NewsLetter

Information by the Law Firm of Lutz Rechtsanwälte

Changes in Corporate Law: Enactment and Important Transitional Provisions

Swiss corporate law is in flux. The following summary about enactment of the current legislative projects and the transitional provisions contained in them is intended to help maintain an appropriate overview.

by Christian Christen

Even seasoned legal experts confess as to some difficulty keeping pace with the speed, the timing, and the method with which Swiss corporate law is being revised nowadays. The latter has already been termed "piggyback method" and "legislation on the fast lane", which threatens to turn corporate law into a "moving target".

Auditing Supervision

The draft of a federal law about accounting and auditing originally written in 1998 contained as fundamental subject to be regulated the submission of account by companies, and their obligation to have their financial statements audited (auditing duty) as well as the requirements for the auditors. This complex has since been subdivided into several partial projects. In the meantime, the auditing supervision law *(Revisionsaufsichtsgesetz)* has been enacted on 1 September 2007 (see also the article by Jörg Witmer in this NewsLetter).

Accounting Regulations

The revision of the accounting law is being integrated in the Code of Obligations („CO") in place of the previous general regulations on commercial bookkeeping (Art. 957 et seq. CO). The fact that the revised accounting provisions also replace the special standards for corporations' annual reports (Art. 662 et seq. CO) was used to justify piggybacking the revision of the accounting law onto the current reform of corporate law.

In general, the transitional provisions of the corporate law reform draft envisions a two year grace period for corporations to adapt to the new law. The same now is in force for the accounting regulations.

According to the Swiss Federal Department of Justice and Police (*EJPD*) the commented draft law on revised corporate and accounting law to be presented to parliament (*Botschaft*) is to appear as of the end of 2007, which, considering the necessary complex revisions of the draft version, especially in fiscal issues, seems a rather ambitious schedule. The new provisions will very likely not be enacted before 2009.

Comprehensive Reform of the GmbH Law and „Small Corporate Law Reform"

The reform of the auditing obligation

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for corporations, share-limited partnership, limited liability companies (*GmbH*) and co-operatives were simply coupled onto the moving train of the reform of the GmbH law. The reform draft for the comprehensive revision of the GmbH law also contains further modifications of the CO, such as those concerning corporations (which could have been accomplished as well within the above-mentioned corporate law reform), co-operatives, commercial register and companies' names. (About the so-called "Small Corporate Law Reform", see the separate article by Romeo Da Rugna in this NewsLetter).

The new law will come into effect on 1 January 2008. GmbHs are to be given a two year grace period to adapt their statutes and rules to the revised law. Corporations and co-operatives also will have two years after the new law coming into effect to make their companies conform to the new law. After this period has passed, the commercial register office will mandate the necessary changes by edict, whereby, according to the draft of the also changed ordinance on the commercial register (see below) any legal entity may only submit a change of articles of incorporation after it applied for an adaptation of its articles of incorporation to conform to the new law.

Reform of the Commercial Register Ordinance

The changes made to the CO in conjunction with the revisions in the GmbH law mentioned above, particularly those concerning the commercial register (Art. 927 et seq. CO), have necessitated a complete reworking of the current Commercial Register Ordinance (*Handelsregisterverordnung*), which also is to come into force as of 1 January 2008.

Fortunately, the draft provides – without any transition period – that now all Cantons (the member states of the Swiss Federation) must make the entries in the main register available on the internet without charge. According to that draft, the registrar offices, in order to provide for the newly possible electronic applications, must within two years after enactment of the ordinance be able to process electronic applications. The rules of the revised ordinance on the commercial register concerning the content of entries in the register are all only to apply to entries made after the ordinance coming into force.

Summary

The time-honored – tongue in cheek – lawyer proverb "knowledge of the law immensely simplifies jurisprudence" is finding unexpected significance in these times of fragmented revisions of Swiss corporate law. In the latter case, it's not only the laws one needs to know but also the *draft legislation*. ■

About the Small Corporate Law Reform

In conjunction with the full reform of the GmbH law (limited liability company law), the Parliament, in the fall of 2005, also passed a partial modification of the corporate law (law on the *Aktiengesellschaft*, „AG"). The intention was, on the one hand, to integrate, to the extent it seemed mandatory for the internal coherence of law, the new clauses introduced into the GmbH law into the corporate law as well, and on the other hand, to use this opportunity to implement other urgent concerns about corporate law. There will be changes, among others, in the following areas:

by Romeo da Rugna

Formation of Single-Person Corporations (Art. 625 Code of Obligations, „CO")
According to today's law, the formation of an AG requires a minimum of three persons. Under the new law, an AG can be formed by one or more natural or legal entities or by other commercial partnerships or companies. This eliminates the need for the widely practiced method that often one or more merely fiduciary agents appear as co-founders. In case of combined corporations (concerns), this new provision allows for the creation of a subsidiary by the parent company alone.

Making Incorporation and Increases in Capital Stock COEasier (Art. 628 para. 2 CO)
If an AG takes over assets from its shareholders or third parties, or intends to take over such assets (*beabsichtigte Sachübernahme*), the articles of incorporation, according to Art. 628 para. 2 CO, must name the assets, the name of the grantor and the consideration paid by the corporation. For transactions with third parties, this requirement has been considered unnecessary for some time now. This duty of disclosure leads to an often unwanted and obstructive publicity. Especially the concrete wording of the clause in the articles of incorporation could grow into a problem for a corporation: Often it was not even certain yet, from whom or at what price an asset was to be acquired. The reality was that a maximum amount was taken out before the pricing negotiations had concluded. This type of disclosure can damage the negotiating position of a corporation. One of the intentions of the disclosure was to prevent that creditors were deprived of share capital that was to serve as security. The revised law now reflects the fact that in a acquisition in kind from *real third parties*, who independently and under real market conditions sell an asset to the corporation in the time following incorporation, such a danger does not exist.

According to the revised Art. 628 para. 2 CO, as of 1 January 2008 such a disclosure will only be required if the corporation acquires or intends to acquire assets *from shareholders* or *from a person close to a shareholder*.

Board Members no Longer Must be Shareholders (Art. 707 para. 1 and 2 CO)
According to the present Art. 707 para. 1 CO, the board of directors of a corporation consists of one or more members who must be shareholders. If an outside person is selected, they can only commence their office after they have become shareholders (Art. 707 para. 2 CO). This provision will be stricken, so that after 1 January 2008 non-shareholders can be elected as board members as well. In order to provide them with the powers necessary to perform their duties, the new Art. 702a CO provides that members of the board have the authority to participate in the general meeting and to introduce motions. The question arises if such non-shareholders who are board members must be present in order to hold a so called *Universalversammlung*, where all shares must be represented.

Lifting of the Nationality and Residency Requirements (Art. 708 CO)
Once more, the nationality and residency requirements are going to be changed. According to the current Art. 708 CO, the majority of the board members must be persons of Swiss nationality and resi-

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dence. For holding corporations with foreign interests, exceptions from this rule may be permitted, whereby a board member authorized to represent the corporation still must be a Swiss resident. In view of the fact that these regulations create a location disadvantage and lead to discrimination of Swiss residents of foreign nationality, a consistent new rule is being created for both, the GmbH and the AG.

The new Art. 718 para. 3 CO merely requires that the AG (or the GmbH respectively) must be represented by at least one person with Swiss residence. This requirement can be met by either a board member or a member of the executive board.

New Rules for Self-Contracting (*In-sich-Geschäfte*)

The new Art. 718b CO requires a written document for the case that in entering into an agreement the corporation is represented by the same person with whom it enters into that agreement. This requirement is waived only if the transaction is a current business matter with the performance of the corporation not exceeding the value of CHF 1,000. This limit refers to prices as they would be charged to third parties. The value of contiguous transactions is to be added up. Contracts containing performance which cannot be defined in a numerical market value always must be in writing. In addition, the general considerations and guidelines developed for such transactions still need to be observed.

Deleting Persons' Names and Representation Authorities in the Commercial Register (Art. 938b CO)

According to the new Art. 938b CO, persons entered into the commercial register as organ (*Organ*) who are leaving their position, can now themselves file for their name to be deleted. The law as it is today, requires that the corporation has been idle for 30 days before they can do that (Art. 711 para. 2 CO). The mandate as an organ terminates in any case when a resignation is submitted to the company. Therefore not only those leaving their posts but also third parties have a significant interest in a speedy correction of the commercial register entry since entries which have become incorrect can lead to errors (and perhaps even to consequential damages).

Name of Company (Art. 950 CO)

And finally, beginning 1 January 2008 an AG (as previously already the limited liability company) must always state the legal form of organization of the company (adding „AG" to its name). In the past, an AG was only required to do so when names of persons had been included in the company's name (Art. 750 para. 2 CO). ■

Changes in Auditing Law

by Jörg Witmer

In the past, only Swiss corporations had to have by law their business transactions verified by an auditing office; in the case of GmbHs (limited liability companies) that auditing was optional. Now, in the course of revising the law about limited liability companies, the auditing rules are going to be changed from the ground up for all types of capital corporations (corporations, share-limited partnerships, limited liabiltity companies, co-operatives).

Objective of the Changes in the Law

The objective was, on the one hand, to improve quality and independence of the auditing, while, on the other hand, matching the standards for large corporations with international guidelines and providing SME's relief in relation to their auditing obligation. In addition to the substance of the new auditing provisions, there will be comprehensive supervision of the auditors themselves whose requirements profile now also must be commensurate with the size of the corporation to be audited. The corresponding regulations are found in the Auditing Supervision Law ("RAG" for *Revisionsaufsichtsgesetz*).

Which Auditing for Which Corporation?

In the future, the question whether a corporation must have its financial statements audited is no longer answered by what type of corporation it is but by its economic size and importance. In addition, scope and content of the audit are differentiated by law based on size and importance of the company to be audited. This is intended to take into account the need for a simplified and thus less expensive auditing procedure for smaller corporations, while at the same time establishing a comprehensive auditing standard for large and publicly traded corporations.

A *regular audit* will, in the future, be mandatory for companies of one of three simplified categories:

• Publicly held corporations

These are corporations (a) that are traded on a stock exchange, (b) have outstanding bond obligations or (c) in which at least 20% of assets or sales contribute to the balance sheet of a corporation according to (a) or (b).

• Economically significant companies

These are corporations, exceeding two of the following three benchmarks in two consecutive years: balance sheet total of 10 million Swiss Franks, sales proceeds of 20 million Swiss Franks and an average of 50 full-time employees.

• Corporations who themselves provide for a regular audit

Corporations can, in their articles of incorporation, provide for a regular audit or it can be decided case by case by the general assembly or demanded by stockholders representing at least 10% of the share capital ("Opting up").

Corporations not meeting the above criteria automatically are subject to the limited auditing (also known as *"Review"*). Small companies with a yearly average of less than 10 full time employees can, by unanimous company vote, waive any auditing ("Opting out") or decide on a non-professional audit ("Opting down"). A single shareholder or partner, however, can demand re-introduction of audits.

Scope of Audits

The *regular audit* includes essentially those items already subject to audits today. As an important new item, however, such an audit must verify the presence of an internal control system (*Internes Kontrollsystem*, IKS) and take it into account in defining the scope of its own auditing. This linking of internal and external audit (also known as *integrated audit*) has already prompted lively discussion and will, in the course of its practical application, lead to further debate.

A hot issue might also be the risk assessment by the supervisory board required in the appendix of the year-end financial statements. As a part of the yearly accounting this risk assessment would essentially be subject to the audit, but must the auditors' report also state whether the risk assessment is accurate? It is quite obvious that the auditors, in view of the experiences of spectacular corporate collapses (Swissair, Enron, Worldcom, Parmalat, etc.) might see

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themselves pushed into a more corporate role and be under pressure to themselves undertake the risk assessment.

The review is limited to verifying if facts exist which could lead to the conclusion that the yearly accounting or the profit disbursement application do not meet the legal requirements or articles of incorporation. The intention is to go for a negative confirmation that such facts do not exist. In the case of many smaller companies, this type of check will in fact probably correspond to the presently established audit standard.

Audit Supervision

The new RAG provides for an accreditation procedure for licensing all auditors or auditing companies. Audit *experts* and their auditing companies, i.e. auditors who audit publicly traded corporations (see definition, above), are, in addition, subject to governmental supervision. This is established in conjunction with a comprehensive set of quality control tools and a sanction system. Aside from revocation of such a license, now also prison terms and penalties up to one million Swiss Franks can be imposed. ■

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"Miss Dugan, will you send someone in here who can distinguish right from wrong?"

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