As an alternative to having the shareholders approve the variable compensation (or parts thereof) in a binding retrospective vote, companies may choose to combine a prospective (binding) vote on the entire remuneration, both fixed and variable, with a retrospective consultative (i.e. non-binding) vote on the compensation report (*Vergütungsbericht*). Both SWIPRA and zCapital accept that there may be legitimate reasons why a retrospective vote could be deemed inappropriate and that a consultative vote, though not binding, may nonetheless be an effective means for shareholders to express their views.

Even though many companies (and their legal advisors) have not yet concluded the process of drafting the necessary amendments to the articles of incorporation which they intend to propose to the shareholders, it appears that a majority will opt for the prospective approach. In light of the views described above, it is expected that in most companies' annual general meetings there will also be a consultative vote on the compensation report (which may not be reflected in the articles of association). Further, there is also a preference that the prospective vote be with reference to the following business year. There seem to be relatively few companies in favor of a vote in relation to the current business year or the period between two annual general meetings (or, in exceptional cases, yet another reference period). Finally, current trends suggest that one vote for both the fixed and variable compensation will be the predominant choice, though by comparison to the aforementioned decisions it is arguably of much less consequence whether one vote or separate votes are held.

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Prohibited Compensation Payments under the Minder Ordinance (VegüV)

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The ordinance implementing the Minder Initiative also introduces new criminal offenses in connection with certain specific and now illicit compensation payments to certain senior persons associated with a listed company. The affected compensation payments encompass: severance payments, payments in advance and commissions for certain M&A transactions. This article endeavors to shed more light on scope and consequences of such prohibited payments.

By Thomas Reutter/Daniel Raun

1) Introduction

On 3 March 2013 the Swiss people approved by referendum a popular initiative imposing restrictions on executive compensation in listed companies first promoted by Swiss entrepreneur Thomas Minder (the so called Minder Initiative). The constitutional amendment approved in this referendum was transposed by the Swiss government into a more detailed and more specific implementing legislation: The Ordinance against excessive compensation in listed companies (*Verordnung gegen übermässige Vergütungen in börsenkotierten Gesellschaften; Ordonnance contre les rémunerations abusives dans les sociétés anonymes cotées en bourse*; hereafter the Ordinance or ExCompO). Its main objective is to empower shareholders as principals vis-à-vis the executive management as their agents in corporate governance questions and in particular in say on pay.

ExCompO also introduces new criminal offenses in connection with certain specific and now illicit compensation payments to certain senior persons associated with a listed company (article 24 (1) ExCompO). The affected compensation payments encompass: severance payments, payments in advance and commissions for certain M&A transactions (together the Prohibited Compensation Payments). Criminal offenses may lead to harsh sanctions of prison sentences of up to three years and fines.

It is important to clarify the scope of these Prohibited Compensation Payments (see below), but some general considerations on the nature of the new criminal provisions will have to be made first.

2) The new offenses in general

The criminal offense sanctioned by article 24 (1) ExCompO involves Prohibited Compensation Payments by or to certain senior persons. Although these senior persons include members of the board of directors, members of the group's executive management and members of its advisory council (*Beirat*), if any, (together Senior Persons) it will be the members of the group's executive management who will for all practical purposes be liable for receiving Prohibited Compensation Payments and the members of the board of directors who will be liable for granting Prohibited Compensation Payments. Other persons that may be involved, such as assistants to executive management members, persons in the HR department or persons involved in the actual money transfer (e.g. at a bank), may not be punishable.

The punishable act is the awarding or granting (*ausrichtet; octroie*) or the receiving (*bezieht; reçoie*) of Prohibited Compensation Payments. Even though the German word "*ausrichten*" could indicate a requirement to effect the actual money transfer in order to commit the offense, the French and also the Italian version (*corrisponde*) lead to a different and more meaningful interpretation in line with a purposive approach: A Senior Person will hardly ever be involved in the actual transfer of the money; hence the award in the sense of creating or conferring a legal entitlement must be relevant. The act so defined may include the entering into a contract or an affirmative vote in a resolution to grant a Prohibited Compensation Payment to a Senior Person.

In order to be punishable, a Senior Person must have committed the offense knowingly (*wider besseres Wissen; sciémment*). This knowledge must involve knowledge about the legal qualification of the relevant executive compensation as a Prohibited Compensation Payment, e.g. as a severance payment. In particular, the German version of the Ordinance makes it clear that a mere negligent or reckless compensation payment which turns out to be qualified as a Prohibited Compensation Payment, a fact as to which the involved parties have no affirmative knowledge, may not lead to criminal charges. This also means that the board of directors and the executive management may avoid criminal liability by seeking a prior legal expert opinion on the qualification of a certain payment. It would be sufficient for such opinion to reasonably state that it is more likely than not that the compensation payment in question does not qualify as a Prohibited Compensation Payment. Such a conclusion would in our view provide a valid defense showing that the required state of mind for a criminal charge (*subjektiver Tatbestand*) was not present.

The provision aims to prohibit certain payments to Senior Persons considered abusive in order to safeguard corporate assets for the benefit of the shareholders. Board members and executive management are agents or fiduciaries of shareholders and should abstain from what is viewed as "embezzlement"-like conduct. Therefore, a potential damage and loss of corporate assets may only occur once the consideration is transferred to a Senior Person and the criminal offense is only completed when the asset transfer has occurred at least in part. Prior to such transfer, a Senior Person may only be charged with attempted payment of Prohibited Compensation Payments.

Only members of the board of directors or of the executive management (or the advisory council, if any) may be charged with the offense of paying or receiving Prohibited Compensation Payments. However, does this mean that other corporate officers or employees will remain completely outside any criminal risk? The Penal Code (PC) also sanctions aiding and abetting for so-called special offenses (*Sonderdelikte*) whose principal perpetrator by law may come only from a group of people meeting certain criteria such as Senior Persons in the present case (article 26 PC). Consequently, one may argue that inhouse legal counsel, people working in HR or assistants of Senior Persons, acting knowingly, may be charged as accessory in the crime of Prohibited Compensation Payments. However, in more typical settings, people that may take part in any offense of Prohibited Compensation Payments are almost exclusively in positions inferior to Senior Persons and therefore must generally follow their instructions. Also, it will likely in many cases not be immediately obvious whether a payment constitutes a Prohibited Compensation Payment nor would the unfairness or inappropriateness of conduct related to such payment be conspicuous. It is therefore likely that aides and abettors would not usually have the intent of paying Prohibited Compensation Payments and that they would (and should) not be criminally liable.

The nature of the consideration must obviously be an "asset" or a "monetary benefit", but its nature (cash, shares or other forms of consideration) is irrelevant.

3) Prohibited Payments

a) Severance Payments

Severance Payments are inadmissible and may even result in criminal liability. Despite this harsh consequence, the term "severance payments" (*Abgängsentschädigungen; indemnités de depart*) is not defined in the Ordinance or anywhere else. The wording of article 20 (1) ExCompO at least clarifies the obvious: Payments payable as a result of applicable legal provisions upon termination of employment remain permitted. Also, compensation payments until the termination of the contractual relationship with the Senior Person are not prohibited. However, such term is limited by article 12 (1) (2) ExCompO to one year meaning that notice periods (and, by the same token, fixed term employment contracts) may not last for more than one year. But what kind of payments are intended to be prohibited by the Ordinance?

One of the main goals of the Minder Initiative was to abolish "golden parachutes" or "golden handshakes" for Senior Persons that had been observed in practice in particular in connection with change of control transactions. The main characteristic of these payments – irrespective of whether stipulated in the original employment or mandate terms or in any subsequent amendment – is that they are made *ex gratia*, *i.e.* without any specific consideration or performance given by the affected officer. The goal of the new legislation seems to have been to eliminate these *ex gratia* payments. However, there are a number of ways in which these unwelcome payments can be replicated or repackaged and any prohibition is therefore prone to abuse. Considering this, the legislature explicitly put overly lengthy notice periods or fixed contractual terms (in excess of one year) on the same footing as ex gratia payments in connection with termination.

Having clarified the background, the question remains which of the many manners of compensation have to be put on a "black list" because they are akin to prohibited ex gratia payments and which payments should be put on a "white list" because they lack this criterion (see also Ralph Malacrida/Till Spillmann, Corporate Governance im Interregnum, GeskR 2013, p. 485 et seqq., for an overview in German). The "white list" includes payments that are widely believed not to constitute Prohibited Compensation Payments. These include:

– contractually agreed compensation payments that accrue in the period to termination capped at one year's compensation payment;

– compensation for competition bans post termination to the extent not abusive, which will likely be the case if they do not exceed market benchmarks;

– accelerated vesting of equity securities under participation plans: These compensation elements have been awarded on a deferred and often also on a conditional basis. "Whitelisting" of such compensation consideration or grant is justified by commentators as being in the interest of the corporation and because past performance is usually honored by such acceleration (see Malacrida/Spillmann – Corporate Governance im Interregnum, GesKR 2013, p. 497). We believe, however, that the main reason for whitelisting is the fact that the deferred awards would have accrued to their beneficiary with lapse of time in any event. This evidences that such payments are not akin to ex gratia payments in connection with a termination. Acceleration clauses should merely be confined to conferring entitlements earlier in time; if they confer more in amount they should be put at least on a "grey list".

The black list includes:

– Ex gratia payments in connection with termination of office such as golden parachutes and the like whether or not pre-agreed or only agreed upon termination;

– Notice periods or terms of employment or office of more than one year or an extension of any pre-agreed period to a term of more than one year.

The "grey list" includes compensation payments whose admissibility seems unclear to us. Given this uncertainty, it seems more likely than not that such payments would not result in criminal liability. Nevertheless, a cautious approach would clearly command to refrain from such payments.

– Salary increase for the remainder of term of office: An amendment to the terms of employment of a Senior Person having submitted a notice of termination can usually only be justified if the respective officer withdraws his or her resignation. If this is not the case, it seems hard to argue that a salary increase is not a disguised severance payment even though such increase may be justified in exceptional cases.

– Extension of the notice period to up to one year: The same analysis as above applies in our view.

– Compensation payments in termination agreements: It may not be justified to "whitelist" such compensation payments simply because they are in an arm's length agreement. Such payments may constitute ex gratia payments if no adequate performance or waiver of rights by the employee officer is related thereto. However, in light of the severe consequences and *minima non curat praetor*, criminal authorities should only interfere in blatant cases.

b) Payments in advance

Article 20 (2) prohibits "payments in advance" (*Vergütungen, die im Voraus ausgerichtet werden*). The commentary to the draft bill dated 14 June 2013 (Commentary) sheds some light on this rather cryptic term. The intention seems to be to prohibit payments for services that have not yet been performed. Compensation of Senior Persons must therefore be made in arrears according to the intention of the lawmaker (*"erst nach erbrachter Leistung ausrichten…"*; Commentary, 3.9.3). By contrast, sign-on bonuses (*Antrittsprämien*), understood to be a compensation for losses suffered by a newly hired Senior Person at its former position (e.g. forfeiture of options etc.; see additional commentary to the Ordinance dated 8 October 2013 (Additional Commentary)), should remain possible. In light of such scope, it seems to be misleading to refer to a "bonus" or "premium". Rather, the Additional Commentary seems to just allow compensation for losses as opposed to a monetary incentive payment to accept a new position as a Senior Person in a Swiss listed corporate. Contracts stipulating such payments should therefore be carefully crafted and genuine monetary incentives beyond losses suffered, although not clearly prohibited in our view, should be avoided.

In addition, the term "payments in advance" is dangerously unspecific for a criminal liability provision. A payment of a salary on the 21st of a calendar month would still constitute a payment in advance for part of the services in such calendar month. By the same token, an accelerated vesting of options prior to the stated original time of vesting could be viewed as payment in advance.

We note that the intention of the promoters of the initiative was to limit the prohibition of payments in advance to new hires (*Stellenantritt*). The commentary to the initiative explicitly states: "..prior to starting their term of office.." (*"bevor sie ihre Stelle überhaupt angetreten haben"*). It seems unjustified to go even beyond the intention of the promoters in this respect. Also, the principle of legality in criminal proceedings (*Legalitätsprinzip; nulla poena sine lege*) mandates restraint when it comes to a wide interpretation of a rather vague criminal provision. Payments in advance during the term of a Senior Person's office may be reclaimed under private law if they relate to periods for which no services have been performed as a result of early termination. In light of the foregoing, we take the view that the term "payment in advance" is to be interpreted in the narrow way intended by the promoters of the initiative and hence be restricted to payments to newly hired Senior Persons prior to them starting their new position. We note, however, that the legislator of the Ordinance seems to be willing to go beyond this view creating unnecessary legal uncertainty.

c) Commissions for certain M&A transactions

The Ordinance also prohibits certain commissions to Senior Persons in connection with M&A transactions by the listed parent company or its subsidiaries (article 20 (3) Ex-

CompO; *Provisionen für die Übernahme oder Übertragung von Unternehmen*). According to the Commentary a commission is to be interpreted in line with employment law (article 322b of the Code of Obligations) meaning that a commission is the entitlement of the employee to a share of the value (however defined) of a contract entered into by the employer usually expressed as a percentage (see Commentary, 3.9.4). One should note that the term mergers and acquisitions is a bit too narrow as the provision in question covers all sorts of share or asset transfers involving businesses irrespective of their legal form.

The Additional Commentary states that only commissions for M&A intra-group transactions (*konzernintern*) would be affected and hence prohibited. The term "intra-group" seems to be a misnomer. It implies that both transferor and transferee are entities of the same group. This is not the case for the M&A transaction commissions made illegal by article 20 (3) ExCompO. The wording of the provision suggests that it is applicable if either the transferor or the transferee are group companies of the Swiss listed parent. The addition of "…by the company or an undertaking controlled by the company…" also seems to exclude transactions involving a change of ownership of the parent itself. This is probably what was meant by the Commentary when it stated that the criminal provision only encapsulates intra-group transactions, i.e. to the exclusion of transactions in shareholdings of the group's parent. Only for the former a risk of commissions that are economically not justified can be identified according to the Commentary (Commentary, 2.9). This in turn would indicate that the lawmaker was of the view that the interests of shareholders and Senior Persons are aligned when it comes to a change of control of the parent, but are not similarly aligned if a subsidiary is sold. It would seem, however, that alignment of interests is rather a matter of defining the trigger for the commission and less so a question of the level of any given M&A activity in a group of companies. The purpose of differentiating between these two types of transactions remains therefore somewhat elusive. Nevertheless, in light of the principle of legality requiring an unambiguous statutory basis for criminal offenses, commissions for M&A transactions in the listed parent company cannot entail criminal charges in our view.

In any event, payments to Senior Persons for additional work performed in connection with M&A transactions remain possible. It also remains possible, in our view, to identify specified M&A transactions as one or more targets within a variable compensation scheme.

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