IMPORTANT DECISION ON THE EXPIRATION OF BOARD MEMBERS' TERM OF OFFICE

In another landmark decision regarding the expiration of directors' term of office, the Swiss Federal Supreme Court (FSC) held that the term of office of board members not only ends if no timely re-election occurs, but that resolutions taken by a shareholders' meeting convened by board members after the expiry of their term are null and void. However, the same rationale does not apply to the company's auditor.

With this recent decision the FSC further tightens its earlier jurisprudence and underscores the importance of timely and proper re-elections of board members to avoid organizational defects and potential disruptions to the company.

In our briefing, we look at the underlying facts of the case, the consequences of the court's decision and offer recommendations for situations where a deadline for re-election is missed.

BACKGROUND

The underlying facts of the consolidated case 4A_387/2023, 4A_429/2023, decided by the FSC on 2. May 2024, concern the validity of the re-election of a board member. C., the sole member of the board of directors (and one of three shareholders), convened a shareholders' meeting after her term of office had already lapsed. At the meeting, a majority of shareholders re-elected C. as a director. Another shareholder disagreed with such re-election and requested the appointment of an administrator due to the company's organizational defect of not having a validly elected board (see art. 731b para. 1 no. 1 of the Swiss Code of Obligations, CO).

The lower instance court, the Court of Appeal of the Canton of Zug, essentially reasoned that the resolutions of said shareholders' meeting were null and void, and, consequently, the company indeed suffers from an organizational defect. However, contrary to the claimant's request, it appointed C. to the board with sole signature and required her to convene a shareholders' meeting including elections as an agenda item. In addition, the Court of Appeal concluded that the same rationale does not apply to the company's auditor and, therefore, the auditor was still in office.

The FSC ultimately had to decide, among other things, whether the shareholders' meeting convened by C. as a *de facto* director could validly re-elect the board and, therewith, re-establish compliance with corporate law. It also addressed the effect of not re-electing the company's auditor.

MAIN REASONING OF THE COURT

The court confirmed its earlier jurisprudence, according to which the directors' terms of office do not extend if the shareholders fail to timely vote on their respective re-election. In addition, it now clarified, against the view of certain scholars, that a *de facto*

director – in this case a director continuing to act on behalf of the company without being re-elected within the six-months deadline – cannot validly convene shareholders' meetings.

As a direct consequence of the above, the court further concluded that any decisions taken by shareholders' meetings convened by such *de facto* board members are null and void (*nichtig*), at least in cases in which the opposing shareholder objects to the convening of the shareholders' meeting.

Finally, the court also clarified that the same legal reasoning does not apply to the re-election of the company's auditor. It followed the wording of art. 730a para. 1 CO, according to which the auditor's term ends on the adoption of the annual accounts. I.e., auditors remain in office until the shareholders' meeting resolves to approve the annual accounts, regardless of how much time has passed.

CONSEQUENCES OF THE DECISION

Already in 2021, the FSC had decided that directors do not remain in office beyond the six-month deadline provided by art. 699 para. 2 CO if they are not timely re-elected (148 III 69) (i.e., for companies with one-year terms and the calendar year as their financial year, beyond 30 June). While the consequences of such reasoning were not discussed in detail as part of BGE 148 III 69, it has now clarified that such resolutions and actions taken by the board on behalf of the company – *in casu* the convening of a shareholders' meeting to remedy the organizational defect – cease to be valid.

This new decision makes it a lot more difficult for companies to independently remedy such an organizational defect rooted in the lack of a timely re-election of its board members. One remaining option expressly mentioned by the FSC – in practice only suitable for companies with a sole shareholder or a manageable number of shareholders that are on good terms with each other – is the holding of a universal meeting in accordance with art. 701 CO. Such a universal meeting, which requires the presence of the entire shareholder base, can be held without complying with the applicable regulations on convening shareholders' meetings and, accordingly, is not dependent on a functional and duly authorized board of directors to convene the meeting.

Another option in case the six-month deadline has been missed, which was not mentioned by the FSC, would be to reach out to the company's auditor (if there is an elected auditor in the first place). As described, the auditor remains in office regardless of whether an ordinary general meeting is held in due time. In addition, the company's auditor is competent to convene a shareholders' meeting "where necessary" (art. 699 para. 1 CO). Thus, reaching out to the company's auditor and relying on its competence to convene a shareholders' meeting might, if for any reason no universal meeting can be held, be the most straightforward solution for a defunct board.

The last resort, which sometimes may be the only option in the case of an opting-out from audit requirements, is to request that the competent court convenes the shareholders' meeting.

Generally, the consequences of such decisions should not be underestimated, in particular for companies with a large number of shareholders (or a disunited shareholder base) that impedes the possibility of universal meetings. While many privately held companies tend to miss the deadline for their annual general meetings, the risk has increased that such noncompliance leads to far-reaching consequences. Also, members of boards of directors who have not been re-elected in a timely manner should be aware that they are in fact no longer authorized to act as directors and should, therefore, take appropriate measures to protect themselves from personal liability. This may also affect counterparties that contract with such a company, although as long as they act in good faith and have no reason to raise doubts in this regard, they should still be able to rely on the functions and signatory powers registered in the commercial register.

KEY RECOMMENDATIONS GOING FORWARD

Our recommendations in situations involving missed deadlines for re-elections would be:

- **Early planning**: To ensure strict compliance with the statutory six-months deadline, preparations in view of the ordinary shareholders' meeting should start early and also account for certain delays, e.g., in connection with the finalization of the annual accounts and the preparation of the audit report.

- **Change in articles of association regarding longer tenures**: A precautionary measure for private companies could consist of implementing multi-year terms of office. While one-year terms of office are mandatory for listed companies, private companies can decide to implement tenures of up to six years (with the legal default rule being three years). Within these limits, more flexible terms of office in the articles of association should also be admissible in our view (although the FSC has not assessed this question so far), e.g., stating that the term of office is three calendar years, unless a general meeting putting elections on the agenda is actually held earlier.

- **Separation of re-elections**: In case it becomes apparent that the ordinary shareholders' meeting cannot be held within the six-month deadline, the board should consider convening an extraordinary shareholders' meeting for the purpose of re-electing the board in a timely manner.

- **Universal meeting**: In case the six-month deadline has been missed, re-electing the board in a universal meeting with all shareholders of the company present remedies the operational defect.

- **Involvement of the auditor**: If necessary, the company's auditor can convene a shareholders' meeting. If a universal meeting is not possible, reaching out to the auditor would also be an option.

- **Application to the court**: As a last resort, shareholders can reach out to the competent court and request that appropriate measures to remedy the organizational defect

be taken, although this is typically the least desirable option both in terms of time and costs.

- **Due diligence in M&A**: In the context of M&A transactions, in particular in circumstances with a fragmented shareholder base, special consideration should be given to the question of whether re-elections have occurred in a timely manner. Given that re-elections resolved by a shareholders' meeting that was convened by a *de facto* director are null and void, there is a material risk that future actions of such board members are also void. Accordingly, respective representations or indemnities should be agreed, and, in case of uncertainty, the holding of a confirmatory universal meeting should be requested.

- **Increased risk awareness**: Board members should be (made) aware that any actions taken on behalf of the board may be considered null and void if taken after the lapse of the six-month deadline. This substantially increases the risk of directors' personal liability.

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