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# THE CORPORATE GOVERNANCE REVIEW

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FOURTH EDITION

EDITOR  
WILLEM J L CALKOEN

LAW BUSINESS RESEARCH

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Fourth Edition

Editor  
WILLEM J L CALKOEN

LAW BUSINESS RESEARCH LTD

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# EDITOR'S PREFACE

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

In this fourth edition, we can see that corporate governance is becoming a more vital and all-encompassing topic with each year. 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 there. 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 vital staff members. Do they show commitment to all stakeholders or to long-term shareholders only, or mainly to short-term shareholders? There are many variations of 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 SEC, the OECD, the UN's Ruggie reports, 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getting more complex and overregulated, and there are more black swans, while good strategies can quite quickly become outdated.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 outside 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 outside directors understand the business? How much time should they spend on the function? How independent must they be? What about diversity? Should their pay be lower? What are the stewardship responsibilities of shareholders?

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.

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 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 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 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 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 more as a team on policy, strategy and entrepreneurship. It remains a fact that more money is lost through lax 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.

Each country has its own measures; however, the chapters of this book 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 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

March 2014

## Chapter 23

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# SWITZERLAND

*Rolf Watter and Katja Roth Pellanda*<sup>1</sup>

### I OVERVIEW OF GOVERNANCE REGIME

The main source of law for Swiss governance rules is the company law contained in Articles 620ss 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 last decade, in 2000/2001, *inter alia*, as a consequence of the Swissair bankruptcy. One of its outcomes was the issuance of the Swiss Code of Best Practice for Corporate Governance (SCBP) by Economiesuisse,<sup>2</sup> first enacted in 2002 and revised in 2007.<sup>3</sup> It contains a range of guidelines and recommendations for boards of directors of listed companies (the 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.<sup>4</sup> 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

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

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

3 Available at [www.ethosfund.ch/pdf/Code\\_Swiss\\_CG\\_20080221\\_en.pdf](http://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](http://www.six-exchange-regulation.com/admission_manual/06_15-DCG_de.pdf). See also the DCG commentary available at [www.six-exchange-regulation.com/download/admission/regulation/guidelines/swx\\_guideline\\_20070820-1\\_comm\\_en.pdf](http://www.six-exchange-regulation.com/download/admission/regulation/guidelines/swx_guideline_20070820-1_comm_en.pdf).

on the SIX Swiss Exchange Ltd (the SIX) and is largely based on the principle of ‘comply or explain’. The enforcement of the DCG lies in the responsibility of the SIX.

A rather fundamental revision of the company law and accounting provisions of the CO 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 being strenuously debated and it might take years until they come into force. The revision of the company law and accounting provisions of the CO was prepared 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). The Minder initiative required, *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).<sup>5</sup>

On 3 March 2013 the Minder initiative was adopted by a popular vote with a strong majority of 68 per cent. The transitional provision regarding the new Article 95 III of the Federal Constitution of the Swiss Confederation (the Federal Constitution) provides that until the statutory provisions come into force, the Swiss Federal Council shall issue the required implementing provisions within one year of the adoption of Article 95 III of the Federal Constitution.<sup>6</sup> The corresponding ‘Ordinance against Excessive Compensation in Listed Companies’ (the Ordinance) was issued on 20 November 2013, entered into force on 1 January 2014 and will be valid until the implementing legislation by the Swiss parliament is enacted. The Ordinance applies to companies limited by shares having their seat in Switzerland and their shares listed in Switzerland or abroad.<sup>7</sup> The Ordinance obliges such companies to annually submit the top management’s compensation to the shareholders for a binding vote and contains far-reaching new rules on corporate governance with direct effects on boards, executive management, shareholders, pension funds and independent proxies. Moreover, the Minder initiative provides for and the Ordinance implements the principle that 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 and all offences have to be prosecuted *ex officio*.

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 compensation payments.

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5 Available at [www.admin.ch/ch/d/ff/2006/8755.pdf](http://www.admin.ch/ch/d/ff/2006/8755.pdf).

6 Article 197 Paragraph 10 of the Federal Constitution.

7 Article 1 I of the Ordinance.

## 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 as the default rule).<sup>8</sup> 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<sup>9</sup> 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.<sup>10</sup> The relationship between the shareholders' meeting and the board is rather a relationship of parity than of hierarchy; both bodies have distinct responsibilities and competence by law.<sup>11</sup>

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 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 to the management team. However, certain responsibilities cannot be transferred and are considered inalienable duties of the full board.<sup>12</sup> 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 the transferable responsibilities to one or several board members, a management team or other natural persons, subject to an authorisation by the shareholders in the articles of association and the establishment of organisational regulations by the board.<sup>13</sup> 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.<sup>14</sup> 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.<sup>15</sup>

The board is responsible for the representation of the company towards third parties. Unless the articles of association or the organisational regulations stipulate

8 See Article 716 II of the CO.

9 Article 718a I of the CO.

10 Article 716 I of the CO.

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

12 Article 716a I of the CO.

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

14 See Article 707 I of the CO.

15 Article 709 I of the CO.



otherwise, all the members of the board have the individual authority to represent the company without the necessity of a board decision in respect of each.<sup>16</sup> 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 parties. 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.<sup>17</sup>

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):<sup>18</sup>

- 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 the management and the representation (the appointment of the top executive management must remain with the board, whereas the appointment of the lower hierarchical levels may be delegated);
- 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 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)<sup>19</sup> 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)<sup>20</sup> 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 balance sheet pursuant to Article 663b-bis of the CO.<sup>21</sup> The preparation of the compensation

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16 Article 718 I of the CO.

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

18 Article 716a of the CO.

19 Article 663c of the CO.

20 Article 699 II of the CO.

21 Article 13 I of the Ordinance.

report is also a non-transferable and inalienable duty of the board.<sup>22</sup> Such a compensation report has to be published for the first time for the business year 2014.<sup>23</sup>

Where there are several board members the organisation of the board requires the nomination of a chair and of a secretary, although the latter does not have to be a board member.<sup>24</sup> The chair was customarily appointed by the board members; however, the articles of association could also provide for a direct appointment by the shareholders' meeting.<sup>25</sup> Now, the Ordinance provides that, as of the first ordinary shareholders' meeting held after the entry into force of the Ordinance on 1 January 2014, the shareholders' meeting has to elect the chairman of the board (but not the secretary, who will still be elected by the board itself) and is furthermore from now on empowered to dismiss the chairman.<sup>26</sup> 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. 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 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 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 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 these combined roles exists,<sup>27</sup> which is in general justified by efficient communication channels, faster decision times 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 roles of the chair and 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.<sup>28</sup> The (corporate) principle of equal treatment of shareholders does not require the board to provide

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22 Article 5 of the Ordinance.

23 Article 31 I of the Ordinance.

24 Article 712 I of the CO.

25 Article 712 I 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).

27 The CEO is in eight out of 20 SMI<sup>®</sup>-companies a member of the board.

28 Article 717 of the CO.

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, provide for a stricter understanding of a 'level playing field' and aims 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, 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. 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 starting from 2014 the members of the compensation committee, which 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. 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 SCPB recommends the creation of an audit 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 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.

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.<sup>29</sup> 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 sell or purchase assets worth more than 10 per cent of the total assets. Furthermore, the target board is, *inter alia*, not allowed to conclude agreements with either board members or senior management regarding payments to be made upon termination of their employment relationship (golden parachutes). In fact, nowadays such payments are, together with certain other compensation arrangements (e.g., severance payments and incentive payments for transactions within the group), unlawful, according to Article 20 Paragraph 1 of the Ordinance; agreeing to such payments even entails criminal sanctions.<sup>30</sup> The most important duty in the context of takeover situations, 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.<sup>31</sup>

## ii Directors

While the previous law provided a term of office of three years unless the articles of association stated otherwise, now the members of the board, pursuant to the Ordinance, have to be elected individually and on an annual basis by the shareholders' meeting.<sup>32</sup>

In general, 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 knowledge nor qualifications (e.g., in financial or accounting matters); currently, there are also no gender requirements. 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. 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. Furthermore, 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 a right is the right of the shareholders' meeting to remove a board member at any time.<sup>33</sup> However, if a board member steps down at an inconvenient time, he or she is liable for damages arising from the resignation. A notably inconvenient time would be after the board had decided

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

30 See Article 24 I of the Ordinance.

31 Article 29 I of the SESTA.

32 Article 3 of the Ordinance.

33 See Article 705 I of the CO.

to convene a shareholders' meeting, especially during the meeting itself and, in cases of over-indebtedness, during the relevant board deliberation and until the corresponding board resolution had been made or, if necessary, the judge had been notified.

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 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. 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.<sup>34</sup> 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 (1) taken in a flawless decision-making process, (2) made on the basis of appropriate information and (3) free from conflicts of interest.<sup>35</sup> Compliance with these requirements can therefore reduce the liability risk for board members as well as the persons engaged in the senior management of a company. In literature the above-mentioned decision is 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.<sup>36</sup> 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 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

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34 See Articles 754ss of the CO.

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

36 Article 759 I of the CO.

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 selecting, instructing and supervising the senior managers.<sup>37</sup> 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 at the time of the discharge decision.<sup>38</sup>

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 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 management might become risk-averse;
- e* such proceedings potentially lasting several years (e.g., 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 it 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. 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.

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

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37 Article 754 I of the CO.

38 Article 758 of the CO.

a conflict of interests exists;<sup>39</sup> 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, shall request 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., that votes with and without the relevant individual 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 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 the 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 advisable to provide for a special approval by the non-conflicted board members or, potentially, 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,<sup>40</sup> 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 of directors, the executive management and members of the advisory board on administrative boards or executive bodies outside their own group of companies.<sup>41</sup>

### 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, which will apply as of the financial year commencing two or three years (for consolidated accounts of groups) after coming 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

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39 Decision of the Swiss Federal Supreme Court 4A\_462/2009 dated 16 March 2010, consideration 6.3.

40 Draft Article 717a of the CO.

41 Article 12 I Paragraph 1 of the Ordinance.



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 legal entities with an annual turnover above 500,000 Swiss francs;<sup>42</sup> however, even the new provisions 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 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 remuneration. Effective from 1 January 2007, a new Article 663b-bis of the CO came into force requiring transparency regarding the compensation of, *inter alia*, board members and 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. This information contained in the notes of the balance sheet is, as mentioned above, now replaced by the compensation report according to Articles 13ss of the Ordinance. The board has to prepare a written compensation report on an annual basis. Such a compensation report needs to be audited by the auditors of the company and must disclose all remuneration, and loans and credits to the members of the board, the senior management and the advisory board.<sup>43</sup> The new disclosure requirements regarding remuneration are very similar to the ones under the previous law. Furthermore, 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 the rather comprehensive framework of disclosure requirements.<sup>44</sup>

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42 Article 957 of the CO.

43 Articles 13ss of the Ordinance.

44 Article 20 I of the SESTA.



#### IV CORPORATE RESPONSIBILITY

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 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 such a 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 the senior management, in particular with regard to compliance.<sup>45</sup>

Currently, there is no formal whistle-blowing legislation in force, but on 20 November 2013 the Swiss Federal Council adopted a message on a partial revision of the CO in respect of the implementation of a better protection of employees against wrongful termination by an employer if the employee discloses alleged dishonest or illegal activities in the company.<sup>46</sup> 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.

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 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.

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45 Article 716a I Paragraph 5 of the CO.

46 The draft is available at [www.admin.ch/opc/de/federal-gazette/2013/9589.pdf](http://www.admin.ch/opc/de/federal-gazette/2013/9589.pdf).

## 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 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 held for this purpose (both being generally referred to as 'free reserves').<sup>47</sup> 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.<sup>48</sup> 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; 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;<sup>49</sup> often, this threshold is lowered in larger companies in their articles of association. Shareholders have to be provided with the annual report, compensation report and 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.<sup>50</sup> However, this is a rather burdensome, difficult and time-consuming procedure.

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.<sup>51</sup> In the case of issuance of convertible or similar bonds, existing shareholders have a priority right to purchase these instruments, which, in cases of special importance, 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

47 Article 675 II of the CO.

48 Article 692 II of the CO.

49 Article 699 III of the CO.

50 Article 697 of the CO.

51 Article 704 I Paragraph 6 of the CO.

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 the current reform of company law is 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 and by the prohibition of certain compensation forms such as golden handshakes as advance compensations. Other compensations, such as a new-hire compensation, statutory severance payments, and incentive payments for transactions outside the group) as well as compensation at fair market value for non-compete clauses of a reasonable duration are still allowed, provided that they are approved by the shareholders' meeting. Furthermore, the Ordinance provides that various other types of compensations, payments or benefits to the governing bodies require a basis in the articles of association. This applies to grant of loans and pension benefits outside the occupational pension system and to performance-related remuneration and participation plans whose main principles are not set out in the articles of association. However, the Ordinance provides for grandfathering for a term of two years: employment contracts that exist at the time of the entry into force of the Ordinance need to conform to the new rules within two years. If these employment contracts provide compensations that are unlawful according to the Ordinance, such compensations are allowed to be granted during this period. Furthermore, the Ordinance provides for a maximum duration for fixed-term contracts (i.e., no longer than one year) with the members of the board and with the members of the executive management, as well as a maximum termination period of one year for contracts with no fixed term.<sup>52</sup>

## 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.<sup>53</sup> 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.

## 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;<sup>54</sup> there is no right to

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52 Article 12 I Paragraph 2 of the Ordinance.

53 Article 680 I of the CO.

54 Article 706 of the CO.

challenge resolutions of the board. However, any resolution passed by the shareholders' meeting or the board violating fundamental rules of company law is void.<sup>55</sup>

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, 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. 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 have to be amended at the latest in the ordinary shareholders' meeting in 2015.<sup>56</sup> 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; a vote on the base compensation for the term until the next ordinary shareholders' meeting (prospective vote); or 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.<sup>57</sup> 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 it must not constrain the decision-making power of the shareholders' meeting. The binding<sup>58</sup> 'say on pay' vote as a non-transferable power of the shareholders' meeting<sup>59</sup> must necessarily take place on an annually basis.<sup>60</sup> Articles 18s. of the Ordinance apply as of the ordinary shareholders' meeting in 2015.<sup>61</sup> 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

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55 Article 706b and 714 of the CO.

56 Article 18 II of the Ordinance.

57 Article 12 II Paragraph 5 of the Ordinance.

58 See Article 18 III Paragraph 3 of the Ordinance.

59 Article 2 Paragraph 4 of the Ordinance.

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

61 Article 31 II of the Ordinance.

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.

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 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 and semi-annual 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.<sup>62</sup> 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.<sup>63</sup> This leads undoubtedly 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. Furthermore, the Ordinance obliges companies to introduce indirect electronic proxy voting, which means that they need to ensure that powers of attorney and instructions may also be given electronically while corporate proxies are 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.<sup>64</sup>

## VI OUTLOOK

The currently suspended, rather comprehensive revision of Swiss company legislation pursues three principal goals:

*a* the improvement of corporate governance;

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62 Available at [http://swissinvestorscode.ch/wp-content/uploads/Richtlinien\\_16012013\\_e.pdf](http://swissinvestorscode.ch/wp-content/uploads/Richtlinien_16012013_e.pdf).

63 Article 22 of the Ordinance.

64 See Articles 8ss of the Ordinance.

- 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 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 be upheld. The revision is, therefore, evolutionary rather than revolutionary in nature, except in compensation matters. The changes resulting from the approval of the Minder initiative are significant, and listed companies need to align their executive compensation practices while trying to remain competitive to attract, reward and retain key talent.

## Appendix 1

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