The Corporate Governance Review

Second Edition

Editor
Willem J L Calkoen

Law Business Research

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EDITOR'S PREFACE

Willem J L Calkoen

I am proud to present this new edition of *The Corporate Governance Review* to you.

In this second edition, we can see that corporate governance is becoming a hotter topic with each passing year. What should outside directors know? What systems should they set up for better enterprise risk management? How can chairs create a balance against imperial CEOs? Can lead or senior directors create sufficient balance? Should most outside directors know the business? How much time should they spend on the function?

Governments, the European Commission and the Securities and Exchange Commission are all pressing for more formal inflexible acts, especially in the area of remuneration, as opposed to codes of best practice.

More international investors, voting advisory associations and shareholder activists want to be involved in dialogue with boards about strategy, succession and income. Indeed, wise boards have 'selected engagements' with stewardship shareholders in order to create trust.

Interest in corporate governance has been increasing since 1992, when shareholder activists forced out the CEO at GM and the first corporate governance code – the Cadbury Code – was written. The OECD produced a model code and many countries produced national codes along the model of the Cadbury 'comply or explain' method. This has generally led to more transparency, accountability, fairness and responsibility. However, there have been many instances where imperial CEOs gradually amassed too much power and companies have fallen into bad results – and sometimes even failure. More have failed in the financial crisis than in other times, hence the increased outside interest in government acts, further supervision and new corporate governance codes for boards, and stewardship codes for shareholders and shareholder activists.

This all implies that executive and non-executive directors should work harder and more as a team on strategy and entrepreneurship. It is still a fact that more money is lost due to lax directorship than to mistakes. On the other hand, corporate risk management is an essential part of directors' responsibility, and especially the tone from the top.

Each country has its own measures; however, the various chapters of this book show a convergence. The concept underlying this book is to achieve a one-volume text containing a series of reasonably short, but sufficiently detailed, jurisdictional overviews that will permit convenient comparisons where a quick 'first look' at key issues would be helpful to general counsel and their clients.

My aim as General Editor has been to achieve a high quality of content so that *The Corporate Governance Review* will be seen, in time, as an essential reference work in our field.

To meet the all-important content quality objective, it was a condition *sine qua non* to attract as contributors colleagues who are among the recognised leaders in the field of corporate governance law from each jurisdiction.

I thank all the contributors who helped with this project. I hope that this book will give the reader food for thought; you always learn about your own law by reading about the laws of others.

Further editions of this work will obviously benefit from the thoughts and suggestions of our readers. We will be extremely grateful to receive comments and proposals on how we might improve the next edition.

Willem J L Calkoen
NautaDutilh
Rotterdam
April 2012

Chapter 26

SWITZERLAND

Rolf Watter and Katja Roth Pellanda[1]

I OVERVIEW OF GOVERNANCE REGIME

The basic source of law for Swiss governance rules is the Company Law with its manifold revisions, in particular Articles 620 ss. Swiss Code of Obligations ('the CO'). In the course of the rather fundamental reform of 1991, corporate governance rules, in particular those relating to the improvement of shareholders' protection, became law. A new debate was triggered at the beginning of the last decade, in 2000/2001, *inter alia* as a consequence of the Swissair bankruptcy.

One of the consequences was the issuance of the Swiss Code of Best Practice for Corporate Governance ('the SCBP') by Economiesuisse,[2] first enacted in 2002 and revised in 2007.[3] It contains a range of guidelines and recommendations for boards of directors of listed companies ('board' or 'boards') on how to set up the structure and organisation of boards. Notwithstanding its rather far-reaching impact, it is not mandatory and represents a code of best practices, leaving leeway for specific adaptations and modifications by individual companies. On 1 July 2002, the Corporate Governance Directive issued by SIX Swiss Exchange Ltd ('the DCG') entered into force; it was revised in 2008.[4] As stated in its introduction, the DCG 'has the objective of obliging issuers to make available to investors in a suitable form certain key information with regard to corporate governance practices within their company'. It applies to companies whose

1 Rolf Watter is partner and Katja Roth Pellanda is an associate at Bär & Karrer Ltd. The chapter is based on an earlier version by Felix R Ehrat and Sibylle Wälti.

2 Economiesuisse is the largest umbrella organisation representing the Swiss economy (www.economiesuisse.ch/en/pages/default.aspx).

3 Available at: www.ethosfund.ch/pdf/Code_Swiss_CG_20080221_en.pdf.

4 Available at: www.six-exchange-regulation.com/admission_manual/06_15-DCG_de.pdf. See also the commentary of the DCG, which is available at www.six-exchange-regulation.com/download/admission/regulation/guidelines/swx_guideline_20070820-1_comm_en.pdf.

equity securities are listed on the SIX Swiss Exchange Ltd and is mainly based on the principle of 'comply or explain'. The enforcement of the DCG is the responsibility of the Regulatory Board of the SIX Swiss Exchange Ltd.

A rather fundamental revision of the company and accounting provisions of the CO is currently under review by the legislator. One of its main goals is to further strengthen corporate governance rules, in particular relating to shareholders' rights, management and board compensation and proxy rules. The revision is under significant pressure by a far-reaching popular initiative for constitutional reform in the area of compensation of board members and management, which is colloquially called the 'Minder initiative against fat-cat salaries'.[5] The compensation issue has become a 'moving target' in the entire reform and is subject to a (almost) never-ending series of proposals and counterproposals in Parliament and by special interest groups. However, as other parts of the revision are also controversially discussed, it might take some years until the revision or part of it will become law; however, one not unlikely option is that all salary-related provisions will become law towards the end of 2012 in order to have a counter-proposal to the Minder initiative in place once there is a referendum on it.

II CORPORATE LEADERSHIP

According to the CO, the board is the executive body of a company limited by shares (i.e., a one-tier board system is the default rule). The board is therefore responsible for the management of the company; it represents the company in relation to third parties. The board may carry out any legal acts consistent with the company's purpose clause (Article 718a CO). It may pass resolutions regarding all matters not reserved to the general meeting of shareholders ('shareholders' meeting') by law or by the articles of association (Article 716 CO). The relationship between the shareholders' meeting and the board is to be qualified as a relationship of parity rather than of hierarchy; both parties have distinct responsibilities and competences.

However, this legal default concept of the board managing the company no longer corresponds to the reality of today's medium-sized to large companies, and in particular listed companies. Moreover, Swiss company law is rather flexible and allows different governance structures, as pointed out below.

i Board structure and practices

In terms of board structure, Swiss company law allows the board to delegate significant parts of its duties and responsibilities to management (Article 716b CO). Depending on the size and the needs of the company, the board may therefore assume the entire responsibility for the management of the company (this system is adopted predominantly by smaller non-listed companies) or it may delegate the transferable duties and responsibilities to one or several board members or the management, subject to an authorisation by the shareholders in the articles of association and the establishment of organisational regulations by the board. However, certain responsibilities cannot be

5 Available at: www.admin.ch/ch/d/ff/2006/8755.pdf.

transferred and represent inalienable duties of the full board as per Article 716a CO. Thus, it is possible to create a two-tier structure, which is what listed companies typically have and which the SCBP recommends by requesting a majority of non-executive board members. In addition, the two-tier structure is mandatory for banks and insurance companies.

A company's board must consist of at least one individual (Article 707 I CO). In reality, most companies have several board members. In the case of several classes of shares, the articles of association must stipulate that the holders of each share class are entitled to elect at least one representative to the board (Article 709 I CO).

The board is liable for the representation of the company towards third parties. Unless the articles of association or the organisational regulations stipulate otherwise, each member of the board has the authority to represent the company without the necessity of respective board decisions (Article 718 CO). It is, however, common practice, at least in medium- to large-sized companies, that only joint signatory power of any two is granted. The board may also delegate the authority of representation to one or more members of the management or to other parties. At least one member of the board must always be authorised to represent the company and at least one authorised representative, either a board or a management member, must be domiciled in Switzerland.

The law provides for the following catalogue of non-transferable and inalienable duties (Article 716a CO) that cannot be delegated to the management (but for which management does the preparation work):

- *a* determination of the ultimate direction (strategy) and the appropriate means to pursue it (e.g., budget process and establishment of a business plan, issuance of all necessary directives and the establishment of a risk assessment and risk management system);
- *b* determination of the organisation (e.g., decision on the governance structure of the company and the board);
- *c* structuring of the accounting, financial control and financial planning systems (including monitoring the liquidity of the company);
- *d* appointment, removal and succession planning of the persons entrusted with the management and representation (whereas the appointment of the top executive management must remain with the board, the appointment of the lower hierarchical levels may be delegated) and the decision upon the principles of remuneration;
- *e* ultimate supervision of the persons entrusted with the management (including, *inter alia*, the implementation of a state-of-the-art internal control system and clear reporting lines); in particular with respect to the compliance with law, the articles of association and directives issued by the board;
- *f* preparation of the annual report consisting of the financial statements (which have to include for listed companies, *inter alia*, the disclosure of board and senior management remuneration) and a narrative report on the business;
- *g* preparation of the general meeting (which has to be held within six months after the end of each business year) and the implementation of its resolutions; and
- *h* notification of the court in the event that the company is overindebted.

The position of the chair of the board is not provided for in detail by Swiss company law and no duties are explicitly assigned to his or her role. The chair is customarily appointed by the board members; however, the articles of association may also provide for a direct appointment by the shareholders' meeting (Article 712 I CO). In reality, the chair's function is, however, key to the proper functioning of the entire board and to an adequate working relationship between the board and senior management. The chair, *inter alia*, keeps direct contact with senior management (typically represented by the CEO), communicates and engages with important shareholders and stakeholders (in general together with the CEO), organises and conducts the board meetings and sets the agenda, and is, together with or subsidiarily to the CEO, the outside 'face' of the company and takes the lead in crisis situations.

The question of combining the roles of the chair and the CEO in the same person has been and continues to be a subject of significant debate in Switzerland. Although not explicitly excluded by the SCBP, the majority opinion nowadays, voiced in particular by professional shareholders' organisations, is that such a concentration of power does not represent best practice. However, even in large multinational companies a certain tradition of such combined roles exists, which was in general justified by efficient communication channels, faster decision time and a uniformity of decision-making that might be particularly important in crisis situations. The SCBP provides that, as a principle, 'a balance between direction and control should apply to the top of the company' and if the board decides that the role of the chair and of the CEO should be combined in one single individual, the SCBP recommends, for adequate control mechanisms, possibly appointing an experienced non-executive member as independent lead director. One of the roles of an independent lead director is to convene and chair meetings of the board on his or her own when necessary.

The board is required when fulfilling its tasks to observe the following: the duty of care and loyalty; the duty of confidentiality; and the duty to treat shareholders equally (Article 717 CO). The (corporate) principle of equal treatment of shareholders does not require the board to an identical treatment of all shareholders; it must, however, make sure that shareholders be equally treated in comparable circumstances. This principle is of particular significance in relation to communication with and information provided to shareholders. The principle of equal treatment of shareholders is more vigorously applied in listed companies because of capital markets and stock exchange regulations, but even there, large shareholders often get more information than retail shareholders, which is permissible as long as this information is not price-sensitive.

The organisation of the board is within the discretion of its members subject only in cases of several board members to the legal requirement of the nomination of a chair and of a secretary who does not have to be a member of the board (Article 712 CO). The organisational flexibility of the board is rather far-reaching; it may allow for executive and non-executive board members, committees, delegation of management duties, *et cetera*. Furthermore, Article 716a II CO provides for the possibility of assigning responsibility for preparing and implementing the resolutions of the board of directors or monitoring transactions to board committees or individual board members. As a matter of principle and according to the SCBP, the overall responsibility for non-transferable and inalienable duties delegated to committees remains with the board. In all instances, appropriate reporting of such committees or individual members to the full board has to be ascertained. The SCPB recommends the creation of an audit committee, a compensation committee and a nomination committee. It is recommended that the audit committee should consist of non-executive, preferably independent members only, and that a majority of its members should be financially literate, whereas a majority of the members of the compensation committee should consist of non-executive and independent members. No independence requirements are provided by the SCBP for the nomination committee. Other committees, such as a finance committee, a strategy committee, a risk committee, an independent committee consisting of independent board members and established for special situations where a conflict of interests arises (in particular in case of going private or takeover situations), or other *ad hoc* committees may be constituted when needed for an efficient functioning.

In takeover situations, Swiss company and stock exchange laws disempower the board of the target company to a certain extent. The target board is not allowed to conclude any legal transactions that would significantly alter the assets or liabilities of the company without a resolution of the shareholders' meeting (Article 29 II of the Federal Act on Stock Exchanges and Securities Trading ('SESTA')). Moreover, the target company has to give advance notice to the takeover board regarding contemplated defensive measures. Subject to a resolution of the shareholders' meeting, the board must not conclude agreements with either board members or senior management regarding payments upon termination of their employment relationship ('golden parachutes') or sell or purchase assets being worth more than 10 per cent of total assets. The most important duty in this context, however, is that the law requires the board of a target company to submit a report to the shareholders in which its position regarding the offer has to be disclosed, including planned defence measures and conflicts of interest.

ii Directors

No formal requirements have to be met for being nominated to a board; different rules apply to banks and insurance companies. Swiss company law requires neither special knowledge nor qualifications (e.g., in financial or accounting matters) as a precondition for nomination to a board. The same applies in principle to the independence of board members. However, Articles 717 and 754 CO indirectly require a composition of the board that ensures that risks will be recognised and wrong business decisions avoided. Therefore, boards and shareholders are well advised to only propose, and respectively nominate, members to the board who do have the necessary skills. Candidates to a board should ensure that they have enough time, knowledge and experience to meaningfully contribute to the board, as well as a basic understanding of the legal framework and the business. The articles of association may contain certain qualifications and conditions, such as an age limit; no age limits are provided by law but many articles of association provide for them (typically around 70 years). Each member of the board may resign at any time without giving any reason to the shareholders or the remaining board members. The corollary to such right is the right of the shareholders' meeting to remove a board member at any time.

Many boards, even of listed companies, consist of non-executive, outside members only; the SCBP recommends that, as a rule, the majority of the board should be composed of non-executive members. Non-executive, outside members have, as a matter of principle, the same information rights as executive members formally involved in the management. The involvement of non-executive, outside directors in the company's affairs outside of formal board meetings (e.g., direct contacts with senior or lower management, onsite visits of subsidiaries, etc.) very much depends on the rules set by the board and the chair.

The members of the board, as well as all persons engaged in the senior management of the company, may be held liable for any losses or damages arising from wilful or negligent violation of their duties. Such accountability not only applies to formally appointed persons but also to any *de facto* director (i.e., anyone, including shareholders or banks, who takes decisions or materially influences corporate high level decision-making without being formally appointed). The plaintiff may be any individual shareholder, the company itself or, in the case of the company's bankruptcy, any creditor (Article 754 ss. CO). Requirements for a liability are: (1) damages suffered by the company or the plaintiff; (2) breaching of a duty defined by law, the articles of association, the organizational regulations or other internal directives by the respective person or persons; (3) acting intentionally or negligently; and (4) a proximate causation of the breach of duty to the loss sustained. As a matter of principle, there is joint and several liability of all members of the board; an individual member of the board is, however, exempt from liability provided that there has been no fault at all on his or her side. Individual allocation of the damage caused to shareholders, the company or, in the case of bankruptcy, to a creditor, is a matter of subsequent recourse claims between the board members. Very often in potential liability situations, there is a tension between the basic requirement of the board members to stand together and to take a uniform position when sued by an outsider and the desire of each member not to compromise his or her position for the subsequent recourse proceedings. With regard to the burden of proof, Swiss courts typically require that once a breach of duties is established, the board member exonerates himself or herself. If the board lawfully delegated part or all of the management duties, the liability of the board is limited to the required care in selecting, instructing and supervising the senior managers. Moreover, if the shareholders' meeting took the decision to discharge the members of the board and senior management, the latter cannot be held liable in relation to the company and the shareholders approving the resolution. Discharge is, however, of limited relevance, since it is only valid if it relates to facts and omissions known to the shareholders.

In practice, shareholders' actions against board members are rare outside bankruptcy but rather frequent if a company becomes insolvent. Recently, claims have also been brought forward in the context of unfriendly takeovers and even more so in going-private situations. Successful liability claims against boards are, however, still the exception rather than the rule. As a consequence of large corporate failures or crisis situations in the last 10 years (Swissair Ltd, UBS Ltd, etc.), sensitivity has, however, sharply increased. Most claims still end with out-of-court settlements typically financed by D&O insurances; basically all larger companies buy coverage for potential liability claims.

Conflicts of interest are not specifically regulated by the current law; the SCBP, however, recommends that, as far as possible, conflicts of interest should be avoided. Should a conflict arise, the respective board member shall inform the chair who, in turn, shall request a decision by the full board (without participation of the individual concerned). Most scholars and the SCBP recommend that the conflicted individual should abstain from the decision-making (i.e., board discussions and voting) relating to the conflict. Our point of view is that it is advisable that such decisions are made by way of a double vote, i.e., that votes with and without the conflicted individual take place, with a decision requiring in principle two positive votes. This avoids conflicted individuals withholding information and escaping liability. Other possible measures are a 'dealing at arm's-length' and third-party fairness opinions. Moreover, in specific situations (such as a takeover or going private transaction) it can be advisable to establish an independent board committee consisting of board members who have no financial interest in the transaction or any other potential conflict of interest. The independent board committee represents the board in all matters relevant to the transaction and prepares the decision-making by the board, while a separate decision by the independent board committee is recommended as well. The goal of the board in conflict-of-interest situations is to avoid (apart from reputation risk) liability claims. Contrary to other legislation, agreements between the company and a board member or a member of senior management are not *per se* excluded, but the requirement of 'dealing at arm's length' must be rigorously applied, and contracts above 1,000 Swiss francs need to be in writing. In addition, it may be recommendable to provide for a special approval by the non-conflicted board members or, potentially, by a shareholders' meeting. The current revision of company legislation provides for a new provision dealing with conflicts of interests of members of the board and senior management (draft Article 717a CO), which essentially turns the recommendations of the SCBP into law.

III DISCLOSURE

For each financial year, the board has to prepare an annual report consisting of financial statements (consolidated if required) and a narrative business report (Article 662 CO). Specific accounting and valuation rules for non-consolidated accounts apply to companies limited by shares (Article 662a-670 CO) that are going beyond the scope of general accounting rules as per Article 957 ss. CO. These rules generally do not give a fair view of the company's financial position, as the board can still create (and within limits dissolve) hidden reserves. For consolidated accounts that are required for groups that exceed certain size requirements, the board may choose between accounting standards such as Swiss GAAP, the International Financial Reporting Standards/International Accounting Standards or US GAAP, which require the group to present a true and fair view of the group's financial situation. The accounts of Swiss companies have to be audited, although depending on certain size criteria a review is sufficient; furthermore, shareholders in small businesses may decide unanimously not to have any audit. The auditors have to comply with strict independence requirements; more specifically, the auditor must be independent from the board members and major shareholders, and may not engage in activities for the company outside of the audit work that would endanger its independence. In addition, the Federal Act on the Admission and Supervision of Auditors requires that a supervisory authority ensures that audit services are performed only by specialists carrying sufficient qualifications.

The current pending reform of company law provides for a conceptual change regarding accounting rules. If implemented, the rules will no longer depend upon the legal form of the entity but will generally be applicable to all entities (stock companies, limited liability companies etc.), again depending on certain size criteria.

Listed companies are subject to further-reaching disclosure obligations governed by stock exchange regulations (e.g., the DCG), must comply with certain accounting standards and must, for example, publish half-year interim statements. As far as the DCG is concerned, failure to disclose certain information must be justified in the annual report ('comply or explain'). In addition, listed companies must comply with disclosure requirements regarding the remuneration of the board and senior management members; significant shareholders and their participation have to be disclosed in the notes to the balance sheet. *Ad hoc* publicity requirements for listed companies and disclosure requirements for important shareholders, and their holding cross certain thresholds (3, 5, 10, 15, 20, 25, $33^1/_3$, 50 or $66^2/_3$ per cent of voting rights), complement the rather comprehensive framework of disclosure requirements.

IV CORPORATE RESPONSIBILITY

An effective and efficient risk management is required by the law and by self-regulation. The board is responsible for setting up an appropriate risk management framework and appropriate systems for internal control and risk management tailored to the size, complexity and risk profile of the company; risk management should apply to both financial and operational risks. In addition, it has to continuously (typically each year, unless extraordinary situations arise) assess the risk situation of the company. In the notes to the annual accounts, it must be confirmed that such risk assessment has taken place. Swiss law does not require the establishment of a specific risk committee on the level of the board. The SCBP, however, recommends an internal audit function that should report to the audit committee or, as the case may be, to the chair.

Compliance with the law is an integral part of the risk framework of each company; its significance is increasing due to ever-stricter regulation and enforcement of certain rules and regulations (e.g., in relation to the fight against corruption). As already mentioned, one of the non-transferable and inalienable duties of the board is the supervision of senior management, in particular with regard to compliance (Article 716a I paragraph 5 CO).

Currently, there is no formal whistle-blowing legislation in force, and there is still a certain resistance in many Swiss companies to stipulate appropriate rules. Larger multinational companies, however, normally have certain procedures promoting and protecting whistle-blowing. Draft legislation is currently being discussed regarding protecting an employee against wrongful termination by an employer if the employee discloses alleged dishonest or illegal activities in the company (draft Article 321a bis, 336 II lit. d CO).

Corporate social responsibility ('CSR') is still a relatively new concept in Switzerland, even though many components of CSR already form part of the law or of self-regulation. Apart from the legal elements of CSR, its requirements present a call for sustainable management and a responsible use of the resources of the company.

Compliance with the law is one of the key responsibilities of the board and of senior management; in addition, employee protection is provided for by the CO, the Employment Act and the Gender Equality Act. Moreover, there is rather far-reaching legislation regarding the protection of the environment. Even though CSR is, as a matter of law and fact, already part of social and corporate reality, tensions between measures and decisions promoting long-term profitable growth of the company on the one hand and CSR rules on the other hand may still exist and have to be appropriately resolved by the board, who is the guardian of the company's interests. Generally, Swiss law does allow a board to take into account both the interests of shareholders (which typically consist in maximizing shareholder return over the medium term) and of the company with all its stakeholders (employees, customers, suppliers, further the community at large). This means for example that if a board decision does not maximise value but can be justified by the legitimate interest of stakeholders, board members cannot be held liable for it.

V SHAREHOLDERS

i Shareholder rights and powers

The financial rights of shareholders basically consist of the right to receive dividends provided that the shareholders so decide and liquidation proceeds if the company is dissolved. Dividends may only be distributed from the disposable balance sheet profit and from specific reserves formed for this purpose (both being generally referred to as 'free reserves'). For tax reasons, dividends have been substituted in many companies by reductions in the nominal value of shares and the related reimbursements that are tax-free. In addition, far-reaching changes to the tax code, which came into force on 1 January 2011, facilitate the tax-free repayment of capital, namely share premium, to the shareholders.

In terms of non-financial rights, participation and protection rights have to be distinguished. Every share carries one vote and every shareholder has at least one vote. The articles of association may impose restrictions on the number of votes each shareholder can cast. It is not allowed to create shares with multiple voting rights; it is, however, possible to have different classes of shares with different nominal values (and thus different dividend rights, which are always proportional to nominal value) with each share carrying one vote, which leads to voting power not being correlated to the shareholder's financial investment. Certain quorum requirements set by the law or provided for in the articles of association foresee a protection of minority shareholders, as they will *de facto* have veto rights on certain decisions if the quorum is appropriately set.

A shareholders' meeting may be called by one or several shareholders representing at least 10 per cent of the share capital; such amount may be lowered in the articles of association. Shareholders representing shares with a nominal value of at least 1 million Swiss francs may set an item on the agenda of the shareholders' meeting; often, this threshold is lowered in larger companies in their articles of association. Shareholders have to be provided with the annual and the audit report; in addition, each shareholder may request specific information necessary for the exercise of his or her shareholder's rights at the shareholders' meeting. If such information is refused by the board, the shareholder may request a special audit ordered by the competent judge. However, this is a rather burdensome and difficult procedure.

A further protection are the subscription rights of existing shareholders in the case of a capital increase in order to protect them from dilution: these rights may only be withdrawn by a qualified shareholders' decision in specific situations. In the case of issuance of convertible or similar bonds, existing shareholders have a priority right to purchase these instruments, which, in the case of an important reason, may also be limited by a decision of the shareholders.

The allocation of responsibilities between the shareholders' meeting on the one hand and the board on the other, in particular in relation to the determination of compensation to be paid to the board and to the senior management, is one of the most contentious issues in the current reform of company law.

ii Shareholders' duties and responsibilities

Obligations on shareholders (other than to pay in full for the shares upon their issuance) are prohibited under Swiss company law. Moreover, there is no duty of loyalty for shareholders. There are, however, duties and obligations for shareholders in listed companies, such as disclosure requirements regarding qualified participation as per Article 20 SESTA.

Article 717 II CO provides for the obligation of the board to treat the shareholders equally in like circumstances. Therefore, Swiss law provides for relative rather than absolute equality, meaning large shareholders might receive more information than small investors. Whereas company law specifically takes into consideration the circumstances, capital market law and stock exchange regulations, namely rules prohibiting insider dealing and *ad hoc* publicity, provide for a stricter understanding of the 'level playing field' that aims to ensure that price-sensitive information is disseminated on an equal basis. At times, confidentiality undertakings and contractual agreements not to trade based on information received can mitigate the complexity of this issue.

iii Shareholder activism

Swiss law provides for a catalogue of specific rights for shareholders to take legal action in the event of infringement of the law by corporate bodies. For example, each shareholder has the right to challenge resolutions of the shareholders' meeting that are in breach of the law or the articles of association (Article 706 I CO); there is, however, no right to challenge resolutions of the board. Any resolution passed by the shareholders' meeting or the board violating fundamental rules of company law is void.

Shareholders representing at least 10 per cent have certain rights, such as calling a shareholders' meeting and – if they can demonstrate important reasons – requesting the dissolution of the company; this latter right has very little practical relevance, though.

Shareholder activism in the area of listed companies has increased significantly in the past few years. Several high-profile battles promoted by activist shareholders' groups have been widely publicised; typically, activist shareholders have tried to change the board with members who favoured their strategy. The fact that staggered boards, although very often used, are not effective, because board members can be fired at any time by a shareholders' decision, has of course helped the activist shareholders. Other demands often include the return of excess cash to shareholders either in the form of dividends or share buybacks. No code of best practice for shareholders exists in Switzerland.

Compensation of the board and of senior management in listed companies has been high on the agenda of the legislature and the public in the past couple of years. Effective from 1 January 2007, a new Article 663b bis CO came into force requiring transparency regarding the compensation of, *inter alia*, board members and senior management by disclosing the aggregate compensation amount to the board and to each individual member, the aggregate compensation amount to senior management and the highest amount paid to a member of senior management, usually the CEO. Most companies today publish a compensation report as part of the annual report, often disclosing more information than legally required.

The 'Minder initiative', which is still under debate and has not yet been submitted to a popular vote, requires, *inter alia*, that the shareholders have to annually vote in a binding manner on the aggregate compensation amount for the board and senior management, thereby quite substantially changing the current structure of parity between shareholders and the board. Various counterproposals have been under review by the legislature, and it is not yet clear as to what will be submitted as an alternative. Many large companies, for example Novartis Ltd, have introduced a consultative vote on the compensation system in the articles of association ('say on pay'), thereby providing shareholders an opportunity to express their non-binding view on the compensation system of the company.

Swiss law does not provide for specific legal regulations on proxy fights. A shareholder has no possibility to review the share register of the company; therefore, contacts with other, in particular smaller, shareholders are difficult. In the course of the current reform, implementation of rules granting access to the share register in certain circumstances have been discussed but ultimately dismissed.

iv Contact with shareholders

The parameters governing disclosure and reporting to the shareholders are set by company law, by SESTA and its implementing regulations and self-regulation: annual, semi-annual and quarterly reports, *ad hoc* publicity, disclosure of qualified participation of shareholders, etc., constitute elements of this framework. Equal treatment of market participants in the case of listed companies is, as explained above, important.

In Switzerland, institutional investors such as pension funds, the social security system and insurance companies are significant shareholders in many companies; very often, however, they do not exercise their voting rights. Various attempts have been made to induce institutional investors to get more involved and to exercise their shareholder rights. In line with this, investor protection and shareholders advisory organisations have become more important in Switzerland. The current revision of company law contemplates an obligation of pension funds to exercise their votes in listed companies; if adopted, this would undoubtedly lead to an increase in the influence and power of these organisations since pension funds (which are often too small in Switzerland to accurately monitor all companies they have invested in) are likely to delegate their voting rights to them.

VI OUTLOOK

The Swiss Parliament is currently debating the draft of a rather comprehensive revision of company and accounting legislation. The current draft pursues four principal goals:

a the improvement of corporate governance;
b a more flexible capital structure;
c modernising the shareholders' meeting (e.g. electronic voting); and
d a revision of the accounting rules.

With regard to the improvement of corporate governance, there are three principal objectives:

a improvement of shareholder protection;
b improvement of control mechanisms; and
c facilitating better investment decisions of institutional and foreign investors.

Even though the current debate on the new company and accounting legislation is rather far-reaching, the fundamental principles of Swiss company law will be upheld. The revision is therefore rather evolutionary than revolutionary in nature, except for compensation matters.

Appendix 1

ABOUT THE AUTHORS

ROLF WATTER

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Prof. Dr Rolf Urs Watter is a partner with Bär & Karrer Ltd and served on the board and the management committee of the firm for nine years. Rolf Watter graduated from the University of Zurich with a doctorate in law and holds a master of laws degree from Georgetown University, Washington, USA. He has been lecturing at the University of Zurich since 1990.

Rolf Watter is presently a board member in the following listed companies: Zurich Financial Services (member of the audit committee), Nobel Biocare (presently interim chair) and Syngenta (member of the chairman's committee). He is also a board member of Faber Castell (Holding) AG and UBS Ltd Alternative Portfolio and a member of the Regulatory Board of the SIX Swiss Exchange Ltd. He regularly publishes on governance matters and transaction issues and is an editor of the law journal *GesKR* and the *Basler Kommentar*.

KATJA ROTH PELLANDA

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Dr Katja N Roth Pellanda, an associate at Bär & Karrer Ltd since 2005, advises clients in corporate and commercial matters with a particular emphasis on corporate governance and regulatory issues concerning regulated institutes (such as banks) and listed companies. A graduate of the University of Basel, she received a doctorate in law from the University of Zurich, was a visiting researcher at Stanford Law School and holds a master of laws degree in banking and financial regulation from the London School of Economics and Political Science. Katja Roth Pellanda is a member of the European Corporate Governance Institute. She regularly publishes on governance and company law matters.

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