NKF Client News

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The reform of the stock corporation law has reached the finish line

Today, 19 June, the Parliament adopted a comprehensive reform of the stock corporation law by a vast majority. This marks the end of a legislative project that began more than a decade ago, but then got caught up in a maelstrom of trials and tribulations (the initiative "against rip-offs") and whose implementation was on the brink more than once.

With the completion of the reform, an important goal in the further development of Swiss business law has been achieved:

The stock corporation is still the most commonly used legal form in Switzerland for entrepreneurial activities of all types and sizes, from small one-person businesses to global corporations. The figures speak for themselves: Although the limited liability company has been on a triumphal march since the beginning of the 1990s, the stock corporation is still the more commonly used legal form with 221,000 entries in the commercial register at the beginning of 2020. The limited liability company has 207,000 entries, while all other companies regulated in the Swiss Code of Obligations together have almost 21,000. The stock corporation is the Jack of all trades of the Swiss corporate law.

Below, the main features of the future law and its entry into force will be briefly described and a first assessment will be made (section 1.-3.). The most important changes will then be outlined (section 4.-10.).

1. Main Features of the reform

1.1 The unity of the stock corporation law remains intact, but with a greater differentiation between private and listed companies

At all times, it was clear that the *unity of the stock corporation law* was to be maintained. A division into one law for listed stock corporations and another law for private stock corporations was never seriously considered. However, the recent trend towards a greater differentiation according to economic importance has continued. In particular, the special provisions for publicly listed companies have been further extended, for example with regard to mandatory content of the articles of association, through greater flexibility in the structuring of the capital base, and especially with regard to the powers of the general meeting to determine the salaries of executive management and boards of directors.

1.2 The stock corporation will remain purely capital-related in the future

It was also undisputed that the stock corporation should remain a *capital-related corporation*, contrary to the limited liability company, where the focus on participants' personality rights, competences and interests is of central importance. Furthermore, the articles of association cannot oblige the shareholder(s) to do more than contribute the amount determined for the subscription of a share.

If the company is to focus more on the shareholders, and one does not wish to choose the limited liability company as a vehicle, then this must be implemented – as before – by agreements, such as shareholders' agreements and possibly a network of contractual relationships with the company, such as employment agreements, rental agreements, supply agreements etc.

1.3 Each body will continue to have certain irrevocable tasks

The reform maintains a "*separation of powers*" between the board of directors and the general meeting. According to the so-called *principle of parity*, the board of directors retains certain irrevocable powers (including determining strategy, defining the organization of the company, and the most important personnel decisions). These powers exclude or only indirectly enable the general meeting to influence the company, for example through the fact that the purpose of the company is defined in the articles of association.

1.4 Flexibility, administrative simplifications and exploitation of digital opportunities

The reform brings much-welcomed *flexibility* and *administrative simplification* in various areas. As an example, the period for carrying out an ordinary capital increase will be extended from three to six months, and a *one-time call on creditors* will suffice in the future for the capital reductions, instead of the current three times. Finally, stock corporations will be able to fully benefit from the *opportunities provided by digitalization* without being obliged to do so, both in the board of directors and when dealing with the shareholders.

2. A look into the future

The new law requires adjustments to other decrees, in particular the *Ordinance for the Commercial Register*. The new law will not come into force immediately, but rather at the earliest in the second half of 2021, and probably not before 2022 or even according to the director of the Federal Office of Justice, 2023. A transitional period of two years is envisaged.

No special precautions need to be taken, as the reform is explicitly designed in such a way that *no changes to the articles of association* are necessary. However, companies should consider whether they wish to take advantage of the extended possibilities offered by the new law, such as by making the capital base more flexible through the introduction of a capital band or simplifying the procedures for the general meeting and board of directors through electronic means.

3. A "Major" Stock Corporation Law Reform?

Contrary to the original intentions, the result of the many years of reform work will not be described as a "major" reform or a departure for new shores. Nevertheless, it should be warmly welcomed as there are numerous simplifications and new freedoms. Digitalization is taken into account. Controversial issues are clarified and, here and there, misguided court practice is corrected. Thus, the stock corporation will continue to be available in the future as a suitable legal form for companies of all kinds, and will be simple to use, adaptable, shareholder-friendly and up-to-date.

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Some important innovations are outlined in the following sections:

4. A more flexible capital base

The concept of the stock corporation as a *company with a fixed share capital that can only be changed by way of a formal procedure* is not being changed. However, the capital base will be made more flexible and modernized in detail. At the same time (see section 5), protection against financial collapse is strengthened:

4.1 Making the share capital more flexible

A real innovation of the reform is the so-called *capital band*. It complements the concept of authorized capital, which was introduced during the last comprehensive reform of corporate law in 1991. This allows the decision on a *capital increase* to be delegated, within certain limits, by the general meeting to the board of directors. In the future, the board of directors shall also be authorized to *reduce capital*, thus creating a range within which the board of directors can increase and decrease the share capital on its own. The scope is generous: the authorization can be granted for an increase or reduction of up to 50 % and can last for up to five years (compared to two years under the current law). The general meeting may of course narrow the scope or even allow only an increase or only a reduction.

4.2 Increased opportunities for participation certificates

For companies without listed shares, any *participation capital* (which in practice is rare) may not, as before, be more than double the share capital entered in the commercial register. For publicly listed companies, on the other hand, participation capital *of up to ten times the share capital* will be permitted in the future.

4.3 Pragmatic solution for determining the nominal value of shares

It is well known that the *nominal value* of a share has nothing to do with its real value. A high nominal value can also lead to an undesirably high market price. In recent decades, the legislator has taken into account this latter issue by repeatedly reducing the minimum nominal value from initially CHF 100 to CHF 10 and finally to one centime. An obvious next step would have been a switch to no-par-value shares. However, this would have entailed complicated adjustments across the entire stock corporation law which would not have been acceptable. Instead, the future law stipulates that the nominal value must simply be "greater than zero". Without having to abandon the system of a fixed nominal value, this allows for any number of share splits (achieving the flexibility that would be associated with no-par-value shares without having to abandon the system of a fixed share capital divided into fixed partial sums).

4.4 Rules for interim dividends

Certain foreign investors are used to receiving quarterly or half-yearly dividends. In practice, such requirements have already been accommodated, although the permissibility of this was not entirely undisputed. The future law now provides clarity on the conditions for such *interim dividends*.

4.5 Share capital in foreign currencies

The proposal to be able to have the share capital – which remains unchanged at a minimum of CHF 100,000 – in a *foreign currency* was highly controversial until the end. Ultimately, a liberal solution prevailed: share capital will be permitted not only in Swiss francs but also "*in the foreign currency that is essential for the business activity*", whereby the Federal Council will determine which foreign currencies are permissible. This ensures consistency with accounting, in respect of which the use of foreign currencies is already permitted today.

5. Improvement of the Chances of Restructuring

The customary Swiss restructuring law has various weaknesses. The reformed stock corporation law will address these weaknesses - complementing the already completed revision of the restructuring law in the context of the debt enforcement and bankruptcy law – with the aim of increasing the chances of a successful restructuring without exposing the creditors to additional risk.

5.1 Improved "early warning system"

In case of a threatened financial crisis, the "*early warning system*" is intended to have a better and earlier effect. Thus, in addition to the existing measures in respect of capital loss (where 50 % of the share capital and certain reserves are no longer covered) and over-indebtedness, *impending insolvency* will be introduced. This makes sense, because experience shows that illiquidity leads more often to the collapse of a company than (temporary) over-indebtedness.

5.2 More time for restructurings

If a stock corporation is *over-indebted*, the law requires the court to be notified. In principle, this makes sense, to avoid further damage to creditors. However, the publicity usually generated by such notification, can in itself reduce any realistic chances of restructuring to zero. Therefore, it has become established practice to postpone the notification in order to allow for a silent restructuring. The courts have endorsed this in principle, but there is uncertainty as to what the conditions for a postponement should be and how long it should last. The future law now stipulates that a postponement is permissible if there is a reasonable prospect that the over-indebtedness can be remedied within a reasonable period of time and in any case within three months at the latest (which is not likely to be sufficient in complex situations).

5.3 Subordination as an aid in restructuring

The judge may also not be notified if individual creditors declare a *subordination*, i.e. if they subordinate their claims to the extent of the over-indebtedness to those of all other creditors. This creates room for the implementation of restructuring measures. Even though this possibility already exists under the current law – it is used, for example, in group relationships in which the main creditors are other group companies – the reform corrects a court practice which had made subordination a risky process for the board of directors.

6. Strengthening of shareholder rights and the protection of minorities

6.1 Raising "Lex Minder" from the level of an ordinance to that of a formal law

Strengthening the position of shareholders as owners of the company is a central concern of the reform. For publicly listed companies, this will be achieved by *shifting powers from the board of directors to the general meeting*, which, admittedly, has already taken place.

In March 2013, as is well known, the popular "initiative against rip-offs" was passed by a massive majority of the Swiss people in a referendum. It aims to put a stop to excessive executive salaries at publicly listed companies by expanding shareholders' rights. A provisional implementation of the constitutional provisions was came in the form of an ordinance of the Federal Council which entered into force on 1 January 2014. The reform of the Swiss stock corporation law now *raises these provisions to the level of a formal law*. The new provisions are consistent with the ordinance, with Parliament resisting the temptation to go beyond the scope of the now established and proven ordinance or to introduce additional tightening.

Under the new rules, the general meeting (instead of the board of directors as was previously the case) is responsible for determining the total remuneration of the board of directors on the one hand and the executive board on the other (as well as that of any advisory board). In addition, the general meeting is mandatorily responsible for the election of the chairman of the board of directors, a compensation committee composed of members of the board of directors and the independent proxy.

6.2 Strengthening of minority rights

Minority rights will be strengthened by way of a number of measures, which tend towards maintaining the model rather than introducing groundbreaking innovations as follows:

- The *thresholds* for asserting minority rights, such as the right to propose items for inclusion on the agenda of the general meeting or the right to initiate a special audit, will be lowered and, in addition, different rules will apply to publicly listed companies with a typically broad shareholder base compared to private companies (the quorums under the present law, which apply uniformly to all companies, made it practically impossible to exercise certain minority rights in public companies).
- The *information rights* of shareholders will be moderately improved, although in case of doubt, the legitimate confidentiality interests of the company will continue to take precedence.
- The shareholders' *right to take legal action* will also be facilitated. An extreme proposal by the Federal Council, which would have enabled a small minority and their legal representatives to bring legal action at the expense of the company and against the will of the majority, was rejected early on by the Parliament, and rightly so.

7. Modernisation and flexibilisation of the provisions for the general meeting

7.1 Utilization of digitization

The rules for the general meeting will be *modernized,* in particular by *allowing the use of electronic means of communication*. These are all *possibilities, not mandatory requirements*. In the future, it will be possible to participate in and pass resolutions of the general meeting electronically. It will even be possible to hold the general meeting entirely by electronic means in the form of a virtual general meeting.

7.2 New possibilities for holding general meetings

In addition, the provisions for *holding the general meeting* will be made more flexible. In the future it may:

- be held *in writing* (which was previously only possible for resolutions of the board of directors; for the general meeting it was necessary to grant a power of attorney);
- take place at *several venues* at the same time; or
- be carried out without a conference venue *virtually* and *by electronic method*s.

However, the concept of the general meeting per se will not be impacted. In the case of publicly listed companies with many small shareholders the "Landsgemeinde" concept remains in place, where the results are known in advance because the independent proxy exercises the majority of the votes – often over 90 % – in accordance with the instructions given to him by the shareholders days in advance.

The question of whether it should be permissible to hold the *general meeting* of a Swiss company *abroad* has led to Homeric discussions in the Councils and their committees. As a compromise, it is now stipulated that it is permissible to hold the general meeting abroad if – and only if – the articles of association provide for this and if an independent proxy is appointed. Furthermore the location of the meeting must not make it objectively difficult for any shareholder to exercise his rights (which also applies to general meetings held in Switzerland).

The choice of a foreign venue will be particularly useful for Swiss subsidiaries of foreign groups, which in the future will be able to hold their general meetings at the headquarters of the parent company as the sole shareholder.

7.3 Confidentiality of the independent proxy

In the late phase of parliamentary deliberations, a recent common practice by independent proxies, which is legally not unproblematic, came to light and was the subject of discussion. This practice involves independent proxies informing the companies or their board of directors prior to the general meeting of the instructions received in the form of yes and no votes. Since, as mentioned, the majority of votes are almost always exercised through the independent proxy, companies know in advance what the outcome of the votes will be. They consider this necessary in order to prepare the meeting adequately. Opposing shareholders, on the other hand, consider this an unjustified advantage for the company.

After a long discussion, the Parliament has found a compromise: The independent proxy may "provide the company with general information on the instructions received", but not earlier than three working days before the general meeting. At the general meeting itself, the independent proxy must disclose what information was given to the company. This regulation puts an end to the grey area that heretofore existed.

8. Changes for the board of directors

As for the general meeting, the board of directors will also have the statutory option of *using electronic means of communication* on a voluntary basis.

Reference has already been made to the shift in power from the board of directors to the general meeting in the case of publicly listed companies. It should be added that a one-year term of office is now mandatory for the members of the board of directors of publicly listed companies, whereas, previously, three- or even four-year terms of office were permissible.

Standing for (re)election every year may be uncomfortable for board members, but in practice nothing has changed.

There are no significant changes for private companies.

9. No Changes for the statutory auditors and audit law

The reform *does not envisage any major changes* in respect of auditors and their duties. This part of stock corporation law already underwent a fundamental revision in the wake of a comprehensive reform of the law on limited liability companies.

Under Swiss stock corporation law, the auditors are subject to the same strict liability provisions as the members of the board of directors and the executive management. Since the responsible bodies are all *jointly and severally* liable, the auditors are often hit particularly hard: because they are suspected of having assets and insurance coverage and their mistakes are often well documented, they become the most prominent target of liability suits, even if they are usually not the main actor in the event of violation of their duties. The Federal Council proposed a defusing of the situation by replacing joint and severally liability with merely *several liability*. However, Parliament surprisingly rejected this.

10. Socio-political topics

In the course of the reform of Swiss stock corporation law, legislation was also passed on topics that one could classify as socio-political rather than stock corporation law:

10.1 Gender quotas for the board of directors and the executive management of publicly listed companies

In the context of the reform discussions, the proposal to introduce *gender guidelines for the board of directors and executive management of publicly listed companies* has probably received the most media attention. After lengthy debate, Parliament has finally decided in favor of an order that applies exclusively to approximately 300 major companies, whereby each gender should be represented on the board of directors by at least 30 % and on the executive management by at least 20 %. There is no provision for sanctions in the event of failure to achieve the targets, but the reasons for the failure and the measures to be taken must be disclosed in the compensation report. These obligations will become binding for the board of directors five years after the new law comes into force (ten years for the executive management). If developments continue as they have in recent years, it is foreseeable that achieving the minimum gender targets will not create any major problems (percentage of women in the executive management of SMI companies in 2019: 28.2 %).

10.2 Transparency provisions for companies in the raw materials sector

A further topic, only marginally related to stock corporation law, is the *transparency regulations for companies in the raw materials sector*. They must publish an annual report disclosing payments to governmental and quasi-governmental agencies if the threshold value of CHF 100,000 is exceeded. For the time being, only companies that *extract raw materials* will be affected, but the Federal Council is authorized, as part of an "internationally coordinated approach", to extend the scope of application to companies that *trade raw materials*.

10.3 Rules for activist shareholders

Following the intensive "locust debate" in Germany, the Federal Council also addressed the question of whether action should be taken against any harmful activities of *investment and private equity companies*. It rejected this on the ground that negative effects were not proven. After all, publicly listed companies will in future be able to reject an acquirer of shares not only if such acquirer "does not expressly declare that it has acquired the shares in its own name and for its own account" but also if it does not confirm "that there is no agreement on the redemption or return of corresponding shares and that it bears the economic risk associated with the shares".

10.4 Responsible business initiative as the battlefield in the coming months

In parallel to the reform of the stock corporation law, the political bodies were also required to discuss a *popular initiative "for responsible businesses – to protect people and the environment"*. This *"responsible business initiative"* requires companies based in Switzerland to ensure that human rights and international environmental standards are observed by their subsidiaries and by foreign suppliers that they de facto control. It would be possible to sue in Swiss courts for damages caused by foreign subsidiaries and controlled companies abroad.

The attempt to use the tried and tested Swiss tactic of meeting the initiators of a popular initiative with a counter-proposal and thus persuading them to withdraw their initiative recently failed. It is therefore expected that a referendum on the initiative will be held in November of this year. This could then be the starting point for further reform steps.

10.5 No loyalty shares, at least not for now

The proposal to introduce so-called *loyalty shares* was intensely discussed, but failed in Parliament. On the basis of a resolution by a majority of shareholders, stock corporations should be given the option to provide in their articles of association for a premium on shares that have been entered in the share register for more than two years as belonging to the same owner: an increased dividend, a higher subscription right or a lower purchase price when new shares are issued, in each case up to 20 %. The issue will remain on the political agenda; the Federal Council has been instructed to examine the pros and cos of loyalty shares.

If you have further questions or comments on this topic, please reach out to your regular NKF contact.

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