The Corporate Governance Review

Third Edition

Editor
Willem J L Calkoen

Law Business Research

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THE LAW REVIEWS

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THE PRIVATE COMPETITION ENFORCEMENT REVIEW

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EDITOR'S PREFACE

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

In this third edition, we can see that corporate governance is becoming a more prominent topic with each year. We see that everyone wants to be involved in 'better corporate governance': parliaments, governments, the European Commission, the SEC, the OECD, the UN (as demonstrated in its 'protect, respect and remedy' framework), the media, supervising national banks, shareholder activists and other stakeholders. The business world is getting more complex and overregulated, and there are more black swans, while good strategies can become quite quickly outdated. Most directors are working diligently; nevertheless, there have been failures in some sectors and this means that trust has to be regained. How can directors carry out their increasingly complex work and communicate with all the parties mentioned above?

What should executive directors know? What should outside directors know? What systems should they set up for better enterprise risk management? How can chairs create a balance against imperious CEOs? Can lead or senior directors create sufficient balance? Should outside directors understand the business? How much time should they spend on the function? How independent must they be? Should their pay be lower? What about diversity?

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 practices set aspirational standards.

More international investors, voting advisory associations and shareholder activists want to be involved in dialogue with boards about strategy, succession and income. Indeed, wise boards have 'selected engagements' with stewardship shareholders in order to create trust. What more can they do to show stakeholders that they are improving the enterprises other than by setting a better 'tone from the top'. Should they put big signs on the 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 codes along the model of the Cadbury 'comply-or-explain' method. This has generally led to more transparency, accountability, fairness and responsibility. However, there have been instances where CEOs have gradually amassed too much power, or companies have not developed new strategies and have fallen into bad results – and sometimes even failure. More are failing in the financial crisis than in other times, hence the increased outside interest in legislation, further supervision and new corporate governance codes for boards, and stewardship codes for shareholders and shareholder activists.

This all implies that executive and non-executive directors should work harder and increasingly as a team on strategy and innovation. It is still a fact that more money is lost due to lax directorship than to mistakes. On the other hand, corporate risk management is an essential part of directors' responsibilities, and sets the tone from the top.

Each country has its own measures; however, the various chapters of this book show a convergence. The concept underlying this book is to achieve a one-volume text containing a series of reasonably short, but sufficiently detailed, jurisdictional overviews that will permit convenient comparisons, where a quick 'first look' at key issues is 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, and I hope that this book will give the reader food for thought; you always learn about your own law by reading about the laws 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
April 2013

Chapter 25

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 with its manifold revisions contained in Articles 620ss. of the Swiss Code of Obligations ('the 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 last decade, in 2000/2001, *inter alia*, as a consequence of the Swissair bankruptcy.

One of its consequences was the issuance of the Swiss Code of Best Practice for Corporate Governance ('the SCBP') by Economiesuisse,[2] first enacted in 2002 and revised in 2007.[3] It contains a range of guidelines and recommendations for boards of directors of listed companies ('board' or 'boards') on how to organise boards. Notwithstanding its rather far-reaching impact, it is not mandatory and represents a code of best practices, leaving leeway for specific adaptations and modifications by individual companies. On 1 July 2002, the Corporate Governance Directive issued by SIX Swiss Exchange Ltd ('the DCG') entered into force; it was revised in 2008.[4] As stated in its introduction, 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

1 Rolf Watter is a partner and Katja Roth Pellanda is an associate at Bär & Karrer AG.

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

3 Available at www.ethosfund.ch/pdf/Code_Swiss_CG_20080221_en.pdf.

4 Available at www.six-exchange-regulation.com/admission_manual/06_15-DCG_de.pdf. See also the commentary of the DCG available at www.six-exchange-regulation.com/download/admission/regulation/guidelines/swx_guideline_20070820-1_comm_en.pdf.

Exchange Ltd ('SIX') and is largely based on the principle of 'comply or explain'. The enforcement of the DCG is the responsibility of SIX.

A rather fundamental revision of the company law and accounting provisions of the CO is currently under review by the legislator. One of its main goals is to further strengthen corporate governance rules, in particular relating to shareholders' rights and board and management compensation. While part of this revision (i.e., the accounting provisions) entered into force on 1 January 2013, the governance provisions are still being strenuously debated. The revision is under significant pressure from a far-reaching popular initiative for constitutional reform in the area of compensation, which is colloquially called the 'Minder initiative against fat-cat salaries'. The 'Minder initiative' requires, *inter alia*, the mandatory and binding approval for board and executive compensation of Swiss listed companies by its shareholders, as well as a ban on severance payments (e.g., golden handshakes and parachutes).[5] The compensation issue has become a 'moving target' in the reform as a whole and been subject to a long-winded series of proposals and counterproposals in parliament and by special interest groups. On 3 March 2013, a popular vote on the Minder initiative will be held; even if it fails, an indirect counterproposal put forward by the Swiss parliament will enter into force, which would compel companies to hold votes on executive pay, although the results will not necessarily be binding. However, other parts of the revision of the company law provisions are still being discussed, and it might take some years before they become law.

II CORPORATE LEADERSHIP

According to the CO, the board is the executive body of a company limited by shares (i.e., one-tier board system as default rule). The board is therefore responsible for the management of the company and represents the company in relation to third parties. The board may carry out any legal acts consistent with the company's purpose clause[6] and may pass resolutions on all matters not reserved to the general meeting of shareholders ('shareholders' meeting') by law or by the articles of association.[7] The relationship between the shareholders' meeting and the board is rather a relationship of parity than of hierarchy; both parties have distinct responsibilities and competences by law .

However, this legal default concept of the board 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 rather 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 and competences to management.[8] Depending on the size and

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

6 Article 718a of the CO.

7 Article 716 of the CO.

8 Article 716b of the CO.

the needs of the company, the board may therefore assume the entire responsibility for the management (this system is adopted predominantly by smaller non-listed companies) or it may delegate the transferable responsibilities and competences to one or several board members or a management, subject to an authorisation by the shareholders in the articles of association and the establishment of organisational regulations by the board. However, certain responsibilities cannot be transferred and represent inalienable duties of the full board. Thus, it is possible to create a two-tier structure, which is what listed companies typically do and which 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.[9] In reality, most companies have several board members. In case of 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.[10]

The board is responsible for the representation of the company towards third parties. Unless the articles of association or the organisational regulations stipulate otherwise, each member of the board has the authority to represent the company without the necessity of respective board decisions.[11] It is, however, common practice, at least in medium-sized to large companies, that only joint signatory power of any two is granted. The board may also delegate the authority of representation to one or more members of management or to other parties. At least one member of the board 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.

The law provides the following catalogue of non-transferable and inalienable duties[12] that cannot be delegated to management (but for which management often does the preparation work):

a determination of the ultimate direction (strategy) and the appropriate means to pursue 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);

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 persons entrusted with management and the representation (whereas the appointment of the top executive management must remain with the board, the appointment of the lower hierarchical levels may be delegated) as well as the decision on the principles of remuneration;

9 Article 707 I of the CO.

10 Article 709 I of the CO.

11 Article 718 of the CO.

12 Article 716a of the CO.

e ultimate 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 the 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 for listed companies, inter alia, the disclosure of board and senior management remuneration) and a narrative business report;

g preparation of the shareholder meeting (which has to be held within six months after the end of each business year) and the implementation of its resolutions; and

h notification of the court in the event that the company is over indebted.

The position of the chair of the board is not provided for in detail by Swiss company law and not many duties are explicitly assigned to this role. The chair is customarily appointed by the board members; however, the articles of association may also provide for a direct appointment by the shareholders' meeting.[13] In reality, the chair's function is key to the proper functioning of the entire board and to an adequate working relationship between the board and the management. The chair, *inter alia*, (1) keeps direct contact with 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 question of combining the roles of the chair and the CEO in the same person has been subject of significant debate in Switzerland. Although not explicitly excluded by the SCBP, the majority opinion nowadays, voiced in particular by professional shareholders' organisations, is that such a concentration of power does not represent best practice. However, even in large multinational companies a certain tradition of such combined roles exists, which was in general justified by efficient communication channels, faster decision time and a uniformity of 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 role of the chair and of the CEO should be combined in one single individual, the SCBP recommends, for adequate control mechanisms, to appoint an experienced non-executive member as independent lead director. One of the roles of an independent lead director is to convene and chair meetings of the board 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.[14] The (corporate) principle of equal treatment of shareholders does not require the board to an identical treatment of all shareholders; it must, however, make sure that shareholders be equally treated in comparable circumstances. This principle is of particular significance in relation to the communication with and information provided to shareholders. It is more

13 Article 712 I of the CO.

14 Article 717 of the CO.

vigorously applied in listed companies because of capital markets and stock exchange regulations, 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 mitigated by confidentiality undertakings and contractual agreements not to trade on information received.

In cases of several board members the organisation of the board requires the nomination of a chair and of a secretary who does not have to be a board member.[15] 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, et cetera. Furthermore, Article 716a II of the CO provides for the possibility of assigning responsibility for preparing and implementing the 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. The SCPB recommends the creation of an audit committee, a compensation committee 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 case of going private or takeover situations), or other *ad hoc* committees may be constituted when needed for an efficient functioning.

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 conclude any legal transactions that would significantly alter the assets or liabilities of the company without a resolution of the shareholders' meeting.[16] Moreover, 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 conclude agreements with either board members or senior management regarding payments upon termination of their employment relationship ('golden parachutes') or sell or purchase assets being worth more than 10 per cent of total assets. The most important duty in this context, however, is that the law requires the target board to submit a report to the shareholders in which its position regarding the offer has to be explained, including planned defence measures and conflicts of interest.

ii Directors

No formal requirements have to be met for being nominated to a board; different rules apply to banks and insurance companies. Swiss company law requires neither special

15 Article 712 of the CO.

16 Article 29 II of the Federal Act on Stock Exchanges and Securities Trading ('SESTA').

knowledge nor qualifications (e.g., in financial or accounting matters). The same applies in principle to the independence of board members. 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 to the extent possible. Therefore, boards and shareholders are well advised to only propose, and respectively nominate, members to the board 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. The articles of association may contain certain qualifications and conditions, such as an age limit; no age limits are provided by law but many articles of association provide for them (typically around 70 years of age). 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 right is the right of the shareholders' meeting to remove a board member at any time.

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 of formal board meetings (e.g., direct contacts with senior or lower management, onsite visits of subsidiaries, etc.) very much depends on the rules set by the board and the chair.

The board members, as well as all persons engaged in the senior management of the company, may be held liable for any losses or damages arising from wilful or negligent violation of their duties. Such accountability not only applies to formally appointed persons but also to any *de facto* director (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.[17] Liability presupposes: (1) damages 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. As a matter of principle, 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. 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 between the board members. Very often in potential liability situations, 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

17 Article 754ss. of the CO.

board member exonerates himself or herself with respect to fault. If the board lawfully delegated part or all of the management duties, the liability of the board is limited to the required care in selecting, instructing and supervising the senior managers. Moreover, if the shareholders' meeting took the decision to discharge the board members and senior management, they 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.

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. Actions by a company itself against current or former board members nowadays happen more often, but are still rare; however, a board should, when making its decision whether to file a claim, 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 folllwing:

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 management might become risk-averse;

e such proceedings potentially lasting several years (c.f., 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 availablity of directors and officers' insurance.

The board should consider the middle to long-term interests of the company to be paramount in any decision and not the public perception of a civil liability as a punishment for misconduct, but successful liability claims against boards are still the exception rather than the rule. Most claims still end with out-of-court settlements, typically financed by D&O insurance; basically, all larger companies buy coverage for potential liability claims. However, as a consequence of large corporate failures or crisis situations in the past 10 years (Swissair Ltd, UBS Ltd, etc.), awareness of the issue has sharply increased.

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 respective board member must inform the chair who, in turn, shall request a decision by the full board (without participation of the individual concerned). Most scholars and the SCBP recommend that the conflicted individual should 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., that votes with and without the conflicted individual take place, with a decision requiring in principle two positive votes. This avoids conflicted individuals withholding information and escaping liability. Other possible measures to address conflicts are a 'dealing at arm's length' and third-party fairness opinions. Moreover, in specific situations (such as a takeover or going private transaction) it can 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 of interest. The independent board committee represents the board in all matters relevant to the transaction and prepares the decision-making by the board, while a separate decision by the independent board committee is recommended as well. The goal of the board in conflict-of-interest situations is to avoid (apart from reputation risk) liability claims. Agreements between the company and a board member or a member of the 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 recommendable to provide for a special approval by the non-conflicted board members or, potentially, by a shareholders' meeting. The current revision of company legislation provides for a new provision dealing with conflicts of interests of board members and senior management,[18] which essentially turns the recommendations of the SCBP into law.

III DISCLOSURE

For each financial year, the board must prepare an annual report consisting of financial statements (consolidated if required) and a narrative business report (Articles 957ss. of the CO). A new law on accounting rules entered into force on 1 January 2013, whose changes will apply as of the financial year commencing two or three years (for consolidated accounts of groups) after the entry into force (i.e., 2015 and 2016). According to the new rules, the accounting standards no longer depend upon 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 a statement of income and expenditure on a cash basis and a statement of assets and liabilities. Specific accounting and valuation rules apply to legal entities with an annual turnover above 500,000 Swiss francs; however, even the new provisions generally do not assure a fair view of the company's financial position, as the board can still create (and within limits dissolve) hidden reserves. Listed companies, large 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 from the board members and major shareholders, and may not engage in activities for the company outside of the audit work that would endanger its 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 specialists carrying sufficient qualifications.

18 Draft Article 717a of the CO.

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 the remuneration of the board and senior management; 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 crossing certain thresholds (3, 5, 10, 15, 20, 25, 33 1/3, 50 or 66 2/3 per cent of voting rights) complement the rather comprehensive framework of disclosure requirements.

IV CORPORATE RESPONSIBILITY

An effective and efficient risk management is required by 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 company; risk management should cover to 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 notes to the annual accounts, it must be confirmed that such risk assessment has taken place. Swiss company law does not require the establishment of a specific risk committee on 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 due to 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.[19]

Currently, there is no formal whistle-blowing legislation in force, and there is still a certain resistance in many Swiss companies to stipulate respective rules. Larger multinational companies, however, normally have procedures promoting and protecting whistle-blowing. The legislator is currently discussing the necessity of a better protection of employees against wrongful termination by an employer if the employee discloses alleged dishonest or illegal activities in the company.

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 rather far-reaching 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

19 Article 716a I, Paragraph 5 of the CO.

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 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.

V 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 of 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 and from specific reserves formed for this purpose (both being generally referred to as 'free reserves'). 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. 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. Certain quorum requirements set by the law or provided for in the articles of association foresee a protection of 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; such 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; often, this threshold is lowered in larger companies in their articles of association. Shareholders have to be provided with the annual and the audit report; in addition, each shareholder may request specific information necessary for the exercise of his or her shareholder's rights at the shareholders' meeting. If such information is refused by the board, the shareholder may request a special audit ordered by the competent judge. However, this is a rather burdensome and difficult procedure.

A further protection element are 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. In the case of issuance of convertible or similar bonds, existing shareholders have a priority right to purchase these instruments, which, in the case of an important reason, may also be limited by a decision of the shareholders.

The allocation of competences 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, is one of the most contentious issues in the current reform of company law.

ii Shareholders' responsibilities and competences

Obligations on shareholders (other than to pay in full for the shares upon their issuance) are prohibited under Swiss company law. 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 20 of the SESTA.

Article 717 II of the CO provides for the obligation of the board to treat the shareholders equally in similar circumstances. Therefore, Swiss company law provides for relative rather than absolute equality, meaning large shareholders might 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, provide for a stricter understanding of a 'level playing field' that aims to ensure that price-sensitive information is disseminated on an equal basis. At times, confidentiality undertakings and contractual agreements not to trade based on information received may mitigate the complexity of this issue.

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 corporate bodies. 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;[20] 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.

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 staggered boards, although very often used, are not effective, because board members can be fired at any time by a shareholders' decision, 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 buybacks. 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. The aim of these guidelines is that the

20 Article 706 I of the CO.

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. Effective from 1 January 2007, a new Article 663b-bis of the CO came into force requiring transparency regarding the compensation of, *inter alia*, the board members and the senior management by disclosing the aggregate compensation amount to the board and to each individual member, the aggregate compensation amount to the senior management, and the highest amount paid to a member of the senior management, usually the CEO. Most companies today publish a compensation report as part of the annual report, often disclosing more information than legally required.

The Minder initiative, which has been submitted to a popular vote for 3 March 2013, requires, *inter alia*, that the shareholders have to annually vote in a binding manner on the aggregate compensation amount for the board and the senior management, thereby quite substantially changing the current structure of parity between the shareholders and the board. Many large companies – for example, Novartis Ltd – have introduced a consulting vote on the compensation system in the articles of association ('say on pay'), thereby providing shareholders an opportunity to express their non-binding view on the compensation system of the company.

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, contacts with other, in particular smaller, shareholders are 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 Contact with shareholders

The parameters governing disclosure and reporting to the shareholders are set by Swiss company law, by SESTA and its implementing regulations and self-regulation: annual, semi-annual and quarterly reports, *ad hoc* publicity, disclosure of qualified participation of shareholders, etc., constitute 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. Recently, investor protection and shareholders advisory organisations have become more important in Switzerland. The current revision of Swiss company law contemplates an obligation of pension funds to exercise their votes in listed companies; if adopted, this would undoubtedly lead to an increase in the influence and power of these 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.

VI OUTLOOK

The Swiss parliament is currently debating the draft of a rather comprehensive revision of Swiss company legislation. The current draft pursues three principal goals:

a the improvement of corporate governance;
b a more flexible capital structure; and
c modernising the shareholders' meeting (e.g., electronic voting).

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

a improvement of shareholder protection;
b improvement of control mechanisms; and
c facilitating better investment decisions of institutional and foreign investors.

Even though the current debate on the new Swiss company legislation is rather far-reaching, the fundamental principles of Swiss company law will be upheld. The revision is therefore rather evolutionary than revolutionary in nature, except in compensation matters. If the Minder initiative is approved in the popular vote on 3 March 2013, the Swiss parliament must adopt the respective implementing legislation, which will be subject to a facultative referendum. Generally, it is expected that it will take at least two years for the new legislation to enter into force. In the event that the Minder initiative is rejected, the indirect counterproposal will become law subject to a facultative referendum. In any case, the changes will be significant and listed companies will need to align their executive compensation practices while trying to remain competitive in order to attract, reward and retain key talent.

Appendix 1

ABOUT THE AUTHORS

ROLF WATTER

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Rolf Urs Watter is a partner with Bär & Karrer and served on the board and the management committee of the firm for nine years. He graduated from the University of Zurich with a doctorate in law and holds a master of laws degree from Georgetown University in Washington, DC. He has been lecturing at the University of Zurich since 1990.

Dr Watter is presently a board member in the following listed companies: Zurich Financial Services Ltd (member of the audit committee) and Nobel Biocare (presently chairman). Further he will be chairman of the board of PostFinance and is also a board member of Faber Castell (Holding) AG and UBS Alternative Portfolio as well as a member of the Regulatory Board of the SIX Swiss Exchange. He regularly publishes on governance matters and transaction issues and is an editor of the law journal GesKR and the Basler Kommentar.

KATJA ROTH PELLANDA

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Katja Nicole Roth Pellanda, an associate with Bär & Karrer since 2005, advises clients in corporate and commercial matters with a particular emphasis on corporate governance and regulatory issues concerning regulated institutes (such as banks and insurances) and listed companies. A graduate of the University of Basel, she received a doctorate in law from the University of Zurich, was a visiting researcher at Stanford Law School and holds a master of laws degree in banking and financial regulation from the London School of Economics and Political Science. Dr Roth Pellanda is a member of the European Corporate Governance Institute. She regularly publishes on governance and company law matters.

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