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Federal Council Publishes Draft Bill for Swiss Investment Screening Act

On 15 December 2023, the Federal Council published the dispatch and the draft bill of the Investment Screening Act. The main goal of the draft bill is to prevent the acquisition of control of Swiss companies ("takeovers") of Swiss entities by foreign investors if such takeovers would threaten public order or security in Switzerland. Under the proposed rules, takeovers of domestic companies active in certain critical industries by foreign state-controlled investors are subject to prior approval. Compared to the preliminary draft published in May 2022 for consultation, this marks a significant narrowing of the bill's scope of application. While the introduction of such an investment control regime would be against Switzerland's long-standing tradition of an investor-friendly regulatory landscape, it is likely that this law, if enacted, would only have a very limited impact.

1 INTRODUCTION

On 15 December 2023, the Federal Council published the dispatch and the draft bill of the Investment Screening Act (*Investitionsprüfgesetz*). This follows the publication of a preliminary draft of the act in May 2022 and consultation proceedings until September 2022. The main goal of the draft bill is to prevent takeovers of Swiss entities by foreign investors if such takeovers threaten public order or security in Switzerland. The Federal Council had been mandated by a parliamentary motion to draft the legislation despite itself being opposed to the introduction of a foreign investment control regime in Switzerland.

The Federal Council's view remains unchanged even though the scope of the draft Investment Screening Act has been significantly reduced compared to the preliminary draft. In its dispatch the Federal Council again advocates against introducing an investment control regime due to an unfavorable cost-

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benefit ratio, the sufficiency of the existing regulatory framework and the absence of any known cases in the past where a takeover has put the public order or security in Switzerland at jeopardy.

The results of the consultation in large parts mirror the Federal Council's negative stance. Out of the 72 responses received, a majority of 38 stakeholders were opposed to the introduction of a general investment control regime altogether while several other respondents expressed support for the introduction only subject to the act's scope of application being narrowed.

Taking into account the responses received during consultation, the Federal Council applied a number of changes to the preliminary draft, which are described in more detail below. The overall goal of the legislation, however, continues to be the same: to equip Federal authorities with the means to prevent foreign investments that threaten Switzerland's public order or security.

2 REDUCED SCOPE OF THE DRAFT BILL

To address the concerns raised during the consultation process, the scope of application of the legislation has been reduced compared to the preliminary draft published in 2022. Most importantly, under the revised scope, transactions would only be screened if (i) the acquirer is a foreign state-controlled investor and (ii) the takeover relates to a domestic company that operates in a critical sector, with *de minimis* transactions being exempt. Acquisitions of domestic companies that operate outside of critical sectors by foreign state-controlled investors no longer fall within the scope of the legislation. The same applies to takeovers of domestic companies in critical sectors by foreign (private) investors that are not state controlled. Put differently, in the absence of any other applicable restrictions (such as the existing regulation in the financial sector) the acquisition of targets active in critical sectors by investors that are not state-controlled as well as the acquisition of targets active in non-critical industries by state-controlled acquirers will continue to be permissible.

3 INVESTMENT SCREENING PURSUANT TO THE DRAFT BILL

3.1 Transactions subject to the Investment Control

Under the proposed rules, takeovers by foreign state-controlled investors of domestic companies active in certain critical industries are subject to prior approval.

3.2 Takeover

The draft bill defines a takeover as any transaction by which one or more investors directly or indirectly gain control over one or more previously independent undertakings or parts thereof. According to the dispatch, the definition is based on the definition of a business combination (merger) under antitrust laws. Consequently, already established administrative practice and jurisprudence would also be relevant for the purposes of the Investment Screening Act.

As a principle, the term "takeover" is to be understood broadly. The proposed legal definition mentions mergers, acquisitions of a participation and the conclusion of an agreement as a non-exhaustive list of examples. The legal form of the transaction that leads to the investor(s) obtaining control is not relevant. The draft bill explicitly includes parts of undertakings, thereby making it clear that a transaction regarding a business unit or certain assets (or even a single asset) may also fall within the scope of the regulation.

The draft bill's reference to undertakings (or parts thereof) which were "previously independent" could be misunderstood to mean that the acquisition of a company that already has a controlling shareholder or beneficial owner does not fall within the control regime. However, the legislator's true intention was to exclude transactions within a group of companies (e.g., in the context of intragroup

restructurings) where ultimate beneficial ownership does not change.

3.3 Acquirer: Foreign State-controlled Investors

The preliminary draft had provided that, subject to limited exceptions for natural persons from EU/EFTA member states, any takeover by foreign entities or individuals would have been subject to prior approval to the extent relating to a domestic company active in a critical sector, regardless of whether the investor was controlled by, affiliated with or acting on behalf of a government.

In one of the more significant changes compared to the preliminary draft, the draft bill applies approval requirements only to relevant transactions by state-controlled investors. The following are considered foreign state-controlled investors under the draft bill's legal definition: (i) a foreign state body, (ii) a company with its head office outside Switzerland that is directly or indirectly controlled by a foreign state body, (iii) an entity capable of owning assets that is directly or indirectly controlled by a foreign state body or (iv) an individual or legal entity that acts on behalf of a foreign state body. Pursuant to the dispatch, the draft bill's definition of state-controlled is to be construed broadly. Specifically, it is not decisive whether control by the state is actually exercised. The mere existence of the possibility to e.g. influence the management or to block investment decisions is sufficient.

Whether an investor is deemed state-controlled would have to be determined on a case-by-case basis. For example, sovereign wealth funds typically focus on independence from their respective sponsor jurisdictions and their governance is mostly set up in a way to avoid interference by the government. It could therefore be argued that they should not be deemed "state-controlled" However, the dispatch states that it is sufficient for the investor to have received funds for the takeover and/or to be mandated by a state in order for it to be state-controlled. This corresponds to the broad and functional understanding that should be applied under the draft bill.

3.4 Target: Domestic Companies Operating in Critical Sectors

3.4.1 Definition of Domestic Company

In a somewhat unusual move, the preliminary draft proposed two alternative legal definitions of domestic company (i.e., the target of the takeover). Under the narrower of the two alternatives, only companies registered in the Swiss commercial register that are not part of a group of companies domiciled or with headquarters outside of Switzerland would have been captured by the legislation. Therefore, the takeover of a Swiss incorporated subsidiary of a foreign group of companies would never have been the subject of investment control proceedings.

In the draft bill the Federal Council decided to use the broader of the two alternatives proposed in the preliminary draft whereby any target registered in the Swiss commercial register falls under the definition, regardless of whether it is part of a foreign-domiciled or headquartered group of companies. As a consequence, if a state-controlled investor intends to acquire a group headquartered abroad that has one or more subsidiaries in Switzerland active in a critical sector, Swiss investment control would apply, and the entire transaction would be subject to investment control approval being granted in Switzerland.

The draft bill defines a company as any consumer or supplier of goods and services in the economic process, regardless of the legal or organizational form. Based on this broad and functional definition, a Swiss branch of a foreign entity would also qualify as a domestic company to which the draft bill would apply if the branch operates in a critical sector.

Conversely, the takeover of a company that is managed from or headquartered in

Switzerland but incorporated or registered abroad is outside the scope of the draft bill.

3.4.2 Critical Sectors

The other significant reduction of the scope of the proposed legislation is that transactions would only ever be subject to investment control if the target company operates in a critical sector. Takeovers of targets active in non-critical sectors by state-controlled investors are not regulated by the draft bill.

The draft bill sets out an exhaustive list of such sectors, subdivided into two groups. The first group contains sectors that are particularly critical. Takeovers of domestic targets in these sectors are always subject to approval unless they are below the *de minimis* thresholds described in section 3.4.3 below. These include the defense and space industry, energy and water supply sector and providers of central security relevant IT systems and services.

The second group contains industries where takeovers only require approval if the domestic company exceeded 100 million Swiss francs in revenue (or 100 million Swiss francs in gross earnings in the case of banks) in the two financial years preceding the filing of the request for clearance (see chapter 4 below). This second category includes university hospitals and general hospitals, the pharmaceutical and medical protective equipment industry, operators of goods and passenger transport and logistics infrastructure (such as airports) and food distribution centers, operators of domestic telecommunication networks and systemically relevant financial market infrastructures and banks.

The above list mostly corresponds to the critical sectors of the preliminary draft. However, the draft bill now authorizes the Federal Council to exempt takeovers by investors from certain jurisdictions provided there is sufficient cooperation with such states to prevent any threats to the public order and security in Switzerland.

3.4.3 Exemption for *De Minimis* Transactions

The draft bill introduces a new *de minimis* threshold whereby transactions are only subject to approval if the domestic target had at least 50 full-time equivalents (FTE) on average or alternatively at least 10 million Swiss francs of revenue in the two business years preceding the submission of the request. To determine whether a threshold is reached, the revenue or FTE of any subsidiaries controlled by the domestic company are included whereas other affiliates (such as parent companies) are disregarded. If the transaction relates to a specific business unit or part of a business or domestic company only, the revenue and/or FTE of that unit or part are relevant.

The Federal Council bases this exemption on the assumption that it is improbable for a takeover of a company that does not exceed the aforementioned thresholds to endanger the public order or security. Interestingly, the dispatch also states that while it cannot be excluded that small companies may own or develop technology that is relevant to public security, the Federal Council does not want to impede the financing of start-up companies by foreign investors. In other words, the Federal Council gives more weight to facilitating innovation in Switzerland than preventing foreign state-controlled investors from investing in early-stage technology, even where exceptionally such technology could be relevant for public order or security.

While the dispatch is certainly correct in stating that it is unlikely for a target company that does not exceed the *de minimis* thresholds to be relevant for the public order or safety, the reasoning for the exemption seems questionable. The draft bill has already significantly reduced the scope of the investment control to exclude any transactions outside of critical sectors and by non-state-controlled investors, as described above. It is not evident that there was any need to disapply the legislation based on additional threshold considerations. If exceptionally a foreign-controlled investor

intends to take over a small domestic company that, despite its size, is relevant for Switzerland's public order or safety (for example, because the company provides niche military technology that the Swiss Armed Forces are reliant on) then the Swiss investment control authorities should not be deprived of the possibility to review the transaction.

4 CRITERIA FOR APPOVAL OR INTERVENTION

Article 4 of the draft bill states that a takeover will be approved if there is no reason to assume that the public order or security is endangered as a result of the takeover. Just like the preliminary draft, the draft bill complements this general principle by a non-exhaustive list of criteria that may be taken into account by the competent authorities (see below in section 5). These include criteria related to past or current behavior of the investor or the government of the investor's home jurisdiction and, namely (i) whether the investor has in the past engaged, or is currently engaging, in any activities that pose or posed a threat to the public order or security of Switzerland or any other state, (ii) whether the investor or the government of the investor's home jurisdiction is attempting or has attempted to obtain information regarding the domestic company through espionage or (iii) whether the investor has conducted or is currently conducting espionage. Not surprisingly, if sanctions have been imposed against the investor this can also be a relevant consideration.

Further, the authority can factor into its decision whether the products, services or infrastructure of the domestic company can be substituted within a reasonable period of time. Finally, acknowledging the increasing importance of information in today's world, approval of a transaction may be refused if the investor would obtain access to security relevant information or sensitive personal data through the takeover.

The preliminary draft had also foreseen the distortion of competition as a decision factor. However, the Federal Council found this to be incompatible with Switzerland's obligations under international treaties.

Rather than prohibiting a takeover altogether, a transaction can be approved subject to certain conditions. This presupposes that the threat to the public order or security can be eliminated by imposing conditions. In case of any uncertainty whether any available conditions are sufficient to do so the transaction would have to be prohibited. On the other hand, any conditions that do not serve the purpose of preventing or limiting the threat (such as purely politically motivated measures) would not be permissible.

5 INVESTMENT CONTROL PROCEEDINGS

5.1 SECO

The responsibility for approving transactions falling within the scope of the draft bill lies with the Swiss State Secretariat for Economic Affairs (SECO).

The proposed approval procedure has three stages: (i) voluntary pre-screening, (ii) filing and start of phase I as well as (iii) full review and phase II.

5.2 Pre-Screening

The draft bill introduces the possibility for the involved persons to voluntarily request a non-binding pre-screening of an intended transaction.

The pre-screening has the goal of providing guidance whether the intended transaction is likely to fall within the scope of the draft bill. The non-binding nature was introduced in order to clearly distinguish the pre-screening from the more formal phase I (and phase II) proceedings.

Likely due to the more informal nature of the pre-screening and to allow for the necessary flexibility, the draft bill contains no additional procedural regulations on timing, appeal, etc.

5.3 Filing and Phase I

The official procedure requires the foreign state-controlled investor, i.e. the envisaged acquiror, to file an approval request with SECO prior to completion of the transaction. This allows the involved parties to sign the transaction agreement and include a condition precedent to closing regarding approval of the transaction, as is already done in several other jurisdictions in comparable circumstances.

The draft bill does not yet contain any information on the documentation that will have to be filed but instead grants the Federal Council the power to specify the required documentation at ordinance level. It is expected that this documentation will in particular encompass a description of the foreign state-controlled investor, the target, information on the (beneficial) owners and available financing as well as a statement on the reputation and guarantee of proper business conduct.

Once the complete filing has been made, SECO will decide within one month whether the transaction can be approved or if a phase II review procedure has to be initiated. In its decision, SECO consults with co-interested administrative units and the Swiss Federal Intelligence Service (FIS).

Given that the one-month period only starts once the filing is complete, it is desirable for the Federal Council to clearly specify the required documentation in order to avoid a back-and-forth between the applicant and SECO with the resulting delay in starting the clock.

The phase I decision will be made in writing and notified to the foreign state-controlled investor and the target. The decision to start the full review does not constitute an order (*Verfügung*) and is therefore not subject to an appeal.

5.4 Full Review and Phase II

The draft bill provides that in case a full review is initiated, SECO will decide within three months and in agreement with co-interested administrative units as well as in consultation with the Swiss Federal Intelligence Service (FIS) whether to approve the takeover.

The Federal Council is competent to decide on the permissibility of the takeover (i) if either SECO or a co-interested administrative unit opposes such takeover or (ii) in cases of significant political implications. Therefore, a decision not to grant the approval for a takeover will be taken by the Federal Council.

During the full review and until the approval, the effectiveness of the takeover is suspended. Accordingly, and absent an extension, the draft bill provides for a maximum delay of four months.

5.5 Implicit Approval and Extension of Deadlines

In case no decision is made within the one-month period of phase I or three-month period of phase II, the draft bill provides for an implicit approval of the transaction.

However, SECO may extend these deadlines in case (i) the review is hindered by circumstances within the control of the foreign state-controlled investor or the target, (ii) required information from foreign authorities is outstanding or (iii) the Federal Council resolves on the approval.

5.6 Urgent Procedure

If required for the protection of public order and safety, the Federal Council may directly approve a takeover.

6 REMEDIES AND SANCTIONS

6.1 Remedies

The draft bill states that the Swiss Federal Act on Administrative Procedure (*Verwaltungsverfahrensgesetz*) shall apply to the bill's proceedings and, in particular, any appeals to the Swiss Federal Administrative Court.

In principle, only the foreign state-controlled investor and the target are permitted to appeal any decisions.

The Federal Council shall resolve on the measures in case of transactions that were completed without prior approval, approvals that are granted based on incorrect information or in case of covenants or conditions that were not complied with. The draft bill explicitly provides for divestitures as possible measures.

6.2 Sanctions

In case of the above-mentioned violations, the draft bill provides that the combined entity may be sanctioned with a fine of up to 10% of the entire worldwide turnover of the target in the two years prior to the takeover. This is a deviation from the preliminary draft where the fine was calculated on the basis of the transaction value.

6.3 Evaluation of the Draft Bill

The draft bill requires SECO to inform the public every four years on the implementation, decisions taken, and sanctions imposed.

In addition, SECO will have to evaluate the necessity, effectiveness, suitability and economic efficiency of the foreign investment control regime – a clear hint that the Federal Council does not consider these criteria to be fulfilled. At the latest after ten years, SECO will have to provide the Federal Council with a report on these evaluations, with this report becoming publicly available.

7 CONCLUSION AND OUTLOOK

The draft bill will now be subject to discussion in the Swiss parliament. It therefore remains to be seen if, when and in which form an investment control regime will be introduced in Switzerland.

Implementing an investment control regime goes against Switzerland's tradition of an investor-friendly regulatory landscape. However, the majority of OECD or EU member states have already implemented such an investment control regime, with the draft bill having a narrower scope than most of these regimes.

Thanks to this narrow scope, and the fact that in the Federal Council's view no takeovers in the past have threatened public order or security in Switzerland and as such would not have qualified as permissible takeovers, the draft bill, if enacted, would in our view have a very limited impact and be unlikely to change Switzerland's attractiveness for foreign investors.

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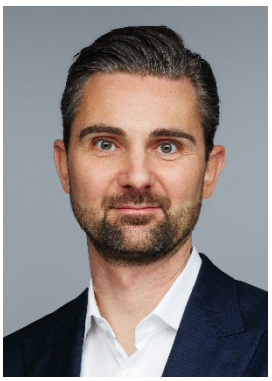

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