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Recent Developments on Foreign Direct Investment Controls in Switzerland: new draft legislation

I. INTRODUCTION

Although Switzerland is one of the world's largest recipients of foreign direct investments (**FDIs**), it has traditionally kept a liberal foreign investment policy and has therefore refrained from establishing cross-sector legal mechanisms for the systematic screening of FDIs. Nonetheless, in line with the global tendency to strengthen FDI controls, National Councillor Rieder submitted a motion to the Counsel of States in 2018 calling for the introduction of general FDI controls in Switzerland. Even though the Swiss Federal Council decided against this motion, both chambers of the Swiss Parliament have voted in its favour and requested the Swiss Federal Council to draft a bill on FDI controls.

On May 18, 2022, the Swiss Federal Council published its preliminary draft of the Swiss Foreign Investment Review Act (**FIRA**) together with its explanatory report (the **Explanatory Report**), the consultation of which will last until September 9, 2022. After the consultation, the deliberation in parliament will follow.

After an overview of the current foreign investment control rules in Switzerland (cf. *infra* II), we will focus on the proposed legislation on FDI control (cf. *infra* III).

II. CURRENT FOREIGN INVESTMENT REGULATORY FRAMEWORK

Although Switzerland did not establish general notification duties or approval requirements for FDIs (no catch-all rule), certain foreign investments already require governmental approval:

— The Swiss Federal Law on Acquisition of Real Estate by Persons Abroad (so-called 'Lex Kohler') limits the possibility for persons abroad to acquire residential properties in Switzerland. Properties used for commercial purposes (such as offices, manufacturing facilities, storage areas, shopping centres or hotels) can be acquired with few (or no) restrictions by foreign investors. The Lex Kohler covers both direct and indirect acquisitions (incl. mortgage financings granted by foreign investors and banks). 'Foreigners' under the Lex Kohler include foreigners without residence in Switzerland and foreigners with residence in Switzerland who are neither citizens of an EU or EFTA (European Free Trade Association) country nor have a valid settlement permit (C permit). Acquisition via a legal entity can only take place if the company is domiciled in Switzerland, not foreign controlled and is managed by persons who are domiciled in Switzerland. Acquisitions of real property which 'are against Swiss highest national interests' are prohibited by the Lex Kohler.

— In the banking and finance sector, if foreign investors directly or indirectly hold more than half of the voting rights of, or have, otherwise, a controlling influence on, a bank or a securities firm incorporated in Switzerland, the granting of the required license is subject to specific requirements. Moreover, non-foreign controlled Swiss banks and securities firms must obtain a special licence when a controlling stake is transferred to foreign investors.

— In the aviation industry, the license required for the commercial transportation of passengers or cargo by air to and from Switzerland may be refused to foreign-based companies unless reciprocal rights are granted to Swiss companies by the respective foreign states.

— In the absence of any international treaties to the contrary, licences for nuclear activities can be denied to companies incorporated abroad. The same rule applies to radio and communication licenses, unless reciprocal rights are granted to Swiss companies by the respective foreign states.

— It is also worth mentioning the recently adopted federal law on underground freight transport which limits the holding of shares and voting rights by foreigners in underground freight transport infrastructures in Switzerland.

— National security concerns through the sale of critical infrastructure has been addressed until now in practice by maintaining public ownership over the relevant companies and infrastructure, such as Swiss federal railways, Swiss Post, Swisscom, Swissgrid, Zurich and Geneva airports, Rhine ports, RUAG, Skyguide, etc.). Note that following the acceptance of a parliamentary initiative adopted by Swiss parliament, a preliminary draft legislation has been adopted by the Swiss Federal Council which imposes a governmental approval for any acquisition by foreign investors (within the meaning of the Lex Kohler) of strategic energy infrastructure.

III. DRAFT FOREIGN INVESTMENT REVIEW ACT

A. PURPOSE

Under the draft legislation, Swiss authorities may prevent acquisitions (*infra*, III.A.1) of Swiss private or state-owned companies (cf. *infra*, III.A.2) by foreign investors (*infra*, III.A.3) that would endanger or threaten Switzerland's public order or security (*infra*, III.C).

The FIRA provides for a cross-sector as well as a sector specific review of transactions with a *de minimis* exemption threshold (*infra*, III.B).

1. Acquisition

The FIRA defines the meaning of 'acquisition' as any transaction whereby a foreign investor directly or indirectly acquires control over a Swiss company, *i.e.* the ability to exercise decisive influence over the activities of the latter.

An 'acquisition' is only deemed to exist if all or part of an existing Swiss company is taken over, meaning that the establishment of an entirely new company (so-called "greenfield investment") is not covered by the FDI control mechanism.

According to the Swiss Federal Council, the concept of 'acquisition' should also include the acquisition of substantial assets, namely those assets without which the target company would no longer be able to pursue its economic activity and would therefore become an empty shell (*e.g.*, facilities, machinery, patents). A merger of a foreign company with a non-foreign controlled Swiss Company should also be considered as an 'acquisition'.

2. Swiss Company

In its Explanatory Report, the Swiss Federal Council proposes two options for defining the notion of a 'Swiss company'. The two concepts differ as to how Swiss subsidiaries of foreign groups should be treated. Under option 1, Swiss subsidiaries of foreign groups shall qualify as 'Swiss Companies', but not under option 2. Accordingly, both the acquisition of a foreign-controlled Swiss subsidiairy by a foreing investor and the acquisition of foreign holding company owning a Swiss subsidiary would be subject to FDI controls under option 1, but not under option 2. The Swiss government seems to favour Option 1 as it would allow the review of all potential problematic acquisitions, *e.g.* the acquisition of a Swiss subsidiary owned by a (non-problematic) foreign private group by a (problematic) state-owned foreign company, as a result of which Switzerland's public order or security would be endangered or threatened. If Option 1 is adopted by parliament, the rules under which a Swiss subsidiary would be considered as controlled by a foreign entity (group) will very likely be inspired by the Lex Kohler.

3. Foreign Investor

In order to qualify as 'foreign investor' under the FIRA, both the statutory head office and the place of the actual head

office of an acquiring company or group must be abroad. A group-wide approach applies towards groups of companies. Thus, a Swiss subsidiary of a foreign group shall be considered as a 'foreign investor'; conversely, a foreign subsidiary shall not qualify as a 'foreign investor' if the statutory or actual head office of the group to which it belongs is located in Switzerland.

Foreign natural persons (not from the UE/EFTA) investing directly in Swiss companies are considered as 'foreign investor'.

B. TRANSACTIONS SUBJECT TO REPORTING AND APPROVAL

The FIRA provides for a *de minimis* threshold, according to which acquisitions of Swiss companies that, in the past two financial years, have had on average less than 50 full-time employees and have generated worldwide annual turnovers of less than CHF 10 million are not subject to FDI control.

If one of the above thresholds is exceeded by the Swiss target company, three different categories of transactions trigger FDI control:

— Acquisitions by state-owned or state-affiliated foreign investors are subject to FDI control *per se*, irrespective of the sectors in which the Swiss target company operates. Foreign investors are considered as 'state-owned' or 'state-affiliated' if they are directly or indirectly controlled by a government body of a foreign state, which has the ability to exercise decisive influence over the activities of the controlled company, regardless of the extent to which this ability is actually exploited.

— Acquisitions by private foreign investors are subject to FDI control if the Swiss target company operates in particularly critical sectors to public order and security, regardless of any turnover threshold (apart from the aforementioned *de minimis* threshold). Such sectors are exhaustively listed in the FIRA and include the defense industry, the energy and water supply sector as well as companies that supply important security-related IT systems or services to Swiss authorities.

— Economically significant acquisitions by private foreign investors are also subject to FDI control if the Swiss target company (i) operates in critical sectors to public order and security and (ii) has generated an average annual turnover (or in case of banks gross earnings) of at least CHF 100 million in the past two financial years. These critical sectors are listed in the FIRA and include hospitals, companies in the pharmaceutical and medical products industry, Geneva and Zurich airports, railway infrastructures, food distribution centers, telecommunication network operators or owners, as well as banks and financial market infrastructures of systematic importance.

The Swiss Federal Council will have the authority to extend the scope of the FDI control mechanism for a maximum period of twelve months to other categories of Swiss undertakings if it is necessary to ensure public order or security.

C. APPROVAL CRITERA

An acquisition subject to FDI control shall be approved if, viewed *ex ante*, there is no reason to assume that it would endanger or threaten public order or security.

According to the Explanatory Report, a takeover is likely to endanger public order or security, for example, if the foreign investor is engaged in activities that have a detrimental effect on the public order or security of Switzerland, or if 'significant distortions of competition result from the acquisition' (the idea is not to review distortions of competition *per se* but their consequences on Swiss public order and safety: for instance a Swiss company providing weapons to the Swiss army is going bankrupt as a result of unfair competition by another Swiss company controlled by a foreign state-owned company).

The Swiss authorities would mainly consider whether the foreign investor and its beneficial owner enjoy a good reputation and thereby guarantee proper business conduct, as well as the extent to which the foreign investor would have access to the critical parts of the target company. In this respect, the FIRA contains a non-exhaustive list of approval criteria. In particular, the Swiss authorities should take into account factors such as the involvement of the foreign investor in activities having a detrimental effect to the public order or security of Switzerland or other states (a threat to Swiss public order is more likely if the foreign investor has endangered other states in the past), the engagement of the foreign investor (or its home state) in espionage. Other criteria include whether (i) the foreign investor has been directly or indirectly subject to sanctions under the Swiss Embargo Act, (ii) critical services, products or infrastructure of the target company can be replaced within a reasonable period of time (the aim is to avoid any risk of shortage), or (iii) the foreign investor may have access to important security-relevant information or sensitive data.

Rather than being prohibited, an acquisition may be approved subject to specifics requirements and conditions,

provided that these conditions allow to rule out any threat to public order and safety.

D. APPROVAL PROCEDURE

1. Overview

The foreign investor must notify the Swiss State Secretariat for Economic Affairs (**SECO**) prior to the completion of the acquisition. Until approval is granted, completion of the acquisition is suspended under civil law.

The Swiss Federal Council will provide an exhaustive list of documents that must be submitted to SECO, which may include the description of the foreign investor's sources of financing and ownership structure.

In the event of suspected non-compliance or violation of the obligation to file an application for approval, SECO should initiate an approval procedure *ex officio*.

The prohibition against execution of an acquisition without approval can be enforced by administrative measures (incl. the possibility for SECO to order divestiture) and violations can be sanctioned up to 10% of the transaction value.

2. Phase 1: Direct Approval

Within one month of receipt of the application for approval, SECO decides whether the acquisition can be approved directly (phase 1) or whether there are grounds for conducting a screening procedure (phase 2).

SECO shall take its decisions in agreement with the competent administrative units involved and after having conferred with the Swiss Federal Intelligence Service (**FIS**). The administrative units involved are units of the central federal administration designated by SECO on a case-by-case basis, but including in all cases the State Secretariat of the Swiss Federal Department of Foreign Affairs and the General Secretariat of the Swiss Federal Department of Defence, Civil Protection and Sport. SECO and the administrative units involved, but not the FIS, each have a veto right: if no agreement is reached among them, a screening procedure must be initiated (cf. phase 2, *infra* III.D.3). In cases of minor importance, the administrative units involved may authorise SECO to take the decision on its own.

3. Phase 2: In-depth Examination

If a screening procedure (in-depth examination) has to be initiated, SECO decides, in consultation with the administrative units involved and the FIS, within three months of the initiation of the screening procedure, whether the acquisition is approved or not.

If the acquisition is rejected by SECO or one of the competent administrative unit or if SECO and the involved administrative units are of the opinion that the acquisition is of 'considerable political significance', the decision-making authority is transferred to the Swiss Federal Council, which must take its decision at the latest during its first regular meeting after expiry of the aforementioned three-month period.

E. LEGAL REMEDIES

Non-approval decisions, whether issued by SECO or the Swiss Federal Council, are subject to appeal to the Swiss Federal Administrative Court. Only the foreign investor and the Swiss target company have standing to appeal. In cases of considerable political significance, judicial review will be limited to compliance with due process rights.

IV. CONCLUSION

The consultation period of the FIRA will run until September 9, 2022.

The Federal Council still advises against introducing new legislation as it considers the cost/benefit ratio to be unfavourable and the existing regulations to be sufficient.

As the matter has already been strongly discussed in parliament during the debate on the Rieder motion, the draft legislation will most likely be subject to numerous amendments.

Should the proposed legislation enter into force, foreign investors and relevant Swiss target companies will have to assess these new investment control law risks before entering into a (problematic) takeover transaction and address these risks with adequate contractual provisions.

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