In several ways, the reform is specifically aimed at strengthening the rights of minority shareholders, the guiding principle being the realisation of "*shareholders' democracy*". A functioning democracy on the one hand requires that everyone, no matter the size of the stake, has a say but on the other hand it also requires that majority decisions are accepted and implemented. Similarly, in determining the "right" level of minority rights in a company, a balancing must be struck between what rights should be granted to an individual shareholder and where such rights should be limited, for the sake of operational efficiency of a company (which, in turn, should benefit all shareholders). Thus, numerical thresholds for the exercise of shareholders' rights must not be prohibitively high but must not be too low either.

Against this background, it is understandable and probably a good thing that in terms of protecting minority rights the reform is not a revolution. Rather, it is the result of a balancing act of the function of certain shareholders' rights and the corresponding threshold requirements. Still, as a general statement, one can note that the new corporate law will be more shareholder and, specifically, minority shareholder friendly than the current one. As described in some detail in this article, several thresholds for information and participation rights were lowered, certain features such as a "special audit" or an action for reimbursement according to article 678 CO are facilitated in order to make it more practical and accessible, and some of the hurdles for shareholder lawsuit are lowered. It remains to be seen whether in practice this reform will have a noticeable effect, and in particular, whether it will, as some groups seem to expect, lead to more shareholder activism and shareholder lawsuits.

Remo Decurtins (remodecurtins@quinnemanuel.swiss)
Jonas Hertner (jonashertner@quinnemanuel.swiss)

Changes for Listed Companies under the Corporate Law Reform: Gender Quotas and Say-on-Pay

Reference: CapLaw-2020-55

The corporate law reform brings about numerous revisions to the law affecting both private and listed companies as well as a number of revisions that apply to listed companies only. The following article provides an overview of certain changes for listed companies not described elsewhere in this issue of CapLaw.

By Daniel Raun / Annette Weber

1) Introduction

On 29 June 2020, Parliament adopted the final bill of the Swiss corporate law reform. This brought to a conclusion a process that had been formally initiated in November of 2016 with the submission of an initial draft bill by the Federal Council, but was preceded by years of discussion and a failed reform attempt in 2013. The Federal Council has yet to determine when the new law will enter into force. 1 January 2022 is a probable effective date.

While the reform preserves the fundamental underlying principles of Swiss corporate law, there are a number of features that will partially reshape and modernize the corporate legal landscape in Switzerland, often paving the way for more flexibility on the part of companies and their boards of directors. Apart from these genuine changes the reform also serves to formalize certain concepts already applied as a matter of practice and/or endorsed in legal doctrine or to implement provisions currently contained in other acts. While some changes universally apply to companies, whether private or public, other provisions bind listed companies only.

In this article we describe the rules on gender quotas that will be newly introduced into Swiss law as part of the reform. We also provide an overview of certain new rules on compensation and related matters.

2) Rules on Gender Quotas

With the introduction of gender quotas for board of directors and executive management (article 734f of the revised Code of Obligations (CO)), Switzerland follows other European jurisdictions, but has its own regime. Although not explicitly stated, these rules aim to increase the number of women on boards of directors and executive managements of larger Swiss companies. The rules instead refer to the underrepresented gender, using a gender neutral language.

The obligation to comply with the rules on gender quota is only applicable to listed companies crossing the thresholds set out in article 727 (1) (2) CO defining the scope of application for companies subject to an ordinary audit. As the rules should only apply to larger companies under exclusion of SME, the legislator chose to use the existing thresholds for the ordinary audit.

In the case that the board of directors of subject companies does not consist of at least 30% or the executive management of subject companies of at least 20% of members of the underrepresented gender, the respective company must disclose in its compensation report the reasons and state the measures implemented to promote the underrepresented gender. Hence, the rule is not a rule on gender quota *strictu sensu* and as used in certain other jurisdictions, but rather a disclosure obligation combined with an obligation to take action in case the thresholds are not met. The law does neither set any requirements as to the content of the explanation nor the measures which a non-compliant company has to take.

The new rule does not provide for an explicit basis for a claim in case of a violation or omission of the above-outlined duties. In case of non-compliance, it will be very difficult in practice to assert a claim against the non-compliant company as the non-compliance will typically not result in a measurable loss. In the light of the comply-or-explain approach, the five-year (for board of directors) and ten-year (for executive management) transition periods are generous, allowing companies to adopt slowly.

If we compare the new rules with the regimes of other jurisdictions, it is striking that they have much stricter regimes. For example, Germany requires that at least 30 % of a supervisory board's positions must be allocated to the underrepresented gender. An election which violates this principle is void and the positions which would need to be filled by the underrepresented gender remain vacant. Norway introduced a threshold of 40 % for members of the board of directors of corporations already in 2008. Companies not complying with this threshold may even be dissolved after several warnings. In contrast to the Swiss regime, these and other jurisdictions require strict compliance with the quota and impose heavy sanctions in case of non-compliance.

The Federal Council justified the comply-or-explain approach by arguing that it is proportionate and will not excessively interfere with the organizational freedom of corporations. The explanation provided by the Federal Council stands in contradiction to the main reason for the necessity for gender quota rules: the belief that mandatory rules are necessary to have more gender balanced boards and executive managements. A lax regime, which is limited to larger companies – of which many are exposed to a higher scrutiny of the public – allowing corporations to escape relatively easy from the regime will likely not be a key enabler for gender equality.

3) Rules on Compensation and Related Matters

In 2013 the Federal Council enacted the Ordinance against Excessive Compensation (OaEC) following the approval of the so-called Minder initiative earlier that year. The OaEC increased shareholders' say on a number of corporate governance matters and, most importantly, introduced an annual binding vote on executive compensation ("say on pay"). The provisions came into effect on 1 January 2014. The corporate law reform will now see the transfer of these provisions to the CO along with the introduction of a number of new provisions. While some of these new rules lead to genuine changes (albeit not fundamental ones), other provisions mostly serve to put into formal law views that have already been expressed in legal doctrine or practices applied by many companies. A number of more restrictive proposals have been abandoned in the course of the legislative process leading up to the final bill. The new provisions are described below.

a) Compensation for non-compete covenants

The new provisions comprise an express rule governing compensation for non-compete covenants of members of boards of directors, executive management and advisory boards. While under the current law there seems to be a general consensus that paying a compensation in exchange for a non-compete undertaking by an executive should be possible under certain conditions, the lack of any specific rules combined with the potential criminal sanctions in case of payments of certain prohibited types of compensation often caused insecurity in practice. It was often stated in legal doctrine that the payment is permissible if it is in the interest of the company that a leaving member of the executive be bound to a non-compete and to the extent the compensation paid to the executive is within the range of compensation previously paid to the relevant individual. However, there were no conclusive answers to a number of very relevant questions in practice, including whether in using the past compensation of an executive as a benchmark for the non-compete compensation may also include variable compensation.

The reform will clarify two aspects in this regard. First, it specifies that a non-compete may only be compensated if the non-compete is commercially justified, something which seems rather obvious given that directors would potentially expose themselves to liability when paying (or receiving) a compensation for which there is no commercial justification. Second, the compensation may not exceed the average of the compensation for the last three business years. As the provision does not limit this to the base salary the relevant average amount includes any compensation components, including any short- or long-term variable compensation. The new provision will not restrict the duration of non-compete covenants as such but only the amount that can be paid to compensate the individual. It is therefore possible, for example, to agree on an 18 months non-compete provided that the aggregate compensation for the entire duration does not exceed the three-year average.

b) Sign-on bonuses

The reform will also introduce a rule specifically addressing sign-on bonuses. Under the new law, sign-on bonuses will be prohibited if they do not compensate for a demonstrable financial disadvantage. In other words, a company may grant to a new executive replacement awards or pay a cash sign-on bonus if and to the extent the executive as a result of changing his employment has incurred a financial disadvantage, typically through a loss of entitlement to a cash bonus or share award received under his previous employment contract. This is generally in line with views held in legal doctrine today already.

c) Off-market compensation in connection with previous engagements

The OaEC requires that compensation paid directly or indirectly to a former member of the board of directors, executive management or advisory board in connection with previous activities or that are not customary in the market be disclosed in the compensation report. The reform will introduce an outright ban of payments that are connected to a previous engagement as a member of a corporate body *and* are off-market. Where the compensation is connected to the previous engagement but is in line with market practice, disclosure must be made in the compensation report.

d) Prospective shareholder vote on compensation

Initially, the draft proposal sought to prohibit prospective voting by shareholders on variable compensation (i.e., shareholder votes for future periods, typically the following business year). Under the final bill prospective voting remains permissible but the company is required to submit the annual compensation report to an advisory vote. This is already common among many companies with prospective voting and considered good practice.

e) External mandates

Under the provisions of the OaEC a listed company's articles of association must state the maximum number of positions on the supreme governing or administrative bodies of entities that require registration in the Swiss commercial register or a corresponding foreign register that members of its board of directors, executive management or advisory board may hold. As outside management functions are not considered to be mandates in a supreme governing or administrative body, these are not captured by the OaEC and listed companies do not have to impose any limit in their articles of association in this regard. This will change once the reform comes into effect. The articles of association will then need to set a limit for comparable functions in other enterprises that pursue a commercial purpose, which includes serving on the management of another company. Roles in not-for-profit organizations and foundations and associations etc. that do not pursue commercial objectives will be out of scope. Any necessary changes to articles of association have to be made within a transitional period of two years from the effective date of the reform.

Daniel Raun (daniel.raun@baerkarrer.ch)
Annette Weber (annette.weber@baerkarrer.ch)