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Contributing editors
Ueli Studer, Kelsang Tsün and Joanna Long

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About the Editors

Ueli Studer
UBS Switzerland AG

Ueli Studer is a managing director at UBS and, as general counsel Switzerland, a member of UBS Group Legal's management team. In this role, he serves as UBS divisional general counsel personal and corporate banking, including WM Switzerland and, regionally, as general counsel Region Switzerland. He is also a member of the executive board of UBS Switzerland AG as the entity's general counsel. Mr Studer joined UBS in 2006 and has since held four distinct management positions within UBS's legal department. For eight years, he led the legal corporate finance and structured transactions team dealing with bespoke, large and complex transactions. After that, Mr Studer served as head legal products and distribution, combining several teams under one cross-divisional roof providing legal support to the firm's value chain. In 2018, Mr Studer assumed the role as head group functions legal providing globally coordinated legal advice on regulatory, corporate, contractual, transactional and technology matters of group relevance before assuming his current role as general counsel Switzerland in 2021. Before joining UBS, Mr Studer worked for the Swiss law firm Bär & Karrer AG for several years advising domestic and global companies on M&A, capital markets and financing transactions. Mr Studer is a Swiss-qualified attorney and holds degrees from the University of Berne (lic iur) and the University of London (LLM).

ueli.studer@ubs.com

Read more from this editor on Lexology

Kelsang Tsün
UBS Switzerland AG

Kelsang Tsün is a managing director at UBS heading the group corporate legal team within the group functions legal team. Group corporate legal advises on large internal corporate transactions and reorganisations, M&A transactions as well as on corporate law, treasury and contracting matters affecting the group. Prior to that, Mr Tsün was leading the group treasury legal team and also served as legal counsel in the legal corporate and institutional clients team advising on complex domestic and international financing transactions. Before joining UBS in 2010, Mr Tsün worked at a business law firm in Zurich for a number of years advising Swiss and international clients on corporate and commercial law matters, with a focus on M&A as well as financing and restructuring transactions. Mr Tsün is a Swiss-qualified attorney and holds a degree from the University of St Gallen (lic iur HSG).

kelsang.tsuen@ubs.com

Read more from this editor on Lexology

Joanna Long
UBS Switzerland AG

Joanna Long is a director in the group corporate legal team at UBS and a member of the group M&A legal team. Her practice focuses on group own account Swiss and international M&A transactions. She also advises on domestic and international internal reorganisations, corporate law and corporate governance matters. Prior to joining UBS in 2019, Ms Long worked at Bär & Karrer AG focusing on private M&A, private equity and corporate law. She relocated to Switzerland in 2017, having practised for several years at a Luxembourg business law firm advising large international groups and private equity houses. Ms Long is an Irish-qualified lawyer, admitted to the Roll of

Solicitors in Ireland and holds a law degree from University College Dublin (BCL European). She is admitted as a solicitor of the Senior Courts of England and Wales.

joanna.long@ubs.com

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Labour and Employment

Manuel Werder and Valerie Meyer Bahar[1]

Transfer of employees

Overview

In Swiss M&A transactions, there are two key issues with regard to labour and employment law:

- the transfer of the target company's employees to the buyer, if the two companies are to be merged or otherwise combined; and
- the dismissal of the employees of the target (or both the target and the buyer) company, if the M&A transaction is to be combined with a restructuring of the workforce of the new company.

The applicable regime for the transfer of employees depends on whether the transaction is structured as a share deal or an asset deal.

1 Manuel Werder and Valerie Meyer Bahar are partners at Niederer Kraft Frey Ltd.

Share deals

A mere change in the ownership of the shares in the target company does not have an impact on the employment relationships between the target company and its employees. Consequently, in share deals, the employment agreements between the target company and its employees are not affected by the transaction and remain in full force and effect.

Under Swiss law, it is generally possible to implement unilateral changes to the terms of the employment agreement to the detriment of the employees, provided certain requirements are met and the notice period is respected when making such changes.

Asset deals

General principle: transfer of all employees

In asset deals that constitute a transfer of a business undertaking, all employees working for the transferred business and the employment agreements with such employees with all respective rights and obligations are transferred to the buyer automatically as a matter of law, unless an employee rejects the transfer. If only a part of a business is transferred (eg, only the manufacturing department, but not the sales department), the same principle applies to all employees who by way of their function belong to the transferred part.

The same principle applies to transactions that are structured as mergers, demergers or transfers of assets in the form of a universal succession according to the Swiss Merger Act.

The seller and the buyer are jointly and severally liable for any claims of the employees that fell due prior to the transfer or that fall due until the date on which the employment relationship could be or is terminated as a result of the refusal of the transfer (see 'Refusal of transfer and termination'). While the seller and the buyer are free to agree on a different cost-bearing regime, this arrangement is only effective between them and does not affect their joint and several liability in relation to the employees.

Procedure: information and consultation obligations

Information obligation

If employees are transferred in an asset deal, merger or demerger, the employees' representatives or, if there is no employees' representation in place, the employees of all involved companies (ie, as applicable, the transferring and the surviving company) must be informed about the reason for the transfer and the legal, economic and social consequences of the transfer for the employees.

Consultation obligation

Where measures affecting the employees are envisaged as a result of the transfer, the employees' representatives or, if there is no employees' representation in place, the employees themselves must be consulted in good time before the relevant decisions are taken.

Such measures may include dismissal, change of workplace or change of other work conditions. The requirement to consult in good time means that there must be sufficient time for a consultation (ie, for the employees to make proposals how such measures might be avoided or their impact mitigated), and for those proposals to be taken into account by management.

As a rule of thumb, a period of two weeks is considered to be sufficient for the consultation, and there should be some additional days for the management to consider the proposals, if any. Thus, there should ideally be three to four weeks from the time when the employees are first informed to the time when the decision about the transaction is taken by the shareholders' meeting(s) of the respective companies.

Sanction in case of violation of the information and consultation obligation

In the sphere of a mere transfer of employees, there are few sanctions if the information and consultation obligations are not adhered to, in particular as it will generally be very difficult for the employees to establish any claim for damages on such grounds.

However, in the case of mergers, demergers and transfers of assets governed by the Swiss Merger Act, the employees' representative may request an injunction to prevent the respective transaction from being registered in the Swiss Registry of Commerce if the information and consultation obligations have not been complied with, thus effectively preventing the transaction from being completed.

Refusal of transfer and termination

The general principle is that all employees and employment relationships are transferred, including employees who are unable to work (eg, because of illness). Any agreement between the seller and the buyer by which the circle of transferred employees is limited is invalid as a matter of law (no cherry-picking).

However, the employee may refuse to transfer to the new employer, or any of the involved companies may terminate the employment relationship:

- Refusal: if an employee refuses the transfer, the employment agreement of the employee is terminated pursuant to the statutory (not contractual) notice period.[2]
- Termination: the mandatory transfer of all employees in the case of an asset deal does not affect the target company's or, after the transfer, the new employer's right to terminate the employment relationship in accordance with the terms of the employment agreement, in particular by respecting the contractual (or statutory) notice period (see also 'Dismissal of employees').

In view of the mandatory and automatic transfer of all employment relationships, employees who have refused the transfer, or employees whose employment relationship has been terminated by the target company, will nonetheless transfer to the new entity if the applicable notice period has not yet expired

2 Seven days during the probation period, one month during the first year of service, two months in the second to ninth years of service and three months thereafter, all such notice periods to expire at the end of a calendar month.

at the time of the transfer, and the (new) employer is bound to the employment contract until the termination date of the employment.

The parties to an M&A transaction often wish to avoid the transfer of employees who either refused to transfer, or whose employment relationship has been terminated by the target company. This can either be achieved by planning sufficient time from the initial information and consultation phase to allow for the termination of the employment relationship(s) prior to the transfer date, or by entering into mutual termination agreements with the employees, providing for a termination date prior to the transfer.

Finally, while the terms of the employment relationship remain unchanged by the transfer, the new employer may change such terms after the transfer. An exception to this rule applies with regard to collective bargaining agreements, which continue to remain in force for a year (subject to an earlier end of their term).

Dismissal of employees

Mass dismissals

The dismissal rights of the employer are not affected by an M&A transaction. In accordance with the general rules of Swiss law, if a significant number of employees are to be dismissed, the specific rules governing mass dismissals must be adhered to:

- Mass dismissals are notices of dismissal given by the employer to employees of a business (1) within 30 days of each other (2) for reasons not pertaining personally to the employees that (3) affect:
    - at least 10 employees in a business normally employing more than 20 and fewer than 100 employees;
    - at least 10 per cent of the employees of a business normally employing at least 100 and fewer than 300 employees; or
    - at least 30 employees in a business normally employing at least 300 employees.

The goal of the mass dismissal proceeding is primarily the protection of the labour market against a sudden rise in unemployment in a certain regional

area and segment of the labour market. It is thus generally permitted to stagger dismissals over a longer period of time in order not to reach the thresholds set out above in individual 30-day periods, and thus to avoid triggering the mass dismissal proceedings.

An employer who considers a mass dismissal has an information and consultation obligation: the employer must furnish the employees' representative or, where there is none, the employees themselves with all appropriate information and, in any event, with the reasons for the mass dismissals, the number of employees to whom notice may be given, the number of employees normally employed and the period during which the employer plans to issue the notices of termination.

The employees must then be consulted, namely, at least be given the opportunity to formulate proposals on how to avoid such dismissals or limit their number and how to mitigate their consequences. Such proposals must be considered by the employer before deciding on whether to move ahead and issuing the notices of termination. In order to comply with the requirements, the employees should be given about two weeks to consult, and the employer then has to review their proposals, if any, before deciding on the mass dismissal. A violation of this consultation obligation may render subsequent notices of termination abusive, entitling the employee to a penalty payment equal to up to two monthly salaries.

The cantonal employment office has to be notified of any intended mass dismissal. The notification must include the information given to the employees as well as the results of their consultation, and is a prerequisite for the subsequent dismissals to be valid.

The notices given in a mass dismissal are subject to the terms of the employment agreements of the employees and Swiss law, in particular with regard to the applicable notice period.

Social plan

A social plan is an agreement by which an employer and employees set out measures to avoid dismissals or to reduce their numbers and mitigate their effects.

The employer is obliged to enter into negotiations with the goal of establishing a social plan if it normally employs at least 250 employees and intends to make at least 30 employees redundant for reasons that have no connection with them personally within a 30-day period. Dismissals over a longer period that are based on the same operational or corporate decision are counted together.

If there is an obligation to negotiate, the employer must, if there is a collective bargaining agreement in place, negotiate with the employee associations that are party to such agreement. If there is no collective bargaining agreement, the negotiation will take place with the employees' representative or, if there is none, directly with the employees.

If no agreement can be found between the parties, an arbitral tribunal is appointed, which will issue the social plan in the form of a binding arbitral award.

HR due diligence

The following HR legal topics typically arise in Swiss M&A transactions and consequently form part of HR due diligence and contractual clauses in transaction agreements.

Management retention

In a broad number of transactions, in particular in private equity and venture capital transactions, management retention is of utmost importance. The buyer often achieves this goal by payment of retention boni or the allocation of shares in the target or the buyer.

The granting of a participation triggers a variety of corporate law issues relating to the allocated shares, such as transfer restrictions, call options, tag-along and drag-along rights, etc, which are typically addressed in a shareholders' agreement.

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Non-compete obligations

The legal due diligence typically includes the verification whether the target company's key employees are bound by contractual non-competition and non-solicitation clauses, and whether the enforceability of such clauses has been strengthened by a contractual penalty.

Non-compete clauses may be found in employment agreements or shareholder agreements. The following discussion addresses frequent questions relating to non-compete clauses in employment agreements.

Non-compete obligations under Swiss Employment law

During the term of the employment, the obligation not to compete with the employer is inherent in the employee's statutory duty of loyalty towards the employer.

Employees working full-time for an employer are therefore in general restricted from accepting any employment function with any other employer and are in particular obliged to refrain from running a competing business for their own account or from working for or participating in such a business. Part-time employees may work for other employers if such activity is compatible with the statutory duty of loyalty, in particular if there is no competition between the two employers.

After the termination of the employment, the employee is still bound by a secrecy obligation, but not by an obligation not to compete with the employer. An obligation to refrain from engaging in any activity that competes with the (former) employer for a certain period of time after the end of the employment relationship must be explicitly agreed between the employer and the employee in writing, and is subject to a variety of legal restrictions.

Limitations of non-compete clauses

Swiss law is based on the principle that employees shall be free to change their employer and to continue to earn their living (economic freedom). Contractual non-compete obligations entered into in the realm of an employment

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relationship are thus subject to strict requirements and limitations, and their enforcement is often difficult. The following applies:

- any prohibition of competition is binding only where the employee has, in the course of the employment relationship, gained knowledge of the employer's clientele or manufacturing and trade secrets and where the use of such knowledge might cause the employer substantial harm;
- the prohibition is subject to the requirement of the written form; and
- the prohibition must be appropriately restricted with regard to time, place and scope.

Typical post-contractual non-compete obligations are entered into for a period of six to 12 months (by law, the maximum length is three years), for the region or country where the employee was active, and limited to the activities or field of business of the employer in which the employee was involved.

Clauses providing for an excessive prohibition of competition may be restricted by a court at its discretion, taking into account all relevant circumstances.

While no compensation must be paid in order for the non-compete obligation to be valid, payment of a consideration increases the likelihood that a non-compete obligation is upheld by a court, as such compensation eases the financial impact the obligation not to compete has on the employee.

Consequences of breach

An employee who infringes the non-compete undertaking is liable to compensate the employer for any damage suffered as a result of such competing activity. The burden of proof regarding such damage is borne by the employer. In practice, it is often difficult – if not impossible – to establish the monetary damage as well as a line of causation (adequate causation) between the competing activity and any damage suffered by the (former) employer.

Therefore, employment agreements often foresee that an infringement of the non-compete undertaking is sanctioned by the obligation of the employee to pay a contractual penalty. To allow for the maximum protection of the employer, such a contractual penalty clause should provide:

- that actual damages are owed in addition to the contractual penalty;

- for the non-competition undertaking to remain in place even if the employee has paid the contractual penalty; and
- that the employer may, in addition to the agreed contractual penalty and any further damages, ask for specific performance and request that the behaviour that constituted a breach of the employment contract be discontinued.

Extinguishment of non-compete clauses

If the employer terminates the employment agreement, a non-compete agreement in the contract of employment is extinguished. An exception applies – and the non-compete obligation remains in force – if the termination was based on a valid reason attributable to the employee. If the employee terminates the employment agreement, the non-compete obligation remains in force, unless his or her dismissal is for a valid reason that is attributable to the employer.

If the non-compete obligation is extinguished owing to termination by the employer, it is possible to agree on a new non-compete obligation (eg, in a termination agreement). However, at this time, the employee will normally only assume such an obligation if he or she is compensated for it.

Finally, non-compete undertakings are extinguished once the employer demonstrably no longer has a substantial interest in their continuation.

Transaction boni

In the course of an M&A transaction, transaction boni are often promised to the management of the target company or another group of involved employees as compensation for their extraordinary efforts in the context of the preparation and implementation of the transaction.

Such transaction boni are typically promised and paid by the target company. Depending on the transaction structure and the timing of the payment, this may result in the buyer economically bearing the payments. Furthermore, although the target company may be the formal employer, the extraordinary services are typically rendered for the ultimate benefit of the seller, who may

be different from the employer. This raises complex intercompany dealing, accounting, tax and pensions issues.

M&A agreements therefore typically contain representations that the target company has not promised transaction boni to its employees or to third parties.

Contractual provisions

Notice periods

Contractual notice periods exceeding the duration of three months or fixed-term contracts without the possibility of early termination may negatively affect the option to dismiss employees of the target company, and should thus be identified.

Severance payments and golden parachutes

Provisions on severance payments (such as golden parachutes) included in employment contracts may render the dismissal of employees expensive and therefore negatively affect the target company's position when seeking to terminate employment relationships. M&A agreements often contain representations that the employment agreements of the target company do not contain such provisions.

In listed companies, severance payments or golden parachutes for the company's management are prohibited as a matter of Swiss law, notwithstanding any contractual agreement to the contrary.

Bonus provisions

Bonus provisions typically form part of the HR due diligence in order to determine whether the target company's HR budget is aligned with its contractual legal obligations.

Swiss law differentiates between discretionary bonus payments that are paid at will by the employer, and bonus payments that form part of the compensation to which the employee is contractually entitled. The assessment whether a bonus belongs in one or the other category is made independently from the

designation of the bonus payment in the employment contract and depends on the nature and structure of such payment, the communication and the handling of such payments in the past, and the amount of the bonus relative to the fixed salary.

Bonus provisions are often the source of disputes, in particular in dismissal situations, and therefore require careful analysis.

Intellectual property clauses

In the context of the acquisition of a target company whose business model heavily depends on intellectual property rights, it is important to verify whether the target company owns all intellectual property rights that it needs for the operation of its business and whether the target company may owe any compensation to any of its employees for inventions and designs potentially produced outside the performance of their contractual obligations.

The pertinent rules under Swiss law are the following. As a matter of law, inventions and designs produced by the employee alone or in collaboration with others in the course of his or her work for the employer and in performance of his or her contractual obligations belong to the employer, whether or not they are protected.

By contrast, inventions and designs produced by the employee in the course of his or her work for the employer but not in performance of his or her contractual obligations belong to the employee. However, in the employment agreement the employer may reserve the right to acquire such inventions and designs against compensation. According to applicable law, the compensation must be appropriate with regard to all relevant circumstances and in particular the economic value of the invention or design, the degree to which the employer contributed, any reliance on other staff and on the employer's facilities, the expenses incurred by the employee and his or her position in the company.

An employee who produces an invention or design outside the performance of his or her contractual obligations must notify the employer thereof in writing, and the employer must inform the employee within six months if it wishes to acquire the invention or design or release it to the employee.

Terms of employment

Time recording, overtime and excess hours

Swiss public law governs the working time of employees as well as the admissibility and compensation of overtime work, work at night, at weekends and on public holidays. These rules apply to all employees, with the exception of top management.

In order to ensure compliance with such laws, employers in Switzerland are obliged to account for the working hours of the employees. This requires the introduction of a time recording system and working time regulations, setting out the general obligations and principles concerning working time and the recording of working time and absences. The existence of the recording system and working time regulations typically forms part of the legal due diligence.

As a matter of principle, the performance of overtime and excess hours must be paid out with a 25 per cent wage supplement. However, the employer and the employee may agree in writing that the performance of overtime and up to 60 excess hours per year may be compensated by the monthly salary. Furthermore, the parties may agree that overtime work and excess hours be compensated by time off in lieu, or be paid out without a wage supplement. The compensation of overtime work and excess hours may have a significant impact on the payroll costs of the target company. Furthermore, accrued overtime and excess hours typically form part of the legal due diligence because of the respective accrued payment obligations of the target company.

Policies and regulations; collective bargaining agreements

In the context of due diligence, the existence of policies and regulations required by law and best practice rules is typically verified, for example, for the reimbursement of expenses (these regulations are also important from a tax perspective), data protection, use of electronic communication, confidentiality undertakings and prevention of insider trading, non-discrimination and prevention of sexual harassment, etc. The absence of such regulations may expose the target company to liability or sanctions.

Furthermore, a part of legal due diligence should review whether the target company's employees fall within the scope of a collective bargaining

agreement, which may contain terms that apply in addition to the terms of the employment agreement, usually to the advantage of the employees.

Collective bargaining agreements, as well as social plans (eg, owing to past restructurings), may also contain commitments by the employer with regard to the employees or restrictions on the employer's contractual right to terminate employment relationships, and thus may have an impact on the profitability of the target company.

Health and safety laws

Swiss law requires the employer to safeguard the employee's personality rights, personal safety, and health and integrity, and ensure that proper moral standards are maintained. The employer must take all measures that by experience are necessary, feasible using the latest technology and appropriate to the particular circumstances of the workplace, provided such measures may reasonably be expected in the light of each specific employment relationship and the nature of the work.

Depending on the industry in which the target company is active, the law, collective bargaining agreements or industry standards may require the employer to implement specific health and safety protections.

Freelancers and consultants

Under Swiss law, whether an individual or a company controlled by an individual legally qualifies as an external service provider or employee depends on the circumstances of the individual case and not the designation of the contractual relationship.

In particular, if an individual is subject to the directions of and integrated in the organisation of a company, he or she may qualify as an employee notwithstanding the fact that the underlying agreement is structured as consultancy, mandate or other agreement implying the independent provision of services.

Such requalification of freelancers or consultants may lead to non-compliance of the target company with its obligations as an employer and exposes the target company to significant legal and financial obligations, for example, with

regard to social security contributions and pension payments, as well as the general obligations of an employer with regard to holidays, continued salary payments in case of illness or accidents and dismissal.

Manuel Werder
Niederer Kraft Frey Ltd

Manuel Werder is a partner at Niederer Kraft Frey. His practice focuses on corporate law and M&A, including private equity and venture capital transactions, often with an Asian aspect. He has expertise in large, complex, cross-border acquisitions, mergers, divestitures and corporate restructurings. His M&A expertise crosses all industries, including financial, industrials and services.

Manuel advises Swiss and international financial institutions and corporations active in different industries in M&A, corporate, commercial, contract, securities and stock exchange law. His expertise also includes investment and shareholders' agreements, joint ventures, commercial contracts and employment law.

Read more from this author on Lexology

Valerie Meyer Bahar
Niederer Kraft Frey Ltd

Valerie Meyer Bahar is a partner at Niederer Kraft Frey. She advises and represents clients in commercial and corporate litigation, with a focus on shareholder and employment litigation; in international and national arbitration; and in all aspects of corporate employment law.

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Valerie advises on all aspects of employment law, for example, on the drafting and implementation of employment agreements; staff and time regulations; compensation matters; dismissals; and the transfer of employees in M&A transactions and restructurings, including mass dismissals. She regularly handles employment litigation relating to, inter alia, wrongful termination and bonus claims.

Read more from this author on Lexology

Niederer Kraft Frey Ltd

Bahnhofstrasse 53
8001 Zurich
Switzerland
Tel: +41 58 800 80 00
manuel.werder@nkf.ch
valerie.meyer@nkf.ch
www.nkf.ch

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