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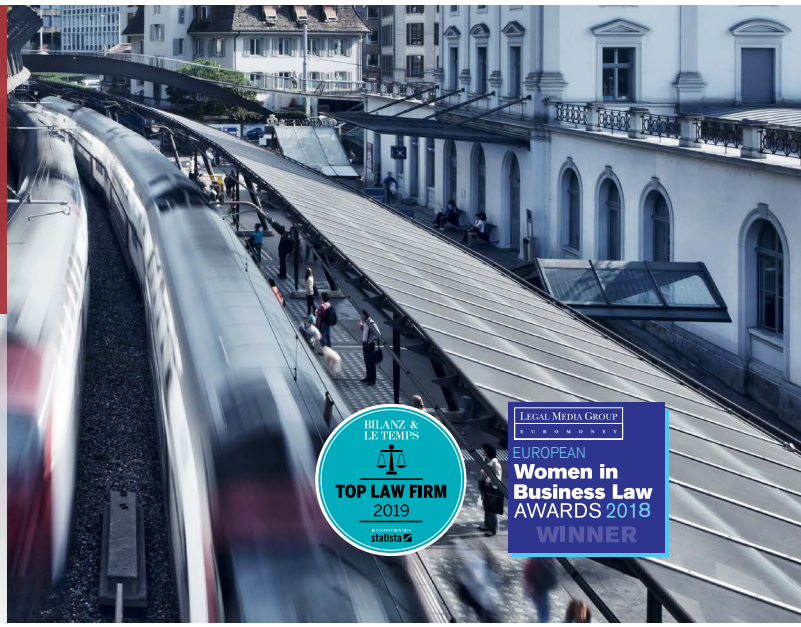
Newsletter



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CORPORATE / MERGERS & ACQUISITIONS

Shareholder representatives on the board of directors - Possibilities and limitations of the flow of information to major shareholders

The interests of major shareholders may be represented and protected on the board of directors of Swiss companies. However, the shareholder representative does not have a special legal status within the board of directors. The disclosure of confidential information by the shareholder representative to "its" major shareholder is only permitted under strict conditions – all the more so in the context of publicly listed companies.

1 INTRODUCTION

Shareholder representatives of major shareholders, be they large or even controlling shareholders, are a frequent phenomenon on the board of directors of Swiss companies – both privately held and publicly listed companies. This often creates a **tension** between, on the one hand, the major shareholder's need to exert as much influence and obtain as much information as possible via the shareholder representative and, on the other hand, the confidentiality interests and obligations of the shareholder representative or the company concerned.

2 INSTRUCTIONS FROM THE MAJOR SHAREHOLDER

2.1 SHAREHOLDER REPRESENTATIVES AS SERVANTS OF TWO MASTERS

In terms of company law, shareholder representatives qualify as "representatives of a legal entity" within the meaning of Art. 707 para. 3 of the Swiss Code of Obligations. They are corporate bodies of the company with all rights and obligations, but at the same time they have a special relationship with a shareholder.

As a **"servant of two masters"**, the shareholder representative has a duty of loyalty and diligence as a regular member of the board of directors and must accordingly safeguard the interests of the company. On the other hand, he is bound by the instructions of the major shareholder.

2.2 COMPLIANCE WITH INSTRUCTIONS AND *DE FACTO* CORPORATE BODY

The shareholder representative may, at its discretion, follow the instructions of the major shareholder whenever they are compatible with the interests of the company. In other words, the performance of its duties towards the

company takes **precedence** over its duty to safeguard the interests of the major shareholder.

If the shareholder representative follows the instructions of the major shareholder mechanically and regularly, the shareholder issuing the instructions may, under certain circumstances, be deemed a so-called ***de facto* corporate body** of the company. As a consequence, the shareholder would become subject to the same responsibility under company law as if it were a formally appointed board member.

3 LIMITED DISCLOSURE OF INFORMATION TO MAJOR SHAREHOLDERS

The need of the represented major shareholder to exchange as much information as possible with "its" shareholder representative is subject to various **legal restrictions**:

3.1 RIGHT TO INFORMATION VS. DUTY OF CONFIDENTIALITY

First of all, it is worth noting that the members of the board of directors are generally subject to **a duty of confidentiality and secrecy** within the framework of their duty of loyalty under company law, which in many cases stands in fundamental contradiction to the major shareholder's right to information. The relevant provisions of Swiss company law do not give major shareholders a general preferential entitlement to information compared to small shareholders.

A shareholder representative is not authorised, as of right, to pass on confidential company information to the major shareholder. This is a matter for the full board of directors to decide.

In principle, the shareholder representative's duty of confidentiality covers all company information that is not generally known, particularly to the extent that its disclosure could cause material or immaterial damage to the company.

The duty to maintain confidentiality relates, on the one hand, to **relative secrets**, with regard to which the company is the owner of the secrets and can, therefore, itself waive confidentiality or allow for (selective) disclosure of confidential information. On the other hand, it pertains to **absolute secrets**, the preservation of which is a statutory obligation (e.g. banking secrecy) or a contractual obligation towards third parties (e.g. non-disclosure agreement). The company cannot decide alone on the disclosure of such absolute secrets. Without the prior consent of all parties involved, the disclosure of such secrets would, even with the approval of the full board of directors, violate the shareholder representative's fiduciary duty under company law and the relevant statutory or contractual provisions.

3.2 RELATIVE EQUAL TREATMENT

The shareholder representative, like any other member of the board of directors, is required to treat shareholders equally under the same conditions. This general principle of relative equal treatment also applies to the disclosure of confidential information to shareholders.

A **preferentialial disclosure** of relative secrets only to individual (major) shareholders may in a specific case be justified under company law if (i) there is an objective reason for doing so, (ii) the overriding interests of the company require it and (iii) the unequal treatment is proportionate.

The status as a major shareholder or ownership of a significant stake in the company is not *per se* a sufficient objective reason for a preferential disclosure of confidential information. The legitimate reason for an informational preference of a major shareholder must rather be based on the **interests of the company** (*Gesellschaftsinteresse*), which must be examined on the basis of the concrete circumstances of the individual case. For example, an unequal treatment in providing confidential information may be justified in the final phase of the preparation of a large transaction which cannot take place without the involvement of the major shareholder.

> "A shareholder representative is not authorized, as of right, to disclose confidential company information to the major shareholder."

The **principle of proportionality** requires the adoption of appropriate measures tailored to the specific case, such as, for example, restricting objectively justified advance information and the time lead itself to what is absolutely necessary, as well as obtaining appropriate contractual confidentiality undertakings from the shareholder in question. In the case of publicly listed companies, trading restrictions (so-called standstill obligations) must be added.

Absolute secrets may not be disclosed at all without the consent of all parties involved.

3.3 RIGHT TO INFORMATION VS. ANTITRUST LAW

When it comes to the flow of information between shareholder representatives and major shareholders, possible **information barriers under antitrust law** must be taken into account, in particular if the major shareholder is in (actual or potential) competition with the company. In such a case, an exchange of competitively sensitive business information or the direct or indirect coordination of behavior among competitors can be sanctioned as an unlawful horizontal competition agreement.

Consequently, in the case of competing companies, disclosure of competitively sensitive business information, in particular on prices, price components, production volumes, customers and markets, must be avoided by all means. Such information may neither be forwarded by the shareholder representative to the competing major shareholder nor may it flow in the opposite direction from the major shareholder to its shareholder representative or from him to the board of directors of the company.

4 SPECIAL ASPECTS FOR PUBLICLY LISTED COMPANIES

For obvious reasons, **publicly listed companies** are subject to even stricter regulation of the flow of information, especially as informational advantages can be exploited directly in the case of listed equity securities.

An **even stricter standard** must therefore be applied with regard to the preferential provision of confidential information to major shareholders in publicly listed companies.

4.1 EQUAL TREATMENT UNDER CAPITAL MARKET LAWS

An essential premise of Swiss capital market law is to ensure a level playing field for all investors, which in particular requires **equal treatment** of the shareholders of publicly listed companies when it comes to access to information.

However, even for publicly listed companies, the principle of equal treatment pursuant to capital market law is relative – it does not entirely exclude, but merely restricts preferential access to information for major shareholders.

Therefore, in specific instances, there can be unequal or preferential treatment of a major shareholder of a publicly listed company in terms of access to confidential information, but only if the additional limitations outlined below are complied with.

4.2 PROVIDING INFORMATION VS. *AD HOC*-PUBLICITY

***Ad hoc*-publicity** is a direct consequence of the principle of equal treatment under capital market law and aims to ensure the true, clear and complete provision of potentially pricesensitive information to all current and potential market participants on equal terms. A selective supply of pricesensitive confidential facts to (major) shareholders therefore violates this fundamental principle of capital market law.

There is an exception under capital market law to the general disclosure obligation, namely the so-called **postponement of disclosure** (*Bekanntgabeaufschub*): This allows a publicly listed company to postpone the publication of a pricesensitive fact if (i) the fact is based on a plan or decision of the company, (ii) its dissemination is likely to adversely affect the legitimate interests of the company and (iii) the company ensures the complete confidentiality of the fact. These requirements may apply, for example, to planned capital increases, planned takeovers or negotiations of new financing arrangements.

"Major shareholders cannot claim preferential information status over other shareholders."

If the conditions for a postponement of disclosure are met, pricesensitive facts may in principle be passed on selectively by the company (directly or via the shareholder representative) to a major shareholder, provided that this is also permissible from a company law perspective (cf. section 3 above), and that it can be ensured that the recipient of the information is subject to a strict confidentiality and standstill obligation.

4.3 PROVISION OF INFORMATION VS. INSIDER SUPERVISORY LAW

Pursuant to Art. 142 para. 1 lit. b of the Swiss Financial Market Infrastructure Act even the (mere) **disclosure** of insider information constitutes illicit market conduct under supervisory law, which can be sanctioned by FINMA. It is often overlooked that this supervisory insider information offense not only applies to banks or other financial service providers subject to FINMA supervision, but must also be observed and complied with by all Swiss publicly listed companies.

In order to fulfil the criteria of a supervisory insider offense, it is sufficient that the individual (e.g. the shareholder representative providing information to its shareholder) ought to have known (*Wissen-Müssen*) that the information in question is a potentially pricesensitive insider information. It is not required that a pecuniary advantage be obtained, nor is individual fault a prerequisite for sanctioning a breach of insider supervisory law. As a consequence, in principle, **any disclosure** of insider information, in particular to a major shareholder, is prohibited.

"Even in the case of publicly listed companies, the preferential provision of information to the major shareholder is not completely excluded, but further restricted."

The safe harbor provision of Art. 128 of the Ordinance on Financial Market Infrastructures contains an (exhaustive) list of **exceptions** to the prohibition of disclosure of insider information. A disclosure of information covered by this provision may thus not be punished as an insider offense under supervisory law (nor under criminal law). This is particularly the case if:

> the recipient of the information is reliant on insider information in order to fulfill its legal or contractual obligations; or

> the disclosure of insider information is indispensable for the conclusion of a contract.

Unfortunately, the regulator has not yet provided any authoritative clarifications on these important safe harbor exceptions, which is very regrettable given their farreaching implications. Nor is there any concrete published practice or FAQ catalogue. Therefore, it is important to carefully examine, in each individual case, whether an intended transfer of pricesensitive information falls within the scope of this catalogue of exceptions or not.

4.4 PROVISION OF INFORMATION VS. INSIDER CRIMINAL LAW

Under certain circumstances, disclosure of insider information is not only inadmissible under insider supervisory law, but it also contravenes **criminal law**. However, a criminal sanction requires (i) that a pecuniary advantage has been obtained or is intended through the disclosure of a pricesensitive fact, and (ii) that the acting person was subjectively acting willfully.

The members of the board of directors and the management of a publicly listed company, and thus in particular the shareholder representatives of a major shareholder on the board of directors, qualify as so-called **primary insiders** in the sense of the criminal law provision. The recipients of information on the major shareholder's end generally qualify as so-called **tip-takers** (secondary insiders) and are thus also subject to the insider criminal provisions.

5 CONCLUSION

Major shareholders of a Swiss company cannot claim preferential information status vis-à-vis other shareholders. When passing on information to "their" major shareholder, shareholder representatives on the company's board of directors must always observe the principles of (relative) equal treatment and act in the interest of the company.

In the case of publicly listed companies, the disclosure of information to major shareholders is also restricted by the hurdles of *ad hoc*-publicity, insider supervisory law and insider criminal law.

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The content of this Newsletter does not constitute legal or tax advice and may not be relied upon as such. Should you seek advice with regard to your specific circumstances, please contact your Schellenberg Wittmer liaison or any of the following persons:

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