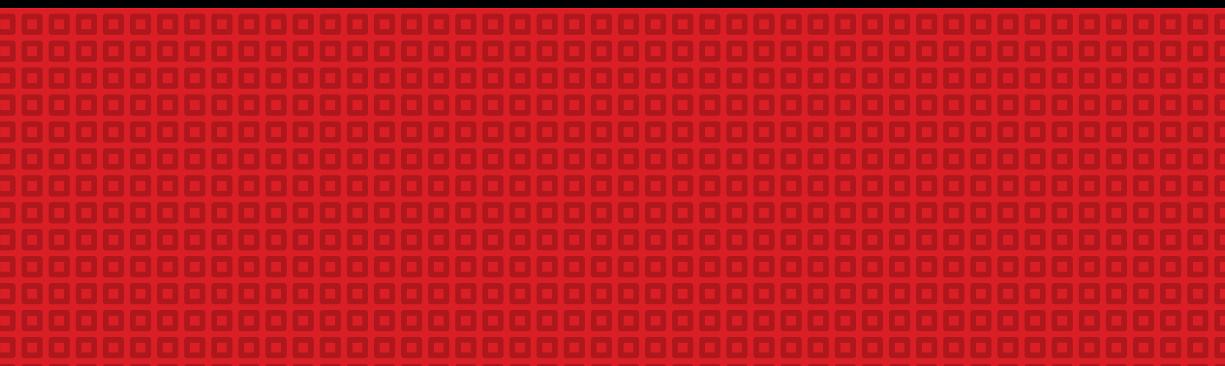
FOREIGN DIRECT INVESTMENT REGULATION GUIDE

THIRD EDITION

Editor
Veronica Roberts



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Publisher's Note

While the appetite, and necessity, for outside capital remains unabated, increasingly this is running into national security concerns as well as stricter regulations on mergers. This step change is illustrated by the growing number of high-profile deals that have been blocked or unwound by regulators in the last few years, or cleared but with commitments. There has also been a significant uptick in activity on the part of screening authorities, both in terms of notifications received and the monitoring of non-notified transactions. Such reviews can have a significant knock-on impact on timetables, making it crucial to consider whether upfront voluntary engagement is worthwhile.

The third edition of the Global Competition Review *Foreign Direct Investment Regulation Guide*, edited by Veronica Roberts, provides practical and timely guidance for both practitioners and enforcers trying to navigate this fast-moving environment. The *Guide* draws on the wisdom and expertise of distinguished practitioners globally to provide essential guidance on subjects as diverse as the evolving perspective on deals with China to the changing face of national security.

CHAPTER 12

Switzerland: Gearing up to a New Comprehensive FDI Control Regime

Fabian Martens[1]

To date, Switzerland does not have a coherent legal framework for the control of foreign direct investment (FDI). Control has been limited to either certain industry sectors or assets. In May 2022, at Parliament's request, the Federal Council had presented a Draft Bill[2] for FDI regulation together with an Explanatory Report[3] for public consultation. As the feedback from a majority of the participants was critical, the Federal Council instructed the Federal Department of Economic Affairs, Education and Research (EAER) to draft legislation by the end of 2023. The Revised Draft Bill for the Federal Screening Act is expected to have a narrowed scope and will focus on foreign state investors.

The first section of this chapter discusses some key issues and provides relevant overviews including regarding certain specific sectors such as energy and telecommunication. The second section begins with a summary of the current legal landscape in force in Switzerland as of September 2023. It continues with an outline of the Draft Bill presented by the Federal Council on 18 May 2022, taking into consideration the latest findings from the consultation ended in 2023.

1 Fabian Martens is a partner at Pestalozzi Attorneys at Law Ltd.

2 'Vorentwurf Bundesgesetz über die Prüfung ausländischer Investitionen', dated 18 May 2022 (the Draft Bill).

3 'Erläuternder Bericht zur Eröffnung des Vernehmlassungsverfahrens', dated 18 May 2022 (the Explanatory Report).

Key issues and overview

Evolving concept of national security

The concept of national security by means of FDI regulation has picked up momentum in recent years. Switzerland does not currently have any comprehensive FDI control legislation. The current legal framework in Switzerland dealing with foreign investments only covers very few sectors such as the purchase of land by non-residents[4] or the acquisition of banks by foreigners.[5]

The introduction of a more comprehensive FDI control regime in Switzerland has been subject to political discussion on several occasions. In spring 2019, the Federal Council of Switzerland answered two political postulates regarding FDI[6] with a report regarding cross-border investments and investment controls.[7] In its report, the Federal Council concluded that, in particular, public ownership of critical infrastructure and the existing regulation provided sufficient protection against threats to the public order and safety of Switzerland. It argued that the liberal structure of the Swiss economy would be at risk if an investment control resulted in a protectionist regime.[8] Nevertheless, by approving the motion Rieder 'Protection of the Swiss Economy by means of Investment Control',[9] Parliament instructed the Federal Council in 2021 to prepare a draft bill regarding the control of FDI.

The Federal Council prepared the first Draft Bill for the new FDI regime in spring 2022. The main goal of the Draft Bill was to mitigate the threat to public order or safety by acquisitions by foreign investors. The Draft Bill is based on the assumption that the main threat may be posed by investors that are close to the government. As a result, the Draft Bill provides that the takeovers of domestic undertakings by foreign public or state-affiliated undertakings in all industries shall be subject to investment control. The Draft Bill of 2022 also included takeovers of undertakings in certain critical industries to be subject to investment control, irrespective of the nature of the investor. However, because the public

4 See 'Acquisition of real estate' below.

5 See 'Banking' below.

6 Postulate 18.3376 Bischof 'Foreign takeovers in Switzerland. Is the current laissez-faire still acceptable?' dated 16 March 2018 and Postulate 18.3233 Stöckli 'Investment control of foreign investments' dated 15 March 2018.

7 Federal Council report, 'Cross-border Investments and Investment Controls', dated 13 February 2019.

8 ibid., p. 54 et seq.

9 Motion 18.3021 Rieder, 'Protection of Swiss economy by investment control', dated 26 February 2018.

consultation this part is expected to be substantially reduced or removed in the revised draft expected to be published by the end of 2023 (the Revised Draft Bill). Small takeovers are exempt from the investment control.

Widening focus beyond China on both sides of the Atlantic

The Draft Bill does not make any reference to the country of origin of the investor. Therefore, it applies to any foreign investor equally. The Explanatory Report mentions that investments from 'booming emerging markets' had been increasing around 2015 but had been slowing down in recent years.[10]

If FDI regulation is introduced now, in spite of even slowing investments from such emerging markets, the assumption may be made that the focus is broader nowadays.

Impact of FDI regimes on investments and transactions in the energy sector

The energy sector is one of the key priorities of the Draft Bill. This is reflected, on the one hand, with a comparatively detailed regulation and, on the other hand, in the fact that any transaction in the industry must be approved irrespective of the undertaking's turnover if the general *de minimis* threshold is reached. In particular, the takeover of the following undertakings in the energy sector is subject to the approval requirement:

- undertakings operating or owning the domestic electricity transmission network (i.e., Swissgrid)[11] or distribution networks on network level 3 or below, if they output at least 450 gigawatt hours per annum (net value of purchases by end consumers or distributors);
- undertakings operating or owning domestic energy plants for the production of 100 megawatts or more; and
- undertakings operating or owning domestic high-pressure natural gas mains in Switzerland.

Impact of FDI regimes on investments and transactions in the technology sector

The Draft Bill only contains limited regulation regarding the technology sector. One reason for this reluctance may be that the Federal Council explicitly wanted to avoid the abuse of FDI control for certain technologies to protect jobs or to

10 Explanatory Report, p. 4.

11 www.swissgrid.ch.

prevent a drain of know-how. The Explanatory Report explains that investment control based on industrial policy could be abused for protectionist reasons. Instead, according to the Explanatory Report, technologies are best supported by a framework supporting innovation and competition, adequate education and research, and an effective protection of intellectual property.[12]

The Draft Bill subjects the takeover of the following undertakings to the approval:

- undertakings supplying domestic authorities with key safety-relevant IT systems or offering such IT services; and
- undertakings operating or owning domestic telecommunication networks.

Tech companies producing dual-use products may also be subject to FDI control.[13]

Remedies

The general proportionality principle requires that the authorities consider 'milder' alternatives to a complete ban of a takeover. Accordingly (and similar to merger control under the Cartel Act),[14] the authority may impose conditions and obligations for the approval of the takeover. This right is explicitly set out in Article 5 paragraph 4 of the Draft Bill.

Conditions and obligations must be appropriate to eliminate a threat to public order or safety. In particular, conditions and obligations that serve other purposes are not permitted under the FDI control regime according to the Draft Bill. The Explanatory Report mentions that, for example, the granting of job guarantees from investors as a condition for approval would not be justified.

In merger control according to the Cartel Act, a clear tendency away from behavioural to structural remedies can be noticed. Structural remedies often offer a cleaner solution with substantially less state intervention in the future. In contrast, behavioural remedies often require efficient monitoring of future behaviour and may become ill-suited or ineffective in changing market environments. It remains to be seen if this priority for structural remedies will also be seen in the administrative practice regarding FDI control.

12 Explanatory Report, p. 5.

13 See 'Takeovers requiring approval' below regarding the defence sector.

14 Article 10 paragraph 2 of the 'Bundesgesetz über Kartelle und andere Wettbewerbsbeschränkungen', dated 6 October 1995 (the Cartel Act).

In addition, it should be noted that the Draft Bill grants the authorities some degree of discretion when taking the conduct of the investor into account. The explanatory notes mention as examples the willingness of the investor to provide additional information to the authority. As the identification of adequate remedies may often require additional information or even proactive suggestions by the notifying parties, non-cooperation regarding the finding of remedies may therefore lead to a more restrictive decision by the authority. However, the Draft Bill clarifies that this does not apply to information that the investor is entitled to withhold.

Analysis of key FDI jurisdictions

Overview of current sector-specific FDI regulation in Switzerland

Switzerland has, to date (September 2023), no comprehensive FDI control regime. This situation will change once the Revised Draft Bill enters into force. Nevertheless, Switzerland already has some regulation in place that regulates or restricts FDI in certain sectors.

Acquisition of real estate

The Federal Act regarding the Acquisition of Real Estate by Non-Residents[15] (Lex Koller), restricts the acquisition of real estate in Switzerland. Non-residents require the approval of the respective cantonal authority, which can only be granted in certain cases defined by the Act. The aim of the Lex Koller is to prevent the 'foreign infiltration' of national ground.

The Lex Koller applies if the following three conditions are met:

- Non-resident: the purchaser must either be a person living abroad or legal entity being controlled by such a person. 'Control' exists if the management of the company can be influenced to a substantial degree. This may be the case due to the financial participation, voting rights, or for other reasons.
- Real estate subject to approval: no approval is required, for example, if the property is acquired as the primary residence of a natural person or if it is used for an economic purpose (business premises).

15 'Bundesgesetz über den Erwerb von Grundstücken durch Personen im Ausland', dated 16 December 1983 (Lex Koller).

- Nature of the right obtained subject to approval: the Lex Koller applies to the acquisition (i.e., the entry into the land register of real estate). However, even other forms of obtaining a similar position as an ownership fall under the approval obligation. This includes the purchasing of shares in non-listed legal entities with the aim of acquiring real estate.

Banking

According to Article 3 *ter* of the Federal Act on Banks and Saving Banks,[16] banks that are, after their foundation, controlled by non-residents are subject to an additional approval by the Swiss Financial Market Supervisory Authority (FINMA). A new approval is required also when qualified participations (e.g., a participation exceeding 10 per cent) of non-residents of such a bank change. The board members and management have an obligation to report any relevant information regarding non-resident control or ownership.

FINMA has extensive tools to enforce these provisions and safeguard the irreproachable business activity.

Overview of the current Draft Bill on FDI control[17]

General remarks and definitions

As stated above, the current Draft Bill is aimed at regulating takeovers of private and public undertakings by foreign investors.

A 'takeover' is defined as any transaction by which the investor(s) directly or indirectly obtain(s) control over an undertaking or parts of it. The term takeover refers to the term under antitrust law. It is sufficient that the investor obtains the possibility of control – an actual exercise of such control is not required. According to the Draft Bill, the acquisition of 'substantial' assets is also deemed a takeover. This may create some degree of legal uncertainty as it may not be clear what such substantial assets include. In contrast, so-called greenfield investments (establishments of new companies) are not covered by the Draft Bill.

'Undertakings' are defined as consumers or suppliers of goods and services active in commerce regardless of their legal or organisation form.[18] The Draft Bill offers two alternative definitions of 'domestic undertakings'. Domestic

16 'Bundesgesetz über die Banken und Sparkassen', dated 8 November 1934 (the Banking Act).

17 The Draft Bill is not yet in force and may be subject to changes after the evaluation of the consultation procedure.

18 See the definition of undertakings under Article 2 paragraph 1 *bis* of the Swiss Cartel Act.

undertakings must, in any case, be registered with the (Swiss) commercial registry. However, the Draft Bill (to date) leaves open whether the Swiss subsidiary of a foreign group would be considered as a domestic undertaking.

A 'foreign investor' includes all undertakings whose main registered seat or place of management is outside of Switzerland and natural persons without Swiss citizenship (with some limited exceptions for EU or EFTA citizens).

Takeovers requiring approval

The current Draft Bill draws a key distinction between takeovers by private investors and public (or state-affiliated) investors.[19] This is based on the assumption that takeovers by private investors are typically economically incentivised and, therefore, bear a lower risk than takeovers by public (or state-affiliated) investors, which may (also) be politically motivated. As a result, takeovers by public (or state-affiliated) investors above the relevant *de minimis* thresholds always require an approval, whereas takeovers by private investors only require an approval for certain sectors (in particular: defence, electricity, gas, water, IT). Some takeovers by private investors are, in addition, subject to a turnover threshold of the domestic undertaking (in particular: university hospitals, pharmaceuticals, transportation and logistics, food supply, telecommunication, finance). It is expected that the Revised Draft Bill will have a narrower scope and focus on foreign public investors taking over a domestic company operating in a particularly critical sector only.

As a general *de minimis* threshold, takeovers of domestic undertakings with fewer than 50 full-time positions and turnover of less than 10 million Swiss francs worldwide on average in the last two business years are exempted from FDI control.

Procedure

The foreign investor must submit the request for approval to the State Secretariat for Economic Affairs (SECO).[20] The application must be made prior to the closing of the transaction. If a transaction requiring approval is closed before the approval is granted, the Federal Council may order appropriate measures to restore legal status, including divestment. In the event of a violation or circumvention of the application duty by the investor, the authority may also open an approval procedure *ex officio*.

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19 See also 'Evolving concept of national security' above.

20 www.seco.admin.ch.

The procedure has two phases. Within one month after receipt of the application (Phase I), the SECO decides whether to open an investigation. The foreign investor is informed in writing. If an investigation is opened (Phase II), the authority has three more months (after opening the investigation) to decide on the approval. Failure to issue a decision within these deadlines for Phase I or II is deemed an approval of the transaction. Extension of deadlines is only possible if the foreign investor or the domestic undertaking have obstructed the investigation or relevant information from the foreign authorities is outstanding.

The foreign investor and the domestic undertaking can appeal against the final decision of the authority. Other interested third parties such as another interested investor have no right to appeal.

The persons and entities involved in a transaction are subject to an information duty to the SECO. This duty directly applies to the foreign investor or the domestic undertaking, but may also include the ultimate owners of a foreign investor.

Substantive assessment

The authority approves the takeover if there is 'no reason to assume that the public order or safety could be threatened by the takeover'.[21] The Draft Bill outlines some of the criteria the authority may consider for their assessment. On the one hand, conduct and characteristics of the foreign investor may be taken into account, such as earlier activities negatively affecting public order or safety of Switzerland or other countries, espionage activities, or pending sanctions against the foreign investor under the Embargo Act.[22] On the other hand, the authority may consider objective criteria such the substitutability of services, products and infrastructure of the domestic country in due course or the access of the foreign investor to highly sensitive personal data. Finally, a substantial distortion of competition as a result of the takeover can be taken into account. The list of relevant criteria is non-exhaustive.

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21 Draft Bill, Article 5 paragraph 1.

22 'Bundesgesetz über die Durchsetzung von internationalen Sanktionen', dated 22 March 2002 (the Embargo Act).

Sanctions for non-compliance

Sanctions for non-compliance with the approval procedure amount to 10 per cent of the transaction value. This includes the closing of a transaction without approval or refusal to comply with the measures ordered to reinstate the legal status. If the transaction value is unknown, the SECO may estimate the transaction value.

Furthermore, violation of the information duties[23] may result in sanctions of up to 100,000 Swiss francs.

23 See 'Sanctions for non-compliance' above.