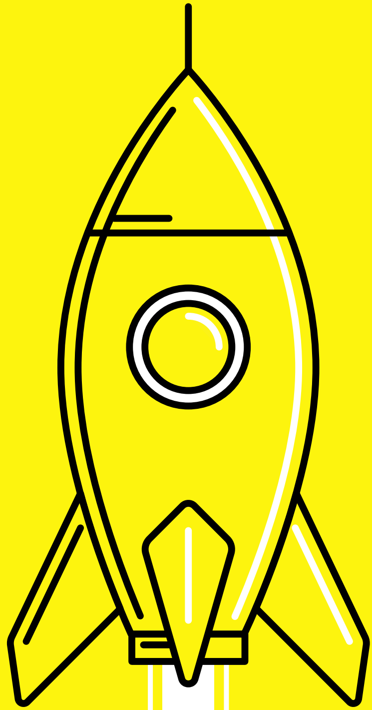
Kellerhals Carrard



Startup

from Incorporation to Exit

Simple guide on selected topics

Foreword

For those who have been out there in the field experiencing the economic development of the last twenty years, the expansion of entrepreneurship in Switzerland, particularly in the French-speaking part of the country, is delightful. While many traditional sectors were facing major challenges, innovation has gradually emerged as the most promising area in our country. Switzerland now appears as one of the countries investing the highest proportion of its GDP in research and development, and is very well positioned, in international comparison, in terms of patents and scientific publications in relation to its population.

This has come in parallel to an improvement in the framework conditions for new technology companies. While it is true that the notion of "startup" is not defined and rarely enjoys a special status in the legal system, the players today have (or can have) a clear vision of the legal and tax issues that will mark the development stages of their company. Think about the mentoring and promotion activities to foster the transfer of technology from the public to the private sector within the "Hautes Ecoles"; or the standardization of investment agreements or shareholders' agreements that have perfectly integrated the business model of high-growth companies. Of course, there are still a number of issues that need to be addressed to improve the ecosystem: scale-up financing, retention of technology in Switzerland following trade sales, easier access to capital markets through democratization of IPOs or STOs or the creation of exchange platforms.
In this context, there is no shortage of information available to business creators. They can find numerous freely available publications, some popularizing, others diving deep into the intricacies of the legal regime applicable to startups, but most often only shedding light on certain aspects. It therefore seemed to us that there was room for a guide that would describe, in a simple, precise and practical way, the legal framework marking all stages of the life of the company, from its incorporation to its exit.

This is the purpose of this guide, written by many authors who share in common their passion and devotion to supporting entrepreneurs and young companies. This spirit has led them to create a legal startup, Seed Up, since "the best way to understand the challenges facing a startup is ... to be one"!

Beyond this creed, we are convinced that the best support for a startup depends on the state of mind of its advisors, who must be not just an observer but a stakeholder in the project, sharing the ups and downs, the dark moments of despair and the exaltation of victories. May this guide be a faithful companion to all those who believe that legal tools can be a means to facilitate the development of their project, and not a necessary evil.

Thank you

The following persons have contributed to the preparation of this guide:

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1. Project and Business Plan

1.1 Context

Any entrepreneurial project requires business planning incorporating consideration of sales, organizational, financial and legal strategy. The entrepreneurial sector has experienced significant growth in recent years and there is an ever-increasing range of tools available to new managers.

The leading tool in this field has long been the business plan. A key part of the curriculum in all the most renowned business schools, this document has been a vital prerequisite for any new company and remains a key reference point for many companies.

In the last few years, however, we have seen new approaches beginning to emerge among entrepreneurs. The current dominant trend is more iterative and experimental than the traditional business plan approach, which focuses on planning. The entrepreneurial world is now abuzz with the “lean startup” method, whose main characteristic is risk reduction.

This chapter presents a brief introduction to these two approaches.

1.2 Business Model and Business Plan

Firstly, it is worth noting that these two approaches can be complimentary and that they pursue a common goal of helping conceptualize an existing company or startup and defining its outlines in economic, organizational, financial and legal terms. The relevance of the tools available depends on what stage the business is at in its life-cycle. The Business Model Canvaas (inspired by the “lean startup” approach) is more relevant to nascent projects, while a Business Plan is more appropriate for maturer companies.

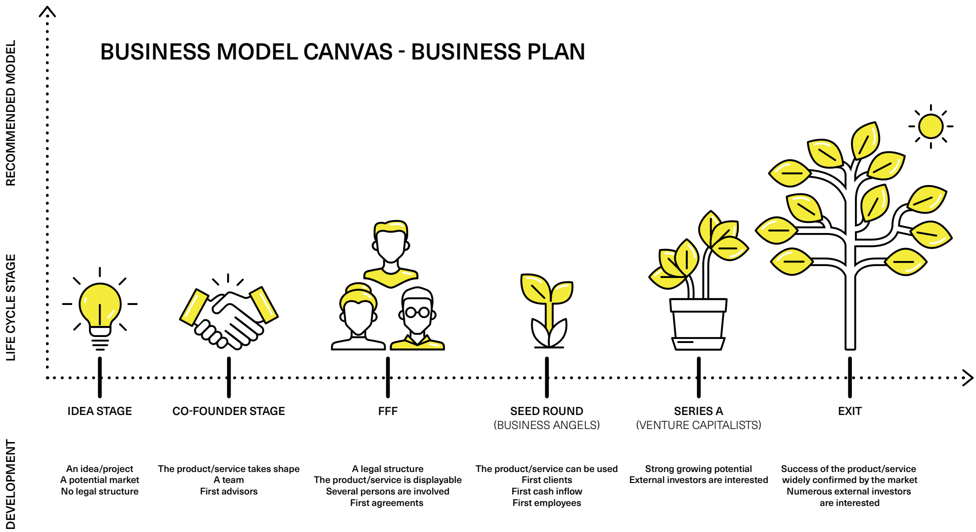


Figure 1 : Approach « lean startup » v. Business Plan

1.2.1 Business Model Canvas

Any startup must define its business model and secure some legal aspects before the Seed Round stage.

The business model sets out the principles according to which the company creates and delivers value to its customers. The general public was introduced to the concept of the Business Model Canvas by A. Osterwalder and Y. Pigneur in 2010 in their book Business Model Generation. It serves as a reference for defining economic models and constitutes an effective and intuitive tool for entrepreneurs at the start of their journey. We believe that a complete business plan is not justified at the embryonic stage of a company, since it needs to include approximate forecasts before even presenting the product/service to the market. The Business Model Canva includes nine clear building blocks:

1. Key Partners: partners and suppliers required by an entrepreneur to perform its key activities.

2. Key Activities: main activities required for the success of the business model.

3. Key Resources: all resources, whether physical (movable and immovable assets), human, financial or intellectual (trademarks, patents, copyright, etc.).

4. Value Propositions: combination of products and/or services that create value for the target customer segment. This addresses their needs and resolves their problems. Value may reside in price and/or quality.

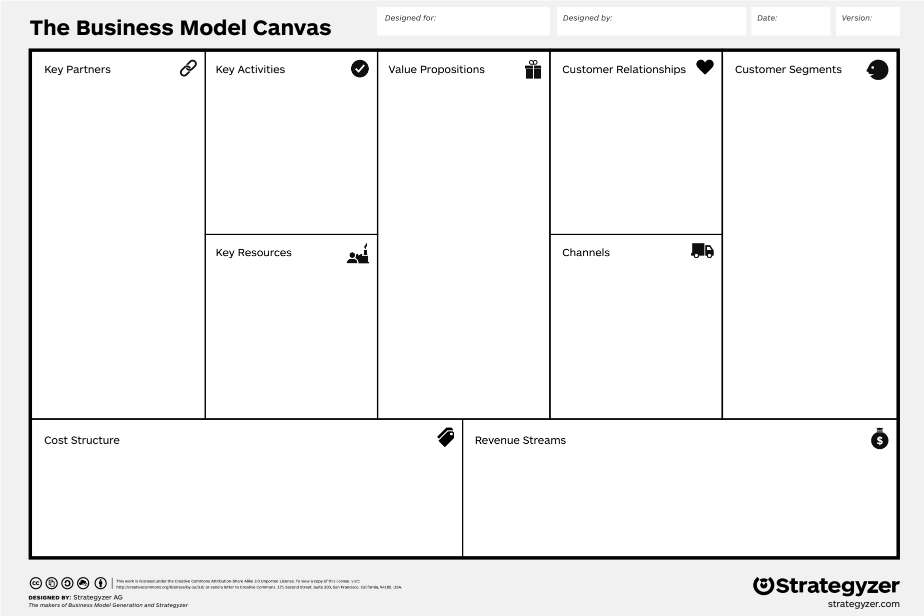
5. Customer Relationship: marketing approach designed to attract and retain customers.

6. Channels: communication, distribution and sales channels.

7. Customer Segments: various groups of individuals targeted by the company's value proposition. These are individuals with similar needs, aspirations and spending power. A distinction is drawn between the mass market, niche market (very specialist customers), segmented market (several types of similar customers) and diversified market (different target customers).

8. Cost Structure: fixed and variable costs.

9. Revenue Streams: cash-flow generated by unique sales, subscriptions, licenses and leasing.



1.2.2 Business Plan

The business plan is a planning tool more adapted to startups at a more advanced stage of development, which have already raised funds from their inner circle and whose product/service is starting to attract its first customers. At this stage, it is advisable to prepare a more comprehensive plan, containing detailed information with a large financial component, particularly forecasts. In any case, the process of preparing the business plan is useful to help an entrepreneur consider essential aspects of his/her business. We should note that a business plan must be presented differently depending on its recipient. An investor, financial establishment or commercial partner will not be interested in the same aspects of the business plan, so its presentation should be adapted to the specific goal.

Here is a standard plan tailored to startups:

1. Management summary: summary of business model, key financial information (revenues, if relevant, and financing needs) and objectives (propositions).

2. Entreprise: headquarters, name, legal form, mission statement, founder(s), structure of share capital, directors and advisors.

3. Management and Personnel: profile of founders and managers, organization chart, decision-making and signature rights, decision-making process and employees.

4. Products/Services: detailed description of components of the product/service, the customer needs they fulfill and problems they solve.

5. Market: description of customer segments targeted, potential market volume, projected market share, growth rate of the market in question and detailed competition analysis (benchmarking of strengths and weaknesses).

6. Marketing: definition of a marketing strategy (positioning: strategy based on cost, differentiation or niche) and operational implementation in terms of product, pricing, communications and distribution policy.

7. Risk Analysis: decline in demand, loss of a strategic partner, loss of market share, major innovation jeopardizing the business model.

8. Production and Infrastructure (where relevant): production site (advantages and disadvantages), infrastructure, production machinery.

9. Financial Planning: obligation to maintain complete accounting records for companies that have achieved revenue of at least CHF 500,000 in the previous year and for legal entities. Otherwise, option of maintaining records for income and expenditure and assets (article 957 of the Swiss Code of Obligations); projections (revenue, costs, earnings, cash flow, break-even, etc.); financing (equity and debt capital); usual financial ratios.

10. Intellectual Property: patent, trade-mark protection, copyright and domain name.

11. Milestones: future targets and deadlines (e.g. fund-raising).

1.3 Legal feasibility study

Legal analyses are part of the definition of the business model. As with the business plan, legal requirements differ depending on the stage in the startup's development. We therefore recommend carrying out certain legal analyses at a micro level (i.e. in respect of specific elements of the company), meso level (i.e. concerning the company overall) and macro level (i.e. relationship between the company and external entities):

- **At the micro level:** legal feasibility study and protection of intellectual property where relevant.
- **At the meso level:** creation of a legal form suited to the situation and a shareholders' agreement.
- **At the macro level:** management of partners.

The legal feasibility study determines the legal compliance of the planned product/service. This study is part of the "lean startup" approach described above, which recommends presenting a product/service to its potential market as soon as possible. It also makes it possible to limit costs and risks of failure or even violation of legal provisions. This analysis therefore needs to be carried out as soon as possible by entrepreneurs to assess their financial risks (probability and amounts) and prepare aspects which will be vital to their future activity.

2. Foundation: choice of legal form, process and associated document

2.1 Context

The choice of legal form is part of a startup's development process. Legal structure is also less of a "choice", strictly speaking, than the result of an analysis of the structure best suited to the company's situation and objectives.

The Swiss Code of Obligations (CO) contains mandatory rules (with no exceptions) and specific dispositive provisions for each legal structure. A sound knowledge of the various legal forms and rules associated with them are required to avoid unpleasant surprises.

In this chapter, we look at the practical elements enabling founders of a startup to decide the legal form they wish to give their business: the type of business, the number of founders, publication of the shareholding structure, and financing needs and risks associated with the business model, all of which are criteria that will be taken into account when choosing the company's legal form.

2.2 Partnerships and Corporations

The Swiss legal system sets out an exhaustive list of forms of companies. It is not therefore possible to organize a company in Switzerland based on foreign law.

In practice, people generally decide to conduct their business in the form of *raison individuelle* (sole proprietorship, SP), *société en nom collectif* (general partnership, GP), *société à responsabilité limitée* (SARL – limited liability company, LLC) or *société anonyme* (SA – corporation).

A distinction is drawn between *sociétés de personnes* (partnerships) and *sociétés de capitaux* (corporations). A general partnership falls into the first category, while LLCs and corporations are *sociétés de capitaux*.

The fundamental difference between these two categories lies in the owners' liability for the company's debt: partners in a *société de personnes* incur unlimited liability in relation to all their assets for the company's debts while only the assets owned by a *société de capitaux* may be used to meet the company's debts and not its owners' (or shareholder's) assets.

2.3 Brief description of the main legal structures

2.3.1 Sole proprietorship - Raison individuelle

A sole proprietorship is not considered a company and is therefore not specifically regulated by the Code of Obligations. It does not have a legal personality. The business is therefore completely personal and embodied in the sole proprietor who operates it.

Unlike *sociétés de capitaux*, it does not have a minimum share capital or organizational structure imposed by law. However, it allows the hiring of personnel and the conclusion of commercial contracts.

The main disadvantage of an SP lies in the fact that its proprietor is directly exposed to his/her creditors if the business fails to make a profit. It is therefore generally limited to tradespeople and local activities, whose economic risk is more manageable.

2.3.2 General partnership - Société en nom collectif

A general partnership is founded by two or more natural persons. It is a partnership that has a quasi-legal personality. Like the SP, it does not have an initial minimum share capital requirement. The corollary is that the partners have unlimited liability for the company's debts, although that liability is subsidiary to the assets of the company, meaning that creditors must first be paid from the company's assets and may only turn against the partners if the bankruptcy proceedings have remained unsuccessful.

2.3.3 LLC and corporation - Société à responsabilité limitée and société anonyme

An LLC is a very interesting legal form for entrepreneurs, since its minimum share capital is relatively low (CHF 20,000) but it is solely liable for the company's debts. Owners of an LLC (called associés or "partners") are therefore protected and their personal assets are not at risk if the business fails.

A corporation has the same characteristic. However, it offers broader options in terms of organizing the share capital, particularly the formation of conditional capital designed to remunerate employees via profit-sharing plans (see chapter 4.4). The owners (called "shareholders") can also remain anonymous in respect of third parties, unlike an LLC, whose partners are registered on the commercial register. A corporation is therefore the preferred form when third-party professional investors (e.g. business angels, wealthy private investors or venture capitalists) wish to invest in a startup.

2.4 Criteria for choosing between the different legal forms

2.4.1 Type of business

The business type is the primary criterion for choosing between the different legal forms: the local or international nature of the business, its development and the type of trade are all factors in deciding the legal form.

2.4.2 The number and type of founders

By definition, an SP is operated by a single natural person, even if the latter may have a number of employees. It is not appropriate for a business with several owners. A GP, meanwhile, cannot be founded by a single person.

Sociétés de capitaux can be formed by one or more natural persons or legal entities.

2.4.3 Publication of the shareholding structure

When SP is chosen as the form, registration of the founder's name in the commercial register prevents any anonymity. The same applies for a GP.

Anonymity of the shareholder base is also excluded in the framework of an LLC since shareholders' names are registered in the commercial register, unlike in the case of a corporation. The corporation is therefore the only form to guarantee investor confidentiality with regards to the public.

2.4.4 The risks linked to the company

The duration of the commitments undertaken by the company, their extent, the risks facing the business and the size of investments are decisive in the choice of legal form. For issues of liability, it is imperative to create a *société de capitaux* when the company faces significant risks.

No business is risk-free; however, the risks effectively incurred should be weighed against the need to invest initial share capital when setting up the company.

2.4.5 Financing needs and share capital structure

Partnerships and SPs do not require any minimum share capital. The possibilities for financing using external funds are therefore highly dependent on the founder's ability to provide personal guarantees (e.g. life insurance or mortgage).

Sociétés de capitaux, meanwhile, require a minimum share capital (CHF 20,000 for an LLC and CHF 100,000 for a corporation, although only CHF 50,000 of the share capital may be actually paid-up in the case of a corporation), conceived to serve as a basic financial guarantee for investors, with Swiss law requiring drastic measures when that buffer is endangered (see chapter 7.3). Financing options then become more accessible for these companies since the share capital constitutes a guarantee in itself for new investors.

Unlike a corporation, the rules governing LLCs make it possible to impose additional obligations on partners, particularly in the form of additional contributions to the share capital. On the other hand, the various share capital increase mechanisms offered by a corporation provide significant flexibility when arranging new shareholdings for one or more investors. For example, the option of creating preferential shares is vital once the startup reaches a certain stage in its development and wants to incorporate professional investors in its share capital. Thus, when the business requires the provision of significant financial resources from third party investors, it is imperative that the activity be carried out in the form of a corporation.

The transformation of an LLC into a corporation is an operation provided for under Swiss law. However, it presents a certain complexity that should not be underestimated, and may lead to unexpected costs. The operation is particularly critical when the conversion takes place during a financing round in order to guarantee the anonymity of the investors.

3. Relations between shareholders

3.1 Context

Shareholders' agreements aim to contractually govern shareholders' rights and obligations to an extent not allowed by the articles of association. The articles of association may not stipulate any obligation on shareholders other than paying the share issue price (article 680 of the Code of Obligations). In practice, however, the need exists to personalize the relations between shareholders. The shareholders' agreement binds all or some of the shareholders belonging to the same company. It typically includes provisions relating to the company's organization (e.g. corporate governance, composition of the board of directors, quorum, majority and veto rights relating to certain important decisions by the board of directors and the general meeting), limits on the transfer of shares and protection of the investment (e.g. anti-dilution, investment procedures).

The shareholders' agreement makes it possible to customize mutual relations between the shareholders. In startups, it is a fundamental document governing, first of all, the relations between the founder-shareholders, and subsequently, the relations with the financial investors during the investment period until exit.

Furthermore, even though a shareholders' agreement will not prevent or resolve all conflicts between shareholders, its rules will play a role in the negotiations and may prevent court proceedings by providing an adequate contractual framework for discussions (including a dispute resolution mechanism).

3.2 Legal regime

The shareholders' agreement is a contract subject to the general rules of the Code of Obligations, but in Switzerland it is not explicitly treated as a typical contract in a specifically dedicated section of the Code.

If the parties pursue a common goal – typically in the case of a voting agreement – they will be deemed to form a simple partnership (société simple, art. 530 et seq of the Code of Obligations). It is necessary to examine whether the services and obligations agreed between the parties are based on a mere relationship of exchange (quid pro quo) or whether, on the contrary, the common objective predominates. In particular, the legal qualification plays a role when a peremptory norm is at stake, or when the agreement has to be interpreted and supplemented (e.g. on its duration).

3.2.1 Effect limited to relations between the parties

The shareholders' agreement is only applicable between the parties to it. Therefore, acts carried out in breach of the shareholders' agreement are valid if they are carried out in accordance with company law and contract law. The agreement may not therefore be enforced on the company and the offender will only face the remedies for breach of contractual obligations as provided in the Code of Obligations.

3.2.2 Should the company be a party to the agreement?

This question is controversial. It is generally agreed that the company should not be bound by provisions affecting the exercise of the shareholder's rights, particularly the voting right. The company is not authorized to impose obligations on its shareholders beyond paying up their shares, any more than it is able to intervene in the process of forming its own will. It must be acknowledged that the company may, however, make specific commitments to its shareholders in respect of the transfer of own shares held by the company (e.g., preemption right of parties to the agreement) or other commitments which do not directly influence the shareholders' voting right.

3.2.3 Necessary coordination

In any case, it is necessary to coordinate, as far as possible, the provisions of the articles of association, the bylaws and the shareholders' agreement, in order to avoid contradictions between their respective provisions.

3.3 Typical provisions of shareholders' agreements

3.3.1 Preamble

It is useful to provide for a contractual mechanism enabling any new shareholders recognized by the board of directors to subsequently adhere to the existing agreement without having to seek the approval and signature of the existing shareholders.

3.3.2 Governance

The shareholders' agreement frequently contains provisions relating to the governance of the company. These provisions shall then be reflected to the greatest extent possible in the articles of association and in the organizational regulations.

Unlike the articles of association, the shareholders' agreement makes it possible to impose almost unlimited obligations on shareholders, namely for governance purposes:

- **Written agreement of the shareholders:** the written agreement of a specific majority of the holders of shares (ordinary and/or preferred shares) for certain decisions of the general meeting, unknown in the corporation law due to the principle of immediacy, represents a useful means of control;

- **Composition of the board of directors:** the composition of the board of directors is crucial. The conclusion of a shareholders' agreement enables derogation from the majority principle, since it makes it possible to determine the composition of the board of directors and to guarantee the number of directors allocated to each shareholders group. It may also allow the possibility of electing independent directors, whose presence on the board is recommended practice. The shareholders' agreement determines which shareholder or group of shareholders can appoint one or more directors, and sometimes names the specific directors who will serve initially for a fixed period of time. Shareholders are then obliged to comply with their contractual commitment by formally electing or re-electing directors at a general meeting. However, and to the extent that a director may be required to resign or be dismissed by the general meeting, it is important to provide for a clear appointment and replacement process;

- **Observer status:** observer status is frequently provided for minority investors wishing to access information by attending board meetings without having the power to influence the decision-making process. In that case, the status of observer should not be given any voting rights and should be subject to a strict confidentiality obligation, particularly when that observer is not a party to the shareholders' agreement bound by its confidentiality provisions;

- **Decision-making:** special rules deviating from the legal principal (dispositive) of the relative majority (art. 713 CO) may be included in the shareholders agreement and reflected in the organizational rules. It is common to require an absolute majority of board members, sometimes including a specific director. Deadlocks must be avoided, particularly when caused by the voluntary or involuntary absence of some directors. The shareholders' agreement may therefore stipulate that if the required quorum is not met, a new session of the board of directors is convened within a specific time-frame and without the need to meet any quorum. Certain important decisions are typically subject to a qualified majority of the board of directors ("important board matters") or the general meeting ("important shareholder matters"). However, those protection provisions must constitute an exception and are not intended to act as a constraint on the board of directors by excessively limiting its decision-making power; also, the parties should be cautious in the common interest before granting veto rights. Important decisions by the general meeting should be included in the articles of association in order to be enforceable on third parties, it being specified that the articles of association may include stricter rules for the important decisions stipulated in article 704 subparagraph 1 of the Code of Obligations, but not less rigorous provisions;

- **Voting instructions:** the agreement by which directors undertake to exercise their mandate based on instructions from a third party referred to as a "management consortium". It is limited by article 717 of the Code of Obligations and only admissible if the company's interests are defined and the directors may not rely on such instructions to restrict their liability;

- **Information right:** the clear definition of the content and modalities of the information to the shareholders party to the agreement is essential in view of the limits of the law as to its content (article 697 para. 1 and 2 CO) and its frequency (article 696 paragraphs 1 and 4 CO). Indeed, the board of directors has no obligation under company law to inform the shareholders between two general meetings, except on the organization of the company in the context of art. 716b para. 2 CO. However, if not all the shareholders are party to the agreement, directors "delegated" by certain parties to the shareholders' agreement will not be allowed to provide "their" shareholders with all the information they become aware of in the course of their mandate;

- **Dividend policy:** The shareholders' agreement may provide for rules on the distribution of profits (dividend policy), which is rarely the case for startups before the exit. In particular, a clause concerning the distribution of profits allows a minority shareholder to ensure a minimum return. The majority shareholder can thus undertake to distribute dividends if there is a distributable profit.

3.3.3 Limits on the transfer of shares

- **Limits on the transfer of shares:** Provisions relating to restrictions on the transfer of shares make it possible to restrict the circle of shareholders and to avoid certain groups of shareholders being able to transfer their securities without the agreement or participation of the others. In particular, financial investors want to avoid undesirable third parties and competitors being able to acquire or increase their shareholding without control, or founders being able to realize capital gains on securities by taking advantage of the issue premium during the financing round. The basic principle involves preventing the transfer of securities other than in the cases and with the procedures set out in the agreement, so that the parties cannot acquire or sell the securities they hold, respectively, or accept the adhesion of new shareholder to the agreement. Attention should be paid, however, to the limits set out in article 27 of the Civil Code regarding the length of the transfer ban. A total ban on share sales (lock-in period) of three to five years would appear acceptable. The basic rule should be accompanied by exceptions and procedures adapted to the parties' specific needs (e.g. transfer to a wholly-owned company, transfer to spouse or descendants);

- **Preferential acquisition right:** the shareholders' agreement offers greater freedom than the articles of association for the organization of acquisition rights. The latter can only find their place in the articles of association if they fall within the restrictions on the transferability of registered shares (art. 685b para. 7 CO). In practice, the preferential acquisition right (or preferential offer right) is more common than the preemption right in the strict sense. While the preemption right is subject to the condition precedent of the conclusion of the agreement with a third party and therefore assumes the completion of negotiations with an acquirer, a preferred option is often a right to notify the intention to transfer or the receipt of an offer in good faith from a purchaser, be it a shareholder or not. In the latter case, the receipt of such an offer triggers the obligation for the shareholder of inviting the other parties to purchase the concerned shares at the same price and under the same conditions offered by the third parties. Partial exercise of the priority acquisition right is often excluded to avoid dilution of the transferor and the maintenance of a blocking minority for the acquirer. In the event the right is exercised by several fellow shareholders, the solution usually involves arranging a proportional distribution between them. If the fellow shareholders fail to exercise their right, the offering party is free to transfer its shares to the purchaser at the same price and under the same conditions within a contractually agreed time limit;

- **Tag along:** the tag-along right requires each party intending to sell its shares to a third party to offer to its fellow shareholders to sell their own shares at the same sale price and under the same sale conditions. This provision is often designed to protect minority shareholders against the risk of an exit of the founders or of the management. The mechanism allows distribution of the control premium between all shareholders. The joint exit right may take the form of a co-sale procedure, whereby each shareholder may sell a proportional share of its securities, or it may take the form of a tag-along in the narrow sense, generally triggered by the sale of the majority of the share capital, allowing minority shareholders to sell their entire stake to the third party purchaser (which, in practice, may have the effect of defeating the envisaged transaction);

- **Drag along:** the drag-along obligation gives majority shareholders the right to force minority shareholders to sell their shares simultaneously. It applies when shareholders representing a certain percentage of the share capital decide to accept an offer from a third party (often an industrial player) willing to purchase all of the company's shares. The insertion of such a mechanism into the agreement is vital for a company with an exit plan, since the purchaser will often insist on owning 100% of the company;

- **Termination of the working relationships:** shareholders' agreements usually contain clauses providing for "put" and "call" mechanisms (i.e., rights to buy or sell) allowing the repurchase of shares by other shareholders, or the company, within the limits of the law (i.e. article 659 CO, which assumes that the company has freely available equity capital and limits the percentage of treasury shares held by the company), in the event of termination of the employment, consultant or other relationship of a shareholder. In particular, the departure of a founder is a delicate matter that justifies making such provisions in advance. Indeed, these clauses prevent people who have left the company on bad terms – following a dismissal or in a litigious context – from remaining in the circle of shareholders. It is common to take account of the circumstances of the "separation" by distinguishing between "good leavers" (e.g. ordinary termination by the employer, the resignation of the employee for good cause or after a certain period, death or incapacity) and "bad leavers" (e.g. extraordinary termination for good cause by the employer, resignation by the employee without good cause or justified reasons, or breach of the shareholders' agreement). The circumstances surrounding the end of contractual relations are reflected in the (higher or lower) sale or purchase price or in the percentage of the shareholding.

3.3.4 Financial provisions

- **Preferential rights for dividend payments and liquidation:** in the private equity sphere, financial investors often ask to subscribe shares with preferential financial rights in the event of the liquidation of the company (in a broad sense that covers any form of investment, in particular in the event of a sale of shares). In this context, the investor wants to ensure it obtains a minimum return on his investment before the liquidation proceeds are distributed to holders of ordinary shares (particularly the founders). Dividend and liquidation privileges frequently complement each other to form a functional unit. They must appear in the articles of association, at least when they concern the liquidation in the strict sense (see article 627 point 9 CO);

- **Anti-dilution (ratchet) clause:** financial investors may ask for protection against financial dilution (not guaranteed by the preferential subscription right) due to a subsequent financing fund. This type of clause particularly applies when the issue price for a share capital increase after the relevant investment is lowered either due to market conditions or difficulties encountered by the company. This mechanism – known as a ratchet clause – allows the investor to subscribe new shares at par value according to a formula designed to reduce the average issue price to reflect the company's new valuation. The right is sometimes associated with a "pay-to-play" clause, which assumes that the beneficiary subscribes to a new round in order to be protected against dilution of its existing shareholding;

- **Participation plan:** when a new investor acquires a shareholding, the shareholders' agreement generally specifies the principle and limits of a participation plan involving the grant of shares or options to the management or a broader circle of employees or consultants. This plan will be based either on the conditional capital (representing a fixed percentage of the share capital registered on the commercial register), on owned shares, or sometimes by shares made available by existing shareholders.

3.3.5 Term

It is common to stipulate a relatively long initial period (e.g., 10 years), followed by tacit renewal at shorter intervals (e.g., 5 years).

3.3.6 Other commitments

- **Non-compete:** the non-compete clause is a standard clause which must particularly include the scope of prohibited activities, the duration and the persons covered (in particular the founders); such a clause duplicates and extends the non-compete clause contained in the employment agreements;

- **Penalty clause:** to ensure that the agreement is adhered to, a penalty clause can be invoked. The penalty clause is often preventive in its effects. A penalty must be paid to the company or to the other shareholders in the event of breach of the agreement, regardless of any actual damage, as would normally be the case. The obligation to sell shares in the event of a breach of the agreement may offer a useful variation, although it requires tight control over the shares.

4. Relations with employees

4.1 Context

All Swiss entrepreneurs must abide by employment law. The Code of Obligations contains the main conditions in terms of employment law, which employers and employees may mutually agree to exclude, subject to mandatory provisions protecting employees; contractual freedom remains the fundamental principle applicable in Switzerland.

Employee remuneration in a startup is often based on participation plans, allowing employees to benefit from a company's future success. The allocation of options, which is very common in practice, requires prior reflection and a disciplined document-keeping to avoid duplicating promises which may prove long and costly to comply with or undo.

4.2 Employment contract

The employment contract may be concluded orally, but in practice it is strongly recommended to draw it up in writing to limit litigation risks.

It contains the usual provisions for this type of relationship (job title, description of tasks, salaries, vacations, overtime, etc.).

In general, Swiss law does not impose a minimum salary: the salary is mutually agreed between the parties. Contractual freedom may be limited, however, by the provisions of a collective employment agreement. Such agreements exist in the hotel and restaurant sectors, for example, as well as in the construction industry. These agreements, negotiated by employer and employee representatives, may impose specific provisions applicable to the sector in question throughout Switzerland (e.g. in terms of minimum salary or holidays). Particular attention should be paid to the existence of such agreements, otherwise there is a risk of contractual provisions agreed with employees being simply null and void.

It is also advisable to be prudent when allocating bonuses. Even if they are discretionary, bonuses may be categorized as salary if paid systematically to an employee for several years. Such bonuses then lose their discretionary nature and become an integral part of the salary. Any employer would be well advised to confirm to the employee in writing that the bonus is discretionary each time it is paid. The situation is different if the bonus is directly linked to achieving certain targets: in this case, the bonus is not discretionary, but contractually due if the targets are met.

Salaries are subject to social security charges, representing around 13.5% of gross salary (half of which is payable by the employee and the other half by the employer). The social security contributions payable by the employee are deducted at source. Responsibility for deducting and paying the social security charges lies with the employer. Salaries are payable even in the event of sickness or accident for a period based on the length of the contractual relationship between the employer and the employee.

The employer must also deduct a tax at source for foreign employees residing in Switzerland (apart from foreign employees holding a “C Permit”, see chapter 4.3). Subject to legal or contractual provisions relating to the notice period, each party is free to end the employment contract at any time. Immediate termination of the contract is also possible under Swiss law when the bond of trust between the parties has been irreparably broken. The parties may also agree a fixed term for the employment relationship, in which case it will end without termination notice on the expiration date of the agreed term (with immediate termination for good cause still being possible).

The employer is nevertheless restricted in its freedom to terminate the employment contract in certain specific situations, for example in the case of sickness, pregnancy or maternity leave. Employees therefore benefit from certain periods of protection offered by Swiss law.

The legal notice period, unless otherwise defined in the contract, is one month during the first year of employment, then two months until the ninth year of the contract and finally three months for employment relations lasting more than nine years.

The working week is generally limited to 45 hours. Employees may be required to work overtime, if they are capable and if the employer's interests justify it. In that case, the employer must compensate overtime with rest periods of the same duration or payment of overtime at 125% of the usual rate (although the employment contract may specify that overtime is paid at the standard rate up to 60 overtime hours per calendar year).

The minimum holiday allowance under Swiss law is four weeks (five weeks for employees aged under 20).

The nature of the startup's business may lead to impose specific restrictions on the employee, particularly in terms of confidentiality, transfer of intellectual property rights and a non-compete clause. These restrictions are not unlimited however, and may be reduced if found to be disproportionate. The following conditions in particular must be met for a non-compete clause to be admissible:

- The non-compete clause must be concluded in writing;
- The non-compete obligation may only be imposed on employees with specific knowledge of the company (e.g. customer lists or trade secrets);
- The clause must not disproportionately limit employees' capacity to earn a living after the end of their contract, particularly in respect of the length of the prohibition period and the territory covered;
- The prohibition may only cover the business sector in which the company operates.

Breach of the non-compete clause may be subject to a penalty clause, i.e. payment of a fixed indemnity removing the need to demonstrate the damage suffered by the employer, which is particularly difficult in the field of non-compete clauses. The penalty clause must also be proportionate (generally a maximum of one year's salary).

Particular attention should be paid to the situation of founders employed at universities: it is common for doctoral students to decide to create a company whose purpose will be the development and marketing of their subject of study. Very frequent in practice, the creation of a spin-off requires scrupulous regulation of the way in which intellectual property rights, generally belonging to the university, can be used by the newly created entity. The universities are familiar with this exercise and have a well-established policy for licensing rights; the exercise is sometimes more complicated with universities that do not have such experience and do not have a technology transfer department.

4.3 Employment of foreign employees

4.3.1 Context

There are more than two million non-nationals in Switzerland, representing a quarter of the country's total population. Legislation concerning foreigners, as well as applicable international law, form the legal basis for controlling foreigners' movement in and out of Switzerland, defining their residency conditions and taking removal measures against them.

Since the Agreement on the Free Movement of Persons (ALCP) came into force between Switzerland and the European Union on June 1, 2002, the dual regime has applied to foreign workers. A distinction needs to be drawn between the rules covering nationals of a member country of the European Union or the European Free Trade Association (EFTA) and those applicable to other third-country nationals. The ALCP was introduced in stages via transitional regulations. The special rules applicable during a transition period vary depending on the countries or groups of countries, with differences in terms of mandatory declaration and authorization procedures. The admission criteria are set out in the Federal Act on Foreign Nationals and Integration of December 16, 2005 (loi fédérale sur les étrangers et l'intégration, LEI) and in the Ordinance on Admission, Residence and Employment of October 24, 2007 (ordonnance relative à l'admission, au séjour et à l'exercice d'une activité lucrative, OASA). They are detailed in the "Directives and comments – Domaine des étrangers".

Since January 1, 2015, the State Secretariat for Migrations (SEM) has been dealing with all matters relating to the law on foreigners and asylum in Switzerland. This modification is in response to the growing importance of this organizational unit, whose field of activity is becoming increasingly broad.

We should note, firstly, that the illegal employment of foreign workers in violation of the law on foreigners constitutes undeclared work within the meaning of the

Federal Law on Undeclared Work of June 17, 2005 (loi fédérale sur le travail au noir, LTN). One of the LTN's objectives is to combat "wage dumping". Regulations governing foreigners' employment contracts are therefore firstly destined to protect foreign workers and, secondly, to ensure equal treatment compared with Swiss workers.

A distinction should be drawn between conditions enabling EU and EFTA nationals, on the one hand, and third-country nationals, on the other, to access the Swiss labor market.

4.3.2 Working in Switzerland for EU and EFTA nationals

Nationals of EU and EFTA member states enjoy total freedom of movement, allowing them to enter, live and work in Switzerland. Labor market access and family reunification are simplified. Such workers enjoy simplified access to the Swiss employment market, regardless of their level of qualification. However, this freedom does not extend to the activities of employment and labor leasing agencies, as well as financial services.

The procedure to be followed depends on the duration of the planned work.

To engage in a short-term gainful employment for a maximum of three months or a maximum of ninety days per calendar year, nationals of the EU member states (EU-27) and EFTA countries do not need a permit. However, the Swiss employer is required to report this gainful employment at the latest on the day before the start of the employment. A simple registration on Federal Authority website is sufficient.

For this purpose, the employer shall use the electronical announcement procedure on the website of the Federal office for migration:

https://meweb.admin.ch/meldeverfahren/?request_language=en

With regards to a lucrative activity of over three months, these same nationals must apply for a residence permit:

The different residence permits

Nationals of EU-27* and EFTA** member states	Third-country nationals
Permit L UE/AELE (short-term permit)	Permit B (residence permit)
Permit B UE/AELE (residence permit)	Permit C (permanent residence permit)
Permit C UE/AELE (permanent residence permit)	Permit Ci (residence permit with gainful employment)
Permit Ci UE/AELE (residence permit with gainful employment)	Permit G (cross-border permit)
Permit G UE/AELE (cross-border permit)	Permit L (short-term permit)
	Permit F (for provisionally admitted foreigners)
	Permit N (for asylum seekers)
	Permit S (for people to be protected

**The EU-27 includes the following countries: Austria, Belgium, Bulgaria, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Spain, Sweden, Slovakia, Slovenia, United Kingdom.*

***EFTA: Iceland, Norway, Principality of Liechtenstein.*

An announcement must be made to the commune of residence of the national, on the site of the service of the population prior to his/her entry in function by presenting the following documents:

- A valid identity card or passport;
- In case of employment: a declaration of employment from the employer or a work statement (employment agreement for example);

- In case of self-employment: the account books in order to prove that the person has the necessary financial resources to support himself/herself. If the person becomes dependent on social assistance, he or she loses the right to reside in Switzerland. The competent service for self-employed persons is the cantonal migration authority (www.sem.admin.ch > entry and residence > living and working in Switzerland).

It should be noted that nationals of certain countries are subject to special conditions.

4.3.3 Working in Switzerland for third-country nationals

Carrying out salaried employment

An employer wishing to hire a national from a third-country state must file a request with the cantonal immigration or labor market authority. If the application is accepted by the canton, it is passed to the State Secretariat for Migration (SEM) for approval. The SEM will then notify the parties and the cantonal authorities of its decision.

For persons subject to a visa obligation, the cantonal migration authorities will send a visa clearance certificate via e-mail to the Swiss diplomatic/consular mission in their home country. The third-country national may then obtain the visa there. Before taking up employment, the third-country national will need to register with the communal authorities within 14 days of their arrival and only then can they begin work.

The following requirements apply to employment of third-country nationals:

- Persons are admitted when it is in the general economic interest;
- Authorization is only granted if established quotas have not been met;
- Third-country nationals may only be hired if no national of Switzerland or an EU/EFTA Member State can be found;
- Only managers, specialists and other qualified workers will be admitted; "Qualified workers" are primarily the holders of higher education qualifications (i.e. from a university or university of applied sciences) who also have specific technical expertise and several years of professional experience. Integration criteria will also be taken into account when issuing temporary residence permits, including: ability to adjust to a new occupational and social environment, language skills and age;
- Salary and working conditions must also be equivalent to those that apply to Swiss nationals.

Self-employed work
Self-employed gainful employment by third-country nationals who are residents in Switzerland must obtain authorization under the cantonal and federal authorization procedures from the first day. For those nationals, only qualified workers are admitted, within limits set by the Federal Council mandate.

Authorization may be granted if justified on economic grounds, if certain personal, financial and business requirements are met, and if permitted by the possible limits on the number of foreign nationals.

Foreign nationals who are married to Swiss citizens or to persons with a permanent residence permit do not require additional authorization to become self-employed.

4.4 Employee participation plans (profit-sharing)

4.4.1 Introductory comments

Employee profit-sharing is a recurring theme in the world of business. Historically, its aim was to align the interests of directors with those of shareholders by allocating stock to directors.

Allocating employees a stake in the company's share capital is common among startups. Its appeal does not lie always in aligning employees' interests with those of founder-shareholders. It often tends to remunerate employees (or consultants) at below-market conditions, in a phase during which liquidity is crucial to the company's development and the financial means are insufficient to pay employees at their market value. It is therefore a remuneration method designed to save liquidity. This situation can lead to the risk of requalification of share or options as income and, consequently, to the strict limitations of labor law.

Employee profit-sharing is not only a financial matter: it also makes it possible to involve employees directly in the life of the company when it takes the form of a stake in the company's share capital. In this context, it has a social function in the company since it will provide the opportunity for employees to participate in making the most important decisions for the startup.

4.4.2 Different forms of profit-sharing

There are generally two forms of participation (profit-sharing) plans (both terms used interchangeably in this guide):

- Ordinary profit-sharing plans;
- Virtual profit-sharing plans.

The beneficiary of an ordinary profit-sharing plan will acquire a stake in the company's share capital, at a future date and if the conditions are met, unlike the beneficiary of a virtual profit-sharing plan, whose profit-sharing is purely financial.

In practice, stock option plans (which fall into the category of ordinary profit-sharing plans since the exercise of an option grants an equity interest in the company) are a very common form of profit-sharing.

It is also possible to grant employees participation certificates instead of shares. In short, holders of participation certificates have economic rights (e.g., distribution of dividends) but do not have voting rights at general meetings.

4.4.3 Share plans

Share plans involve allocating shares in the startup to employees (generally in the form of shares). They may be allocated to employees free of charge or at a preferential price.

In a share plan, employees immediately become shareholders in the startup, with all the associated rights (right to attend the general meeting, voting right, dividend right, right to request special audits, etc.).

What are the advantages and disadvantages of such a plan?

Advantages

- Allocating employees a stake in the company's share capital represents the most advanced form of integration into the social life of the company, as it allows them to participate in taking the most important decisions for the startup;
- The employees have a direct incentive to increase the company's value since they hold a stake in its share capital;
- For the startup, it provides a form of remuneration without immediate cash financing.

Disadvantages

- The obvious flip side of the potential to participate in the upside in case of success is the risk for the beneficiaries of losing this part of their remuneration in the event of failure or bankruptcy of the company;
- Share plans generally provide for grants of ordinary shares: in a startup, the successive financing rounds often result in the issuance of preferential shares (including preferential liquidation rights in the event of the company's sale) which may eventually leave meager pickings for the employees if the exit is not a significant financial success;
- The issuance of capital and its distribution to employees necessarily results in dilution of existing shareholders;
- Managing a large number of shareholders (founders, investors and employees) may be problematic for the company and generates significant operational costs. In addition, the fate of departing employees must be settled: the redemption of shares allocated to employees requires that the other shareholders (or even the company) have the necessary liquidity at the time of the employee's departure.

Share allocations are taxed at the time the shares are provided to the employees. The tax is calculated on the difference between the cash value of the shares and the price paid by the employee (if the employee had to pay for acquiring the shares).

Any lock-in period (i.e. a period during which employees are barred from selling their shares) is taken into consideration when calculating the tax since a 6% reduction applies to the cash value of securities for each year of lock-in.

The decisive advantage for employees occurs when they come to sell their shares. Assuming the startup is subject to an exit (e.g. in the event of sale of the company to a third party), the gain realized on the sale of the securities will be, in principle, tax free (capital gain).

4.4.4 Stock option plans

Stock option plans are the most common form of employee profit-sharing in practice.

Under such plans, employees are granted a contractual right (the option) to acquire the company's securities under conditions defined in the plan.

Options may be allocated free of charge or in return for payment. In the latter case, the price to be paid by the employee to acquire the option itself should not be confused with the exercise (or strike) price, i.e. the price payable to exercise the option and acquire the underlying securities.

The allocation of options may have different objectives and the conditions set out in the plan or the grant agreement must be drafted so as to achieve those objectives:

- Options may be allocated to increase employee loyalty: in that case, the options may not be exercised for a certain period (the "vesting period"), thereby ensuring the loyalty of employees who will generally lose their rights in respect of a portion of their options if they leave the startup. In principle, it is stipulated that a predefined percentage of the options granted in a certain year will "vest" (i.e., become exercisable) each year (e.g. 25% a year, with all options granted in this particular year becoming vested at the end of the four-year vesting period);
- Options may be allocated to reward certain employees' performance. For instance, options will be allocated to employees who achieve certain pre-determined targets (e.g. obtaining a CE Mark).

The above-mentioned advantages of share plans are applicable from the moment the option is exercised and the employee becomes a shareholder in the company.

The option does not create exactly the same dynamics within the company as the allocation of shares. The option tends to create a short-term incentive for the beneficiaries: the upside for the employee lies in the ability to exercise the option at a price that is lower than the market value of the shares. It is uncommon for employees to exercise their options, acquire the underlying securities and keep those securities. In principle, the employee will exercise the option in order to immediately sell the underlying securities and realize a gain (however, it is possible to impose a blocking period during which the shares cannot be sold). From this point of view, employee profit-sharing has very different characteristics from the share plan.

For tax purposes, options are generally taxed "at exercise", based on the difference between the cash value of the securities obtained with the options and the exercise (or strike) price paid.

4.4.5 Virtual plans

In the context of a virtual plan, employees are not allocated a stake in the start-up's share capital. Instead they are granted "virtual" rights entitling them to a certain level of remuneration depending on changes in the value of the startup.

In a so-called "phantom" plan, employees are granted a certain number of virtual shares recorded in a register. The plan will set out the conditions under which the employee is authorized to sell his/her shares (virtually) in return for remuneration based on the value of the securities on a specific date. This allows the employee to benefit from the increase in the value of the company's shares without being a shareholder in the startup and without being able to exercise any shareholder rights (right to attend the general meeting, voting right, dividend right, right to request special audits, etc.).

It is also possible to limit the employee's remuneration to the capital gain on the "virtual" securities between the date of their (virtual) allocation and the date of their (again, virtual) sale. This type of plan is called a Stock Appreciation Right.

Virtual plans avoid dilution of the share capital. They also reduce the number of shareholders, thereby reducing administration costs. However, they play only a minor social role within the startup, since they do not grant any shareholder rights to employees.

From a tax perspective, the principle is simple: the employee is taxed at the time of cashing out, on the amount received, as in the case of ordinary income.

5. Relations with third parties

5.1 Marketing of goods and services in Switzerland

5.1.1 The key elements of the product marketing strategy

Any startup that reaches a stage of maturity in the design of its products faces the question of how to hit the market.

A startup must therefore make important choices regarding implementation of its marketing strategy.

Startups and their customers: marketing based on the type of products offered

A startup can generally market and sell tangible goods (common consumer goods, medication, etc.) and intangible goods (usage rights for software, applications, databases, etc.).

A startup may also, on a primary or secondary basis, supply services (application development, consultancy services, etc.) or act as a business introducer (between purchaser and seller, service provider and consumer, etc.).

The distinction based on the type of products offered is important because it directly influences the type of contract to be concluded with the other party and the legal rules applicable to the relationship.

The table below summarizes the main categories of contracts which can govern relations between a startup and its customers, subject to the specific characteristics of each case:

Types of products marketed	Type of contract concluded with the startup
Marketing of tangible goods	Sale agreement (contrat de vente – articles 184 et seq of the Code of Obligations).
Marketing of intangible goods	License agreement (contrat de licence – type of contract not specifically governed by the provisions of the Code of Obligations).
Provison of services	- A project agreement (contrat d'entreprise – articles 363 et seq of the Code of Obligations) - An agency agreement (contrat de mandat – articles 394 et seq of the Code of Obligations). The relationship may be defined as a project agreement when a result is guaranteed by the startup and that result takes the form of a work (tangible or intangible). With an agency agreement, performance of the agreement implies only an obligation of means, without any guarantee concerning the result (except the undertaking to perform state of the art services with the aim of achieving the result). It is sometimes hard to distinguish between an obligation of result and an obligation of means. It is therefore important for a startup to clearly define the legal relationship formed with its customers.

Startups and their distribution partners: direct marketing and marketing via a distribution network

A startup may market its products by dealing directly with its customers or using a distribution network (in which case the startup will use a commercial partner to sell its products).

If the startup uses a distribution network, the distribution partner's business model must be clearly defined. The partner may operate on its own behalf, purchasing the products at its own risk to sell on to customers, or simply act as an intermediary on behalf of the startup, as its direct or indirect representative.

The distribution partner's business model will also have a decisive influence on the legal form of the contract to be concluded between the startup and the distribution partner:

Role of the distribution partner	**Type of contract to be concluded with the distributor**
The distribution partner buys goods in its own name to resell to customers.	Distribution agreement (contrat de distribution – type of contract not specifically governed by the provisions of the Code of Obligations) and similar contracts (franchise). A license agreement may be used in the framework of marketing the intangible goods.
The distribution partner acts simply as an intermediary representing the startup in respect of customers. In this case, the startup is the contractual partner of the customers introduced by the distribution partner.	The law mainly provides for two types of sales representation agreement: - Agency agreement (contrat d'agence – articles 418a et seq of the Code of Obligations): the distribution partner is the agent for the startup and acts in the name and on behalf of the startup (direct representation). The agent's role may involve (i) indicating an opportunity for the startup to conclude a deal ("introducing agent") and/or (ii) negotiating the terms of the sale to be concluded directly between the startup and the customer ("negotiating agent"); or - Commission agreement (contrat de commission – articles 425 et seq of the Code of Obligations): the distribution partner is the commission agent for the startup and concludes contracts in its own name but on behalf of the startup (indirect representation).

The establishment of a network of distributors, agents and commission agents is based on the premise that the parties intend to be bound for a certain period (generally between two and five years).

Conversely, if the parties intend to collaborate on a specific or isolated project, a sale agreement is usually used or, if the startup's contracting party acts solely as intermediary, brokerage contracts (articles 412 et seq of the Code of Obligations).

When the distributor is completely incorporated into the marketing concept of a startup that has put in place unified distribution, according to a specific marketing concept it has developed, a franchise agreement is often used. That form of distribution, which is less common in Switzerland than in the rest of the European Union, is used to establish bakery and fast food chains, fitness businesses, etc.

The above-mentioned distinctions are subject to countless variations. For instance, if the distributor is tasked with the production (based on recipes and specifications transmitted by the startup) as well as the marketing of the products in question, the agreement concluded between the startup and the distributor will also include a production license or even a project agreement aspect.

5.1.2 The limits on freedom to implement its distribution strategy

In principle, under Swiss law, the parties involved in a product marketing relationship are free to organize it however they wish, given that most provisions of Swiss law are not mandatory. This leaves the parties with significant room for manoeuver to negotiate the terms of the agreement between them. In this context, startups are recommended to pay particular attention to the following points:

- **Products:** product range to be marketed; modification of the range;
- **Price:** determination of prices and their revision during the term of the agreement;
- **Exclusivity:** any territorial/customer exclusivity granted to the distribution partner;
- **Targets:** any targets in terms of sales, minimum purchase volumes and consequences resulting from non-compliance with them (loss/reduction of exclusivity, termination of the agreement);
- **Orders:** Process of establishing product order schedules (rolling forecasts) and placing orders, binding character of orders;
- **Logistics:** parties' obligations, distribution of costs (including costs for transport, insurance, customs duties and other taxes) and risks associated with products' transportation and delivery;

- **Marketing:** product marketing and promotion policy (e.g. minimum expenses, reimbursement of certain costs, etc.);

- **After-sales service:** parties' obligations in relation to (i) product maintenance and (ii) management of warranty claims.

While the parties to a contract have a wide margin of discretion with regard to the content of their contract, they are nevertheless bound to comply with Swiss mandatory or semi-mandatory law.

Imperative and semi-imperative provisions resulting from the type of agreement

It is necessary to legally qualify the relationship between the parties in order to determine any imperative and semi-imperative rules imposed by law. In particular, startups must be attentive to the following rules:

- **Sale and project agreement:** a startup is free to exclude any warranty if it sells products intended for personal or family use. The Swiss system is based on the "all or nothing" principle, meaning that if the startup does not want to completely exclude any warranty, it must offer a minimum warranty of two years for new goods (and one year for second-hand goods). The situation may also be summed up as follows:

Contractual waiver of limitation periods	Professional seller	Private seller (consumer)
Professional buyer	No limitation on contractual amendment of warranty periods for new or second-hand goods.	No limitation on contractual amendment of warranty periods for new or second-hand goods.
Private buyer (consumer)	- For new goods: minimum two-year warranty period. - For second-hand goods: minimum one-year warranty period. - Any clause stipulating a reduction in the legal limitation periods for the warranty for defects is unlawful and therefore null and void.	No limitation on contractual amendment of warranty periods for new or second-hand goods.
In any case, other limitations on liability in the event of faults, as well as total exclusion of warranty, remain valid in principle		

- **Agency agreement:** any agency agreement includes numerous imperative provisions designed to protect the agent, whether a natural person or legal entity, particularly the right to a special indemnity when a non-compete clause has been included or a stipulation that termination notice periods should be identical for both parties.

Special case of goodwill indemnities

A goodwill indemnity can be defined as the right for an agent to be remunerated for the customers it has generated for the startup during the term of the agreement.

As an imperative provision of the agency agreement (article 418u of the Code of Obligations), in a famous ruling (ATF 134 III 497) the Federal Court extended goodwill indemnities to distribution agreements provided that territorial exclusivity is granted to the distributor and that the following two cumulative conditions are met: (i) the distributor is incorporated into the licensor's sales organization such that it is in a similar situation to that of the agent (e.g. the startup benefits from the right to approve all the distributor's sale outlets; the establishment of a customer relationship management system; the obligation on the distributor to incur investments for promotional purposes); (ii) customers are transferred to the startup at the end of the agreement: in an ordinary distribution relationship, the customers are attached to the distributor, which acts in its own name and on its own behalf. However, if the startup subsequently profits from customers generated by the distributor, then a goodwill indemnity will be due (examples: the distributor has generated customers that are now strongly attached to the start-up's products or brand; the distributor is obliged, directly or indirectly, to transfer those customers to the startup at the end of the agreement).

The goodwill indemnity must be "appropriate". However, it is capped at the "net annual gain resulting from the agreement and calculated based on the average for the last five years or the average for the entire length of the contract if that is less", in accordance with article 418u subparagraph 1 of the Code of Obligations. The court has wide discretionary powers in this respect.

Due to its imperative nature, the goodwill indemnity may not be contractually excluded, including in distribution agreements when the above-mentioned conditions are met. On the other hand, agents and distributors are free to waive this goodwill indemnity on expiration of the agreement (and not before). A declaration of full and final settlement may therefore free the startup from any risk of such an indemnity being claimed.

Regulatory aspects

With the exception of some specific regulated industries such as banking and insurance, distributors active in Switzerland are not generally obliged to obtain State licenses or authorizations to market their products.

According to the principle of free movement of goods within the European Union, products manufactured and sold in accordance with applicable legislation in a member country of the European Union may generally be sold in Switzerland without excessive formalities or other technical constraints, in accordance with the Federal Law on Technical Barriers to Trade (LETC) and the ordinance governing the marketing of products manufactured according to international regulations (OPPEtr). However, some business sectors are subject to more restrictive rules, for example foodstuffs and medical supplies.

A startup with an international business is therefore advised to check the legal rules applicable to its business in each country. This precaution will allow it to adapt its activity or check its product's compliance with national rules. In the framework of a distribution relationship (e.g. a distribution, agency or commission agent agreement), a startup may "delegate" verification of its business's or product's compliance within a territory to its commercial partner. However, delegation of verification of a business's or product's compliance within a territory to a commercial partner does not necessary exclude the startup's liability in the event of violation of laws in the country in question.

Competition law

Swiss competition law is strongly influenced by European Union competition law. Distribution agreements in a broad sense, including licenses and, under certain conditions agency and commission agreements, are considered by the Swiss competition authority (the COMCO) as vertical agreements between companies active at different levels of the product manufacturing and marketing chain (producer-distributor/wholesaler-retailer).

Swiss competition law aims to prevent the harmful consequences of restrictions on competition in order to promote competition in the interests of a market economy based on a liberal regime. Pursuant to article 5 subparagraph 4 of the Federal Law on Cartels and Other Impediments to Competition (LCart), two types of agreements are considered as particularly prejudicial to an effective competition regime: agreements relating to prices and agreements allocating territory. Placed in a context of vertical relationships and distribution, a startup must pay particularly close attention to any agreement concluded with a contractual partner. Subject to justification on grounds of economic efficiency, a startup must particularly exclude from its agreements:

- **Agreements imposing minimum or fixed resale prices on distributors:** one of the core principles of competition law is that the reseller of products (e.g. an authorized reseller) must be able to freely determine its resale prices, without intervention from the startup (although the startup is allowed to set maximum prices). For the time being, the Swiss Federal Competition Commission (COMCO) adopts particularly restrictive practices, to such an extent that the simple transmission by a licensor of recommended price lists to its retailer network may be considered a retail price fixing agreement if those recommendations are effectively applied by a significant number of network members.

- **Allocation of exclusive territories absolutely excluding parallel imports:** the prohibition on allocating territories is primarily designed to combat isolation creating “high price islands”. Although it is possible to grant distributor exclusive territories, imports must still remain possible. Therefore, any obligation imposed on a distributor to not respond passively to approaches made from outside its sales territory (“passive sales”) seriously contravenes competition law and would expose a startup to significant sanctions. Sales made via internet generally constitute passive sales.

Since a ruling in principle by the Federal Court (ruling dated June 28, 2016, in case 2C_180/2014 referred to as the “GABA ruling”), restrictions imposing fixed or minimum prices on resellers and/or allocating exclusive territories absolutely excluding any parallel imports are considered qualitatively serious, independently of any actual impact on the market or the market share of participating companies.

A startup may be severely sanctioned if it concludes an agreement on one of the above-mentioned aspects with a commercial partner, even if the competition market is not actually affected. In that case, sanctions in the event of a violation of competition law may amount to 10% of revenues achieved in Switzerland during the previous three years, in accordance with article 49a subparagraph 1 LCart. It is therefore very important that a startup bears in mind possible risks in relation to competition law when concluding agreements with commercial partners.

It should be stated that other types of agreements may prove problematic in respect of competition law. For instance, any agreement which could undermine market competition may be sanctioned by the Swiss competition authority or a foreign authority. The COMCO publishes communications relating to various issues on its website. Following the GABA ruling, it has also adapted its previous communication on the assessment of vertical agreements dated June 28, 2010, in order to assess the lawfulness of certain agreements. Startups must bear in mind the risks of any possible anti-competitive behavior.

5.2 Marketing of goods and services via the internet

5.2.1 Introduction

E-commerce has become a standard tool allowing buyers and sellers to carry out commercial transactions remotely via the internet. The notion of e-commerce should be understood in a broad sense since various types of goods may be sold, e.g. licenses (in the case of acquisition of software, an SaaS, etc.), goods (for example by ordering articles via the internet), services (for example by using translation platforms), etc. The following considerations aim to draw the startup's attention to the various issues in relation to e-commerce or the operation of a web platform.

5.2.2 Absence of a Swiss consumer law for e-commerce

There is no consumer code or law in Switzerland governing e-commerce specifically. Swiss consumer law comprises disparate rules appearing in various legislation (Code of Obligations, Law on Unfair Competition, Product Liability Act, Code of Civil Procedure, etc.).

Unlike European legislation, Swiss law does not have a specific law governing online sales: the general rules on sale contracts contained in articles 197 et seq of the Code of Obligations are applicable. A startup selling goods and services to the European Union via the internet must be vigilant, since it will become subject to the provisions of European law governing online sales and data protection (e.g. the use of cookies).

5.2.3 Importance of general terms and conditions

Due to the potential distance between the various parties to an e-commerce transaction, there is a greater risk of misunderstanding regarding the nature of the object or service purchased.

In order to anticipate the rules applicable to the relationship between the parties (buyer/seller/platform, etc.), it is strongly advisable to use general terms and conditions of use. Once accepted by the parties, the general terms and conditions will apply in addition to the legal rules applicable to their relationship and be contractually binding. They may include mechanisms which differ from Swiss legal provisions when those are not imperative.

The general terms and conditions must be incorporated into the relationship between the parties in order to be enforceable on them. A mechanism should also be included to ensure that the co-contracting party "accepts" application of the general terms and conditions. This generally occurs via an "I accept the general terms and conditions" check-box.

Under Swiss law, no legal provision exists requiring the general terms and conditions to be provided or effectively accepted before concluding an agreement. However, in addition to being expressly referred to in the agreement, the general terms and conditions must be available and accessible to the parties at the time the agreement is concluded, in the language of the place that the consumption or transaction occurs, or that of the consumer. Furthermore, the general terms and conditions must comply with certain standards in order not to contravene the Law on Unfair Competition: the general terms and conditions must not create conditions excessively favorable to the party imposing the use of its general terms and conditions. The startup must pay particular attention to unusual clauses: the consumer's attention must be clearly drawn to unexpected or unusual clauses in the general terms and conditions (e.g. via the use of a different font highlighting the provision in question).

Finally, attention should be paid to the clauses contained in the general terms and conditions, which must not infringe imperative provisions of competition law (see chapter 5.1.2).

5.2.4 Absence of a cooling-off period in Switzerland

No legal cooling-off period applicable to distance contracts currently exists in Switzerland. At present, this right is limited to contracts concluded via doorstep selling or similar (in the workplace, on public transport, on the street, etc.).

Only "exceptional" circumstances, applicable generally to all sale contracts, allow online purchasers to completely or partially cancel a sale agreement, namely i) error (articles 23 et seq of the Code of Obligations), ii) deception (article 28 of the Code of Obligations), iii) constraint (articles 29-30 of the Code of Obligations) or iv) serious defects with the object purchased (article 205 of the Code of Obligations). In that case, the purchaser may annul the agreement and claim reimbursement.

A cooling-off period may be contractually agreed, however, for instance in the general terms and conditions.

5.2.5 Debiting credit cards during an internet transaction

Unless otherwise stipulated in the agreement, it is usual in Switzerland for the parties to perform their payment and delivery obligations immediately, i.e. at the time of conclusion of the agreement. This system is not suited to distance sales and particularly online sales. In these hypotheses, the principles of immediacy and simultaneity cannot be respected, since the goods must still be shipped to the buyer. However, contractual freedom authorizes the parties to specify different deadlines for their respective obligations, e.g. in the form of a deferred payment (payment after the date the agreement is concluded), payment in installments, or pre-payments (special rules set out in articles 227a et seq of the Code of Obligations). The rules set out above may also be included in the payment mechanism using bank cards.

It is common, for instance, to specify that a credit card will be debited at the time the order ships or when the customer confirms the order on the website. The question of when the price is due to be paid and the payment terms must therefore be addressed in the general terms and conditions.

5.2.6 Requirements concerning online payment services

In order to combat money-laundering, the Anti-Money Laundering Act of October 10, 1997 (loi sur le blanchiment d'argent, AMLA) imposes certain obligations on persons who, in a professional capacity, accept, hold on deposit or help to invest or transfer third parties' assets. They are referred to as financial intermediaries.

When a customer pays the startup directly for its product or service, the startup is receiving a payment in exchange. That situation does not cause any problems in respect to the anti-money laundering law.

The situation becomes more complex when the startup collects money on behalf of a third party (particularly when the startup acts as an intermediary between a supplier of goods/services and the consumer). When a startup provides a payment service by collecting money for a third party, the business risks fall within the application scope of the AMLA, with all the resulting consequences. In order to determine whether a startup is subject to the AMLA, it should be determined whether it operates a payment service. The question particularly arises when a startup operates a marketplace or crowdfunding site.

The notion of professional financial intermediary was formalized in the Federal Act on Financial Institutions of June 15, 2018 (Loi fédérale sur les établissements financiers, LEFin) and depends on numerous circumstances (commission on transactions, flow of funds in cash or by bank transfer, volume of transactions, etc.) which must be analyzed on a case-by-case basis.

If a startup is subject to the AMLA due to its role as a payment service, it is subject to the following obligations:

- A duty to verify the identity of the co-contracting party and beneficial owner (see article 45 AMLO-FINMA);
- A duty to register with a self-regulatory organization (organization setting out the rules to follow for compliance with the AMLA rules and exercising a level of supervision over financial intermediaries);
- A duty to clarify the economic background and purpose of a transaction in the event of doubt;
- A duty to establish certain documents (AMLA documentation: identity of the beneficial owner, list of business relations subject to the AMLA, etc.) and to conserve them; and,
- A duty to report justified suspicions of money-laundering and to freeze funds involved in the suspicious transaction.

It results from the foregoing that it is imperative for a startup to research its anti-money laundering obligations if it collects money for a third party.

5.2.7 Website content and the possibility offered to users to add content to the website

Operation or use of a website implies the obligation to monitor the content of posts and, if necessary, specify goods and services which may not be offered (whether in the general terms and conditions or a supplementary document).

For example, it will be necessary to ban:

- The sale of products infringing intellectual property rights (e.g. counterfeit products);
- The sale of stolen products (handling stolen goods);
- The sale of banned electronic products (e.g. illegal listening devices, radar jammers);
- The sale of computer storage media containing personal data in breach of data protection law;
- The sale of materials containing genocide denial, pornography/child pornography, violence, etc.

Managing a website’s content is particularly important when users of the site have the ability, for example, to publish posts or sell products and services on it.

5.2.8 Specific rules concerning the sale of products covered by intellectual property

A frequent question in practice is whether a company can acquire goods abroad that are protected by intellectual property rights in order to resell them online.

From the perspective of copyright and trade-mark law, a product acquired with the holder's authorization in one country can be lawfully resold in another country (principle of international exhaustion of intellectual property rights). A startup may therefore acquire books in one country and resell them to customers online.

An exception exists for audiovisual works. This (temporary) exception is created by intellectual property law concerning parallel imports and procurement of audiovisual works on the Swiss market. Swiss copyright stipulates that audiovisual storage media (e.g. DVDs and Blue-Ray) may only be marketed once cinemas have finished showing the work. The exploitation of audiovisual works is generally done "in cascade", i.e. firstly in cinemas, then in the form of videos/DVDs and finally on television, with the aim being to protect cinema distribution. In Switzerland, the country's linguistic configuration means that the temporary exception is dictated by the end of screening in cinemas in the region in question: DVD imports in French are authorized once cinema showings have ended in French-speaking Switzerland, regardless of other linguistic regions.

5.2.9 A few e-commerce rules to comply with in respect to unfair competition

In respect of e-commerce, the Law on Unfair Competition of December 19, 1986 (loi fédérale contre la concurrence déloyale, LCD) imposes a few minimum information duties (article 3 subparagraph 1 letter s of the LCD). For a behavior to be neither unfair nor unlawful, the law requires the party offering the goods, works or services online to comply with the following conditions:

- Clear and complete indication of its identity and contact address, including email;
- Clear and complete indication of the various technical stages leading to the conclusion of an agreement;
- Supply of the appropriate technical tools for detecting and correcting input errors before sending an order;
- Immediate confirmation of the customer's order by email.

The aim of the above-mentioned requirements is to rectify, at least partially, the informational imbalance affecting the relationship between the professional and the consumer. They increase transparency regarding the identity of the professional and the stages in conclusion of the agreement. In the event of non-compliance with the above-mentioned points, the consumer (as well as consumer associations and the Confederation) may ask for civil or criminal sanctions to be imposed. Violation of the LCD does not, however, result in annulment of the agreement.

Customer solicitation can take various forms, from sending goods which have not been ordered to advertisement.

On the subject of sending goods which have not been ordered, Swiss law stipulates that a person who receives such goods from a commercial company is not obliged to return them or keep them (article 6a subparagraph 2 of the Code of Obligations). Therefore, the approach involving sending goods to consumers with a payment slip is not binding in any way on the consumer. However, this type of behavior may fall in the ambit of unfair competition law.

Regarding the sending of mass advertising (spam), protection against unsolicited advertising is provided for in the LCD (article 3 subparagraph 1 letter o of the LCD). In general, the law stipulates that a person who sends or commissions the sending of mass advertising by (automated) email must first receive the recipient's consent. There is one exception to this principle however. The LCD considers that a company which (i) has obtained its customers contact details at the time of the sale of goods, works or services and (ii) informed them that they could opt out of receiving mass advertising via telecommunication, does not act unfairly if it sends them such advertising without their consent, providing that advertising relates to similar goods, works and services. The LCD does not therefore impose a general ban on sending advertising by email to consumers but provides the legal framework to perform it legally.

6. Data protection

6.1 Context

In the course of its business, a startup may accumulate a large quantity of data concerning its customers, suppliers or employees. In Switzerland, the processing of personal data is subject to the Federal Data Protection Law of June 19, 1992 (loi fédérale sur la protection des données, LPD). Any company that processes personal data must therefore ensure that it complies with legal requirements.

The LPD is not designed to protect the personal data itself, but the personality of the person in question. Protection covers living natural persons and legal entities. With regards to the legal entities, the revised legislation will exclude them from the scope of protection.

The processing of personal data is a major challenge due to its commercial exploitation by big players in the digital world.

6.2 Application scope

The notion of personal data is a very broad one. It covers all data potentially identifying a person (e.g. first name, last name, address, telephone number, social security number, etc.). Data is not covered by the LPD, however, if it is irreversibly rendered anonymous.

Some data is referred to as sensitive. This particularly includes data relating to health, private life, race, religious or political opinions. There is also a notion of personality profile when a range of data gives a relatively complete picture of a natural person. Specific duties and requirements apply if sensitive data or personality profile data are processed.

Data processing is subject to LPD requirements in the event of collection, communication, exploitation, modification, conservation, archiving or destruction of data. In that case, the simple fact that a startup collects and conserves customer data such as address, date of birth, etc. constitutes data processing within the meaning of the LPD.

6.3 Rights and duties in relation to processing of personal data

6.3.1 Basic principles: lawfulness, good faith, identifiability, proportionality and purpose

Data processing must be lawful, i.e. not contrary to legal provisions. It must be done in good faith, i.e. with the knowledge of the person in question, who must expect the data to be collected and processed. The data must be processed for a precise purpose and only data that is appropriate and objectively necessary to achieve that purpose may be processed. When data is collected for a specific purpose, it may not subsequently be used for another purpose without the consent of the relevant person.

6.3.2 Subcontracting

The processing party, i.e. the data controller, is responsible for all processing of the data it collects and processes. It remains liable even if it subcontracts some data processing to a third party. Therefore, if a company plans to subcontract data processing to a third party, it is advisable to conduct a brief due diligence in respect of the subcontractor to ensure that it will comply with the requirements applicable in terms of personal data processing. It must then be explicitly stated in the agreement concluded with the subcontractor that the latter must comply with legal data protection requirements. Standard subcontracting agreements are available from the website of the Federal Data Protection Commissioner (https://www.edoeb.admin.ch/edoeb/en/home/data-protection/handel-und-wirtschaft/transborder-data-flows/outsourcing.html).

6.3.3 Access right

The persons in question must be able to access their personal data. In other words, anyone can ask a company whether it has processed their personal data, without having to provide good cause. In that case, the data controller must send them all information about their data (origin, purpose of processing, category of data processed, recipients of the data, etc.). Access to the data must be provided free of charge and in writing. No one may waive their access right in advance. It is therefore pointless to ask for an access right waiver when collecting data. Any such waiver would be null and void and the company would still have to grant the person access to their data.

6.3.4 Data security

When processing data, the data's security must be protected using technical and organizational measures. Technical measures relate particularly to IT security (e.g. anti-virus protection, IT network security) and the security of the premises in general (alarm, access control, etc.). Organizational measures are those relating to the company's internal organization. For example, it is advisable to restrict employees' access to the personal data processed on a need-to-know basis.

6.3.5 Cross-border communications

In the framework of its activity, a company may need to transfer the personal data it processes abroad, e.g. to a subcontractor, a branch, a parent company, a board member or even for storage on an IT server located abroad.

The communication of personal data to foreign countries is unlawful if it presents a serious threat to the personality of the person in question. The law assumes that such a threat exists if legislation in the recipient State does not ensure personal data protection equivalent to that in Switzerland. However, if the State's legislation does ensure sufficient protection, cross-border communication of data to that State is authorized. This is particularly applicable in the case of European Union Member States, whose protection of personal data is deemed adequate, meaning it is possible to transfer data to European Union Member States. However, in the United States, for example, data protection is not deemed to be adequate. The Federal Data Protection Commissioner keeps a list (available online) of countries to which data may be transferred (https://www.edoeb.admin.ch/edoeb/en/home/data-protection/handel-und-wirtschaft/transborder-data-flows.html).

If personal data protection is not deemed sufficient in a foreign State, the transfer of data to that State may be lawful, but only under certain conditions. In particular, the person concerned may consent to their data being transferred abroad. For a person's consent to be considered valid, the person must first have been informed of the fact that their data will be transferred to one or more defined States and that the legislation in those States does not provide protection deemed to be equivalent to that in Switzerland. Their consent must also have been given to the transfer for a defined purpose. Consent given to the general transfer of data abroad is not considered sufficient. For example, it is not sufficient to simply mention in the general terms and conditions that customers' personal data may be transferred abroad. It must be stipulated that the data will be transferred to such and such a State and for such and such a specific purpose. The person's consent must also be given explicitly when sensitive data is to be transferred. It is therefore advisable to require the person's active consent, for example by completing a section of a form or checking a specific box.

6.3.6 Other special provisions

Respect for the requirements of the LPD do not give exemption from compliance with the requirements specific to certain business sectors (e.g. patient confidentiality and banking secrecy). When a company is subject to specific "sectoral" rules, it must also ensure that it complies with them.

6.4 European regulation

6.4.1 Introduction and application scope

On April 27, 2016, the European Parliament adopted a new General Data Protection Regulation 2016/679 (GDPR). The GDPR is directly applicable in all Member States of the European Union since May 25, 2018. In certain cases, the GDPR may even apply to a company established in Switzerland, if that company processes personal data in association with a business located within the European Union or a subcontractor located within the European Union. The GDPR also applies to a Swiss company, even when it does not have any establishment in the European Union, if it (i) offers goods or services in the European Union or (ii) tracks the behavior of residents of the European Union.

A company offers goods and services within the European Union if it targets residents of the European Union. Indicators of this type of offer include using a language or common currency of the European Union, or mentioning customers or users within the European Union. Simply having a website which is accessible from the European Union is not sufficient however.

6.4.2 Some obligations for companies subject to the GDPR

Companies subject to the GDPR must:

- Keep a register of processing operations indicating the nature and purpose of the processing and the categories of recipients and data processed;
- Appoint a representative within the European Union;
- Carry out a preliminary impact analysis in the event of a high risk to the rights and freedoms of the persons concerned;
- Send the supervisory authority a notification in the event of a personal data security breach at the latest within 72 hours, as well as to the person concerned in the event of a high risk to their rights and freedoms.

Companies subject to the GDPR who do not comply with its requirements face severe penalties of up to €20 million or 4% of the group's revenue (not just the revenue of the company in question).

6.5 Reform of the LPD in Switzerland

On September 15, 2017, the Federal Council adopted a proposal to totally reform the LPD. The revised LPD was adopted on September 25, 2020 and Swiss companies will have to adapt their practices to comply with the new requirements.

The main objective of the reform is to harmonize Swiss law with European law and offer individuals better protection. Among the novelties and particularities of the revision of the LPD, we can mention the following:

- The revision has the particularity to apply henceforth to data of natural persons only, to the exclusion of legal persons;
- Duty to inform: the individuals will be informed of the processing of their data regardless of the type of data concerned. The duty to inform covers the identity and contact details of the data controller, the type of data processed and the purpose of the processing. In case of automated individual decision making, the data subject must be given the opportunity to state his or her point of view;
- As in European law, when the envisaged processing entails a high risk for the personality and fundamental rights, the company responsible for the processing must carry out a prior impact analysis. In the event of a data security breach, the controller must be informed of the breach without delay;
- The list of acts constituting a criminal offence has been extended and the penalty increased to a maximum amount of CHF 250,000.

7. Financing of the startup

7.1 Financing round and share capital increase

7.1.1 Context

In practice, raising equity via a financing round is the most common method of financing for young Swiss startups. It makes it possible to finance the company's development without any debt or payment of interest by allowing new investors to acquire a stake in the company at a premium reflecting the value attributed to the company at the time of the investment. These new shareholders will therefore acquire all the rights associated with holding equity interests (voting rights, information rights and, in some cases, preferential dividend and liquidation rights).

7.1.2 The equity-raising process

Equity-raising has three phases:

- the preparation phase;
- the negotiation phase; and
- the investment implementation phase.

The preparation phase

The preparation phase generally lasts one to two months and its objective is to prepare for negotiations with potential investors. During this phase, it is vital for the startup's management to establish a valuation of the company and a business model or business plan (see chapter 1). The company's corporate, contractual and financial documentation also needs to be prepared during this phase, in order to allow potential investors to efficiently conduct a legal, financial and tax audit promptly when the time comes. At this stage, it is also advisable in practice to prepare a draft term sheet or letter of intent (LOI) containing the essential financing terms and conditions sought by the startup.

The negotiation phase

Once the preparation phase is over, the search for investors can begin. Before entering any negotiation or concrete discussions, it is vital to sign a confidentiality agreement with the potential investors in order to protect the company's intellectual property and know-how, as well as any other confidential information communicated. During this phase, once the likely future investor(s) is(are) identified, the parties generally sign a term sheet and begin the negotiation and drafting of the investment agreement, as well as the new shareholders' agreement where relevant. Before signing the final contractual documentation, potential investors generally carry out a legal audit, a financial audit and, in some case, a tax audit in order to identify and estimate the risks associated with the proposed investment. In practice, the audit phase may take several months, particularly if the relevant documentation is not made available rapidly or in a sufficiently organized way by the company. As a general rule, the negotiation phase lasts between one to six months.

The investment implementation phase

Once the parties have reached an agreement, the investment may be implemented. The implementation phase not only includes the signing of the contractual documentation, but also completion of the formal stages required by Swiss law, including holding a shareholders' general meeting in the presence of a notary to decide on the increase in the share capital, as well as submitting the registration application to the competent office of the commercial register, accompanied by the legal documentation required. The equity raised may only be paid up and used by the company once the share capital increase is registered in the commercial register.

The Swiss authorities are usually fairly quick and the formalities required to implement the share capital increase generally take one to two weeks. The duration may be longer when investors are foreign entities or persons and documents need to be legalized and apostilled abroad. Depending on the circumstances, the implementation phase may therefore take between two weeks to two months.

Proper preparation is vital for any startup seeking financing. This is particularly true given the startup's often precarious financial situations and the duty of diligence incumbent on the board of directors, whose members may, under certain conditions, be held personally liable for seeking financing and adopting remediation measures if those actions are deemed dilatory.

Process of an equity financing round

Preparation	Negotiation	Implementation
- Valuation of the company - Financial plan - Participation model - Share register - Pitch document - Preparation of the Term Sheet	- Non-disclosure agreement - Term Sheet - Legal, tax and financial due diligence - Draft of the final agreements	- Signing of the investment agreement, the shareholders agreement and other related agreements - Capital increase - Entry in the commercial register
1 - 2 months	**1 - 6 months**	**2 weeks - 2 months**

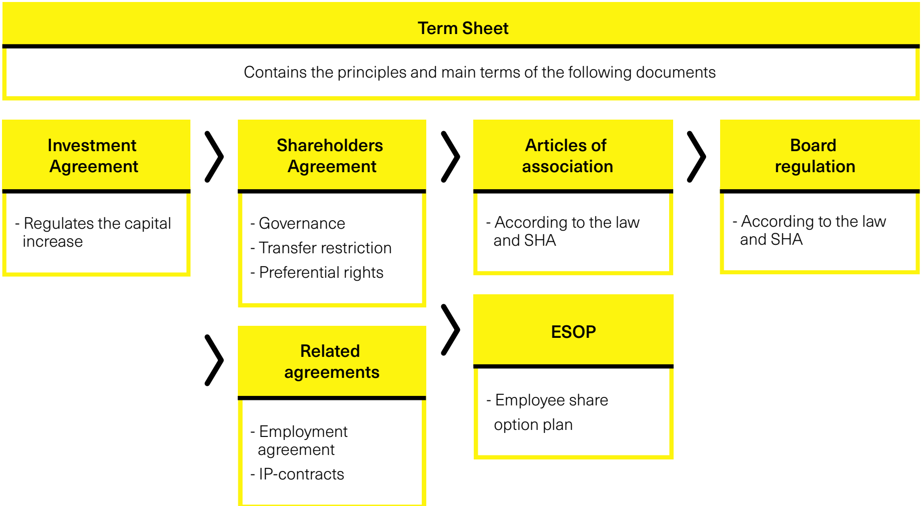
7.1.3 Contractual documentation

In the context of a fund-raising, the main contractual documents are a term sheet (or letter of intent [LOI]), the investment agreement, along with a (revised) shareholders' agreement.

It is also common for potential investors to require the modification of certain related agreements (such as the employment contracts of "key" employees or agreements concerning the company's intellectual property), as well as the adoption of new corporate documents, namely revised articles of association, new bylaws for the board of directors and a (new or revised) participation (profit-sharing) plan.

In this chapter, we will concentrate on the term sheet, the investment agreement and the preferential liquidation rights.

Legal documents in an equity financing round



Term Sheet

During the preliminary phase of negotiations, the parties generally conclude a term sheet or letter of intent (LOI).

The term sheet is a non-binding document concluded between the company and the potential investor defining the framework for negotiations, as well as the main terms and conditions of the proposed investment.

During negotiation of the term sheet, it is advisable to identify potential “deal-breakers”, from the point of view of the startup or the investor, since it is difficult in practice to derogate from the term sheet at a later date despite its mostly non-binding character.

The term sheet provides non-binding rules governing the main economic and commercial aspects of the proposed investment, which shall be subsequently included and reflected in a definitive and binding manner in the investment agreement, as well as the new shareholders’ agreement, where relevant. These components include:

Economic aspects	Aspects relating to control
Investment amount	Restrictions on the transfer of shares
Price per share and the valuation of the company	Drag-along, tag-along and forced exit
An anti-dilution mechanism	Minimum quorums and veto rights
Investor's preferential rights	Composition of the board of directors
Any warranties provided by the company and/or founders	Non-compete clauses
Profit-sharing plan and amount of the new conditional capital	Shareholders' information right

The term sheet also frequently and non-bindingly provides for the adoption of new corporate documents. In practice, the changes made to the articles of association, the internal bylaws as well as the shareholders' agreement often grant a certain degree of influence or control to investors in the framework of the company's decision-making process (e.g. minimum attendance quorum, shares with preferential voting rights, veto right, etc.).

In principle, the term sheet's binding clauses include confidentiality clauses, exclusivity clauses, clauses allocating negotiating costs, designation of applicable law and competent jurisdiction. Exclusivity clauses are designed to prevent the startup from negotiating at the same time with other potential investors. It is therefore important for the board of directors to assess, in view of its duty of diligence and the startup's financial situation, the maximum exclusivity period which can be granted as the company may fall in dire need for money if the negotiations fail at the end of the exclusivity period.

The drafting and negotiation of the term sheet are important stages, which should not be underestimated. As a general rule, during negotiation of the term sheet, investors require certain rights to be granted to them to enable them to influence or even control important corporate decisions to be made in the future, as well as to maximize their investment by means of preferential liquidation rights and anti-dilution mechanisms. At this stage of the negotiations, it is important for a startup to be supported by qualified experts and advisors. The continuation of negotiations and the signing of definitive contractual documentation generally depend on the completion of a satisfactory legal, financial and tax audit by the investor.

Investment agreement

The investment and share subscription agreement is the agreement signed by the company, the investor and, in many cases, the existing shareholders, governing the terms and conditions for fund-raising. The investment agreement (together with the revised shareholders' agreement) typically includes:

N°	Clauses	Comments
1	**Investment amount**	The capital contribution in return for the subscription and issue of new shares may take several forms (in cash, in kind, via the transfer of assets or offsetting of debt). Share capital investments generally take the form of a cash contribution however. Other types of capital contribution, referred to as "qualified", require additional formal requirements to be met in order to protect the share capital.
2	**Price per share and the valuation of the company**	The price per share subscribed depends on the valuation of the company. The valuation of the company is set by the startup itself. Depending on the means and level of sophistication of the investor, the latter will also carry out a financial due diligence, assisted by experts in the field, in order to establish the valuation of the company. A startup's value is difficult to ascertain, particularly when it does not generate any positive cash flow. The price per share is composed of the par value of the security and the share premium (agio), which depends on the company's value.

3	**Number and type of shares**	The number of shares to be issued to the investor is governed by the investment agreement and depends on the total amount of the investment agreed and the price per share. In the framework of an investment, the company may issue ordinary or preferential shares in favor of investors. Preferential rights may correspond to voting rights or rights in the event of dividend distributions or liquidation of the company (in a broad sense, including in the event of sale of the company) (see chapter 7.1.4).
4	**Milestones**	The parties may agree on an investment in one or more tranches. An investment in several tranches, which is then often subject to the completion of certain development stages or financial results (milestones), protects the investor from the risks incurred, while giving the startup medium-term visibility over its financing sources. When negotiating financing in several tranches, it is vital for the startup to agree to realistic and achievable milestones.
5	**Use of the investment**	The parties may agree on a general use of the investment (e.g. development of the company and its technology) or define a more precise use (e.g. the development of a precise technology or entry in a new market). In practice, the parties frequently agree on a use of the investment according to a business plan prepared by the company.

6	**An anti-dilution mechanism**	An anti-dilution clause offers protection to the investor in the event that the startup's shares are subscribed by new investors at a later date at a lower price than the price paid by the investor. Several types of anti-dilution clauses exist, which may be more or less favorable to investors (broad based or narrow based). Special attention should therefore be paid to the content of the clause and the mathematical anti-dilution formula used which, if poorly negotiated, can imply drastic consequences in practice for the startup's existing founders and shareholders.
7	**Preferential rights (shares with preferential voting rights or preferential liquidation rights)**	In some cases, shares with preferential voting rights (article 693 of the Code of Obligations) are required by investors in order to increase their influence in the company's decision-making process. We refer the reader to chapter 7.1.4 concerning the liquidation privileges. Although negotiated in respect of the investment, preferential voting and liquidation rights are usually enshrined in the new shareholders' agreement.
8	**Restrictions on the transfer and control of shares**	Restrictions on the transfer of shares are designed to allow investors and other shareholders to control the shareholding structure, particularly in order to secure their exit. For more details, we refer the reader to chapter 3.3.3.
9	**Exit**	When investing in a startup, investors often have a medium-term exit strategy (three to seven years) and aim for a corresponding capital gain. The exit may take several forms, such as the sale of all the company's shares (a share deal), sale of the company's assets (an asset deal), an initial public offering (IPO) or liquidation of the company. In order to be able to impose the exit on other shareholders, the majority investors generally require a right to impose an enforced sale on minority shareholders (a drag-along right).

10	**Composition of the board of directors**	Investors often require the right to have one or more representatives on the board of directors. Such representatives are frequently members of the management team or employees of the investor in question, who are then delegated as board members to allow the investor to engage actively in, and closely monitor, the management and development of the startup.
11	**Quorums and veto rights**	Investors frequently require the stipulation of minimum attendance and voting quorums before the shareholders' general meeting and/or the board of directors can make certain decisions. The purpose of such quorums is to allow the investors to influence, or even in some cases determine, the outcome of certain important corporate decisions. In some cases, a veto right is also required by investors for certain particularly important decisions.

12	**Any warranties provided by the company and/or founders**	In the framework of the investment agreement, the founders may be required to grant guarantees to investors in order to obtain the desired financing for their startup. Special attention should be paid to the content and scope of the guarantees provided, in terms of the personal risk incurred by the founders. Several mechanisms exist for limiting those risks, e.g. limiting: - the maximum amount of damages which may be required; - the validity period of the guarantees (e.g., 3, 6, 12 or 18 months after the fund-raising); - the scope of the guarantees in light of what the investor knew or should have known at the time the investment agreement was concluded, particularly following a legal, financial and tax audit. In this respect, the investment agreement is an innominate agreement under Swiss law, which contains, in particular, components that fall under the law of sale of goods. Thus, the regime of the sold good (articles 197 et seq of the Code of Obligations) is applicable by analogy to the investment agreement, unless otherwise agreed by the parties. Generally, the company, respectively its founders, provide the guarantees. In order to avoid a violation of article 680 of the Code of Obligations (prohibition of repayment of contributions) and cash compensation by the organs, the agreement provides for a compensation mechanism (in the form of a capital increase for an issue price equivalent to the nominal value) in the event of a breach of the guarantees.

13	**Non-compete clauses**	Non-compete and non-poaching (i.e., non-hiring) clauses are usually required from the founders who play a role in the management and development of the company, as well as from the company's key employees. Such commitments not only make it possible to protect the interests of investors and other shareholders, but first and foremost, the interests of the company. The validity of the non-compete and non-poaching clauses is subject to imperative law restrictions insofar as they relate to employees. Swiss law defines the limits of such commitments in terms of duration and scope (business sector and territory).
14	**Shareholders' information rights**	The shareholders' information right is particularly restricted under Swiss law, particularly due to the formal constraints imposed by the Code of Obligations. The shareholders' information rights are therefore frequently expanded in the shareholders' agreement.
15	**Adoption of a profit-sharing plan**	A capital contribution may be accompanied by the establishment of an employee profit-sharing plan. The adoption of a profit-sharing plan is generally in the interests of the company, giving it additional means of attracting and retaining talented personnel. The investment agreement generally specifies the maximum number of options or shares (or a maximum share percentage) which can be issued in the framework of the plan as well as, in some cases, the options' exercise price. In other areas, it is usual to grant the startup's board of directors flexibility in the management and implementation of the profit-sharing plan.
16	**Confidentiality**	The investment agreement generally contains a confidentiality clause covering not only the existence and content of the agreement, but also all information exchanged by the parties in the context of the negotiation and implementation of the investment.

17	**Negotiating costs**	The parties generally specify the allocation of costs for negotiating the investment in the investment agreement. It is common for those costs to be payable by the startup.
18	**Assignment of applicable law**	It is advisable to always specify the law where the startup's headquarters is located as the law applicable to the investment agreement.
19	**Assignment of jurisdiction**	The competent courts in the place where the start-up's headquarters is located are generally assigned exclusive jurisdiction by the parties. In some cases, the parties also choose international commercial arbitration as a method for resolving disputes, although this is only justified in the case of a major investment.

Several documents are generally appended to the investment agreement, particularly share subscription forms; the registration application to the commercial register; a table showing the current shareholding structure and proposed shareholding structure, as well as a business plan prepared by the startup.

7.1.4 Preferential liquidation rights

When investing in a startup, investors often have a medium-term exit strategy (three to seven years), i.e. a capital gain when making the investment. The exit may take several forms, such as the sale of all the company's shares (a share deal), sale of the company's assets (an asset deal), an initial public offering (IPO) or liquidation of the company.

In order to maximize their investments in the company at the time of the exit, sophisticated investors such as venture capitalists generally require preferential rights to be granted over the sale proceeds, the dividend and the liquidation, in addition to the adoption of an anti-dilution mechanism. We will focus here on preferential liquidation rights in the broad sense.

Normally, the liquidation proceeds (whether from a liquidation in the narrow sense or sale of the company) is distributed between the shareholders in proportion to their respective contributions to the share capital. In other words, only the paid-up nominal value is decisive, excluding any premium paid by the shareholder in exchange for the issue of shares. However, the shareholders may choose to derogate from the legal solution, by stipulating that priority should be given, when allocating any liquidation proceeds, to investors who subscribed shares at a higher price. The preferential right over the liquidation proceeds is usually governed by the company's articles of association, as well as by the new shareholders' agreement negotiated at the time of the investment.

Two types of preferential liquidation rights primarily exist: participating rights and non-participating rights:

- In the first case, the investor receives a priority amount (typically corresponding to a multiple [e.g. 1.2x] of the amount of the initial investment, sometimes bearing interest). The balance of the liquidation proceeds is then divided between all shareholders, including the investor, in proportion to their contribution to the share capital;
- The second case differs from the first in that the investor is not included in distribution of the dividend balance after receiving a priority amount.

Preferential liquidation rights are very common in practice and can have dire consequences, particularly when the startup is not successful and has to be liquidated. In this case, if technology exists which needs to be sold to a third party, generally at a knockdown price due to the failure of the startup, this lone asset will be sold for the exclusive benefit of investors with preferential liquidation rights.

7.2 Convertible loans

7.2.1 Context

A startup's financing is of vital importance. The launch phase is particularly difficult since bank financing is not generally accessible to a startup.

In this context, financing a startup through a convertible loan is an alternative to the "traditional" equity financing option through an immediate share capital increase. It particularly makes it possible to respond very quickly to liquidity crises, which do not generally leave the board of directors enough time to achieve a consensus among existing shareholders and perform the formal steps necessary to complete the capital increase before the corresponding new funds are available to the startup.

7.2.2 Type of agreement and standard contractual clauses

Convertible loans are loan agreements (in cash) whose principal characteristic is that repayment will not necessarily take the form of a payment to the lender (as in the case of a simple bank loan within the meaning of articles 312 et seq of the Code of Obligations), but the issuance of equity securities of the startup upon occurrence of an event triggering the conversion. In the event of conversion of the loan, the lender becomes a shareholder in the startup.

In addition to the amount of the loan, the agreement provides the terms and conditions for the release of the funds to the startup, as well as the agreed use of the borrowed funds. The agreement will also set a maturity date from which the loan will be either (i) repaid in cash (including any interest accrued), or (ii) converted into securities of the startup (shares or units) (assumption of the convertible loan agreement). The agreement often also stipulates remuneration of the loan granted in the form of an interest or a discount on the issue price set for the next financing round.

The terms of the conversion are also set out precisely in the agreement. This conversion may be mandatory, based on the occurrence of certain predefined events (a new financing round or sale of the company, for example), or optional, i.e. at the discretion of the lender or group of lenders. In the framework of the conversion procedure, the agreement will also stipulate (i) the issue price of the securities to be issued upon conversion (a price which must be determined or determinable at a minimum), as well as (ii) the type of securities (i.e., in a corporation, the category of shares – ordinary or preference) to be issued. If the lender is not already a shareholder in the startup at the time of conclusion of the agreement, a contractual obligation should be imposed on it to adhere to the shareholders' agreement upon becoming a shareholder at the time of conversion, since the conversion will have the effect of granting shareholder status to the lender.

Finally, it is common for the convertible loan agreement to feature a subordination agreement, given the financial and especially often fragile situation of the start-up, especially in the early stages of its existence. Such a clause thus provides that the lender's claim resulting from the loan (including any interest accrued) will be paid (ranked) after all other creditors in the event of an over-indebtedness of the company within the meaning of article 725 subparagraph 2 of the Code of Obligations, so that the debt may not be repaid to the lender while the company remains over-indebted. This subordination responds to strict conditions, described in chapter 7.3.3) below.

7.2.3 Practical advantages of convertible loans for a startup

Immediate funding

The major advantage of convertible loans lies in the fact that the startup has immediate access to the loan amount, without having to enter into lengthy valuation negotiations: the funds are generally made available to the startup on conclusion of the agreement. This immediate access to the amount is not possible with a "traditional" funding round to increase the company's share capital, since the funds are transferred on an escrow account and that these funds are to be released to the startup only after registration of the share capital increase on the commercial register, which may take several days or even several weeks. Immediate access to funding may be decisive to the startup's survival, particularly to meet mandatory deadlines (e.g. payment of salaries).

(Temporary) restriction of the circle of shareholders

Another advantage of the convertible loan agreement is to provide the startup with additional funds without having (for the time being) too large a circle of shareholders, which could create obstacles within the company, particularly if the circle of shareholders becomes very disparate. However, this advantage needs to be considered carefully, since in principle the lender will acquire shareholder status at a later date, upon conversion.

7.2.4 Tax treatment of the convertible loan

General

The bond is referred to as a "classic convertible loan" for tax purposes if: (i) the loan issued by a Swiss company, (ii) the conversion right must allow for the subscription of newly created participation rights of the Swiss company issuing the bond or of a Swiss (or foreign) related company, and (iii) if the bond is issued at par or with a premium, the repayment of which must be made at par.

Stamp duty

No stamp duty is levied at the time of issuance of the convertible loan.

At the time of conversion into capital (new shares created), stamp duty must be declared. The system is that of self-declaration (form 7 of the Federal Tax Administration), which must be made within 30 days of the entry of the increase in participation rights in the Commercial Register.

Stamp duty is levied at a rate of 1% on issues and increases of share capital, with a deductible of up to CHF 1,000,000 and is due to the amount received by the company in consideration for the participation rights, but at least on the nominal value.

Withholding tax

The periodic interest paid to the creditor of the loan is exempt from withholding tax by the debtor of the interest, provided that it corresponds to the market rate or (for existing shareholders) to the rate admitted by the Federal Tax Administration.

However, at the time when the issuer of the loan accepts funds from either (i) more than 10 creditors against the issuance of IOUs on identical terms, or (ii) consistently more than 20 creditors against the issuance of IOUs on variable terms, it must levy 35% withholding tax on the interest served. This is also a self-declaration procedure.

Direct federal tax and cantonal and communal taxes on income and wealth

For the issuer of the loan, the interest paid on its debt is deductible from its taxable income; conditional capital is not taxed.

The periodic interest received by creditors constitutes a return on taxable assets. The assets of the debt must be included in the wealth/assets of the creditors.

7.3 Restructuring of the startup

7.3.1 Context

When a company is in financial difficulty, it runs two risks which may lead to bankruptcy:

- If the company is unable to meet its ongoing expenses due to a lack of liquidity, any unpaid creditor may apply for its bankruptcy, providing certain judicial procedures are followed;
- If the losses generated reduce the equity below a certain level, Swiss law stipulates certain obligations for the board of directors (as well as the auditor) if the assets no longer sufficiently cover the share capital, and particularly if they no longer entirely cover the company's debts.

It is common for a startup to begin to generate losses. The board of directors must take particular care to ensure that the company is adequately financed, both in terms of liquidity and balance sheet. Otherwise the board members' personal liability may be triggered.

We will focus here on the second aspect mentioned above, i.e. the consequences and measures to take in relation to balance sheet losses, as well as on certain practical aspects to bear in mind in a difficult financial situation.

7.3.2 Legal regime

Article 725 subparagraph 1 of the Code of Obligations

If the net assets (i.e., excess of assets over liabilities) do not amount to at least 50% of the share capital (by par value) and mandatory reserves, the board of directors must convene a general meeting and submit restructuring proposals to the meeting. The law does not define the content of such measures, which depend on the situation and may take several forms, particularly:

- Organizational measures: reducing costs, re-negotiating certain agreements, selling certain assets to generate liquidity or increasing income;
- Accounting measures: reducing share capital to absorb the loss; drawing down any reserves; re-valuing certain assets within the limits permitted by accounting law;
- Debt reduction or renegotiation: converting debt into capital; subordinating debt, at least to the level of the over-indebtedness (see below); obtaining debt write-offs from certain creditors (potentially combined with the allocation of profit-sharing certificates, see below); repaying debt by transferring assets (beware of actions to set aside such transfers, see below);
- Contribution of liquid assets: increasing share capital (immediately or via future conversion of a new loan, generally subordinated); making à fonds perdus capital contributions (without any share capital increase).

The above measures are generally combined, according to the circumstances.

Article 725 subparagraph 2 of the Code of Obligations

If the board of directors has serious grounds to fear that the company's assets no longer cover all debts, it must prepare an audited interim balance sheet. If that balance sheet (at going-concern value) reveals insufficient assets (over-indebtedness), the board of directors must draw up a second balance sheet, also audited, this time for winding-up (at liquidation value). It is rare, although not impossible in practice, for this second balance sheet to present a better situation than the first. If both balance sheets reveal over-indebtedness, the board of directors has two options:

- The company may continue its activities if creditors accept to "subordinate" their debts in an amount at least equal to the over-indebtedness, i.e. agree, in the event of bankruptcy, to be paid only after all other creditors have received 100% of their claim;
- If such a subordination cannot be obtained, the board of directors must notify the court; if the board of directors refuses or delays the notification to the court, and if the over-indebtedness is blatant, the auditor (if the company has one) has an obligation to notify the court itself. On receipt of the over-indebtedness notice, the court shall convene a hearing to declare the company bankrupt, unless:
    - The board of directors (or a creditor) manages to demonstrate the likelihood that the company's restructuring appears possible; in that case, the court shall adjourn the bankruptcy decision, giving the company a certain period to take the necessary restructuring measures;

- The board of directors requests a composition moratorium; in that case, the court shall declare a provisional moratorium of a maximum of four months, suspending proceedings against the company and allowing the implementation of a restructuring plan or composition agreement (coordinated distribution of the company's assets to its various creditors) under the supervision of a court-appointed commissioner. If the court considers that the plan submitted to it during the provisional moratorium supports the prospects of a restructuring plan or composition agreement, it grants a new (definitive) moratorium of four to six months (which may be extended).

7.3.3 Practical implications for startups

Liability for failing to notify the court

If the board of directors fails to notify the court when the company is over-indebted, nothing happens in principle, provided the company is able to meet its ongoing expenses. However, if the company subsequently becomes bankrupt, the members of the board of directors (and under certain conditions the auditor) may be held liable for the increase in the company's over-indebtness between the moment the court should have been notified and the actual amount of debt owing at the time the bankruptcy was eventually decided. If concrete restructuring measures may be executed, the board of directors exceptionally has a grace period of an additional four to six weeks to notify the court from the time it has serious reasons to be aware of the over-indebtedness. This scenario accounts for more than three-quarters of cases of directors' liability in Switzerland.

Liquidities required for a going-concern balance sheet

Except in exceptional cases, the company's balance sheet at going-concern value will typically show a better financial situation than the balance sheet at liquidation value (which includes costs for winding-up, terminating employment contracts and leases, and may not attribute any value to certain intangible assets appearing in the going-concern balance sheet). Companies mainly tend to use the balance sheet as a going-concern when assessing the company's over-indebtedness. However, that is only possible if the company has sufficient liquid assets to meet its short-term obligations, i.e. amounts to be paid within 12 months. Therefore, once a company finds itself short of liquid assets, technically it can no longer draw up accounts as a going-concern. In that case, if refinancing cannot be established (e.g. due to the failure of negotiations with an investor), the board of directors may be accused of lateness in notifying the court in a situation of over-indebtedness resulting from a liquidation balance sheet, which is the only one applicable in those circumstances.

Payment of social security charges

The board of directors must pay particular attention to the payment of social security charges. In particular, the portion of employee's part of social security charges, withheld from the salary, must be paid, since non-payment is subject to criminal penalties. Special standards make members of the board of directors personally liable for payment of social security charges due on employees' salaries up until bankruptcy.

Subordination agreement

In order to release the board of directors from its obligation to notify the court in the case of over-indebtedness, the subordination of a debt must meet strict conditions, i.e. be for an unlimited period (until the company is no longer over-indebted), unconditional (not be associated with achieving certain targets or a decision by another party), and the creditor itself must be in a financial position that allows it to write-off the debt if necessary. The Chamber of Certified Accountants and Tax Consultants has prepared a standard subordination agreement which is advisable to use to ensure the validity of the subordination and so avoid possible liability.

Profit-sharing certificates

In order to encourage creditors to agree to make certain concessions to enable the company's restructuring, it is possible to grant them profit-sharing certificates (bons de jouissance). These profit-sharing certificates are created by a provision in the articles of association, but do not appear in the balance sheet and do not constitute a liability for the company. They simply give their holders rights in the case of distribution of profits, liquidation or issuing of new shares. Here are some examples of profit-sharing certificates (which can be described very loosely providing they do not create any obligation negatively impacting the company's financial results):

- For example, a creditor that has written off a debt of 100 will receive 100 + 5% interest per annum on any profit distributed in the form of dividends or on any liquidation proceeds, before shareholders receive anything;
- A creditor that has agreed to entirely subordinate its debt of 100 will be granted a right (but not an obligation) to subscribe 50 shares at the time of the next capital increase (in addition to any shares the creditor may subscribe by converting its subordinated debt at the time of that capital increase).

Setting aside of transfers

When the company finds itself in a critical situation and there is a threat of bankruptcy, the law stipulates that the (debtor) company may not pay some of its creditors to the detriment of others who will only receive a percentage of their debt (a dividend for example) from the bankruptcy. The affected creditors may bring a claim against the recipient of the payment in the form of an action to set aside the transfers (action révocatoire) in the following cases:

- When the debtor has made donations (or transactions under excessively favorable conditions) in favor of certain persons in the year preceding the bankruptcy;
- When, in the year preceding the bankruptcy, at a time when it was already over-indebted, the debtor provides security (e.g., pledges) for existing debts, or has repaid a debt other than in cash (e.g., by transferring certain assets), or has repaid a debt before its due date, unless the beneficiary creditor can establish that it was unaware of the over-indebtedness (and should not have been aware of it given the circumstances);
- When, in the five years preceding the bankruptcy, the debtor has acted in other ways to the detriment of its creditors and the beneficiary of those actions could and should have been aware of it.

In practice, actions to set aside transfers raise difficulties when establishing restructurings involving the transfer of certain assets (or parts of companies) to third parties that are also creditors, and which could therefore find themselves at an advantage, or when the proceeds of the sale are to be used to refinance (entirely or partially) a bank loan. Depending on the circumstances, caution sometimes requires the transaction to be placed under the protection of the court (or a commissioner appointed by the court), via bankruptcy deferment or composition moratorium proceedings.

8. Exit

8.1 Sale of the company

8.1.1 Context

The exit, allowing shareholders to monetize their investment, may take the form of a so-called “trade sale”, i.e., the sale by the shareholders of the company’s shares (so-called “share deal”) or a sale by the company of (some of) its assets and liabilities (so-called “asset deal”). An exit may also be realized via an initial public offering (IPO), which places the company’s shares on a stock exchange and enable the shareholders to later sell their shares on an organized stock market (see chapter 8.2). A trade sale occurs when the company is sold to another company, either through a sale of the company itself or of its shares (share deal), or through a sale by the company of its assets (asset deal).

8.1.2 Trade sale in general

The sale process includes various stages, in particular:

- The communication by the sellers of a teaser containing a summary description of the company to sell, without identifying it since the recipients have often not made a confidentiality commitment;
- The signing of a confidentiality (or non-disclosure) agreement;
- The communication by the sellers of an Information Memorandum for the attention of potential buyers, particularly including a more detailed description of the company, with indications of its estimated value and the asking price;
- The signature of a letter of intent (Term Sheet/Letter of Intent/Memorandum of Understanding) formalizing the main aspects of the proposed transaction and the sale process, without binding the parties at this stage;
- The financial, accounting, legal and tax due diligence audit conducted by the purchaser. At this time, a data room should be prepared by the sellers (in the form of hard-copy binders made available to the purchaser or, more often, in electronic form allowing remote consultation and inspection by the sellers of the documents consulted); the data room contains most of the company’s documentation (corporate documents, financial statements, all types of contract, documentation relating to insurance, employees, disputes, etc.);
- Negotiation of the sale agreement;
- Signature and performance of the sale agreement.

8.1.3 Content of a company sale agreement

The most standard case of a company sale in Switzerland involves the sale of shares (“share deal”). This often presents tax advantages for the seller and allows the purchaser to obtain all of the target company’s rights and obligations. In this section we will describe the standard content of a share purchase agreement, before moving on to examine the specific characteristics of the asset deal in the next section.

Object of the sale

The object of a share purchase agreement is simply the shares in the target company. However, it should be verified that the seller has all the rights to those shares, particularly that they have not been pledged to secure a loan, and that the seller is the holder of all existing share certificates. It is not uncommon in practice for former shareholders to have neglected to hand back share certificates (or to properly endorse them in favor of the new shareholder) or to formalize the transfer of shares with adequate documents. Negligence at this stage may prove difficult to correct, especially when the former shareholder cannot be reached or is not (or no longer) prepared to cooperate.

Signing and closing

It is not uncommon for the parties to agree on all aspects of the agreement, but then have to wait for certain formalities to be completed before the price can be paid and the shares transferred. In that case, the agreement is signed, but is subject to conditions; if the conditions are met, the agreement becomes complete and closing must take place: the seller transfers its shares and the purchaser pays the price; to the contrary, if the conditions are not met in the set deadline, the parties are released from all obligations. Such conditions between the signature and the closing may include obtaining approvals from third parties or administrative authorizations (e.g. the competition commission), signing employment contracts with certain key employees, obtaining confirmation from the tax authority of a tax ruling on certain aspects of the transaction or the purchaser obtaining the financing required to pay the sale price.

Price

The purchase price may be fixed or variable. Even a fixed price may require adjustments, depending on the circumstances at the time of closing of the transaction (e.g., adjusting to the exact value of the company’s equity at the time of closing, or deduction from the sale price of the company’s net debt). The price may also vary based on the future event (so-called earn out), e.g., the achievement of certain targets such as minimum revenue, minimum profit, obtaining a patent, a marketing authorization, etc.).

The purchaser may withhold part of the purchase price, which it may offset if any of the guarantees are breached. Alternatively, that portion of the purchase price may be deposited with a third-party escrow. The escrow will release it to the seller at the end of the guarantee period if no breach has occurred or else to the purchaser insofar as it has suffered damage due to breach of the guarantees. To a certain extent, this depositing with a third party also allows the seller to ensure that the purchaser will not try to wrongfully invoke guarantees to reduce the portion of the purchase price remaining due.

Guarantees

When negotiating the sale agreement, the drafting of guarantee clauses is of particular importance. The Code of Obligations does not specifically govern company sales. Without specific guarantee clauses in the agreement, the law, by default, only provides for a guarantee of the seller as to the physical and legal existence of the thing sold. In the case of the sale of shares, the guarantee therefore only relates to the ownership of the shares, not the characteristics of the underlying company. The purchaser must therefore include guarantees in the agreement covering all aspects it considers decisive to ensure the acquired company has the value attributed to it and justify the price paid.

The results of the due diligence audit will lead the potential purchaser to (i) require guarantees allowing it to receive compensation if the company turns out not to have the promised characteristics, (ii) reduce the price and personally assume the financial charge in the event the risk occurs, (iii) take measures to reduce or avoid the risk, particularly by making the transaction dependent on elimination of the risk (e.g. by obtaining a necessary permit) or by opting for an asset deal that excludes transfer of the identified risk, or else (iv) abandon the transaction altogether, if the identified risk is deemed too great to accept.

The guarantees generally relate at least to (i) ownership of the shares, (ii) compliance of the company's business with legal requirements, (iii) the accuracy of the company's accounts, (iv) the company's conduct since the date of the last audited accounts, (v) the payment of all taxes and social security charges due by the company, (vi) the company's assets, particularly intellectual property rights, any shareholdings in other companies or ownership of buildings, (vii) the company's major contracts and their validity (clients, suppliers, leases, leasing contracts), (viii) the company's employees (particularly payment of their salaries, their overtime and vacations, the absence of any bonuses promised and not reflected in the accounts, compliance with collective labor agreements), and (ix) the absence of disputes involving the company (or their precise description and the allocation of resulting risks between the purchaser and the seller).

Guarantees are given for a certain period (which may vary depending on the type of guarantee); their extent is often limited to a maximum amount.

We should note that guarantees also need to be included in the asset deal agreement, since the purchaser will need to specify the exact characteristics it expects from the company, rather than relying on the general principles of sales law.

Other clauses

Share purchase agreements contain many other clauses, of varying importance, particularly relating to:

- The seller's obligation not to compete with the company after the sale;
- The obligation on the seller to pass on contacts, introduce the purchaser to customers and provide certain services during a transition period;
- The continuation of a working relationship between the company and the seller for a certain period of time at a certain salary;
- The right for a party (generally the purchaser) to assign its rights under the agreement to a third party (often a company in the same group) before the closing;
- Applicable law and jurisdiction (court or arbitral tribunal) assigned to hear any disputes arising from the agreement.

8.1.4 Asset deal

When the purchaser is interested in acquiring, for example, only part of the company's assets or the company presents a significant risk in terms of its liabilities which the purchaser does not wish to accept, the parties may decide to proceed on the basis of an asset deal.

Under Swiss law, two different sets of legal rules exist allowing the sale of a company's assets and liabilities:

- The transfer of assets and liabilities individually, pursuant to the rules of the Civil Code and the Code of Obligations: in that case, each asset must be transferred under its own specific conditions (transfer of possession for movable assets, registration on the land register for immovable assets, registration on the register of patents, trademarks, designs, etc. for intellectual property rights, written assignment for debts). The transfer of obligations and agreements, as well as, in some cases, the transfer of certain debts require third-party consent; this consent may be tacit (e.g. if no response is received within a certain time), but a notice needs to be sent to all the company's co-contracting parties;
- The transfer of assets within the meaning of articles 69 et seq of the Federal Act on Merger, Demerger, Conversion and Transfer of Assets and Liabilities: this law allows the universal transfer of assets and liabilities; all assets referred to in the agreement are transferred in a single deed. In principle, third

parties' consent is not required, since the transfer is enacted by law upon its registration in the commercial register. This approach has the advantage, at least in principle, of allowing the transfer of agreements without the need to obtain the consent of all counterparties. However, it must be published in the commercial register, meaning that the conditions of the transaction, including the price paid, will be accessible to the public by simply consulting the commercial register.

In both cases, the process implies drawing up an inventory of the assets and liabilities transferred.

Furthermore, a company transfer by means of an asset deal implies informing employees in advance of the transaction and, if measures concerning employees (particularly dismissals) are planned, consulting them in order to enable them to submit proposals.

8.2 Initial public offering (IPO)

8.2.1 Context

An initial public offering (IPO), which often involves issuing new shares, represents a way for a company to (i) raise additional funds to finance the development of its business, and (ii) allow shareholders, particularly financial investors, to monetize their investment by selling shares, not to a single purchaser or group of purchasers (as in the case of a trade sale), but to a multitude of purchasers through an organized market.

Unlike a trade sale, in which the company is often restructured to allow its integration into the purchaser's group, the IPO allows the company to remain independent, with its management generally remaining in place, often with the addition of one or two senior persons to carry out specific roles required for the IPO and for complying with the new rules applicable to the company once it is listed on a stock exchange.

Advantages of an IPO

- Simplified access to capital markets to obtain financing (during the IPO and subsequently, through share capital increases or bond issues in the market);
- Liquidity of securities, allowing gradual divestment and a level of objectivity in respect of the value of securities;
- Possibility of creating remuneration plans (stock option plans), the value of which is more easily measurable by employees;

- Enhanced profile for the company and its products and easier recruitment of qualified personnel.

Disadvantages of an IPO

- The IPO itself is a long and strenuous process, which consumes a lot of the management's time and energy and diverts it from developing business for several months (e.g. preparation of a prospectus and supply of a large amount of due diligence information for verification purposes, restatement of financial statements, presentation of the company by management to future investors in the IPO at road shows, etc.);
- Being a listed company entails significant regulatory obligations (obligation to publish periodic financial statements, application of specific accounting rules, heightened requirements in terms of auditor qualifications, limits on remuneration of directors and executives, obligation to announce certain events and certain securities transactions);
- The listing exposes the company to stock-market fluctuations, which can have a harmful effect on business, for example by increasing the cost of credit, or indirectly by encouraging directors to favor short- or medium-term strategies to the detriment of a longer-term strategy not recognized by the market. An IPO also requires measures to be taken to increase the liquidity of securities, particularly by ensuring that the company is followed by analysts.

8.2.2 IPO process

The IPO process generally takes six to nine months:

- The first operations involve selecting internal participants (management or directors) and external participants (i.e. one or more investment banks which will help place the securities with investors; auditor capable of preparing the financial statements according to a recognized account standard; experienced law firm; communications company);
- At the start of the process:
  - the stock exchange on which the IPO will be launched must be selected at a very early stage, since its regulations will dictate numerous stages in the process;
  - the main bank must understand the company's positioning and specific characteristics in order to define the best way of presenting the investment in the IPO to potential future investors (the equity story);
  - the personnel must be trained in the need to keep the IPO process confidential, or risk having the process halted by order of a supervisory authority;

- a data room must be set up containing the company's essential documentation (corporate documents, all types of agreements, regulations, certifications, processes, risk management, etc.), and made available to lawyers in connection with the drafting of the prospectus.

- Several working groups are then created, coordinated by a person or group of people within the company, entirely dedicated to the task if possible:

  - Banks assist with the preparation of presentations to financial analysts, who will make recommendations, and presentations to investors themselves at road shows typically held in the final two to three weeks prior to the IPO date; banks also prepare the order book (in which investors indicate the amounts they wish to invest depending on various possible share prices), advise the company on setting the issue price and coordinate operations with the stock-exchange computer systems to ensure correct execution of orders placed by investors and trading from the first day of listing;

  - Lawyers draft most of the prospectus, the content of which aims to describe to investors the company's activities and organization, its financial results in recent (generally three) years, the planned use of the funds raised via the IPO and, above all, risk factors for investors. The prospectus must contain all the key information, which must be accurate and supported by reliable sources. Lawyers check this by analyzing documents provided by the company as part of a due diligence process. Errors or omissions in the prospectus can trigger the liability of all parties involved in issuing the new shares. The lawyers also prepare the subscription agreement, which is signed by the company with the banks at the time of listing on the stock exchange (for the subscription of new shares offered to the public via the participating banks);

  - The auditors restate the company's accounts for the last two or three years to present them according to the standards required by the selected stock exchange (typically IFRS or US GAAP). This process often raises issues not previously identified and not always easy to solve;

  - The communications company updates the company's website, to be activated on the date of listing on the stock exchange. Similarly, to take account of restrictions imposed by many countries on the offering of securities within their territory, adequate filters need to be put in place to ensure that the information is only accessible to its intended recipients.

- A few weeks before actual listing on the stock exchange, the company sets the price range in which the shares will be offered for subscription. On this basis, a preliminary prospectus is published for the investor road show. It is only after the road show that the banks, having collected all the indications of interest, and then the firm subscriptions from interested investors, help the company to set the definitive issue price at which the shares will actually be sold by the company on the first day of its listing;

- On the IPO day, i.e. the first trading day, the new shares – subscribed by investors (often via the intermediary of banks) at the price set by the company – start to trade at the stock-market price (based on supply and demand). The company is now listed and, as such, is immediately subject to all applicable obligations.

8.2.3 Practical aspects

Internal governance of the process

It is vital at a very early stage to define the persons within management and the board of directors who will be responsible for (i) leading and coordinating the various participants and ensuring everyone carries out their tasks timely and adequately and (ii) preparing decisions by the board of directors and keeping directors adequately informed of the progress of the process, in particular towards the end of the process when directors must be available on a moment's notice to approve voluminous documents prepared during numerous weeks or months.

Management of the schedule

Compliance with the schedule is important: windows of opportunity for an IPO are unpredictable. The process is generally launched when the period appears favorable, but there are never any guarantees that the window will remain open, meaning that the process is often, if not always, carried out rapidly or even very rapidly, generating significant stress for those involved. Any delays must be avoided.

Category of shares

It is common for shareholders' agreements to stipulate the automatic conversion of all preference shares into ordinary shares at the time of an IPO. This may generate tensions between different categories of shareholders regarding the path to take towards an exit, with some favoring a trade sale to protect their privileges, while others, who hold ordinary (or less preferential) shares, will favor the more egalitarian route of an IPO.

Lock-up

To facilitate the placement of the securities in the market, it is common for the company's shareholders and management to undertake to retain their shares for a certain period of time after the IPO (typically between 6 and 12 months). This is called a "lock-up period". The aim is to prevent all shareholders wishing to monetize their investment from simultaneously offering their securities for sale on the market immediately after the IPO, thereby artificially lowering the share price due to excessive supply.

Obligations applicable to listed companies

We mentioned above the numerous regulatory obligations applicable to listed companies. The listing often requires the appointment of a single person, generally highly qualified, to be responsible for ensuring compliance with those obligations and investor relations (updating of the website, announcement of important events to the regulatory authorities and the stock market, declaration of management transactions and crossing of thresholds by large shareholders, ensuring internal compliance of employees with the rules governing the trade of the company's stock, insider trading, etc.). The company must also comply with corporate governance rules, which, as a minimum, often require the creation (or formalization) of audit and remuneration committees within the board of directors.

Engagement letter with banks

Attention must be paid to banks' remuneration for their services. In principle, they are mostly remunerated based on a successful outcome, although they also receive fixed amounts covering their costs in the event the IPO is not completed, particularly due to market conditions or the choice of the company to finally pursue another transaction. Engagement letters with banks often stipulate a remuneration to be paid on other transactions and those clauses require special attention. Similarly, the company must be careful not to give banks complete discretion over the amount of fees invoiced to the company by its own advisors (lawyers, etc.).

Choice of stock exchange

The main criteria relate to the market potential, since some stock exchanges have a competitive advantage in certain economic sectors (e.g. medical technology, financial activities, etc.). The degree of the regulator's intervention and responsiveness should also be taken into account to maximize the IPO's chances of success, without undue delays and without being forced to disclose information which the company may consider strategic and therefore confidential.

Setting the price

The company (or its existing shareholders) will generally tend to favor the highest possible price for issuing the new shares, in order to minimize the dilution for a given investment amount or increase the investment amount for a given dilution. Conversely, banks will want to ensure that the IPO includes a discount to allow initial investors to make an immediate profit on the listing and so allow the banks to attract interest from their circle of clients traditionally looking to invest in IPOs. This tension will need to be resolved at the time the price is set, immediately prior to the first day of listing. However, it should be remembered that due to the lock-up (see above), most existing shareholders will not be able to benefit from a high IPO price if the price subsequently falls before the end of the lock-up period.

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