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A New Attempt at Swiss Corporate Law Reform: Draft Federal Council Bill in Consultation

The Federal Council opened the consultation process on a preliminary draft bill aimed at a comprehensive revision of Swiss corporate law. The revision is set to affect both listed and non-listed Swiss companies. The preliminary draft bill suggests numerous amendments, including both long-awaited improvements and controversial proposals. The consultation period ends on 15 March 2015.

1 INTRODUCTION

The road towards a revised Swiss corporate law has been long and bumpy. Already in 2007, the Federal Council published a draft bill for a reform of Swiss corporate and accounting law. In early 2009, parliament split the draft bill into two separate bills. The undisputed amendment of the **accounting law** was adopted separately and entered into force on 1 January 2013 (cf. our June 2013 newsletter). The proposals regarding **corporate law**, however, fell victim to a heated parliamentary debate on the indirect counterproposal to the popular initiative "against excessive compensation" of 2008 (so-called Minder initiative). The Minder initiative was approved in early 2013 in a popular referendum and a new art. 95 para. 3 was added to the Swiss Federal Constitution as a result. As the initiative expressly provided for transitional implementation, the Swiss Federal Council implemented it by issuing the Ordinance against Excessive Compensation in Listed Companies (**Compensation Ordinance**), which entered into force on 1 January 2014 (cf. our November 2013 newsletter). On 28 November 2014, the Federal Council published a **new preliminary draft bill** for a comprehensive **revision of Swiss corporate law** (**Preliminary Draft**) for consultation.

The Preliminary Draft aims at **modernizing traditional Swiss corporate law**, in particular by improving corporate governance by strengthening shareholders' rights and the enforcement thereof. Further, the provisions governing capital, accounting and restructuring shall be modernized. The Preliminary Draft also suggests a number of **new rules in response to specific concerns** (such as greater participation of shareholders of listed companies, transparency requirements for commodity companies, gender quotas). Lastly, the Preliminary Draft seeks to formally implement into federal statutory law the rules now regulated on the level of the Compensation Ordinance governing **compensation** of the board of directors and executive management **in listed companies**.

2 CORPORATE GOVERNANCE, SHAREHOLDERS' RIGHTS AND THE ENFORCEMENT THEREOF

2.1 FURTHER DEVELOPMENT OF CORPORATE GOVERNANCE

With the aim to improve corporate governance, the Preliminary Draft seeks to facilitate shareholders' participation and access to information. For that purpose, the draft contains, *inter alia*, the following proposals:

> Shareholders of **listed companies** holding a stake equal to or larger than **3%** of the share capital or of the votes shall be able to request the **convening of a shareholders' meeting** (the current threshold of 10% remains unchanged for non-listed companies);

> The **thresholds** entitling a shareholder to propose **agenda** items and **motions** to the shareholder's meeting shall be lowered to **0.25%** for **listed** and **2.5%** for **non-listed** companies (currently 10% or shares with a nominal value of CHF 1m);

"The draft bill is set to strengthen shareholders' rights, particularly in non-listed Swiss companies."

> The board of directors shall be required to include **motions** of **significant shareholders** to any items set on the agenda as well as the **reasoning** for such motions in the **invitation to the shareholders' meeting** (the threshold values of 0.25% or 2.5%, respectively, apply);

> The **information rights of shareholders** shall be enhanced; for instance, the board of directors of **non-listed** companies shall reply to shareholders' requests for information at least **twice a year**;

> The **compensation report of listed companies** shall contain additional information regarding **individual compensation** of members of **management** and regarding **mandates** of members of the board of directors and executive management at other companies. In contrast, the board of directors of **non-listed** companies shall inform on the compensation of the companies' governing bodies at the **shareholders' meeting**.

Further, the Preliminary Draft suggests a specific **duty of care of the board of directors** to determine the company's **compensation** considering (in translation) "the economic situation of the company and its long-term prosperity" and ensuring that remuneration is "in an adequate proportion to the tasks, performance and responsibility of the recipients".

The Preliminary Draft also seeks to **modernize** the **shareholders' meeting** by, for instance, allowing online participation or even the holding of a **cyber shareholders' meeting** (without physical presence). Further, listed companies shall be required to set up an **electronic forum for debate** among shareholders before the shareholders' meeting.

2.2 FACILITATE THE ENFORCEMENT OF SHARHOLDERS' RIGHTS

A further object of the Preliminary Draft is to facilitate procedural enforcement of shareholders' rights. In this context, the Preliminary Draft suggests the following measures:

> The requirements shall be lowered for obtaining **court orders** for a **special investigation** and for filing **restitution claims** against members of the companies' governing bodies who have received undue or obviously disproportionate benefits; with respect to restitution claims, in particular, a partial **reversal of the burden of proof** to the detriment of such recipients of benefits is suggested;

> Shareholders shall be allowed to file **liability or restitution claims for the benefit of the company at the company's expense**, subject to prior approval of such cost coverage either by the shareholders' meeting or by a court of law;

> **Time periods** for liability and restitution claims shall be **extended** and new grounds for suspension of the statutes of limitations are suggested;

> The law shall allow submission of **corporate law disputes** to arbitration, if the articles of association provide for the **exclusive jurisdiction of an arbitral tribunal**. Such arbitration clause shall be binding also vis-à-vis shareholders and directors joining the company after the adoption of a respective provision.

2.3 GENDER DIVERSITY IN GOVERNING BODIES

Referring to similar efforts in the EU with regard to supervisory bodies, the Preliminary Draft suggests a minimum **representation quota for both genders of 30%** for the **board of directors** and for **executive management**. This provision shall take effect after a transition period of five years from the entry into force of the new law and shall apply only to **listed companies** who meet at least two out of the following three **thresholds**: CHF 20m total assets, CHF 40m annual turnover and 250 full-time positions. Companies subject to but not fulfilling the quota shall be required to explain the reasons for the underrepresentation and inform about measures taken to promote the underrepresented gender in their compensation report (comply or explain). Notably, the Preliminary Report goes further than the current version of the (non-binding) Swiss Code of Best Practice for Corporate Governance (as updated in autumn of 2014), which requires both genders to be represented in the board of directors.

2.4 TRANSPARENCY OBLIGATIONS FOR COMMODITY COMPANIES

In accordance with analogous efforts in the EU and the US, the Preliminary Draft proposes a transparency obligation for listed or large **companies active in the exploitation of natural resources**. Such companies shall be required to publish an annual group-wide **report on consideration to public authorities** exceeding CHF 120 000 in value (e.g. royalties paid for the extraction of resources). Further, the Preliminary Draft reserves the right of the Federal Council to widen the scope of application of the transparency obligations to include also companies solely active in commodity trading.

3 MODERNIZATION OF PROVISIONS GOVERNING CAPITAL, ACCOUNTING AND RESTRUCTURING

3.1 MORE FLEXIBLE PROVISIONS ON CAPITAL AND ACCOUNTING

The Preliminary Draft responds to requests for an update of the rules governing the incorporation and the capital of

a Swiss company and a further improvement of certain accounting provisions. To this end, the proposed changes include, *inter alia*, the following:

- **Share capital denomination** as well as **accounting** and **financial reporting** shall be fully possible in a **foreign currency**;

- Incorporation and capital increase shall be facilitated by **abolishing** the restrictive provisions on the so-called (intended) **acquisition of assets**, by modernizing the provisions on contributions in kind and by adding a statutory provision on **subscription** of shares **by offsetting receivables**;

"The revised provisions facilitate incorporation and changes in share capital, creating a more flexible, investment-friendly framework."

- **Changes in share capital** shall be **facilitated**; in particular, companies shall be allowed to introduce a so-called **capital band** (simplified increase and decrease of up to 50% of the share capital during a period of 5 years);

- The provisions on **statutory reserves** shall be renewed, notably to distinguish between **capital reserves** (including paid-in capital surplus, so-called agio, and capital contributions) and reserves from **retained earnings**;

- The provisions on **dividend distributions** shall be amended in order to explicitly allow **repayment of agio** (subject to certain limitations) and distribution of **interim dividends**.

3.2 FINANCIAL INCENTIVE TO INCREASE SHAREHOLDERS' PARTICIPATION

A significant number of shareholders of Swiss listed companies do not register their shareholdings with the company and are therefore not allowed to vote these shares (so-called **dispo shares**). This can affect decision-making negatively. Aiming to reduce the number of dispo shares, the Preliminary Draft suggests that companies shall be allowed to provide (a) for an up to **20% higher dividend** for **shareholders voting** their shares, or (b) for an up to 2**0% lower dividend** for **shareholders not voting** (voting bonus-malus system) in their articles of association.

3.3 ENHANCED DUTIES IN CORPORATE RESTRUCTURINGS

The Preliminary Draft provides for a new early warning system for potential financial difficulties, aimed at initiating – in combination with the revisions of Swiss Debt Enforcement and Bankruptcy Law entered into force on 1 January 2014 (cf. our October 2013 newsletter) – **restructurings** at an **earlier** stage. If there is **well-founded concern** that a company will **become illiquid in the following 12 months**, the board of directors shall be required to prepare a **liquidity plan**. If the plan does not confirm impending illiquidity, the plan shall be subject to an additional plausibility check by the auditor. If the plausibility check fails or if the liquidity plan confirms impending illiquidity, the board shall be obliged to convene a shareholders' meeting and propose restructuring measures (as is already the case currently). The same procedure shall be followed **if losses occur in three successive financial years** or if the assets no longer cover at least two thirds of the share capital plus legal reserves (so-called **capital loss**). Where there is a prospect of financial restructuring, notification of the court may be deferred by up to 90 days.

4 COMPENSATION IN LISTED COMPANIES (COMPENSATION ORDINANCE)

The proposed legislation on compensation in Swiss listed companies is based largely on the Compensation Ordinance. Listed companies shall remain free to define in their articles the details regarding the annual binding shareholders' say on pay of the board of directors and executive management. However, the Preliminary Draft suggests some debatable limitations:

- The widely introduced practice of voting on compensation in advance (**prospective budget votes**) shall be **prohibited** with regard to **variable compensation**;

- Companies shall be required to set a maximum **ratio of fixed compensation to total compensation** for members of the board of directors and executive management in their articles of association;

- A *de facto* limitation of **non-compete covenants** to **12 months in employment contracts**; in addition, the **compensation** for such covenants must be in line with **market standards**.

"Listed companies shall not be allowed to conduct prospective say-on-pay votes on variable compensation."

5 CONCLUSION AND OUTLOOK

A first analysis of the Preliminary Draft leads to the following conclusions:

- In its core, the proposed revision of Swiss corporate law contains a number of **improvements to be welcomed**. This is particularly true for areas where flexibility is increased (e.g. incorporation and changes in share capital) and for proposals aimed at eliminating certain ambiguities (e.g. on distributions and reserves). This will allow for a framework that is better suited and more readily adjustable to the needs of Swiss companies and their investors.

- Not all changes proposed, however, necessarily increase the freedom of scope, which must continue to be a key element of Swiss legislation in a climate of increasing global competition. In particular, **non-listed** companies and their directors would face **rather stricter regulatory requirements** with regard to shareholder participation (corporate governance). Moreover, directors would be subject to increasingly detailed duties. Yet, the assessment of many proposals is a **matter of perspective**: While (minority) shareholders will

welcome a strengthening of their rights, affected companies will balk at potential additional efforts.

> The Preliminary Draft also includes **exploratory first proposals**, set to test new grounds. These will, in the further course of the legislative process, be held against criteria of **practicality** (e.g. the voting bonus-malus system, cyber shareholders' meeting, statutory arbitration clause) and **public acceptance** (e.g. gender quotas, transparency obligations for commodity companies).

> The **restrictions regarding** the **compensation regime of Swiss listed companies** put up for discussion by the Preliminary Draft are **clearly undesirable**. The proposed partial prohibition of prospective votes on compensation appears particularly questionable, given that many Swiss listed companies (and their shareholders) have already implemented such a voting model based on the Compensation Ordinance.

A first impression of how the Preliminary Draft will be received by the various interested parties may be gained from their respective written comments submitted in the **consultation process up to 15 March 2015**. The time schedule of the legislative process is currently not determined yet. However, we do not expect a revised Swiss corporate law to enter into force before 2018.

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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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