newsletter does not constitute legal or tax advice and may not be relied upon as such. Should you seek advice with regard to your specific circumstances, please contact your Schellenberg Wittmer liaison or any of the following persons:

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