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CORPORATE FINANCE/M&A - SWITZERLAND

Reducing share capital: current law and expected changes

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AUTHORS

Alexander Vogel

Remo Müller

Introduction
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Introduction

On 16 June 2020 the legislature passed draft modifications of Swiss corporate law, which would amend, among other things, substantial parts of the Code of Obligations. This marked the end of what is generally known as the 'large corporate law reform' which officially started in 2007. Since then, numerous parts of the reform project have been buried, changed, introduced to or removed from the main part of the project to be dealt with separately.

As part of the 'final' modifications dated 16 June 2020, the provisions concerning the reduction of the share capital of Swiss corporations will be amended. The new law's entry into force has yet to be scheduled but, together with most of the new provisions, it is expected to come into force in 2022. On entry into force, the new provisions will become applicable to existing corporations. Within two years of the law coming into force, corporations' articles of association and regulations must be adapted to the new law. Two years after the law comes into force, provisions in corporations' articles of association or regulations that are not compliant with the new law will be deemed to have lapsed.

Reducing share capital of Swiss corporations

Nominal share capital

A corporation's nominal share capital, which is recorded in its articles of association and the commercial register – and is thus visible to third parties – as well as in the balance sheet (as part of the equity on the liabilities side), represents a blocking number intended to ensure that the funds made available by the shareholders of a Swiss corporation as a risk-capital buffer to cover any liability are not returned to the shareholders without appropriate publicity (capital protection principle) and in violation of the principle of prohibition on capital repayment. However, the share capital is not actually blocked in factual terms (eg, book money in an account or items in a room), but is a figure for calculation purposes only. Historically, and as of today, the legislature has made significant efforts to protect nominal share capital.

When reducing a corporation's nominal share capital, a formal procedure must be observed, intended to ensure that the interests of the corporation's creditors are safeguarded. Correspondingly, capital reduction procedures are of a formalistic nature, although in certain cases simplifications do apply. A resolution of the shareholders' meeting is always required, as well as the involvement of the board of directors and a notary public. An auditor's report often need be obtained, confirming in advance that all claims of creditors will be fully covered after the capital reduction has been carried out. As a general rule, a publication in the *Official Gazette of Commerce* must be made, advising creditors to make their claims against the corporation and, if necessary, request that they be secured.

Currently, this public notice to creditors must be made three times; under the new law, one time will suffice. A capital reduction must often be filed for entry in the Swiss commercial register; under the new law, this must be done within six months of the resolution of the shareholders' meeting on the capital reduction – otherwise, such resolution will be deemed to have lapsed. In principle, only the reduction of the nominal share capital is subject to this special protection. Accordingly, a repayment of paid-in reserves (share premium) does not qualify for a capital reduction in the aforementioned sense. The share premium is not part of the specially protected nominal share capital and is not explicitly shown in the commercial register. Therefore, if they are aware (eg, by inspecting the documents deposited with the commercial register office) of the payment of a share premium, third parties cannot have a protectable expectation or interest that any share premium will not be distributed to the shareholders at a later date (see below).

Demergers and mergers
If a capital reduction takes place in connection with a demerger or merger under the Merger Act, special provisions must be observed.

Capital reductions
The principle of (relative) equal treatment of shareholders also applies to capital reductions (ie, individual shareholders may not be deprived of their rights as shareholders by a selective capital reduction (or a capital reduction that is not justified for objective reasons) – namely, not in the context of a capital reduction to Sfr0 with a subsequent increase. If a capital reduction is to take place by cancelling treasury shares previously acquired by the corporation itself, the principle of equal treatment must already be observed at the time of the acquisition of the shares (eg, share purchase agreement).

The capital reduction is effected either by a cancellation of shares (ie, a reduction in the number of shares issued) or by a reduction of the nominal value of shares. In the first case, the consent of the shareholders concerned must be obtained for the capital reduction to be valid, unless the shares to be cancelled have previously been acquired by the company and thus qualify as treasury shares.

A capital reduction can be combined with one or more capital increases. In this case, the nominal share capital is reduced and simultaneously increased again either to the previous amount or to a higher or lower amount. Currently, these combinations are specifically regulated only in the Commercial Register Ordinance, whereas in future they will also be explicitly provided for in the Code of Obligations. In addition to the capital reduction, the capital increase and the aforementioned combinations, the new law introduces a new institution, the so-called 'capital band'. The capital band will allow a company's board of directors to increase and/or decrease the nominal share capital within a certain range provided for in the articles of association. Thus, it will (among other things) introduce the possibility to conduct an authorised capital reduction which does not exist under current law.

A corporation's nominal share capital may be reduced below Sfr100,000 only if there is a simultaneous reincrease to at least Sfr100,000.

The Code of Obligations distinguishes between constitutive and declaratory capital reductions. In the latter case, a loss amount is eliminated (restructuring) by adjusting the articles of association and the commercial register entry to reflect what is already considered to be a reality (ie, a formal correction of the nominal share capital, which has already been reduced by losses, to the lower amount of equity actually still available; thus, there is no actual outflow of funds with this type of capital reduction).

In principle, this declaratory capital reduction is permissible only for as long as the corporation is not 'overindebted' (ie, has suffered such high losses that its balance sheet shows a surplus of liabilities instead of an asset surplus (in other words, if the sum of its liabilities exceeds the sum of its assets)). However, even in this case, a declaratory capital reduction is permissible, provided that there are sufficient subordinated claims by creditors to allow the board of directors to refrain from notifying the court in order to initiate bankruptcy proceedings. In the case of a constitutive capital reduction, on the other hand, the funds released by the capital reduction and thus the reduction of the blocking number are regularly returned to the shareholders (cash outflow) or, in exceptional cases, used to create free reserves (or, in the special case of a capital reduction, to cancel treasury shares where the cash outflow precedes the capital reduction). A constitutive and a declaratory capital reduction can be combined, whereby the (stricter) procedural norms of the constitutive capital reduction must be observed.

In practice, constitutive capital reductions with a maximum amount – instead of a fixed amount – are accepted, but not declaratory capital reductions. The new law expressly sets out this option. Further, it will clarify that the notice to creditors and the procedure to secure or satisfy creditor claims can also be carried out after the shareholders' meeting has passed a resolution on the capital reduction. Further, it will clarify that a corporation's obligation to provide security for creditors' claims will not apply if it satisfies such debt or proves that future satisfaction is not jeopardised by the capital reduction, which is presumed if a respective audit report is available confirming such assessment. Moreover, creditors will have to request security for their claims within 30 days from the date of publication of the notice to creditors, as opposed to within the current two-month period. Further, creditors will have to request security for their claims only to the extent of the reduction of the previous coverage by the capital reduction; the current general obligation to secure or satisfy in entirety any creditor which files a request will no longer apply.

Under the new law, a capital reduction must be based on an (interim) balance sheet that is no older than six months when the shareholders' meeting resolves to reduce the nominal share capital.

Audit reports
Boards of directors often must obtain an audit report from a licensed audit expert. Such a report is also necessary where a corporation has no statutory auditors. In the case of a constitutive capital reduction, the auditor must confirm that the claims of the creditors of the corporation are fully covered despite the reduction in capital. The new law will clarify that the audit report can also be obtained only after the shareholders' meeting has passed a resolution on the capital reduction. Moreover, in the future, it must refer to the annual financial statements or interim financial statements that are no more than six months old and the result of the public notice procedure. In the case of the declarative capital reduction, the auditor must confirm that the claims of the creditors of the corporation are fully covered despite the reduction of the share capital and that the share capital reduction amount does not exceed the amount of the accumulated (net) losses. Under the new law, only the latter needs to be confirmed.

Articles of association
Currently, it is the shareholders' meeting that resolves to amend the articles of association, whereas in future it will be the board of directors. The board of directors will have to do so as part of its confirmation of compliance with the capital reduction regulations, which require certification by a notary public (under current law, notary publics regularly certify their own findings in this regard).

Declaratory capital reductions
The procedure for a declaratory capital reduction is simpler than the procedure for a constitutive capital reduction. The main difference is the elimination of the public notice to creditors and of the obligation to secure or satisfy creditor claims, provided that the capital reduction (in terms of amount) is carried out at the maximum in the amount to eliminate the accumulated (net) losses, which must be expressly confirmed by the audit report. Consequently, no public deed on the confirmation of full compliance with the capital reduction regulations is required. In addition, the future obligation to prepare an interim balance sheet will not apply in this case.

For further information on this topic please contact Alexander Vogel or Remo Müller at Meyerlustenberger Lachenal by telephone (+41 44 396 91 91) or email (alexander.vogel@mll-legal.com or remo.mueller@mll-legal.com). The Meyerlustenberger Lachenal website can be accessed at www.mll-legal.com.

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