

THE CORPORATE
GOVERNANCE
REVIEW

SEVENTH EDITION

Editor
Willem J L Calkoen

THE LAWREVIEWS

THE CORPORATE GOVERNANCE REVIEW

The Corporate Governance Review

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PREFACE

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

In this seventh edition, we can see that corporate governance is becoming a more vital and all-encompassing topic with each year that passes. We all realise that the modern corporation is one of the most ingenious concepts ever devised. Our lives are dominated by corporations. We eat and breathe through them, we travel with them, we are entertained by them, most of us work for them. Most corporations aim to add value to society and they very often do. Some, however, are exploiting, polluting, poisoning and impoverishing us. A lot depends on the commitment, direction and aims of a corporation's founders, shareholders, boards and management and employees. Do they show commitment to all stakeholders and to long-term shareholders, or mainly to short-term shareholders? There are many variations on the structure of corporations and boards within each country and between countries. All will agree that much depends on the personalities and commitment of the persons of influence in the corporation.

We see that everyone wants to be involved in 'better corporate governance': parliaments, governments, the European Commission, the US Securities and Exchange Commission (SEC), the Organisation for Economic Co-operation and Development (OECD), the UN's Ruggie reports, the media, supervising national banks, more and more shareholder activists and other stakeholders. The business world is getting more complex and overregulated, and there are more black swans, while good strategies can quite quickly become outdated. Most directors are working diligently, many with even more diligence. Nevertheless, there have been failures in some sectors, so trust has to be regained. How can directors do all their increasingly complex work and communicate with all the parties mentioned above?

What should executive directors know? What should non-executive 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 non-executive directors understand the business? How much time should they spend on their function? How independent must they be? What about diversity? Should their pay be lower? What are the stewardship responsibilities of shareholders? What are the pros and cons of shareholder rights plans?

Governments, the European Commission and the SEC are all pressing for more formal inflexible legislative acts, especially in the area of remuneration. Acts set minimum standards, while codes of best practice set aspirational standards. We see a large influence on 'norms' by codes and influential investor groups.

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

What more can they do to show all stakeholders that they are improving their enterprises other than through setting a better ‘tone from the top’? Should they put big signs on their buildings emphasising integrity, stewardship and respect?

Interest in corporate governance has been increasing since 1992, when shareholder activists forced out the CEO at General Motors and the first corporate governance code – the Cadbury Code – was written. The OECD produced a model code and many countries produced national versions along the lines of the Cadbury ‘comply or explain’ model. This has generally led to more transparency, accountability, fairness and responsibility. However, there have been instances where CEOs gradually amassed too much power or companies have not developed new strategies and have produced bad results – and sometimes even failure. More are failing since the global financial crisis than previously, hence the increased outside interest in legislation, further supervision and new corporate governance codes for boards, and stewardship codes for shareholders and shareholder activists. The European Commission is developing a regulation for this area as well.

This all implies that executive and non-executive directors should work harder and more as a team on policy, strategy and entrepreneurship. More money is lost through lax or poor directorship than through mistakes. On the other hand, corporate risk management is an essential part of directors’ responsibilities, and sets the tone from the top. How can directors do their important work well without being petrified of attacks from shareholders’ regulations and the press?

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

My aim as 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 and best practice by reading about the laws and practices 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
March 2017

SWITZERLAND

*Rolf Watter and Katja Roth Pellanda*¹

I OVERVIEW OF GOVERNANCE REGIME

The main source of law for Swiss governance rules is the company law contained in Article 620 et seq. of the Swiss Code of Obligations (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 further governance debate was triggered at the beginning of the previous decade, in 2000/2001, *inter alia*, as a consequence of the Swissair Ltd bankruptcy. One of its outcomes was the issuance of the Swiss Code of Best Practice for Corporate Governance (SCBP) by Economiesuisse,² first enacted in 2002 and revised in 2007 and 2014.³ It contains a range of guidelines and recommendations for boards of directors of listed companies (the board or boards) on how to organise themselves. Notwithstanding its rather far-reaching impact, it is not mandatory and represents a code of best practice, leaving leeway for specific adaptations and modifications by individual companies. On 1 July 2002, the Corporate Governance Directive issued by SIX Swiss Exchange Ltd (DCG) entered into force; it was revised in 2008 and 2014.⁴ 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 equity securities are listed on the SIX Swiss Exchange Ltd (SIX) and is largely based on the principle of 'comply or explain'. The enforcement of the DCG lies within the responsibility of the SIX.

A rather fundamental revision of the company law is currently under review by the legislature. One of its main goals is to further strengthen corporate governance rules, in particular relating to shareholders' rights and board and management compensation. While a part of this revision (i.e., the accounting provisions) entered into force on 1 January 2013, the governance provisions are still controversially debated. A preliminary draft⁵ of the revised CO (the Preliminary Draft) has undergone a public consultation, which concluded on 15 March 2015; the results of this process were published in autumn 2015.

1 Rolf Watter is a partner with Bär & Karrer AG and Katja Roth Pellanda is head of corporate law at Novartis AG.

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

3 Available at www.economiesuisse.ch/en/Documents/swisscode_e_web.pdf.

4 Available at www.six-exchange-regulation.com/admission_manual/06_16-DCG_en.pdf. See also the DCG commentary available at www.six-exchange-regulation.com/download/admission/regulation/guidelines/swx_guideline_20070820-1_comm_en.pdf.

5 Available at www.admin.ch/ch/d/gg/pc/documents/2499/OR-Aktienrechte_Entwurf_de.pdf.

A major part of the revision is the implementation of the ‘Ordinance against Excessive Compensation in Listed Companies’ (the Ordinance) into formal law. The Ordinance is the result of a far-reaching popular initiative for a constitutional amendment in the area of compensation, colloquially called the ‘Minder initiative against fat-cat salaries’ (the Minder initiative),⁶ which was adopted in 2013 by a popular vote with a strong majority of 68 per cent. The transitional provision of the constitutional amendment provided that, until the statutory provisions come into force, the Swiss Federal Council had to issue implementing provisions within one year;⁷ this was done through the Ordinance, which applies to companies limited by shares with their domicile in Switzerland and their shares listed in Switzerland or abroad.⁸ The Ordinance obliges such companies to annually submit the top management’s compensation to the shareholders for a binding vote and contains far-reaching rules on corporate governance with direct effects on boards, executive management, shareholders, pension funds and independent proxies. It also outlaws certain payments, such as certain golden handshakes (but allows a new manager to be indemnified for losses suffered with the former employer) and severance payments. Moreover, the Ordinance implements the principle required by the Minder initiative that certain contraventions to the Ordinance are sanctioned by imprisonment of up to three years and a fine of up to the equivalent of six years’ annual compensation. All offences have to be prosecuted *ex officio*.

On 23 November 2016, the Swiss Federal Council submitted to the Swiss parliament a revision of the Preliminary Draft (the Revised Draft). The most important changes by the Federal Council to the Preliminary Draft are: (1) no ban on prospective shareholder voting on variable compensation but a duty to hold a consultative vote on the compensation report; (2) no duty to set the relationship between fixed and variable compensation in the articles of association; (3) no duty to establish and operate an electronic shareholder forum; and (4) no right for shareholders to institute legal proceedings at the expense of the company. The guidelines on gender representation at senior executive level remain in place but the Federal Council has lowered this requirement to 20 per cent, whereas the level for boards of directors remains at 30 per cent. If a company fails to meet these gender guidelines, it will have to disclose the reasons for its non-compliance, as well as current and planned actions to meet the targets.

Unlike the Minder initiative, the ‘1:12 initiative’ was rejected by the Swiss voters in November 2013 by a large majority of 65 per cent. This initiative aimed at introducing a salary cap of 12 times the lowest salary within a company. The outcomes of the Minder and 1:12 initiatives show that Swiss voters require a tight corporate governance regime in respect of compensation but desire no governmental intervention regarding the amount of absolute level of compensation.

II CORPORATE LEADERSHIP

According to the CO, the board is the executive body of a company limited by shares (i.e., the one-tier board system is the default rule).⁹ The board is therefore responsible for the management of the company and represents the company in relation to third parties. The

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

7 See Article 197 X of the Federal Constitution.

8 Article 1 I of the Ordinance.

9 See Article 716 II of the CO.

board may carry out any legal acts consistent with the company's purpose clause¹⁰ and may pass resolutions on all matters not reserved to the general meeting of shareholders (the shareholders' meeting) by law or by the articles of association.¹¹ The relationship between the shareholders' meeting and the board is generally described as a relationship of parity rather than a hierarchy: both bodies have distinct responsibilities and competence by law.¹² But Swiss law permits shareholders to dismiss board members in a general meeting at any time.

However, the legal default concept of the board directly managing the company no longer corresponds to the reality of today's medium-sized to large companies, and in particular of listed companies. As Swiss company law is very flexible, different governance structures are possible, as will be explained below.

i Board structure and practices

In terms of board structure, Swiss company law allows the board to delegate significant parts of its responsibilities to the senior management. However, certain responsibilities cannot be transferred and are considered inalienable duties of the full board.¹³ Depending on the size and the needs of the company, the board may therefore assume the entire responsibility for management (this system is adopted predominantly by smaller non-listed companies) or it may delegate all transferable responsibilities to one or several board members or the senior management, subject to an authorisation by the shareholders in the articles of association and the establishment of organisational regulations by the board.¹⁴ Thus, it is possible to create a two-tier structure, which is what listed companies typically do and is what the SCBP recommends, by requesting a majority of non-executive board members. Such a two-tier structure is mandatory for banks and insurance companies.

A board must consist of at least one individual.¹⁵ In reality, most companies have several board members. Where there are different 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.¹⁶

The board is responsible for the representation of the company towards third parties. Unless the articles of association or the organisational regulations stipulate otherwise, all the members of the board have an individual authority to represent the company.¹⁷ It is, however, common practice, at least in medium-sized to large companies, that only joint signatory power, of any two board members, is granted. The board may also delegate the authority of representation to members of management or to other employees. At least one member of the board, or two board members in cases of joint signatory power, 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.¹⁸

10 Article 718a I of the CO.

11 Article 716 I of the CO.

12 See, *inter alia*, the decision of the Swiss Federal Supreme Court BGE 100 II 384, consideration 2.a).

13 Article 716a I of the CO.

14 Article 716b I of the CO; Article 6 of the Ordinance.

15 See Article 707 I of the CO.

16 Article 709 I of the CO.

17 Article 718 I of the CO.

18 Article 718 II, III and IV of the CO.

The CO provides the following catalogue of non-transferable and inalienable duties that cannot be delegated to the management (but for which the management often does the preparatory work):¹⁹

- a* determination of the strategy and the definition of the means to implement it (e.g., budget process, establishment of a business plan, issuance of all necessary directives and establishment of a risk control and management system);
- b* determination of the organisation (e.g., decision on the governance structure of the board and management and the organisation of the business along business lines);
- c* structuring of the accounting system, the financial controls and the financial planning (including monitoring the liquidity of the company);
- d* appointment, removal and succession planning of the members of the management team and the persons authorised to sign on behalf of the company (the appointment of the top executive management must remain with the board, whereas the appointment of the lower hierarchical levels may be delegated);
- e* supervision of management (including, *inter alia*, the implementation of a state-of-the-art internal control system and clear reporting lines), in particular with respect to compliance with the law, the articles of association and the directives issued by the board;
- f* preparation of the annual report consisting of the financial statements (which have to include, *inter alia*, the significant shareholders and their shareholdings)²⁰ and a narrative business report;
- g* preparation of the shareholders' meeting (which has to be held within six months after the end of each business year)²¹ and the implementation of its resolutions; and
- h* notification of the court in the event that the company is over-indebted.

The Ordinance requires the board to prepare a compensation report that replaces the disclosure of board and senior management remuneration in the notes to the statutory financial statement.²² The preparation of the compensation report is also a non-transferable and inalienable duty of the board.²³ The Revised Draft requires companies with a prospective vote on variable compensation for the board and senior management to have an advisory vote on the compensation report.

Where there are several board members, the organisation of the board requires the nomination of a chair and of a secretary, but the latter does not have to be a board member.²⁴ The chair was customarily appointed by the board; however, the articles of association could also provide for a direct appointment by the shareholders' meeting.²⁵ Now, the Ordinance provides that, in listed companies, the shareholders' meeting has to elect and dismiss him or her.²⁶ The role of the chair is not defined in detail by Swiss company law and few duties are explicitly assigned. In reality, the chair's function is key to the proper functioning of the entire

19 Article 716a of the CO.

20 Article 663c of the CO.

21 Article 699 II of the CO.

22 Article 13 I of the Ordinance.

23 Article 5 of the Ordinance.

24 Article 712 I of the CO.

25 Article 712 II of the CO.

26 Article 4 I and III in connection with Article 29 I of the Ordinance; boards could also suspend a chairman but then have to call a shareholders' meeting (Article 726 of the CO).

board and to an adequate working relationship between the board and the management. The chair, *inter alia*, (1) keeps direct contact with the senior management (typically represented by the CEO), (2) communicates and engages with important shareholders and stakeholders (in general together with the CEO), (3) organises and conducts the board meetings and sets their agendas, (4) is, together with or subsidiarily to the CEO, the outside ‘face’ of the company, and (5) takes the lead in crisis situations. The chair has a deciding vote if not prohibited by the articles of association. Cumulative voting within the board is not possible under Swiss law.

The question of combining the roles of the chair and the CEO in the same person has been the subject of significant debate in Switzerland. Although not explicitly excluded by the SCBP, the majority opinion nowadays, voiced in particular by proxy advisers, is that such a concentration of power does not represent best practice. However, a certain tradition of these combined roles exists,²⁷ which is in general justified by efficient communication and faster 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 roles of the chair and the CEO are combined, adequate control mechanisms should be implemented, including the appointment of an experienced non-executive board member as independent lead director. One of the roles of an independent lead director is to convene and chair meetings of the board without the chair when necessary.

The board is required when fulfilling its tasks to observe the duty of care and loyalty, the duty of confidentiality and the duty to treat shareholders equally.²⁸ The principle of equal treatment of shareholders does not require the board to provide identical treatment to all shareholders; it must, however, make sure that shareholders are treated equally in comparable circumstances. This principle is of particular significance in relation to the communication with and information provided to shareholders. Therefore, Swiss company law provides for relative rather than absolute equality, meaning large shareholders might under certain circumstances receive more information than small investors. Whereas company law specifically takes into consideration the circumstances of the specific case, capital market law and stock exchange regulations, namely rules prohibiting insider dealing and *ad hoc* publicity rules, provide for a stricter understanding of a ‘level playing field’ and aim to ensure that price-sensitive information is disseminated on an equal basis; but even there, large (institutional) shareholders often get more information than retail shareholders, which is permissible as long as this information is not price-sensitive or is mitigated by confidentiality undertakings and contractual agreements not to trade on information received.

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, etc. Furthermore, the CO provides for the possibility of assigning responsibility for preparing and implementing resolutions of the board, 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 or third parties remains with the board. In all instances, appropriate reporting to the (full) board has to be ascertained. Under the previous law the creation and revocation of board committees was in the sole discretion of the board. Article 7 of the Ordinance now provides that the

27 The CEO is in seven out of 20 SMI companies a member of the board.

28 Article 717 of the CO.

members of the compensation committee, who need to be members of the board, have to be elected by the shareholders' meeting. Even though the wording of the Ordinance does not explicitly state that a compensation committee is required for listed companies, there is, according to legal scholars, an affirmative duty to establish one. This view is confirmed by Article 733 I of the Revised Draft, which states that the shareholders' meeting has to elect a compensation committee. The basic principles of the duties and responsibilities of the compensation committee have to be determined by the articles of association and, therefore, by the shareholders; still, details may be stipulated in the organisational regulations (i.e., by the board). The SCBP also recommends the creation of an audit 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 (for example, in the event of going private or takeover situations), or other *ad hoc* committees may be constituted when needed for an efficient functioning of the board.

ii Directors

While the law provides in general that the members of the board need to be elected by the shareholders' meeting for a term of office of three years unless the articles of association state otherwise,²⁹ the members of the board of listed companies have to be elected individually and on an annual basis.³⁰ Boards can therefore not fill vacancies by themselves. Further, staggered boards are not possible for listed companies.

In general, no formal requirements have to be met for being nominated to a board but certain rules apply to banks and insurance companies. Swiss company law requires neither special knowledge nor qualifications (e.g., in strategic, financial or accounting matters); currently, there are also no gender requirements. However, this is likely to change in the future with the proposed introduction of a gender quota for the board of listed companies as part of the current revision.³¹ Compared with quotas implemented and proposed in other jurisdictions (e.g., Norway and Germany), the proposed revision is less intrusive as it would only foresee a comply or explain approach.

Regarding the independence of board members, there are, in principle, no specific requirements. However, Articles 717 and 754 of the 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 only to propose and nominate members 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 of the company. Furthermore, the articles of association may contain certain qualifications and conditions, such as an age or a term limit; no such restrictions are provided by law, but many articles of association provide for them (typically around 70 years of age and a 12-year maximum term).

29 Article 710 I of the CO.

30 Article 3 of the Ordinance.

31 Article 734f of the Revised Draft.

Each board member may generally resign at any time without giving any reason to the shareholders or the remaining board members. The corollary to such a right is the right of the shareholders' meeting to remove a board member at any time.³² However, if a board member steps down at an inconvenient time, he or she is liable for damages arising from the resignation.

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 board members in the company's affairs outside formal board meetings (e.g., direct contacts with senior or lower management and on-site visits of subsidiaries) very much depends on the rules set by the board and the chair.

The board members, as well as senior management, may be held liable for any losses or damages arising from wilful or negligent violation of their duties. This accountability not only applies to formally appointed persons, but also to *de facto* directors (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. Liability presupposes: (1) damage suffered by the company or the plaintiff; (2) a breach of a duty defined by the law, the articles of association, the organisational regulations or other internal directives by the defendants; (3) acting intentionally or negligently; and (4) a proximate causation of the breach of duty to the loss sustained.³³ In connection with the required breach of duty the Swiss Federal Supreme Court now expressly acknowledges that courts have to exercise restraint in the retrospective review of business decisions and only examine whether a business decision was reached in a sound manner; the Court requires that the business decision was taken in a flawless decision-making process, made on the basis of appropriate information and free from conflicts of interest.³⁴ Compliance with these requirements can, therefore, significantly reduce the liability risk for board members as well as senior management. In the legal literature, these court decisions are regarded as recognition of the 'business judgement rule' as a principle of Swiss corporate law.

As a matter of law, there is joint and several liability of all board members; an individual board member is, however, exempt from liability provided that there has been no fault at all on his or her side.³⁵ 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 among the board members. Very often when a claim is filed, 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 board 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 with respect to fault. If the board lawfully delegated a part or all of the management duties, the liability of the board is limited to the required care in

32 See Article 705 I of the CO.

33 See Article 754 et seq. of the CO.

34 Decision of the Swiss Federal Supreme Court BGE 139 III 24, consideration 3.2.

35 Article 759 I of the CO.

selecting, instructing and supervising the senior managers.³⁶ Moreover, if the shareholders' meeting took the decision to discharge the board members and senior management, the latter cannot be held liable by 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 at the time of the discharge decision.³⁷

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 hostile takeovers and even more so in going-private situations. One of the main reasons for the reluctance of shareholders to pursue legal action against board members is the financial risk associated with it. The Revised Draft does not facilitate the possibility of shareholders bringing lawsuits, as initially proposed in the Preliminary Draft.³⁸

Actions by a company itself against current or former board members happen more often nowadays, but are still rare; however, when making its decision whether to file a claim, a board should weigh the chances of success (and the possible monetary reward, taking also into account any asset protection moves that defendants are likely to make) against all the risks, which include the following:

- a* the financial risk of losing the case (which in Switzerland leads to a duty to indemnify the winning defendant for his or her costs and to the payment of the court costs);
- b* future (negative) media coverage;
- c* consequences for future hiring (i.e., negative consequences if a company is seen to 'go after' its own people);
- d* the danger that management might become risk-averse;
- e* the fact that such proceedings may potentially last several years (as happened, for example, in the *Swissair* case) and the fact that pursuing claims will be time consuming for the current management, as not all work – and certainly not all decision-making – can be delegated to (outside) lawyers; and
- f* negative impact on future cost and availability of directors' and officers' insurance (D&O insurance).

The board should consider the medium to long-term interests of the company to be paramount in any decision, rather than how its decision may be perceived by the public, which often wants to see punishment for misconduct. Generally successful liability claims against boards are still the exception rather than the rule. Most claims end with out-of-court settlements, typically financed by D&O insurance; basically, all larger companies buy coverage for potential liability claims because a number of corporate failures or crisis situations in the past 10 years (Swissair Ltd, UBS Ltd, etc.) has sharply increased awareness of the liability issue.

According to the Swiss Federal Supreme Court the above-mentioned duty to safeguard the interests of the company in good faith requires that the board ensures by appropriate measures that the interests of the company are duly considered if a risk of a conflict of interests arises;³⁹ but 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 board member concerned must inform the chair who, in turn,

36 Article 754 I of the CO.

37 Article 758 of the CO.

38 Article 697j et seq. of the Preliminary Draft.

39 Decision of the Swiss Federal Supreme Court 4A_462/2009 dated 16 March 2010, consideration 6.3.

requests a decision by the full board (generally without the participation of the individual concerned). Most scholars and the SCBP recommend that the individual concerned should fully abstain from the decision-making (i.e., board discussions and voting) relating to the conflict. Our point of view is that such decisions should generally be made by way of a double vote (i.e., votes with and without the relevant individual should take place, with a decision requiring in principle two positive votes). This avoids the individuals concerned withholding information and escaping liability. Other possible measures to address conflicts are ‘dealing at arm’s length’ and third-party fairness opinions. Moreover, in specific situations (such as a takeover or going-private transaction) it may be advisable to establish an independent board committee consisting of board members who have neither a financial interest in the transaction nor any other potential conflict. The independent board committee represents the board in all matters relevant to the transaction and prepares the decision-making by the full board; a separate decision by the independent board committee to recommend the transaction is advisable as well. Such a process allows liability claims (and reputational risk) to be avoided in conflict-of-interest situations.

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 advisable to provide for a special approval by the non-conflicted board members or, in small companies, by a shareholders’ meeting. The current revision of company legislation includes a new provision dealing with conflicts of interest of board members and senior management,⁴⁰ which essentially turns the recommendations of the SCBP into law. In addition to this, the Ordinance requires that the articles of association include the number of permissible activities of the members of the board, senior management and members of an advisory board (if any) on administrative boards or executive bodies outside their own group.⁴¹ Since the Ordinance provides no maximum number of permissible activities outside the company, the limit selected by the companies ranges from as few as five to as many as 50 positions for a board member. The corresponding limits for the senior management are considerably lower in most companies, and never exceed the limits for the board members.

III DISCLOSURE

For each financial year, the board must prepare financial statements (consolidated if required) and, under certain circumstances, a management report (Article 957 et seq. of the CO). A new law on accounting rules entered into force on 1 January 2013 and applies from 2015 (2016 for consolidated accounts). According to the new rules, the accounting standard no longer depends on the legal form of a company but will generally be applicable to all entities according to certain size criteria. For legal entities with revenues of less than 500,000 Swiss francs, it is sufficient to prepare an income statement and account for expenditures on a cash basis and a statement of assets and liabilities. Specific accounting and valuation rules apply to all legal entities with an annual turnover above 500,000 Swiss francs;⁴² however, even these new rules generally do not assure a true and fair view of the company’s financial position, as the board can still create (and within limits dissolve) hidden reserves. Listed companies, large

40 Revised Draft Article 717a of the CO.

41 Article 12 I Paragraph 1 of the Ordinance.

42 Article 957 of the CO.

cooperatives (with at least 2,000 members) and foundations subject to an ordinary audit must prepare financial statements in accordance with generally accepted accounting standards such as Swiss GAAP, IFRS or US GAAP, which require the company to present a true and fair view of its financial situation. The auditors have to comply with strict independence requirements; more specifically, the auditors must be independent of the board members and major shareholders, and may not engage in activities for the company outside the audit work that would endanger their 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 sufficiently qualified specialists.

Listed companies are subject to more far-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 compensation. Nowadays, the board has to prepare a written compensation report on an annual basis, which has to be audited; it must disclose all compensation, loans and credits to the members of the board, the senior management and the advisory board (if any).⁴³ The new disclosure requirements under the Ordinance regarding compensation are very similar to the ones under the previous law.

Finally, and as mentioned above, 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 if their holding crosses certain thresholds (3, 5, 10, 15, 20, 25, 33.3, 50 or 66.6 per cent of voting rights) complement their framework of disclosure requirements.⁴⁴

IV RISK MANAGEMENT

An effective and efficient risk management is required by the law and the SCBP. 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 business of the company; risk management should cover both financial and operational risks. In addition, the board has to continuously (typically each year, unless extraordinary situations arise) assess the risk situation of the company. In the management report, it must be confirmed that the risk assessment has taken place. Swiss company law does not require the establishment of a specific risk committee at board level. 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 because of 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.⁴⁵

43 Article 13 et seq. of the Ordinance.

44 Article 120 I of the FMSA.

45 Article 716a I Paragraph 5 of the CO.

Currently, there is no formal whistle-blowing legislation in force, but on 20 November 2013 the Swiss Federal Council adopted a proposal for the implementation of better protection for employees against wrongful termination by an employer if the employee discloses alleged dishonest or illegal activities in the company.⁴⁶ There is still a certain resistance in many Swiss companies to stipulating rules on whistle-blowing. Larger multinational companies, however, normally have procedures promoting and protecting whistle-blowing.

V CORPORATE RESPONSIBILITY

Corporate social responsibility (CSR) is still a relatively new concept in Switzerland, even though some components of CSR already form part of the law. Requirements generally cover a call for sustainable management and a responsible use of the resources of the company; employee protection is provided for by the CO, the Employment Act and the Gender Equality Act. Moreover, there is extensive 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, which is the guardian of the company's interests. Generally, Swiss company law does allow a board to take into account both the interests of shareholders (which typically means maximising shareholder returns over the medium term) as well as the interests of the company with all its stakeholders (employees, customers, suppliers and, further, the community and the environment at large). This means, for example, that if a board decision does not maximise value but can be justified by the legitimate interests of stakeholders, board members cannot be held liable for it.

VI SHAREHOLDERS

i Shareholder rights and powers

The financial rights of shareholders basically consist of the right to receive dividends provided that the shareholders approve them, and liquidation proceeds if the company is dissolved. Dividends may only be distributed from the disposable balance sheet profit on the stand-alone accounts of the top company of a group and from specific reserves held for this purpose (both being generally referred to as 'free reserves').⁴⁷ For tax reasons, dividends have been substituted in many companies by either payments out of surplus or reductions in the nominal value of shares as such payments are withholding tax-free.

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 may cast.⁴⁸ 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.

46 The draft is available at www.admin.ch/opc/de/federal-gazette/2013/9589.pdf.

47 Article 675 II of the CO.

48 Article 692 II of the CO.

Certain quorum requirements set by the law or provided for in the articles of association have the effect of protecting 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; this 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;⁴⁹ often, this threshold is lowered in larger companies in their articles of association.

Shareholders have to be provided with the annual report, the compensation report and the audit opinion; in addition, each shareholder may request specific information necessary for the exercise of his or her rights at the shareholders' meeting. If this information is refused by the board, the shareholder may request a special audit ordered by a judge.⁵⁰ However, this is a rather burdensome, difficult and time-consuming procedure. To facilitate the exercise of minority shareholders' rights, the Revised Draft lowers several thresholds and hurdles, such as: (1) lowering the percentage of the share capital or voting rights required for shareholders to request a shareholders' meeting from 10 per cent to 5 per cent; (2) changing the amount of the share capital or voting rights required for the right of shareholders to ask for an item to be put on the agenda from shares with a total nominal value of at least 1 million Swiss francs to 0.5 per cent of the share capital or voting rights; (3) invitations to shareholders' meetings must include a brief explanation of each motion of the board of directors (also indicating the respective shareholders requesting the items); and (4) shareholders meetings can be held at several locations or as online meetings.⁵¹

A further protection element is afforded by the subscription rights of existing shareholders in the case of a capital increase, which protect them from dilution: these rights may only be withdrawn by a qualified shareholders' decision in specific situations.⁵² In the case of issuance of convertible or similar bonds, existing shareholders have a priority right to purchase these instruments, which, in certain cases, may also be limited by a decision of the shareholders.

Article 95 III of the Federal Constitution and the Ordinance strengthen shareholders' powers in listed companies in different ways. As mentioned above, the shareholders, *inter alia*, have to elect the chairman of the board as well as the members of the compensation committee. One of the most contentious issues in Swiss corporate law in the past has been the allocation of responsibilities between the shareholders' meeting on the one hand and the board on the other hand, in particular in relation to the determination of compensation to be paid to the board and to the senior management. In this respect, the Minder initiative and its implementing provisions strengthen shareholders' powers in listed companies by providing a binding 'say-on-pay' vote for the compensation of the board, the executive management and the advisory board (if any) and by the prohibition of certain compensation forms such as severance payments. Other compensations, such as a new-hire compensation, severance payments due under employment law (e.g., during a termination period even if there is gardening leave) as well as compensation at fair market value for non-compete clauses of a reasonable duration are still allowed, provided that (except for non-compete payments) they

49 Article 699 III of the CO.

50 Article 697 of the CO.

51 See Articles 699 Paragraph 3, 699b, 700, 701a Paragraph 2, and 701d of the Revised Draft.

52 Article 704 I Paragraph 6 of the CO.

are approved by the shareholders' meeting or have a basis in the articles of association. Such a basis is also necessary for the grant of loans and pension benefits outside the occupational pension system and for performance-related remuneration and participation plans. Furthermore, the Ordinance provides for a maximum duration for fixed-term contracts (no longer than one year) with the members of the board and senior management, as well as a maximum termination period of one year for contracts with no fixed term.⁵³

The Revised Draft provides legal certainty and makes only minor changes to the Ordinance. The following amendments are, however, noteworthy: (1) clarification that sign-on bonuses may only be paid if they compensate for actual losses of benefits granted by an executive's former employer; (2) compensation for post-contractual non-compete undertakings may only amount to the average annual compensation over the past three years and must be commercially justified, but no time limit is imposed; (3) companies with a prospective vote on variable compensation must hold an advisory vote on the compensation report; and (4) the compensation report must disclose all other companies in which the members of the board of directors or the executive management hold offices (including publication of the names of the member, function and company).⁵⁴

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.⁵⁵ 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 set out in Article 120 of the FMSA.

iii Shareholder activism

Swiss company law provides for a catalogue of specific rights of shareholders to take legal action in the event of an infringement of the law by the board, management or auditors. 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;⁵⁶ there is no right to challenge resolutions of the board. However, any resolution passed by the shareholders' meeting or the board violating fundamental rules of company law is void.⁵⁷

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 composition and appoint members who favoured their strategy. The fact that board members can, as mentioned above, be fired at any time by a shareholders' decision and the need to re-elect board members annually 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 buy-backs. Effective from 21 January 2013 a code of best practice for institutional investors governing the exercising of participation rights in Swiss listed companies has been enacted.

53 Article 12 I Paragraph 2 of the Ordinance.

54 See Articles 735c Paragraph 3 and 5 and 735 Paragraph 4 of the Revised Draft.

55 Article 680 I of the CO.

56 Article 706 of the CO.

57 Article 706b and 714 of the CO.

The aim of these guidelines is that the institutional investors exercise their participation rights in a more systematic manner and communicate the principles and processes used to their clients.

Compensation of the board and the senior management in listed companies has been high on the agenda of the legislature and the public in the past couple of years. As mentioned before the Minder initiative and its implementing Ordinance require, *inter alia*, that the shareholders annually hold binding separate votes on the aggregate compensation amount for the board, the senior management and the advisory board, thereby quite substantially changing the current structure of parity between the shareholders and the board. The details of the voting on compensation have to be set out in the articles of association, which had to be amended at the latest in the ordinary shareholders' meeting in 2015.⁵⁸ Various models are possible: a vote on a compensation cap, whereby the shareholders state in advance the maximum amount of compensation for the respective governing bodies for the coming year (prospective vote); a vote on the base compensation for the term until the next ordinary shareholders' meeting or for the next financial year (again prospective), combined with a vote on performance-based compensation for the past financial year (retrospective vote). If a prospective vote is chosen, the Ordinance allows that the articles of association provide an additional amount for the hiring of new members of the executive management after the shareholders' meeting has taken place.⁵⁹ A survey among companies listed in Switzerland has shown that more than 90 per cent opted for a prospective model for the board's compensation (and 64 per cent opted for a prospective model for the management team's compensation).

The articles of association can also contain a provision for the course of action to be taken in the event of a negative shareholder vote on the compensation, but the solution chosen must not constrain the decision-making power of the shareholders' meeting. The binding⁶⁰ say-on-pay vote as a non-transferable power of the shareholders' meeting⁶¹ must necessarily take place on an annually basis.⁶² Many large companies had previously introduced a non-binding vote on the compensation system in the articles of association, thereby providing shareholders with an opportunity to express their non-binding view on the compensation system of the company; especially in cases of a purely prospective system, this non-binding vote, which is better aligned to international practice than the binding vote, will probably be maintained.⁶³

Swiss company law does not provide for specific legal regulations on proxy fights. A shareholder has no right to see the share register of the company; therefore, contact with other, in particular smaller, shareholders is 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 Takeover defences

In takeover situations, Swiss company and stock exchange laws disempower the board of the target company (target board) to a certain extent. The target board is not allowed to

58 Article 27 of the Ordinance.

59 Article 12 II Paragraph 5 of the Ordinance.

60 See Article 18 III Paragraph 3 of the Ordinance.

61 Article 2 Paragraph 4 of the Ordinance.

62 Article 18 III Paragraphs 1 and 2 of the Ordinance.

63 Of SMI companies, 95 per cent carried out a non-binding vote on compensation in 2014.

conclude any legal transactions that would significantly alter the assets or liabilities of the company without a resolution of the shareholders' meeting.⁶⁴ However, the target board might convene a shareholder's meeting to have contemplated defensive measures approved (e.g., share repurchase programmes). In such cases, the target board has to give advance notice to the takeover board regarding contemplated defensive measures. Subject to a resolution of the shareholders' meeting, the target board must not sell or purchase assets worth more than 10 per cent of the total assets. The most important duty in the context of takeover situations is that the law requires the target board to submit a report to the shareholders in which its position regarding the offer is explained and planned defence measures and conflicts of interest are disclosed.⁶⁵

'Poison pills' are not permitted under Swiss law; however, Swiss companies may include transfer restrictions that limit the voting rights an acquirer may obtain (i.e., percentage limit in the articles of association) or majority requirements for certain decisions by the shareholder's meeting (e.g., amendment of the articles of association), which have partially a similar effect; these defences have, however, proven only partially effective, as a bidder will usually make it a condition of its offer that a shareholders' meeting of the target abolishes these hurdles – and if the premium is high enough, the target's shareholders are likely to do so. The target board may also search for a white knight but has to grant an unfriendly bidder the same due diligence as it offers a potential white knight.

v Contact with shareholders

The parameters governing disclosure and reporting to the shareholders are set by Swiss company law, by the FMSA and its implementing regulations, and by self-regulation, namely by the SIX; annual and semi-annual reports, *ad hoc* publicity, disclosure of qualified participation of shareholders, etc. constitute further important 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, on 21 January 2013, guidelines for the exercise of participation rights by institutional investors were enacted.⁶⁶ Generally, investor protection and shareholders' advisory organisations have become more important in Switzerland. The Ordinance now contains an obligation for pension funds to exercise their votes in listed companies with respect to motions contained in the invitation to the shareholders' meeting concerning specific matters, such as, for example, the election of board members.⁶⁷ This rule is likely to lead to an increase in the influence and power of investor protection and shareholders' advisory 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 or to follow their recommendations. Furthermore, the Ordinance obliges companies to introduce indirect electronic proxy voting, which means that they need to ensure that powers

64 Article 132 II of the Financial Market Supervision Act (FMSA).

65 Article 132 I of the FMSA.

66 Available at http://swissinvestorscode.ch/wp-content/uploads/Richtlinien_16012013_e.pdf.

67 Article 22 of the Ordinance.

of attorney and instructions may also be given electronically while corporate proxies are currently prohibited. The independent proxy, who must meet the same independence criteria as the auditors, has to be elected on a yearly basis by the shareholders' meeting.⁶⁸

To improve contact with shareholders, the Preliminary Draft obligated listed companies to provide an electronic forum for its shareholders, where agenda items of an upcoming shareholders' meeting could be discussed in advance;⁶⁹ the Revised Draft no longer foresees this possibility.

VII OUTLOOK

As set out at the beginning of this chapter, Swiss company legislation is undergoing a major revision with the Revised Draft. Apart from those planned changes already mentioned, the revision pursues six principal goals:

- a* improving corporate governance;
- b* creating a more flexible capital structure;
- c* modernising the shareholders' meeting (e.g., by introducing electronic voting);
- d* implementing the Ordinance's provision into formal law and proposing related adjustments;
- e* improving coordination of company law with accounting provisions; and
- f* implementing several minor parliamentary initiatives (e.g., gender quotas).

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

- a* improving shareholder protection;
- b* improving control mechanisms; and
- c* facilitating better investment decisions by institutional and foreign investors.

Even though the debate on the new Swiss company legislation is extensive, the fundamental principles of Swiss company law will, in all likelihood, be upheld. The revision is, therefore, evolutionary rather than revolutionary in nature. In compensation matters it will, by and large, implement the Ordinance into ordinary law if the Revised Draft is not changed in parliament. Swiss listed companies will thus continue to have the task of following these rules, which are, in certain areas, stricter than the ones their international competitors face, while having to try to attract, reward and retain key talent.

68 See Article 8 et seq. of the Ordinance.

69 See Article 701g of the Preliminary Draft.

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