December 2014

CORPORATE BRIEFING

Amendment of the Swiss Stock Corporation Law – Preliminary Draft / Consultation

1. Introduction / Background

On Friday 28 November 2014, the Swiss Federal Council presented the preliminary draft for a comprehensive reform of the stock corporation law ("Draft" or "dCO"). The Draft resumes the general reform that had been initiated with the aim of modernising Swiss stock corporation law but was interrupted in 2009, and completes it with topics that have become relevant in the last years. Additionally, it seeks to introduce comprehensive "say on pay" legislation for stock exchange listed companies that shall replace the initial, preliminary provisions that had been introduced, following the famous popular vote of 2013, in January 2014 by way of the Ordinance on Excessive Compensation in Listed Stock Corporations ("OAEC"). The Draft also contemplates the introduction of gender quota for the board of directors and management of listed companies, and increased transparency for large and listed stock corporations in the commodities sector. The Federal Council opened the consultation on the Draft, which will last until 15 March 2015.

2. Main contents of the Preliminary Draft

2.1. New Rules regarding Share Capital and Dividend Entitlements, Reserves

The Draft introduces a number of new provisions designed to increase corporate flexibility. The Draft introduces the possibility to have a share capital in a foreign currency, provided that it is the main currency of the company's business activities (art. 621 dCO). Under the new accounting regulations (art. 957a and 958d CO) entered into force on 1 January 2013, it is already possible to use such functional currency.

The nominal value of a share may be below one cent (which is the current minimal value), but must be higher than zero, and the share capital must be fully paid-up (art. 622 and 632 dCO).

Acquisitions in kind *(Sachübernahmen)* shall no longer be treated as qualified capital contributions. Acquisitions in kind will, thus, be substantially simplified since no statutory report of the board, no publicity in the articles of association or the commercial register and no audit confirmation would be necessary anymore.

A new concept of a share capital band *(Kapitalband)* is introduced by the Draft (art. 653s dCO). Such novel concept provides a flexible instrument for the Board of Directors ("BoD") to increase or decrease the share capital within the range of a maximum and a minimum band, for a period of up to five years. Thereby, the current institution of the authorized capital increase (art. 651, 651a CO) would be abolished. In addition, the call on creditors and the auditor's report for a share capital decrease may become redundant as well. Companies that implement such concept will at least need to have their annual accounts reviewed by an auditor in a limited audit.

The articles of association may implement a dividend system which incentivates active shareholders participation with up to 20% higher dividend entitlements (art. 661 dCO).

The Draft further introduces new rules regarding reserves and interim dividend payments (art. 671ff. dCO).

2.2. New System for Dispo Shares (Dispoaktien) and use of electronic means

The Draft proposes a possible solution to the conflicts that might arise with a large percentage of dispo shares *(Dispoaktien)* in as much as the voting rights of minority shareholders do have increased influence in the general meeting compared to the total issued share capital. Dispo shares are those registered shares of a listed company that are acquired over the stock exchange through an intermediary where the acquirer does not request entry in the shareholders register and therefore does not have the ability to exercise voting rights. The Draft introduces a new model, whereby the intermediary shall be entered in the shareholders register as a nominee with voting powers. The intermediary shall exercise the voting rights based on the individual or general instructions of the owner of the shares. The intermediary can invoice the costs for complying with such nominee-model to the company. As a consequence such costs would indirectly be borne by all shareholders. In addition, art. 11 of the OAEC prohibits the governing officer and the custodian as representative *(Organ- und Depotstimmrechtsvertretung).*

The Draft provides new provisions regarding the use of electronic means in connection with shareholders meetings and requires companies listed on a stock exchange to implement an electronic forum for the discussions purposes among shareholders (art. 701g dCO).

2.3. New Rules regarding Implementation of Ordinance against Excessive Compensation in listed Stock Companies

By way of the Draft, the provisions of the OAEC, which entered into force on 1 January 2014 shall be replaced by proper statutory law and be incorporated in the appropriate federal acts (namely the CO, the Federal Law on Occupational Retirement, Surviving Dependents and Disability and the Swiss Penal Code).

The Draft provides for clarification of certain points in the area of "say on pay" for listed companies that had been left open by the OAEC:

Firstly, criminal prosecution in case of infringement of certain "say on pay" provisions shall apply ex officio *(Offizialdelikt),* and not merely upon demand *(Antragsdelikt)* (proposed art. 154 of the Swiss Penal Code).

Secondly, signup bonuses *(Antrittsprämien)* for members of the BoD and management would only be permissible if they compensate an actual, clearly verifiable financial disadvantage (art. 735c dCO). Otherwise, such compensation would be illegal.

Thirdly, the Draft sets out a number of limitations to competition bans / non-compete obligations, which limitations have to be viewed within the context of the illegality of severance payments under the OAEC and "say on pay" provisions. Under the OAEC, severance payments which are agreed by contract or foreseen in the articles of association qualify as inadmissible compensation and are subject to the OAEC's penal provisions. Many listed companies have so far included in their articles of association a non-competition clause (often with a duration of more than one year), combined with the possibility to pay a compensation for such non-competition *(Karenzentschädigung).* Whilst the conclusion of a non-competition clause is in principle permitted by the CO (art. 340 CO), criticism had been voiced that non-competition clauses of excessive duration could have the character of hidden, and therefore illegal, severance payment. By setting a maximum duration of one year to non-compete obligations, the Draft provides for clarification in this respect: (i) compensation not being at arm's length and based on a non-competition ban, or a compensation based on a competition ban which commercially is not justified, shall qualify as inadmissible and therefore be prohibited; and (ii) non-compete obligations shall not exceed a duration of 12 months.

Compared to the OAEC, the Draft proposes to tighten the scope of a prospective shareholders' vote on "say on pay". Whilst the OAEC permits to conduct a retrospective or prospective vote over fixed and variable compensation, the Draft would only permit a retrospective vote on variable compensation. Hence, a prospective vote would only be permissible for the fixed compensation (art. 735 dCO).

As a true novelty the Draft proposes a benchmark for a balanced gender representation in the BoD and the management of large companies (being companies which exceed two of the following thresholds in two successive financial years: balance sheet total of CHF 20 million, turnover CHF 40 million, 250 fulltime positions on annual average). According to art. 734e dCO, there should be at least a 30% representation of both genders in the board of directors and the management. If this threshold is not reached, the compensation report has to state the reasons for the shortfall and describe the measures to promote the representation of the less represented gender.

2.4. Corporate Governance

The Draft proposes a further strengthening of shareholders' rights of both listed and private companies by reducing the thresholds of shareholding for a request of special investigation (art. 697e dCO), a convocation of a general meeting (art. 699 dCO), the placement of an item on the agenda of the general meeting (art. 699a dCO), the right to make requests during a general meeting (art. 699a dCO), the right to request the dissolution of the company through lawsuit (art. 736 dCO) and requesting an lawsuit at the company's expense (art. 697f dCO). In addition, the existing lawsuit regarding the return of benefits (art. 678 dCO) shall be strengthened as well.

For non-listed companies, the Draft also proposes to require the BoD to disclose information regarding compensation to the members of the BoD and the management at the general meeting (art. 697 dCO).

Furthermore the Draft proposes an extension of the statute of limitation period for filing claims of shareholders in case the company suffered damage. Such period shall be extended from 6 to 12 months (art. 758 dCO). On the other hand the judge may decide to allocate or divide the procedural costs between the claimants and the company (art. 107 dCPC) in order to mitigate the risk of high costs for the claimant, usually a shareholder.

The Draft provides for the possibility of holding "cyber-general meetings", i.e. shareholders meetings without a physical venue. Whilst the first draft reform of the stock corporation law of 2007 still excluded the applicability of such cyber meetings for resolutions to be publicly notarized, the Draft would allow a cyber-meeting also for such resolutions (art. 701d dCO). In case of technical problems occurring on the side of the company, the BoD would in any event have to repeat the vote, without the possibility to provide evidence that the technical problems did not have an influence on the result of the respective vote (art. 701f dCO)

2.5. Restructuring

The proposed articles regarding restructuring and measures focus on the company to take restructuring measures at an earlier stage and to encourage the BoD to make use of the new restructuring measures.

Where there is good cause for impending insolvency of the company, a current liquidity plan including an assessment of the economic situation must be drawn up by the BoD by partial inclusion of the auditors and the shareholders' meeting, so that the solvency of the company is ensured at all times (art. 725 dCO).

Furthermore and if certain conditions are met, the court notification shall be omitted during a tolerance period of 90 days, in case of good prospects that recovery of solvency will gain (art. 725b dCO).

2.6. Transparency of Commodities Sector

The Draft proposes improvement of transparency in the Swiss commodities sectors. The proposed provisions follow the requirements of the (corresponding) EU and US rules. Further the new articles agree with the requirements and recommendations of the Commercial Accounting Rules.

Listed companies and companies engaged in the raw-material mining sector (logging, timber, and mining of metals and minerals) must prepare and publish a written report regarding payments (minimum amount of CHF 120'000) made to public authorities during a company's business year. The Federal Council may extend these obligations (art. 964a et seq. dCO) to other companies in the Swiss commodities sectors.

3. Next Steps / Outlook

The consultation period on the Draft ends on 15 March 2015. It is expected that the Federal Council will elaborate the results of the consultation period until the end of 2015 and publish its message to Parliament around the end of 2016 / first half of 2017. Taking into account the length and complexity of the Swiss legislative process, it will then take several years before an amended Swiss stock corporation law will come into force.

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