BÄR & KARRER

Briefing June 2020

Corporate Law Reform Finally Adopted

On 19 June 2020, the Swiss parliament finally approved a general corporate law reform. The Act amending the Swiss Code of Obligations (Corporate Law Reform) originates from a draft bill the Swiss government published for consultation some thirteen years ago. The project was revised several times, including as a result of the adoption of the Minder initiative, resulting in a draft bill in 2014 and a bill in 2016 which was further amended following the debate in parliament. The Corporate Law Reform seeks to modernise corporate governance by strengthening shareholder rights and promoting gender equality in boards of directors and in senior management. It also replaces the provisions of the Ordinance on Excessive Compensation (Minder-Ordinance) with only a few changes. Furthermore, it aims to facilitate company formation, makes capital rules more flexible and reforms the rules on corporate restructurings. Finally, it introduces certain disclosure requirements for commodity firms.

The effective date of the Corporate Law Reform has not yet been determined. However, we expect that the Corporate Law Reform will enter into force in 2022 (unless submitted to a vote of the people as a result of an optional referendum, which we believe to be unlikely).

At the same time, the Swiss parliament has adopted a counterproposal to the popular initiative on corporate responsibility. This counterproposal has been adopted in a separate act and is subject to the outcome of the vote on the Corporate Responsibility Initiative, which is likely to be scheduled in November 2020.

Executive Pay ('Minder')

The Corporate Law Reform **replaces the provisions of the Ordinance Against Excessive Compensation (Minder-Ordinance)**, which were issued by executive order. The core of the Minder-Ordinance remains unchanged. Contrary to the draft bill of 2014, the Corporate Law Reform **makes only minor changes** to the Minder-Ordinance. This means that Swiss companies do not have to make substantial changes to their existing corporate arrangements on executive compensation.

Compared with the Minder-Ordinance, the following amendments should be noted:

– **Compensation for post-contractual non-compete undertakings may only amount to the average annual compensation over the last three years.** This provides guidance on the maximum amount of compensation that may be agreed with respect to non-competes, although the Corporate Law Reform also requires that the non-compete must be commercially justified.

- The Corporate Law Reform clarifies that **sign-on bonuses may be paid only if they compensate for actual losses**.

- Companies choosing a **prospective vote on compensation** (approving compensation for a future period) must have an **advisory vote on the compensation report**. This corresponds to the current practice of most listed companies.

- The compensation report must **disclose details of which other companies the members of the board and executive management hold office in** (including the name of the member, the function and the company).

- Contrary to the current regime, the articles **need not restrict the number of offices** of members of the board and executive management **in non-profit organisations without an economic purpose** (e.g. charitable foundations or associations).

- **Non-listed companies may decide to opt in partially or fully to** the provisions of the Corporate Law Reform on executive compensation.

Corporate Governance

Shareholders' Rights

The Corporate Law Reform contains new provisions regarding **shareholders' meetings** and shareholders' rights in general, including the following:

- The percentage of share capital or share votes that shareholders must represent to be able to request that the board of directors **calls a general meeting is lowered for listed companies from 10% to 5%.** If the request is properly made, the board of directors must call the meeting within due time, but no later than within 60 days.

- The threshold that must be reached to give shareholders the right to **ask for an item or motion be put on the agenda is lowered for listed companies from CHF 1 million par value to 0.5%** of the share capital or the voting rights. For non-listed companies, the relevant threshold is 5%.

- The invitation to the meeting of listed companies must also include a **brief explanation** of each motion of the board. All companies must include, if so requested, a brief explanation of each motion of the relevant shareholders.

- The Corporate Law Reform further provides **that shareholders holding at least 10% of the share capital or the voting rights of a non-listed company have a right to request information** from the board of directors at any time during the year to the extent necessary for the exercise of their shareholders' rights. The board of directors must respond to each legitimate information request within four months.

- **The independent proxy must keep the instructions received from individual shareholders confidential until the shareholders' meeting.** It may only inform the company on the instructions received on an aggregated basis not earlier than three working days before the shareholders' meeting and has to report to the shareholders at the meeting about the information given to the company.

- The Act will enable companies to **hold shareholder meetings on a purely electronic basis**. However, this will, among other things, require that shareholders may participate in the meeting "real-time", and electronic meetings will need to be repeated if they cannot be conducted properly. Electronic meetings will thus only be advisable in special situations.

- The Corporate Law Reform requires **shareholders' approval for the delisting** of shares with a supermajority of two thirds of the voting rights (and more than half of the capital), departing from current practice which considered this to be a matter falling within the competence of the board of directors.

Gender Representation on Board of Directors and Executive Management

- The Corporate Law Reform sets a **quota of female (and male) representation on the board of directors at 30% and on the executive management at 20% for listed companies**. Failure to comply does not result in fines or other sanctions. Instead, the Corporate Law Reform provides for a **'comply or explain'** system requiring a justification of any failures to meet such gender representation and a description of the measures to promote the underrepresented gender in the compensation report. These provisions will, however, not be implemented immediately, but will be subject to a phasing-in period of five years for boards and ten years for the executive management.

Lawsuits by Shareholders and Creditors

In line with the 2016 draft, the Corporate Law Reform does not generally facilitate the possibility of shareholders bringing lawsuits, as was initially proposed in the preliminary draft of 2014. However, the following should be noted:

- If **unjustified or hidden distributions** (including transactions that are obviously not at arm's length) are made **within a group of companies**, the Corporate Law Reform extends standing to sue derivatively for an action to reverse such distributions to creditors, even outside of bankruptcy. However, we expect the impact of this change to be only limited. This is because such actions would result in significant costs for a suing creditor but only limited benefits since a judgment would benefit the company and only indirectly the creditors. In addition, risks in that regard could be mitigated by including appropriate corporate purpose clauses in the articles of association of the relevant group companies.

- Contrary to the 2016 draft, **audit firms** as defendants in shareholder lawsuits **continue to be jointly and severally liable** for breaches of their duties.

- The Corporate Law Reform expressly allows **arbitration clauses in the articles of association**, eliminating uncertainties under existing law about whether shareholders, directors and executive officers are bound by such a clause. The articles may provide details of the arbitration proceedings, including by reference to arbitration rules. The proceedings are, however, subject to the Swiss Civil Procedure Code (as opposed to the rules on international arbitration in the Federal Act on Private International Law), with the effect that any award of the arbitral tribunal may be challenged before the Swiss Supreme Court and, depending on cantonal law, possibly also before a competent cantonal court.

Capital (including Increases and Reductions) and Dividends

The Corporate Law Reform **generally makes capital requirements more flexible**, although it maintains the concept of a fixed share capital and does not introduce shares without par value. The following proposals are particularly noteworthy:

Capital in General

- It is possible to state the **share capital in a foreign currency** (e.g. USD, EUR, subject to determination of eligible currencies by the Swiss Federal Council), provided that it is also the reporting currency used for the financial statements; shareholders may approve a switch in the currency starting from the next financial year. The main benefit of such a switch is that it will further facilitate dividends and capital distributions in a foreign currency; it will also slightly facilitate any capital increases paid in a foreign currency

- **The nominal value of shares can be any value greater than 0**, so allowing it to go below the current limit of CHF 0.01. This will permit companies with low nominal share values to split shares without undue complications or triggering a potential tax burden.

- **Participation certificates (non-voting stock) listed on a stock exchange** may be issued for an amount of **up to ten times the share capital**. Non-listed participation certificates continue to be capped at 200% of the share capital, as applies today to all participation certificates.

- While **reverse share splits** currently require the unanimous approval of the shareholders, the Corporate Law Reform **facilitates reverse share splits for listed companies** by requiring only a supermajority of two thirds of the voting rights (and more than half of the capital) at the general meeting.

Capital Increases

- **Ordinary capital increases** are **valid for up to six months** (rather than three months as envisaged under the existing law).

  The concept of **authorised share capital is replaced by** what is called a **'capital band'**. Under a capital band, the articles may authorise the board to increase and/or reduce the capital within a predefined band. However, in substance, the authorised capital remains in essence the same. One notable exception relates to the validity of the authorisation, which **may last up to five years**. This is a significant extension of the existing two-year maximum period. However, if the general meeting approves certain capital changes, the capital band must be expressly renewed or else it will lapse.

- The Corporate Law Reform clarifies the rules governing **conditional capital** in several respects, including to the effect that conditional capital may be used for **shareholder options**. It also abolishes current limitations of use and thus now also allows the issuance of **'naked options'** to third parties, which so far were not permitted.

- If a company acquires assets from a related person after incorporation or a capital increase (so-called **acquisition in kind**), the current law imposes cumbersome requirements similar to the ones applicable to a contribution in kind. The Corporate Law Reform **abolishes** these requirements. This substantially facilitates the acquisition of assets from related persons as long as it is consistent with the board's fiduciary duties and does not constitute a hidden distribution.

- Unfortunately, the Corporate Law Reform **does not relax the even more burdensome requirements for contributions in kind**. However, due to the abolishment of the special requirements for acquisitions in kind, these rules may **now be avoided** in many cases by contributing cash or converting reserves and acquiring assets immediately after a capital increase, as explained above.

Capital Reductions

- The rules on **capital reductions are simplified** in several respects (e.g. only one publication in the Swiss Official Gazette of Commerce is required for a creditor call; the creditor call may take place prior to the general meeting; there is a one month instead of two month period for creditor call; and creditor claims need not be secured if it can be shown that the capital reduction does not jeopardise the claims).

- Under the Corporate Law Reform, the board may conduct **'authorised capital reductions' under the capital band** (see above). However, the Corporate Law Reform – contrary to the proposal of the Swiss Federal Council of 2016 – requires that for each individual capital reduction under the capital band a creditor call is conducted and a special audit report is obtained.

Reserves and Dividends

- The Corporate Law Reform **codifies current practice for a distribution of capital contribution reserves** and, contrary to the preliminary draft of 2014, does not introduce more cumbersome audit requirements.

- **The capital and earnings reserves are simplified** and harmonised through the amendment regarding accounting and financial reporting that entered into force on 1 January 2013. In particular, the accounting for own shares codifies current practice.

- **Interim dividends (out of the current year's profits) are permissible** provided that they are based on an audited interim balance sheet. An unaudited interim balance sheet is sufficient if the company has opted out from audit requirements or if all shareholders approve the interim dividend and the claims of creditors are not endangered. This will effectively facilitate the distribution of interim dividends which, while in our view being lawful under the current law, have so far generally not been accepted by audit firms. The new provisions do not affect the current practice of quarterly or extraordinary dividends, which continue to be allowed if they are based on the last annual financial statements.

No new Exemptions from Notarisation for 'Companies in Simple Conditions'

- Contrary to the draft of 2016, parliament has decided not to adopt exemptions from notarisation for certain companies. Accordingly, **the current concept remains** in force for all companies.

Restructuring

Debt-Equity Swaps

The Corporate Law Reform clarifies that **payment of the issue price by way of set-off of an existing debt is permissible for the full nominal value** of that debt even if the company is over-indebted, which had been disputed by some legal scholars. The legal uncertainty under current law had a chilling effect on such transactions, which will be eliminated going forward. On the other hand, the Corporate Law Reform requires that the articles disclose the particulars of the settlement of the issue price by set-off, including the amount of the claim, the name of the shareholder and the amount shares issued on this basis.

Pre-Insolvency Thresholds

Previous drafts of the reform sought to nudge companies away from complacency in the run up to insolvency by **expanding the duties of the board of directors to initiate restructuring measures**. This part of the reform was problematic, and we criticised it in earlier briefings. Luckily, parliament has pushed back on the most burdensome proposals and has clarified the law in important aspects, but there are still new elements that are questionable. The new measures include the following:

- The Corporate Law Reform codifies the **duty of boards of directors to monitor the Company's ability to pay its debts when they become due**. In addition, if there is a threat that the company will become insolvent, the board of directors will need to **take measures to avoid insolvency**, or propose such measures to the general meeting, and, if need be, file for a composition stay. However, parliament has decided not to introduce a duty to establish a formal liquidity plan.

- On the **balance sheet side**, the Corporate Law Reform did not increase the trigger but rather lowered the threshold: the duty for the board of directors to act is triggered under the Corporate Law Reform if the net assets are no longer sufficient to cover half of the share capital, **half of the statutory capital reserves and the statutory earnings reserves that are not repayable to shareholders** (currently, the view of a majority of scholars – even if it makes little sense from a practical perspective – was that repayable legal reserves have to be included in the threshold as well). At the same time, the Corporate Law Reform no longer requires the board of directors to convene a general meeting as a matter of principle but only requires the board of directors to take appropriate measure to overcome the situation and, only where necessary, to propose a motion at the general meeting. Furthermore, companies that have opted out from an annual audit will also need to have their financial statements reviewed by a licensed auditor appointed by the board of directors before they can be approved by the general meeting.

Duties in case of Over-indebtedness

The Corporate Law Reform does **not change fundamentally the final test of over-indebtedness** or balance sheet insolvency but aims at clarifying it:

- In case of **over-indebtedness**, there is under the current law no obligation to file for bankruptcy or a moratorium if creditors accept the subordination of their claims. The Corporate Law Reform does not go so far as to require a waiver of interest payments, but expressly provides that the subordination must also extend to interest payments, which consequently need to be stayed as long as the company is overindebted.

- The board of directors is **not required to file for bankruptcy if it has a well-founded reason to believe that it will be possible to overcome the over-indebtedness in a timely manner but, in any case, within 90 days** following the preparation of the interim balance sheet, provided that the claims of the creditors are not additionally endangered. While replacing the existing broad standard of overcoming the over-indebtedness in the short run with an unambiguous test may offer legal certainty, it is likely to lack flexibility in practice and will force companies into insolvency proceedings if at the end of this period the restructuring does not fully come to fruition. It also appears to be a burdensome standard given the additional requirement that creditor claims may not be additionally endangered.

- **The corporate law moratorium is abolished** under the Corporate Law Reform and all bankruptcy stays are consolidated in the Federal Act on Debt Enforcement and Bankruptcy.

Relief from Avoidance Actions for Restructuring Loans

The Corporate Law Reform amends the Federal Act on Debt Enforcement and Bankruptcy by expressly providing that **debts assumed with the approval of the composition administrator are not subject to avoidance actions**. This should facilitate access to the equivalent of debtor-in-possession financings once composition proceedings have started.

Disclosure by Commodity Firms

Finally, the Corporate Law Reform states that companies operating a business for the purpose of extracting minerals, oil, natural gas or clear-cutting primary forests must produce an annual special **report of payments made to public authorities**. Failure to comply with the applicable rules is subject to criminal sanctions. In addition, the Corporate Law Reform provides that the Swiss government may, in coordination with international initiatives, declare these provisions to be applicable also to companies trading commodities.

These provisions will apply in addition to potential reporting obligations under the Counterproposal to the Corporate Responsibility Initiative (see next section).

Counterproposal to Corporate Responsibility Initiative

Separately from the Corporate Law Reform, but on the same date, the Swiss parliament has adopted a counterproposal (the "**Counterproposal**") to the popular initiative on the responsibility of corporations having their seat in Switzerland for violations of internationally recognised human rights and environmental standards (the "**Corporate Responsibility Initiative**").

The vote on the Corporate Responsibility Initiative is likely to be held in November 2020, and in any case in the first half of 2021. The Initiative, if adopted, would still have to implemented by legislation, which could take years. If introduced, it would include companies' liability for damage caused as a result of violations of internationally recognised human rights or environmental standards committed by the company as well as other companies under its effective control.

As a response to the Corporate Responsibility Initiative, parliament with the express support from the government prepared a milder Counterproposal which will enter into force if the Initiative is rejected at the ballots. The Counterproposal does not provide for specific liability provisions but introduces reporting duties on corporate social and environmental responsibility by requiring larger firms to establish an annual "report on non-financial matters" mirroring the regime existing in the EU. It further provides for due diligence and reporting obligations regarding conflict minerals and child labour.

Outlook

The Corporate Law Reform reforms Swiss corporate law in many areas, although most changes are modest. Nevertheless, Swiss corporates should carefully review the Corporate Law Reform in order to **identify required changes in their governance processes and documentation**. Also, they should consider whether they may **benefit from new opportunities** under the Corporate Law Reform, e.g., under the more flexible capital provisions.

The effective date of the Corporate Law Reform has not yet been determined. The Corporate Law Reform will still need to be supported by implementing executive ordinances in certain areas. However, we expect that the Corporate Law Reform **will enter into force in 2022** (unless an optional referendum is petitioned for, which we believe to be unlikely).

Finally, companies should monitor the **vote on the Corporate Responsibility Initiative** and, depending on its outcome, assess the implications of either the Corporate Responsibility Initiative or the Counterproposal. In terms of timing, we expect that if the Corporate Responsibility Initiative is rejected, the Counterproposal might enter into force already in 2021, or possibly 2022, whereas if the Corporate Responsibility Initiative passes the ballot, a few more years may be needed for it to be fully implemented.

Authors

Prof. Dr. Rashid Bahar
Partner
T: +41 58 261 53 92
rashid.bahar@baerkarrer.ch

Dr. Urs Kägi
Partner
T: +41 58 261 56 13
urs.kaegi@baerkarrer.ch

Dr. Ralph Malacrida
Partner
T: +41 58 261 54 70
ralph.malacrida@baerkarrer.ch

Prof. Dr. Rolf Watter
Partner
T: +41 58 261 52 80
rolf.watter@baerkarrer.ch