Swiss Corporate Law Reform: Share Capital (Part II) - Changes in Share Capital and Capital Band

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This legal update is part of a series summarizing the most important upcoming amendments to Swiss corporate law in a condensed form as relevant for legal practitioners. Previously published legal updates can be found on our website at Swiss Corporate Law Reform 2020. New legal updates on the corporate law reform are regularly e-mailed to our newsletter subscribers and published on our website.

Key takeaways

In addition to the changes described in the last legal update (Share capital – Part I) of this series, the Corporate Law Reform introduces various provisions that provide Swiss companies limited by shares (Aktiengesellschaften) and, to a lesser extent, limited liability companies (GmbH) greater flexibility in designing their share capital structure. It also simplifies certain share capital change procedures. Furthermore, the codification of current practice will increase legal certainty:

The following changes and new provisions apply to companies limited by shares and limited liability companies:

- The existing practice of a share capital increase up to a maximum amount is incorporated into statutory law.
- The period for implementing an ordinary share capital increase is extended to six months.
- The procedure for an ordinary capital reduction is shortened and made more flexible.

The following changes and new provisions only affect companies limited by shares:

- If bonds or similar debt instruments are issued at reasonable conditions by listed companies, the cancellation or restriction of the priority subscription right does not require an additional good cause.
- The previous instrument of the authorized capital increase is discontinued and replaced by the new instrument of the capital band.
- With a capital band, the board of directors can be authorized to proceed with share capital changes (increases and/or decreases) within certain limits for a period of up to five years. The capital band, thus, allows the combination of an authorized capital increase with an ‘authorized capital reduction’, which was previously not stipulated by the statute.
- The introduction of a capital band offers Swiss companies limited by shares more flexibility in designing the equity capital structure.

Introduction

On 19 June 2020, Swiss Parliament adopted the final text of the Swiss Corporate Law Reform. This will bring into force important amendments regarding changes in share capital which are relevant not only for Swiss companies limited by shares but also for limited liability companies. While the text of the Swiss Corporate Law Reform on the level of the statute (Swiss Code of Obligations) is in the meantime final due to the expiry of the relevant referendum period that followed the decision of the Swiss Parliament, the consultation process with respect to the draft of the detailed implementing provisions in the revised Commercial Register Ordinance was published by the Federal Council on 17 February 2021. The consultation process on the draft text of the revised Commercial Register Ordinance will last until 24 May 2021 but should not result in any significant changes to the new law as outlined below. The entry into force of the entire revision of the corporate law including the below modifications is not expected until 2023 according to current estimates by the Federal Office of Justice.

Amendments to existing share capital change methods

While the today available instrument of an authorized capital will be discontinued and replaced by the new instrument of the capital band, the existing instruments of ordinary and conditional share capital increase remain in place, and only selective changes will be made in order to reflect well-established practice in the statute, thereby increasing legal certainty. With respect to share capital reductions, the changes are more comprehensive. This is because current law provides only high-level guidance on the matter, is unclear and incomplete in some respects compared to the provisions on share capital increase procedures. Under the revisions, the share capital reduction will be regulated in the same chapter and with the same density as the capital increase. In addition, all forms of share capital changes are also subject to certain simplifications.

Ordinary capital increase

The procedure of an ordinary capital increase essentially stays as is. Only selective amendments will be made and well-established practice will become statutory law. With regard to the contribution to pay in the amount of the share capital increase in a qualified manner (i.e. contribution in kind, converting debt of the company with the founder or (future) shareholder as lender into equity and conversion of freely disposable equity capital), and the deletion of the rules regarding the (anticipated) acquisition of assets, we refer to our last legal update in the series on the Corporate Law Reform: Share capital – Part I. The new regulation of the ordinary capital increase is equally relevant for companies limited by shares as well as for limited liability companies.

Share capital increase with maximum amount incorporated into statutory law

Art. 650 para. 2 no. 1 of the new Code of Obligations (nCO) stipulates that the resolution of the general meeting must contain information "on the nominal amount or the maximum nominal amount" by which the share capital or the company capital, respectively, is to be increased. Accordingly, the capital increase authorized up to a maximum amount is now set forth in the statute - which has already been applied in practice based on the current Commercial Register

Ordinance.

The requirement of objectivity also applies to the issue price

The protection of shareholders (Aktionäre) and quotaholders (Gesellschafter) respectively against dilution will be strengthened. For instance, it is expressly clarified in the new law that the restriction or cancellation of subscription rights, as well as the determination of the issue price, must not result in any improper advantage or disadvantage to the parties involved. As a result, shareholders and quotaholders are protected against capital dilution through an unreasonably low issue price for new shares.

Practice-relevant clarification for debt-to-equity swaps

If the shareholder's or investor's contribution obligation arising in the course of a share capital increase is to be fulfilled by set-off, the corresponding claim of the company's creditor is deemed to be sufficient cover even if the balance sheet shows that the creditor's claim is not fully covered by assets of the company. This clarifies that so-called debt-to-equity swaps are also permissible in restructuring situations (e.g. if the company is over-indebted). In the future, such a share capital increase by offsetting an existing debt will require a qualified resolution of the general meeting and must be disclosed in the articles of association as well as in the commercial register. If a share capital increase is effected by conversion of freely disposable equity capital, this circumstance must also be stated in the articles of association. Consequently, there is a certain standardization of the regulation of qualified capital contributions (see also the legal update Share capital – Part I in our legal update series on the Corporate Law Reform).

Extension of the deadline for implementation to six months

In practice, the three-month period currently provided for the execution of a share capital increase regularly turned out to be too short in practice. For this reason, the revised corporate law provides that the share capital increase must be executed and filed with the commercial register for registration within a period of six months after the resolution of the general meeting. In order to meet the deadline, it is no longer decisive when the entry in the commercial register occurred going forward, the decisive factor will be the date of filing for registration of the executed share capital increase with the commercial register.

Conditional capital increase

The current law on share capital increases from conditional capital at companies limited by shares is largely unchanged and supplemented only by some selective changes. In addition, well-established practice is transferred into statutory law, which leads to various improvements and more legal certainty.

Extension of the range of potential recipients and field of use

Based on conditional capital, the board of directors may issue conversion and option rights granting the recipients a right to acquire new shares. According to the wording of the new Art. 653 nCO, the potential recipients of such conversion and option rights are no longer limited to employees or creditors of bonds and similar debt instruments. In accordance with and in extension of current practice, shareholders and members of the board of directors of the issuing company or group companies, as well as 'third parties' in general, are now also explicitly mentioned as potential recipients of conversion and option rights. The revised corporate law explicitly states that not only acquisition rights but also acquisition obligations can be covered by conditional capital as underlying for the subsequent issuance of shares. Therefore, the new law codifies established practice for mandatory convertible bonds and similar instruments.

Changes regarding priority subscription rights

In the case of a capital increase from conditional capital, the existing shareholders are entitled to priority subscription rights, which can be cancelled for good cause, as it is the case with subscription rights in the case of an ordinary share capital increase. If shares are listed on a stock exchange and bonds or similar debt instruments are issued at reasonable conditions, good cause will explicitly not be required anymore for the cancellation or restriction of the priority subscription right. Thus, provided that such instruments are issued at reasonable (market) conditions by a listed company, the cancellation of priority subscription rights is permissible without the need for further good cause.

Facilitation of exercise of conversion or option rights

The form in which conversion or option rights must be exercised will no longer be prescribed by law (currently: written form requirement). In future, subject to certain conditions, the form can be determined by the company in its articles of association. If the capital contribution is made in the context of a capital increase from conditional capital upon conversion by offsetting of claims, a bank will no longer have to be involved – unlike in the case of contributions in cash. This considerably simplifies the issuance of convertible bonds, convertible notes or convertible loans and the subsequent conversion of the debt into shares.

Elimination of authorized capital increase

The current authorized share capital increase for companies limited by shares will be abolished and replaced by the more flexible instrument of a capital band. Consequently, Art. 651 et seq. of the Code of Obligations currently in force will be repealed. With the introduction of the capital band, the authorized capital increase is supplemented with an authorized capital reduction option (see also: New instrument: capital band).

Reduction of the share capital

The new law clarifies that for companies limited by shares or limited liability companies, the share capital reduction can be implemented either by a cancellation of shares or quotas, respectively, or by a reduction of the nominal value or a combination of the aforementioned elements. As before, the capital can only be reduced to the minimum capital provided by law (CHF 100,000 for companies limited by shares and CHF 20,000 for a limited liability company, or the corresponding equivalent in the functional currency – see also the legal update Share capital – Part I in our legal update series on the Corporate Law Reform). A reduction below this amount is only possible if the share capital is simultaneously increased again to at least this amount. The new regulation of the capital reduction is equally relevant for companies limited by shares as well as for limited liability companies.

Reduction with maximum amount and adjustments to the protection of creditors

As with the share capital increase, the ordinary share capital reduction with a maximum amount will also be explicitly permitted under the Corporate Law Reform. This may be relevant, for example, if the specific amount of the share capital reduction depends on the outcome of a share repurchase programme.
The creditor protection provisions applicable in the context of the share capital reduction remain unchanged in substance. However, the new law accelerates the process and provides options that render the procedure more flexible. Thus, the public call on creditors required for a share capital reduction will no longer have to be made three times, but only once, and creditors will now have 30 days after publication of the creditors' call to request that their claims be secured, instead of two months as under the current law. On the other hand, the most relevant provisions for the protection of creditors will be retained and more clearly regulated. These include the creditors' call, the obligation to provide security, the audit expert's audit report and the obligation to prepare interim financial statements as already required in current practice if the last balance sheet date is older than six months.

With regard to the timing of the creditors' call, there will be greater flexibility insofar as that the call no longer necessarily has to be made after the resolution of the general meeting to reduce the capital. If the circumstances are clear, the creditors' call can already be made before the resolution to reduce the share capital, which shortens the procedure. Furthermore, based on the relevant financial statements and the outcome of the creditors' call, a licensed audit expert must confirm that the claims of the company's creditors are secured despite the capital reduction that may take place. Also the review process with the audit expert and the issuance of the audit report can take place before or after the resolution of the general meeting. However, the audit expert's report must be based on the outcome of the creditors' call and, thus, always follows the latter, which is not the case under current law.

In addition, the company must secure the claims of the creditors to the extent that the previous cover is reduced by the share capital reduction, should creditors request this within 30 days of the publication of the creditors' call. In line with the proven concepts under the Merger Act, the obligation to provide security does not apply if the company fulfils the claim or proves that the fulfilment of the claim will not be jeopardized by the reduction of the share capital.

The reduction of the share capital must be executed within a period of six months after the resolution of the general meeting.

Clarifications regarding special forms of share capital reductions

If a share capital reduction is carried out in order to eliminate a loss of capital (Unterbilanz; i.e. the net assets fall below the amount of the share capital), the provisions on the protection of creditors (in particular, the securing of claims of the company's creditors, interim financial statements and audit report) do not apply if a licensed audit expert confirms that the amount of the share capital reduction does not exceed the amount of the capital loss. In substance, this new provision is consistent with the previous regulation.

In future, the reduction of the share capital with a simultaneous share capital increase, which is already applied in practice today, but is not systematically regulated by law, will be regulated by statute separately as a special case of a reduction of share capital. In this case, the provisions on the protection of creditors do not apply under certain conditions. If, in the case of a share capital reduction with a simultaneous share capital increase, the number and nominal value of the shares and the amount of the contributions made thereon are not changed, the board of directors also does not have to amend the articles of association. In contrast to the current legal situation, the new share capital contributed in the context of a reduction of share capital with a simultaneous capital increase will not have to be paid up in full; rather, it is sufficient that the previous level of contributions is not reduced.

New instrument: capital band

Introduction

The new instrument of the capital band will replace the previous authorized capital increase and creates the possibility of combining an authorized capital increase with an ‘authorized capital reduction’.

After the revisions come into force, the introduction of the capital band will enable Swiss companies limited by shares to authorize the board of directors in the articles of association to change the equity capital of the company within a range (the capital band) within a period of up to five years without the need for a further resolution by the general meeting.

The introduction of the capital band has the purpose of enabling companies limited by shares to adjust their equity capital in a timely manner as required. An interest in the swift availability and increase of equity capital may exist particularly in connection with acquisitions or planned investments. Conversely, in the case of overcapitalization, the capital band can serve to create more flexibility for capital reductions.

Adoption by the general meeting

Qualified majority required

A company intending to make use of the new instrument of the capital band after the corporate law reform has come into force must include an authorization provision in favor of the board of directors in the articles of association by means of a resolution of the general meeting. This resolution requires a qualified majority of two thirds of the voting rights represented and a majority of the nominal value of the shares represented.

Requirements for the authorization provision

With regard to content, the authorization provision in the articles of association must specify at least the upper and lower limit of the capital band, whereby the upper limit of the capital band may not exceed the share capital registered in the commercial register by more than 50% and the lower limit of the capital band may not be lower than 50% of the registered share capital. The minimum share capital must not fall below 100,000 Swiss francs (or the corresponding equivalent value in the functional currency – see the legal update Share capital – Part I in our legal update series on the Corporate Law Reform). Furthermore, the articles of association must specify the date on which the authorization of the board of directors expires, whereby the maximum authorization period of five years must be observed.

The board of directors can only be authorized to effect a reduction of share capital within the capital band if the shareholders of the company have not opted-out from the requirement of a limited audit.

Freedom in designing specific solutions

Within this framework, the general meeting has a considerable degree of freedom in designing the authorization provision in a specific way. For example, the duration of the authorization can be shortened or the board of directors can be authorized exclusively to make share capital changes in one direction (e.g. only to increase share capital). The articles of association may also further limit the powers of the board of directors and, for example, subject them to restrictions, requirements or conditions. This could include the earmarking of different tranches of share capital changes within the capital band for specific purposes, limiting the powers of the board of directors to a certain number of capital changes, or limiting the amount of each capital change.

Protection of shareholders

In case of share capital increases within the capital band, the shareholders are also entitled to subscribe to that proportion of the newly issued shares which corresponds to their previous participation. If the subscription right is to be restricted or cancelled, the articles of association must specify the restriction or cancellation of the subscription right or indicate the good cause for which the board of directors may restrict or cancel the subscription right.

Changes in share capital by the board of directors

Within the scope of its authorization, the board of directors decides on the increase or reduction of the share capital and passes or determines the necessary provisions and details, insofar as these do not already result from the authorization resolution of the general meeting or the articles of association. Possible methods of increasing share capital within the scope of the capital band are the ordinary capital increase and the increase from conditional capital, whereby the provisions on the ordinary share capital increase or the increase from conditional capital apply analogously. The contributions for paying-in the issue amounts for new shares follow the respective provisions on the incorporation of the company. Accordingly, all forms of possible contributions for paying the issue amount relating subscribed shares are available for capital increases within the limits of the capital band. If the authorization resolution of the general meeting does not already specify the form of the contribution for paying-up of the shares, the board of directors will decide on such form of the contribution in its resolution on the capital increase.

Within the scope of its authorization, the board of directors may reduce the share capital within the limits of the capital band. The provisions on the reduction of the share capital (Art. 653j f. nCO) apply analogously. Thus, the board of directors can use the instruments of (i) the ordinary capital reduction, (ii) the capital reduction in order to eliminate a capital loss and (iii) the reduction of the share capital with a simultaneous share capital increase.

In case the articles of association provide for a capital band and the general meeting additionally agrees on an ordinary share capital increase during the term of the capital band, the authorization of the board of directors shall cease and the capital band must be deleted from the articles of association, unless the general meeting reintroduces a capital band (whereby the upper and lower limit of the capital band must be determined on the basis of the new, increased capital). The general meeting can create and adopt a conditional share capital within or outside the capital band. If the creation takes place outside the capital band, this still has an influence on the capital band, since the upper and lower limits of the capital band are shifted linearly in the case of a share capital increase from conditional capital, but the range of the authorization of the board of directors does not change.

Interplay between repurchase of own shares and reductions within the capital band

Capital reductions within the capital band can be effected in particular through the cancellation of shares. For a company to be able to cancel its shares, it must first acquire them. The acquisition of treasury shares is limited by law to 10% of the share capital and may, therefore, be in conflict with capital reductions within a capital band. Capital reductions within a capital band can – depending on the structure and details of the capital band – amount to more than 10% of the share capital. The revised provisions do not state how this conflict is to be resolved, which leads to some legal uncertainty. While there is broad agreement that the flexible structuring of the capital band must take precedence over this 10% quota, there are differing opinions as to the exact point in time up to which the acquisition is limited to 10%. Some authors in the legal doctrine assume that the acquisition of treasury shares is limited to 10% of the share capital until the board of directors resolves the capital reduction, after which the capital band shall determine the limit for the maximum repurchase of treasury shares for the capital reduction by cancellation.

Protection of creditors

Share capital reductions generally result in a reduction of the company's liability basis. Therefore, certain creditor protection provisions must also be respected in the case of share capital reductions within the capital band. Essentially, in the case of reductions of share capital within the capital band, the provisions on the ordinary share capital reduction concerning the securing of creditors' claims, interim financial statements and audit confirmation will apply.

In sum: more flexibility

The authorization for the board of directors to effect changes in share capital within a capital band, to be stipulated in the articles of association, creates the possibility for flexible adjustment of the company's equity. This, in particular, is because no additional resolution of the general meeting is required for a share capital change. As a result, the authority for share capital changes is transferred from the general meeting to the board of directors. By means of an appropriate design of the capital band and the authorization provision, the general meeting can specify and control the framework for the shift of authority to the board of directors. The degree of actual flexibility achieved by the introduction of a capital band, therefore, also depends largely on the authorization provision in the articles of association. If the authorization provisions are designed in such a manner to create flexibility and to confer broad powers to the board of directors, this can result in substantial changes with regard to corporate governance.

Enactment and need for action

Following the enactment of the new law, which is scheduled for 2023 at the earliest according to current information, Swiss companies will have a transitional period of two years to amend their articles of association and regulations. After this period, provisions of the articles of association that do not comply with the new law will automatically cease to apply. The changes described above, therefore, do not cause need for a mandatory amendment of the articles of association. However, the board of directors, the management or the in-house legal team should carefully consider the new provisions, changes and simplifications of the new law in order to assess whether their organization could benefit from them, and/or to recommend them to the shareholders of the company. The transitional period still leaves time, but for companies using authorized or conditional capital, for example, proactive planning is necessary in order to structure the capital base in an appropriate manner (e.g. implementation of a capital band, adjustments to conditional capital, discontinuation of authorized capital).

Contributors: Franz Schubiger (Partner), Severin Roelli (Partner), Beat Schwarz (Partner), Raphael Widmer (Associate), Yves Ammann (Junior Associate)

Franz Schubiger

Partner
Attorney at law, LL.M.
Co-Head Life Sciences

Pestalozzi Attorneys at Law Ltd
Feldeggstrasse 4
8008 Zurich
Switzerland
T +41 44 217 92 49
franz.schubiger@pestalozzilaw.com

Severin Roelli

Partner
Attorney at law, LL.M.

Pestalozzi Attorneys at Law Ltd
Feldeggstrasse 4
8008 Zurich
Switzerland
T +41 44 217 92 68
severin.roelli@pestalozzilaw.com

Beat Schwarz

Partner
Attorney at law

Pestalozzi Attorneys at Law Ltd
Feldeggstrasse 4
8008 Zurich
Switzerland
T +41 44 217 92 44
beat.schwarz@pestalozzilaw.com