Update

Newsflash November 2016

Corporate Law Reform

After a preliminary draft had been put forward in 2014 and consultation proceedings were carried out, the Swiss Federal Council presented on November 23, 2016 its new draft of the corporate law reform along with the explanatory report (*Botschaft*) and submitted it to parliament. The main proposals of the draft and the main differences to the preliminary draft of 2014 are:

- › **The Ordinance against Excessive Compensation in Public Companies is incorporated into the Swiss Code of Obligations. Several proposals to further tighten the compensation régime for listed companies have been dropped.**
- › **A target gender quota of 30% for the board of directors and 20% for the executive committee of publicly listed companies on a "comply or explain" basis is proposed. This is in line with the preliminary draft except that the percentage for the executive committee has been reduced.**
- › **Major companies in the exploitation of natural resources industry would be required to disclose payments to public authorities (as already included in the preliminary draft).**
- › **Numerous changes in "traditional" corporate law, such as facilitating the process of incorporating and dissolving companies under simple circumstances, permitting 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 capital reserves and interim dividends, and the enhancement of shareholders' rights in terms of better corporate governance.**

The draft law is now being submitted to parliament. While the new law will not be enacted before 2018, in particular listed companies should already consider the draft law in their planning.

After the Federal Council had already issued a draft bill for a reform of Swiss corporate and accounting law in 2007, the accounting law part of the bill was 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) in 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 formal federal law. To this end, the Federal Council had started a consultation process on a preliminary draft in November 2014. Taking into account the feedback from this consultation, the Federal Council has now developed the present draft bill (**Draft)** and the corresponding report.

The Draft covers **three general topics**: first, the compensation rules, i.e. the incorporation of the Compensation Ordinance into the Swiss Code of Obligations (and other federal laws); second, the proposals for a gender quota and disclosure obligations for companies in the natural resources sector; and third, numerous changes in "traditional" corporate law, many of which had already been included in the draft of 2007 and the preliminary draft, and which primarily relate to the areas of capital and legal reserves, corporate governance, and restructuring. The **transitional rules** include an **adjustment period** of two years to make the

necessary amendments to the articles of incorporation and regulations.

I. Say on pay and other compensation rules

The new law will replace the Compensation Ordinance, which was enacted as an interim measure. The provisions of the Compensation Ordinance have by and large been retained. The preliminary draft had included certain stricter rules which were met with resistance in the consultation process and most of which have now been retracted. The differences to the current Compensation Ordinance are the following:

› **Sign-on bonuses** and replacement awards are only permissible if they compensate a "demonstrated financial disadvantage" incurred in connection with a change of employment. The requirement that such disadvantage be "clearly" demonstrated has been dropped.

› Listed companies may only pay compensation for **non-compete covenants** if the non-compete is commercially justified, the consideration is in line with market standards, and such compensation does not exceed the **average annual compensation of the past three years**. The maximum duration of 12 months has been dropped.

› **Compensation payments** in connection with a **previous engagement** as a member of the board or the management that are not in line with market practice are banned. Under the Compensation Ordinance, there is only a disclosure obligation for such payments, provided they are not covered by another prohibition (e.g. as an unlawful 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 other enterprises with commercial objectives" must be included. This means that external management functions (which are outside the scope of the Compensation Ordinance) are also included. For mandates in foundations and associations, the determining 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.

› **Proposals for tighter rules abandoned**: The Federal Council has abandoned some of its proposals for stricter compensation-related rules included in the preliminary draft. Most importantly, **prospective say-on-pay shareholder votes** on variable compensation for the business year to come remain lawful (but the compensation report must then be submitted to an advisory shareholder vote in the following year), and no mandatory maximum ratio between fixed and total compensation ("bonus cap") of the board and the executive committee is required. Also, the proposal that the compensation of each member of the executive committee be disclosed individually in the **compensation report** has been dropped. Instead, the Draft follows the current rule under the Compensation Ordinance requiring only the disclosure of the aggregate compensation amount of the executive committee and the highest amount paid to any one 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 **on the board and 20% on the executive committee** of major public companies. It applies to public companies which exceed the relevant thresholds for an ordinary audit (which is usually the case for public companies). If such companies do not achieve the target quotas after a **transition period of five years for the board and ten years for the executive committee**, they must explain in the compensation report the reasons for the under-representation and the measures taken to promote gender diversity in their corporate bodies. In contrast to the preliminary draft, the Draft distinguishes between the board and the executive committee for the target quota and the transition period.

Following the EU Directives 2013/34 and 2013/50, which also impose **transparency obligations for companies exploiting natural resources**, the Draft requires companies active in such business and subject to an ordinary audit to disclose payments exceeding CHF 100,000 to public authorities (the preliminary draft had set the threshold at CHF 120,000). Companies solely active in commodity *trading* are not subject to this requirement. The preliminary draft had provided for an authorization from the Federal Council to broaden the scope so as to also cover commodity traders, in

line with concerted international efforts, which is no longer proposed.

III. "Genuine" corporate law changes

The changes proposed in the area of traditional corporate law primarily relate to the capital structure, 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 a foreign currency**, which resolves a number of inconsistencies between the accounting rules (which already allow accounting in convertible foreign currencies) and corporate law.

- The **minimum par value of shares of one cent is abolished**. Shares may have any lower par value above zero. This should facilitate share splits. Partially paid-up shares remain permitted.

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

- In very simple circumstances, companies can be **incorporated and dissolved without public notarization** if certain conditions are met.

- A "**capital band**" is to be introduced, i.e. an authorization of the board for max. five years to increase and reduce the share capital within an upper and lower limit. This will allow more flexible and faster capital changes.

- The Draft requires that no one may be placed at an unfair advantage or disadvantage as a result of the **determination of the issue price** of newly issued shares. The preliminary draft went further and required that the issue price could only be set substantially below the actual value of the shares if subscription rights were tradable or with the consent of all shareholders present or represented at the respective shareholders' meeting.

- The rules on **legal reserves** are aligned with the accounting rules, and the creation and dissolution of reserves is clarified. Specifically, the **distribution of capital reserves** (i.e. paid-in capital surplus and other shareholder contributions in excess of the par value) to the shareholders is to be permissible within certain limits. The requirement of an audit report as included in the preliminary draft has been dropped.

- **Interim dividends** will be permitted for audited companies if the articles of incorporation so provide and audited interim financial statements are available.

- The treatment of **treasury shares** is aligned with the accounting rules (deduction from equity of an amount corresponding to the acquisition price shown in the balance sheet as a negative item).

- A "bonus dividend" of up to 20% for shareholders exercising their voting rights that was proposed in the preliminary draft to mitigate the problem of the so-called "**dispo shares**" has been removed in the Draft.

2. Shareholder rights and remedies

According to the Draft, shareholder rights and remedies are to be strengthened to improve corporate governance. This includes the following proposed changes:

- Shareholders holding at least 5% of the shares or votes in private companies have a right to ask questions also between shareholders' meetings. The preliminary draft had provided this right to all shareholders. The board must respond within four months. The proposed obligation to respond twice a year and to report on board and management compensation at the annual shareholders' meeting has been removed.

- The requirements to exercise the right to request a **special investigation** are to be relaxed; the necessary holding threshold is reduced to 3% in public companies and the circumstances for which *prima facie* evidence is to be furnished are somewhat looser.

- The requirements for **lawsuits 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 will no longer be relevant for the outcome.

- The articles of incorporation may include binding **arbitration clauses** for disputes on corporate law matters.

- The possibility for certain **shareholder (derivative) lawsuits at the expense of the company** as included in the preliminary draft has been removed.

3. Shareholders' meetings

The Draft provides for more flexibility with regard to the organization 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 held by electronic means (so-called "**cyber meetings**") and shareholders' meetings taking place abroad or in several locations at the same time are explicitly to be allowed.

- The **threshold** for shareholders in public companies to **call a shareholders' meeting** is reduced to 5% (10% for private companies). Further, the threshold to include **agenda items and motions** is reduced to 0.5% (5% for private companies). The threshold has been raised compared to the preliminary draft.

- The **de-listing** of a company's shares, which is currently in the competence of the board, will require the approval by a shareholders' resolution taken with a qualified majority.

- Public companies may no longer require that a shareholder is only **represented** by **another shareholder** at shareholders' meetings. If the articles of incorporation of a *private* company include such a requirement, each shareholder may request the appointment of an **independent proxy**.

- In public companies, the board is required to **give reasons for its proposed agenda items** in the invitation to the shareholders' meeting.

- The proposed obligation of public companies to set up an **online platform** for discussions ahead of a shareholders' meeting has been dropped.

4. Corporate restructuring and insolvency

The Draft expands the "early warning system" in case of impending insolvency by 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** (or 6 months for companies not subject to ordinary audit), the board must prepare a **liquidity plan** and make an assessment of the company's economic situation. The board must take restructuring measures if it concludes, based on the liquidity plan, that there is a threat of imminent illiquidity. The proposed plausibility assessment by the auditors has been dropped. The Draft further shortens the preview period for companies not subject to an ordinary audit.

- Restructuring measures must be taken 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**"). The Draft no longer includes the warning indicators of a **high annual loss** and a **loss for three consecutive years**.

- In case of a **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 the creditors of their claims and, which is new, in case of a reasonable **prospect of restructuring within 90 days**. Thus, an existing uncertainty in the applicable law regarding the notification period has been resolved.

IV. Outlook

As a next step, the Draft will be submitted to parliament. We do not expect the new law to be enacted before 2018. 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 planning purposes.

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 us in case of any questions.

Your contacts

Zurich

Patrick Schleiffer
patrick.schleiffer@lenzstaehelin.com
Tel: +41 58 450 80 00

Matthias Wolf
matthias.wolf@lenzstaehelin.com
Tel: +41 58 450 80 00

Hans-Jakob Diem
hans-jakob.diem@lenzstaehelin.com
Tel: +41 58 450 80 00

Geneva/Lausanne

Andreas Rötheli
andreas.roetheli@lenzstaehelin.com
Tel: +41 58 450 70 00

Jacques Iffland
jacques.iffland@lenzstaehelin.com
Tel: +41 58 450 70 00

David Ledermann
david.ledermann@lenzstaehelin.com
Tel: +41 58 450 70 00

Our offices

Geneva

Lenz & Staehelin
Route de Chêne 30
CH-1211 Genève 6
Tel: +41 58 450 70 00
Fax: +41 58 450 70 01

Zurich

Lenz & Staehelin
Bleicherweg 58
CH-8027 Zürich
Tel: +41 58 450 80 00
Fax: +41 58 450 80 01

Lausanne

Lenz & Staehelin
Avenue du Tribunal-Fédéral 34
CH-1005 Lausanne
Tel: +41 58 450 70 00
Fax: +41 58 450 70 01

www.lenzstaehelin.com

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