Update

Newsflash December 2014

Corporate Law Reform

On November 28, 2014 the Swiss Federal Council presented a preliminary draft of the corporate law reform and started the consultation procedure. The main proposals are:

- **Implementation of the Ordinance against Excessive Compensation in Public Companies into the Swiss Code of Obligations with certain more stringent rules (e.g., a prohibition of prospective say-on-pay votes and of compensation for non-compete covenants exceeding 12 months).**
- **A target gender quota of 30% for the board of directors and the executive committee of publicly listed companies based on a «comply or explain» approach.**
- **An obligation for major companies in the exploitation of natural resources industry to disclose payments made to public authorities.**
- **Numerous changes in «traditional» corporate law, such as the permissibility of a share capital denominated in foreign currency, a minimum par value below one cent, a «capital band» to give companies more flexibility to increase and reduce their share capital, clarification of the requirements for distributions out of the capital reserves and interim dividends, and the enhancement of shareholders' rights and remedies.**

The consultation period runs until March 15, 2015. The date of enactment is still uncertain and not to be expected before 2017. Nevertheless, companies (in particular listed companies) should already consider the draft in their planning.

After the Federal Council had issued a draft bill for a reform of Swiss corporate and accounting law and submitted it to discussion in the parliament already in 2007, the accounting law part of the bill was carved out, dealt with separately and has been in force since 2013. The discussion of the corporate law part, on the other hand, has been delayed, and with the adoption of the popular initiative against «excessive compensation» (*Minder Initiative*) on March 3, 2013 the issue of management compensation became the focus of the legislation process. The Ordinance against Excessive Compensation in Public Companies (**Compensation Ordinance**), which was adopted to implement the Minder Initiative and has been in force since January 1, 2014, must now be transformed into a formal federal law. This is the background of the preliminary draft for a reform of corporate law (**Draft**) outlined in this Newsflash. The Draft has been submitted together with an explanatory report. The consultation period will run until March 15, 2015.

The Draft covers three general topics: first, compensation rules, i.e. the implementation of the Compensation Ordinance into the Swiss Code of Obligations (and other federal laws); second, new proposals for a gender quota and disclosure obligations for companies in the natural resources sector (which are not really part of corporate law, but nonetheless included in the Draft); and third, changes in «traditional» corporate law, which in part had already been included in the draft of 2007 and which primarily relate to the areas of capital and legal reserves, corporate governance and corporate restructurings.

I. Say on pay and other compensation rules

The Draft is to replace the Compensation Ordinance, which had been enacted as an interim solution. In substance, the provisions of the Compensation Ordinance have by and large remained the same. However, the Draft provides for some stricter rules, which companies that have not yet implemented the Compensation Ordinance may want to take into account in the implementation. The main differences are the following:

> **Prospective shareholder say-on-pay votes** (so-called budget votes) **on variable compensation** are **no longer permissible.** The shareholders are to vote on variable compensation only after the annual accounts have become available. Whether or not the company, in addition to the prospective vote, submits its compensation report to an advisory vote is irrelevant. Should this proposal become law, the many companies which have introduced a prospective model of compensation approval votes would have to amend their articles of incorporation and approval procedures.

> The articles of incorporation must include a **maximum ratio of variable compensation to total compensation** for the members of the board of directors and the executive committee. Such a rule is neither required by the Minder Initiative nor the Compensation Ordinance.

> **Sign-on bonuses** are only permissible if they are to compensate «clearly demonstrated financial disadvantages» incurred in connection with the change of employment.

> Companies may only pay compensation for **non-compete covenants** if the non-compete is commercially justified and the consideration is in line with market standards. Non-compete covenants **exceeding 12 months** are not considered to be commercially justified and may not be compensated. Should this rule become effective, companies whose articles of incorporation provide for non-compete covenants with a longer term would have to amend them.

> **Payments** which are not in line with market practice in connection with a **previous engagement** as a member of the board or the management are also banned. Under the Compensation Ordinance, there is only a disclosure obligation for such payments, provided that they are not covered by another prohibition (e.g. as an impermissible severance payment).

> As regards the **maximum number of external mandates** of members of the board and the executive committee, all mandates «in comparable functions in enterprises with commercial objectives» must be covered in the future. This means that also external management functions (which are not subject to the maximum number under the Compensation Ordinance) are covered. With respect to mandates in foundations and associations, the determinant factor will likely be whether these qualify as «enterprises with a commercial objective», which very often should not be the case. The external mandates must be disclosed in the compensation report.

> According to the Draft, the **compensation report** must specify the compensation received by each member of the board and the executive committee on an individual basis (the Compensation Ordinance only requires the disclosure of the aggregate amount of compensation of the executive committee and the highest amount paid to an individual member).

II. Gender quotas and disclosure obligations for companies exploiting natural resources

The Draft provides for a **target quota of 30%** for the representation of both genders in the board and in the executive committee of major public companies. It is applicable to public companies which exceed the thresholds relevant for an ordinary audit (which is usually the case for public companies). If these companies do not achieve the target quota of 30% for the representation of both genders after a **transition period of five years** they must explain in the compensation report the reasons for the underrepresentation and the actions undertaken to promote gender diversity in their corporate bodies. Thus, the Draft goes beyond the revised Swiss Code of Best Practice, which recommends a representation of both genders in the board but does not require a specific quota.

In accordance with the EU Directives 2013/34 and 2013/50, which also provide for transparency obligations for **companies exploiting natural resources**, the Draft requires companies active in such business and being subject to an ordinary audit to disclose payments exceeding CHF 120,000 to public authorities. Companies solely active in commodity trading are not subject to this requirement, but the Federal Council may broaden its scope to also encompass commodity traders in the event of concerted international efforts.

III. «True» corporate law changes

The changes proposed in the area of traditional corporate law primarily relate to the capital structure, measures for the improvement of corporate governance, and the strengthening of shareholder rights and remedies.

1. **Capital, capital changes, legal reserves and distributions**

The proposed changes include in particular:

> The **share capital may also be denominated in foreign currency**, which resolves a number of inconsistencies between the accounting rules which already now allow accounting in (convertible) foreign currency and corporate law, in particular with respect to distributions.

> The **minimum par value of one cent is abolished**; shares may have any lower par value above zero. This would facilitate share splits. Shares that are only paid-up in part are no longer permissible.

> The **rules regarding (intended) acquisitions of assets**, which currently necessitate a somewhat cumbersome "qualified" procedure for incorporations and capital increases with a number of potential legal pitfalls, are to be **abolished**.

> Introduction of a «**capital band**», i.e. an authorization of the board for a maximum of five years to increase and reduce the share capital within an upper and lower limit. This would allow more flexible and faster capital changes.

> The regulations regarding **legal reserves** are aligned with the accounting rules, and the creation and dissolution of legal reserves is clarified. Specifically, the **distribution of capital reserves** (i.e. paid-in capital surplus and other shareholder contributions made in excess of the par value) is to be permissible within certain limits and if an audit report is obtained.

> **Interim dividends** are to become permissible for audited companies provided that the articles of incorporation permit them and audited interim financial statements are available.

> Companies may provide for an up to 20% higher dividend for shareholders who exercise their voting rights in the shareholders' meetings. This rule aims at mitigating the problem of shares which are not registered in the company's share register (so-called «**dispo shares**») and incentivising active participation in votes. A nominee model as a possible solution to the problem of «dispo shares» is not proposed.

> The treatment of **treasury shares** is aligned with the accounting rules (deduction from equity of an amount corresponding to the acquisition price).

2. **Shareholder rights and remedies**

According to the Draft shareholder rights and remedies are to be strengthened with a view to an improved corporate governance. This includes the following proposed changes:

> Shareholders in private (unlisted) companies are to have the right to ask questions outside shareholders' meetings; the board is required to respond to **questions of the shareholders** twice a year and to report at the annual shareholders' meeting on board and management compensation.

> The requirements for the right to request a **special investigation** are to be relaxed in that the necessary threshold of shares is reduced to 3% in public companies and the circumstances for which *prima facie* evidence is to be furnished are somewhat eased.

> Certain **shareholder (derivative) lawsuits** for the benefit of the company may, upon request of the plaintiff, be litigated **at the expense of the company** provided that the claiming shareholder(s) have an existing participation of at least 3% (in public companies) or 10% (in unlisted companies) and can provide *prima facie* evidence for the claim.

> The requirements for **actions against shareholders, directors and managers for repayment of unduly received benefits** are to be relaxed. In the future, claims may also be brought against related persons of shareholders and members of corporate bodies, and the financial situation of the company is irrelevant for the outcome.

> The articles of incorporation may include binding **arbitration clauses** for disputes relating to corporate law matters.

3. **Shareholders' meetings**

The Draft provides for more flexibility with regard to the organisation of shareholders' meetings, reduces the hurdles for the exercise of shareholder rights, and attempts to foster the participation in the shareholder democracy process:

> Shareholders' meetings that are (exclusively) held by electronic means (so-called «**cyber meetings**«) and shareholders' meetings taking place abroad or in several locations at the same time are expressly to be allowed.

> Reduction of the **threshold** for shareholders in public companies to **request the convening of a shareholders' meeting** to 3% and reduction of the threshold to propose agenda items and motions to

0.25% (10% and 2.5%, respectively, in private companies).

> Public companies are to set up an **online platform** for discussions before any shareholders' meeting.

4. Corporate restructuring and insolvency

With regard to the «early warning systems» in case of impending insolvency, the Draft shifts the focus to the aspect of illiquidity and provides more specific rules regarding the board's duties to act:

> In case there is well-founded **concern about impending illiquidity in the next 12 months**, the board must prepare a **liquidity plan** and an assessment of the company's economic situation. If the board concludes based on the liquidity plan that there is no threat of imminent illiquidity, the liquidity plan has to be submitted to an auditor to ascertain its plausibility. If, however, the board finds that there is a threat of imminent illiquidity, or if the auditor does not confirm the plausibility of the liquidity plan, then the board has to convene a shareholders' meeting and propose restructuring measures.

> The same duties apply for additional warning indicators, namely if the net assets cover less than one third of the aggregate of the share capital and the legal reserves (a so-called «**capital loss**»), in the event of a **rapid decrease of equity**, and if there has been a **loss in three consecutive years**.

> If there is **well-founded concern about over-indebtedness** the board generally still has the duty to notify the insolvency court; such notification can be deferred by obtaining a subordination by creditors of their claims and, which is new, in case of a reasonable **prospect of restructuring** within 90 days.

IV. Outlook

Following the consultation period running until March 15, 2015 a draft of the revised law will be prepared and submitted to the parliament. In view of the significant scope of the Draft and the number of issues that will likely give rise to discussions, we do not expect the new law to enter into force before 2017. Nevertheless, it is advisable (in particular for public companies) to keep an eye on the development of the reform and to take it into account for their planning.

Lenz & Staehelin will monitor the further progress of the corporate law reform and will inform about significant developments. Please do not hesitate to get in touch with the members of the firm indicated below or with your usual contacts in case of any questions.

Your contacts

Zurich
Rudolf Tschäni
rudolf.tschaeni@lenzstaehelin.com

Patrick Schleiffer
patrick.schleiffer@lenzstaehelin.com

Matthias Wolf
matthias.wolf@lenzstaehelin.com

Hans-Jakob Diem
hans-jakob.diem@lenzstaehelin.com

Telefon +41 58 450 80 00

Genf / Lausanne
Andreas Rötheli
andreas.roetheli@lenzstaehelin.com

Jacques Iffland
jacques.iffland@lenzstaehelin.com

Telefon + 41 58 450 70 00

Our offices

Zurich
Bleicherweg 58
CH-8027 Zürich
Telephone +41 58 450 80 00
Fax +41 58 450 80 01
zurich@lenzstaehelin.com

Geneva
Route de Chêne 30
CH-1211 Genève 17
Telephone +41 58 450 70 00
Fax +41 58 450 70 01
geneva@lenzstaehelin.com

Lausanne
Avenue du Tribunal-Fédéral 34
CH-1005 Lausanne
Telephone +41 58 450 70 00
Fax +41 58 450 70 01
lausanne@lenzstaehelin.com

www.lenzstaehelin.com