

LEGAL DEVELOPMENTS FOR DIRECTORS AND OFFICERS IN SWITZERLAND

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Switzerland

In Switzerland, the basis upon which the personal liability of members (the 'directors') of the board of a Swiss joint company (*Aktiengesellschaft*, herein a 'company') could be invoked is rather broad but court cases outside of the bankruptcy of a company are rather rare. However, directors' liability has become an increasingly sensitive topic. Although no legal changes have as yet been introduced, the global focus on corporate governance has resulted in a more rigorous standard for directors (through rules enacted by the SIX Swiss Exchange and by soft law, such as the Swiss Code of Best Practice for Corporate Governance, 'SCBP'), which increases the risk of claims against them.

This chapter offers a brief description of the company's organisation before dealing with the main duties of directors. The principles governing civil liability and indemnification of directors will then be outlined as will the criminal liability of directors.

Organisation and competence of the board

The board consists of one or more directors who need no longer be shareholders. Earlier rules on nationality and residency of directors have also been abolished but at least **one board member or one member of management** who is entitled to represent the company **must be resident in Switzerland**.

In principle, Swiss corporate law provides for a **one-tier board structure**. However, the board has considerable organisational discretion. It may delegate some or most of its powers (save for the non-transferable duties set out below) to one director, to a board committee, or to non-members of the board, such as a CEO or to an executive management team (in banks and insurance companies, directors have to delegate most of their duties to management). Such a delegation requires an authorisation by the shareholders in the articles of association and must be specified by the board in organisational regulations. Thus, it is possible to create a two-tier structure, which is what listed companies typically do and which the SCBP recommends by asking for a majority of non-executive directors.

The board is authorised to **decide on all matters that are not reserved to the shareholders' meeting or to the auditors** by Swiss law or the articles of association. Meetings of the board should **take place as often as business so requires**. As a rule of thumb, at least four meetings should be held each year. If fewer meetings are held, there is a risk of a Swiss court assuming that the board has not complied with its duties.

Main duties of the board

Non-transferable duties of a board

Swiss corporate law stipulates certain **non-transferable duties of a board**:

- **Strategy:** The directors must develop a business strategy and determine the appropriate means to pursue it (eg establishment of a long-term and a medium-term business plan, issuance of appropriate directives and instructions). The aim must be to increase the long-term company value, considering the shareholders' interest.
- **Determination of the organisation:** The board has to decide on the governance structure of the company and of the board itself by enacting organisational regulations. As seen above, the board may delegate management, appoint board committees (eg audit, nomination, compensation and risk committee) and, unless this is reserved to the shareholders' meeting by the articles of association, the board appoints its chairman. If the board chairman and the CEO are identical, the board should, pursuant to the SCBP, provide for adequate control mechanisms (eg by appointing an experienced non-executive director as lead director).
- **Structuring of the accounting system, financial control and planning:** This duty covers not only financial accounting and the preparation of financial statements, where the board retains the ultimate responsibility (eg for determining the accounting standard, the reporting currency and decisions in those areas, where there is discretion) but also the necessity to establish a financial control system, including the monitoring of the liquidity of the company.
- **Appointment and removal of the persons entrusted with management and representation:** Whereas the power to appoint the top executive management must remain with the board, appointments to lower levels may be delegated. Appointments (and succession planning) have to be prepared with all due care and persons who fail to carry out their task properly have ultimately to be dismissed.
- **Supervision:** The board has to supervise management, in particular with respect to compliance with the law, the articles of association, organisational regulations and other internal directives. To fulfil this continuous task, the board has to define clear reporting lines and implement an adequate control system.
- **Preparation of the annual report as well as preparation of the shareholders' meetings and the implementation of the latter's resolutions:** The annual shareholders' meeting has to be held within six months of the end of each business year. The board has to call for the meeting in due time, set the agenda and submit motions for every agenda item.

Special duties arise in the case of financial difficulties of the company:

- **Loss of capital:** If the stand-alone statutory balance sheet of the company shows that the net assets no longer fully cover half of the share capital and the legal reserves, the board must call a shareholders' meeting without delay and propose restructuring measures to the shareholders.
- **Over-indebtedness:** If there is concern that the company's net assets are negative, an interim balance sheet must be prepared and submitted to the auditors for examination. If the interim balance sheet shows that the claims of the company's creditors are neither covered by its assets on a going concern nor on a liquidation value basis, the board must file for bankruptcy. The board may only refrain from doing so if it takes immediate steps to reorganise the business (both operationally and financially) and/or improve the balance sheet such that a sustainable recovery of the company is highly probable; often, certain classes of creditors must in this context be convinced to subordinate their claims to cure the over-indebtedness.

Further duties

Besides these core duties, **other duties** can be relevant in connection with personal liability:

- **Duty to carry out a risk assessment and risk management,** eg define the company's risk appetite and tolerance and monitor possible risks
- **Duty to communicate and engage with shareholders while maintaining confidentiality of non-public information** and ensure that the board is aware of any material changes in the share register and, thus, the shareholder base
- **Duties according to SIX Swiss Exchange Regulation for listed companies:** rules on ad hoc publicity, disclosure of management transactions, corporate governance disclosure (eg on tasks and responsibility within the board and for each committee, work methods, compensation)
- **Duties contained in various other legislation** such as the Merger Act, Criminal Code (eg with respect to insider dealing, price manipulation) or the Old Age Insurance Act.

Standard of care

The directors and the management team must carry out their duties with **due care**, ie a judge would ask what kind of behaviour could be expected in the given situation from someone in the same situation who acts properly. Insufficient skills or 'no time' are no excuses. Directors must always act in the interest of the company (**duty of loyalty**) and must not compete with the company (eg lure away customers or grasp corporate opportunities). Furthermore, directors and persons related to them must conduct business with the company on an **arm's length** basis.

With regard to the **area where the board has delegated** its duties to management, the liability of non-executive directors is limited to the proper selection, instruction and supervision of the managers. Supervision requires an adequate reporting system, and directors must read and analyse the information provided, ask for further information if needed, and take the necessary actions.

In addition, the board must ensure that under like circumstances **shareholders are treated equally**. However, the board may also have regard to the interests of a specific shareholder if other shareholders are not disadvantaged and the decision taken is in the interest of the company. For listed companies, the principle of equal treatment is relevant with regard to the registration in the share register, share buy-back programmes and most importantly the information of shareholders.

Civil liability

Qualification as corporate body and breach of duties

In Switzerland, **directors as well as other persons managing a company** (ie everybody involved in the decision-making process including *de facto* directors such as potentially major shareholders or banks) **are personally liable** if (i) a damage is suffered by the company or the claimant, (ii) they have violated a duty set out by law, the articles of association, organisational regulations or other internal directives by (iii) an intentional or negligent act and (iv) this violation of a duty has caused the damage.

Depending on who is damaged, a successful liability claim can lead to payments to **the company, shareholders or creditors** of the company. Whilst the company and the shareholders may bring a claim at any time, creditors can, in general, only do so once the company has become insolvent and is declared bankrupt. In other words, creditors may not bring claims against a solvent company based on directors' liability, unless they have suffered a direct damage, in which case ordinary tort law principles apply.

With regard to the **burden of proof**, it is the practice of Swiss courts that once a violation of duties is established, the defendant must exonerate himself.

If several directors are liable for a damage, any one of them is **jointly and severally liable** with the other directors to the extent the damage is attributable to each one of them based on their own fault and the circumstances. **Claims are barred after five years**, calculated from the day the injured party has knowledge of the damage and the person liable.

Switzerland

Risk of personal directors' liability in practice

In practice, **shareholders' actions against directors are rare** outside bankruptcy but rather frequent if a company becomes insolvent. Recently, directors' liability claims have also been brought in the context of unfriendly takeovers to put pressure on the board.

Measures to mitigate the risk of liability

Boards can mitigate the risk of personal liability by:

- following a **decision-making process** which leads to unbiased and informed business decisions (eg by taking decisions on the basis of appropriate and timely information after due discussion of the pros and cons, by considering alternatives and their respective risks, by consulting experts in areas where the board does not have sufficient expertise) and carefully drafting the **board minutes** so that they reflect the discussions or at least the fact that an in-depth discussion has taken place
- ensuring an **adequate organisation** of the board and the company
- **delegating** all tasks that can be delegated to management and applying due care in the selection, instruction, and supervision of the managers
- ensuring **compliance** with the financial reporting obligations; closely following the financial situation of the company based on internal reporting; and, in the event of financial distress, taking immediate action

Even though the business judgment rule as applied by US courts has not been formally recognised by the Swiss legislator, it is widely agreed that adhering to the formal criteria provided by this rule significantly reduces liability risk. Consequently, Swiss courts are likely not to review a business decision which is based on (i) proper and meaningful documentation and taken (ii) without any conflict of interest interfering into the decision making process. However, boards must not only focus on formal and procedural requirements but also ensure that they comply with their non-transferable duties in substance.

Insurance and indemnification of directors

Swiss law does not explicitly address the question whether insurance and indemnification of directors is permitted. In a nutshell, the legal situation presents itself as follows:

Advance of legal costs to directors: Such advances by the company are widely accepted. Although successful liability claims against directors are rare, and the legal costs are often shifted to the losing party, directors may encounter a significant expense burden for many years until the proceedings are closed. Several legal authors state as a precondition for such advances, that the company is not the claimant itself and that the claim is not based on a substantial or wilful breach of duties.

Assumption of legal costs by the company: Usually, only part of the costs (ie attorneys' and other advisors' fees) will be covered by the losing claimant in the case of a positive outcome for a director; additionally, most of the law suits end up being settled, in which case no costs are reimbursed. In these cases, the assumption of costs by the company is generally allowed. However, a number of legal authors consider this unlawful if the director is held liable, particularly in cases of wilful or substantial breaches of duties; most authors allow, however, an assumption of cost in case the director has breached his duties only negligently.

Indemnification clauses in articles of association or individual agreements: Such clauses or agreements are in general regarded as unlawful to the extent they also cover wilful or substantial breaches. An indemnification for mere negligence is generally accepted with the argument that forcing directors to be too careful will make them totally risk averse.

Directors' and officers' insurance: There is wide consensus that directors may be held harmless by D&O liability insurance purchased by the company. Normally, intentionally wrongful acts are excluded in such insurance.

Hold harmless clause by the major shareholder (eg the parent company): Such clauses are considered lawful. The parent company then usually also undertakes not to bring any claims against directors in subsidiaries – this of course does not bind shareholders who have not consented to such an agreement nor creditors of the subsidiary. In any case, it is not possible to indemnify directors from criminal liability.

Criminal liability

Directors can become subject to criminal liability if they do not comply with their corporate duties. Apart from fraud, misappropriation, general mismanagement or insider dealing, crimes or offences arising in connection with bankruptcy and debt collection are of particular relevance. In general, as opposed to claims for civil liability, mere negligence will not be sufficient grounds for a criminal liability. ■

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