

## Gesellschaftsrecht 8 January 2016: Model Answer

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<b>Question 1:</b>	<b>Points</b>
Discuss the duties of directors towards their company. Does the size of the company make a difference, for example a small private company as contrasted with a large publicly listed Multi-national Corporation? What interests may other stakeholders have and should directors take those into account? How should directors deal with company assets like information or client lists?	
Essential points to be <b>analysed</b>	
<ul style="list-style-type: none"> <li>• Directors are elected by shareholders to oversee the company</li> </ul>	1
<ul style="list-style-type: none"> <li>• Fiduciary nature of relationship: greater scope than contract</li> </ul>	1
<ul style="list-style-type: none"> <li>• Fiduciary principles necessary to complete the imperfect contract inherent in the corporate principal/agent relationship: How to devise a complete contract to take account of investor's wealth maximisation objective while achieving agent's objectives (financial &amp; non-financial compensation)</li> </ul>	1
<ul style="list-style-type: none"> <li>• Agent of Shareholders versus Agent of Company as a legal Person</li> </ul>	1
<ul style="list-style-type: none"> <li>• Duty of care, skill and diligence – to act as a prudent person does in the management of his own affairs of equal gravity.</li> </ul>	1
<ul style="list-style-type: none"> <li>• Duty of loyalty- to maximize the investors' wealth rather than one's own wealth i.e. not to take advantage of asymmetric information to make side-deals with company clients or suppliers.</li> </ul>	1
<ul style="list-style-type: none"> <li>• Duty of Confidence – to treat company information confidentially</li> </ul>	1
<ul style="list-style-type: none"> <li>• Trading in company information introduces risk of claims of insider dealing</li> </ul>	1
<ul style="list-style-type: none"> <li>• Duty to Avoid Conflicts of Interests</li> </ul>	1
<ul style="list-style-type: none"> <li>• Duty of Disclosure of Material Interests</li> </ul>	1
<ul style="list-style-type: none"> <li>• Business Judgment Rule (USA) i.e. courts will not second-guess directors' good faith decisions: freedom to fail honourably</li> </ul>	1
<ul style="list-style-type: none"> <li>• Duty owed to the Company, where "company" means the shareholders as a whole, though certain other stakeholders may be taken into account especially creditors</li> </ul>	1
<b>Total</b>	<b>12</b>

Question: 2	Points
<p>Company A is a small financial institution incorporated in the UK and listed on the Swiss Stock Exchange. The Chairman of the Board of Directors is Mr X. He is also employed as the Chief Executive Officer and receives a substantial part of his remuneration in the form of bonuses. In addition, Mr X is the founder of Company A and holds 100 of the 1000 shares issued by Company A. These 100 shares are designated in the Company's Articles of Association as "Founder Shares" and carry double votes on the matters known as "Major Proposals" set out in Company A's Articles. Any proposal for the Company that is "major" must be approved by 80% of the shareholders at an Extraordinary General Meeting.</p>	
<p>Company A currently operates from a principal place of business in the United Kingdom. In January 2015, Mr X proposed to the Board "it's time to get out of the UK". A Minority Shareholder learns of this and indicates to the Board he objects and that he intends to oppose any such proposal in every way possible. Before the EGM is announced, Mr X tells the Minority Shareholder "if you don't like it, sell your shares".</p>	
<p>Advise the Board as to:-</p>	
<p>a) The company's rights and restrictions on transfer of its business to another country within the European Union or Switzerland;</p>	
<p>b) Whether another EU country or Switzerland would be preferable in terms of executive pay; and</p>	
<p>c) Any risks the proposal might fail, potential risks to the Board or Mr X personally, and how these could be overcome.</p>	
<p>Essential points to be <b>analysed</b></p>	
<ul style="list-style-type: none"> <li>Financial Institutions fall within CRD III and CRD 1V as realised in UK Law by the Financial Services Act 2010 and expressed in the Prudential regulation Authority rules. Company A is a financial institution falling within the rules.</li> </ul>	1
<ul style="list-style-type: none"> <li>Since 2014, Mr X's bonus is in any event subject to the 50% cash/shares mixture, and the 40%/60% deferral rules, whereby a bonus must be paid in stages over 5 years with no more than 40% in the first year and the remaining 60% paid in three 20% stages in years 3, 4 and 5. No cash front loading. All stages must be a mixture of cash and shares up to 50% in cash.</li> </ul>	1
<ul style="list-style-type: none"> <li>From 1 January 2015 there is now a cap on the amount of a bonus, namely a 1.1 ratio as against fixed salary, so the balance of Mr X's remuneration may need to change so that it is no longer the "substantial" part. However, shareholders could approve a 2:1 ratio. The 2015 regulations also limited relief for deferrals and extended the claw-back period. Conversely, as Company A is a small company, Mr X's bonus may be "de minimis" i.e. £50,000 or less.</li> </ul>	1
<ul style="list-style-type: none"> <li>Swiss rules on executive contract terms including pay apply only to Swiss-incorporated companies, even if listed in Switzerland. Thus Company A captured by UK rules but not Swiss rules as to the size and composition of executive pay. BUT FINMA rules nevertheless require disclosure and shareholder approvals for all Swiss listed companies.</li> </ul>	1
<ul style="list-style-type: none"> <li>Company A has option under Freedom of establishment provisions of EU Treaty to move its primary establishment i.e. change its place of registration OR set up a secondary establishment i.e. a branch or affiliate.</li> </ul>	1
<ul style="list-style-type: none"> <li>If Company A transfers to Switzerland by way of re-incorporation or formation of a subsidiary, it will then be subject to the full range of Swiss rules. But if Company leaves its legal shell behind in the UK, it may nevertheless continue to be subject to UK rules. <i>Daily Mail</i> case.</li> </ul>	1
<ul style="list-style-type: none"> <li>Under the Lisbon Treaty Articles [53 – 55], Company may transfer its legal</li> </ul>	1

registration or main place of business/operations to any other EU Member State.	
<ul style="list-style-type: none"> <li>The receiving Member State may not obstruct the incoming business entity except on certain limited grounds, where such grounds must be applied equally to domestic business entities in accordance with the Gebhard principle and without any indirect discrimination [Caixa]</li> </ul>	1
<ul style="list-style-type: none"> <li>The Member State from which a business entity is exiting may nevertheless continue to impose its rules on the corporate shell if such shell remains registered in the “exit” country, notwithstanding the substance has migrated to another EU Member State. <i>Daily Mail</i> case.</li> </ul>	1
<ul style="list-style-type: none"> <li>Mr X’s suggestion to the minority shareholder that he sell his shares runs risk of encouraging another to deal in price-affected securities based on inside information contrary to UK Criminal Justice Act 1993, Part V.</li> </ul>	1
<ul style="list-style-type: none"> <li>The Board must convene an Extraordinary General Meeting of the Shareholders to approve the proposal to move the Company to another jurisdiction, if this is listed as a “Major Matter” under the Company Articles.</li> </ul>	1
<ul style="list-style-type: none"> <li>Given the near similarity of the rules across the EU (including the UK) and also in Switzerland, is it a proper exercise of the Boards’ powers to move country for the apparent sole purpose of favouring the Chairman/CEO, who is also a substantial shareholder? What is the benefit to the Company as a whole of any such proposed move? Risk to Board of challenge from minority shareholder based on breach of duty, possible judicial review or injunction.</li> </ul>	1
<ul style="list-style-type: none"> <li>To overcome risks, it will be necessary to be fully transparent as to Mr X’s remuneration and then to argue that moving the company abroad is essential to retain valuable employee, whose interests are in fact aligned with Company A.</li> </ul>	1
<ul style="list-style-type: none"> <li>Shareholder Majority Rule; voting at the Extraordinary General Meeting must meet the 80% threshold for “Major Matters”. Re-location of company likely to be a “Major Matter”.</li> </ul>	1
<ul style="list-style-type: none"> <li>Mr X has 10% of the vote multiplied by 2 as a “Founder” = 20%, but that is not enough to carry a motion nor block one. Allied shareholders needed.</li> </ul>	1
<ul style="list-style-type: none"> <li>Nevertheless, Founder Shareholder rights might constitute Mr X as a “controlling shareholder” and so raise issues of oppression of minority.</li> </ul>	1
<ul style="list-style-type: none"> <li>Purpose of the compensation regulations is to align risks of senior managers with shareholders, and also to introduce more caution so as to protect public interest against future bailouts.</li> </ul>	1
<ul style="list-style-type: none"> <li>Proxy battle will be needed to carry the Motion at the EGM, as Chairman and Board will need to assemble more than 80%.</li> </ul>	1
<b>Total</b>	<b>18</b>

<b>Part</b>	<b>Points</b>
<b>Question 3</b>	
<b>Securities regulation aspects of raising capital</b>	
<b>Comparison of the requirements of EU, US and CH law</b>	
EU, US and CH: Prospectus requirement Prospectus = formal document containing all information necessary to enable investors to make an informed assessment of the issue	2
EU: - Scope of the EU Prospectus Directive - Discussion of prospectus liability - Elements of liability are at the Member States level	1
US: - Catch-all prospectus definition - Discussion of prospectus liability - Section 11 and 12(a) of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934 - various elements in the various provisions (e.g. privity requirement, standard of care)	1
CH: - Issue prospectus v. listing prospectus - Discussion of prospectus liability - Art. 752 of the Code of Obligations: coverage = prospectus and as well similar statements - primary and secondary markets	1
<b>Regulatory approval</b>	
EU: Prospectus approval by the competent authority of the home Member State, i.e. state where the issuer is incorporated - passporting mechanism Forbidden to disseminate the prospectus prior to obtaining regulatory approval	1
US: Filing a registration statement (containing prospectus) with the Securities and Exchange Commission (SEC) Forbidden to offer and sell securities during the pre-filing period Allowed to offer securities but forbidden to sell securities during the waiting period - registration statement becomes effective Allowed to both offer and sell securities during the post-effective period = registration statement becomes effective	1
CH: No regulatory approval of the prospectus prior to disseminating the prospectus Control = ex-post = prospectus liability [If securities listed on the SIX Swiss Exchange: approval of the listing prospectus by the SIX Swiss Exchange prior to trading securities on the stock exchange]	1
<b>Company law aspects of raising capital in the European Union</b>	
Shareholder approval required for any change of capital structure Provision of the recast of the Second Company Law Directive Any increase of capital decided upon by the general meeting	1
Discussion of the <i>Pafitis v. TKE</i> case	1
Preemptive rights Provision of the recast of the Second Company Law Directive Definition of pre-emptive rights Shareholder approval required for any limitation or withdrawal of pre-emptive rights	1
Discussion of the <i>EC v. Kingdom of Spain</i> case	1
<b>Subtotal Question 3</b>	<b>12</b>

<b>Question 4</b>	<b>Points</b>
<b>a) Principle of equal treatment under EU law - in general</b>	
No general principle of equal treatment No general obligation to share the gains from control transactions	2
Discussion of the <i>Audiolux v. Groupe Bruxelles Lambert</i> case Similarity to the fact pattern	2
Analysis Sale of the shares of Mr A to Ms C at a premium over the market price = control transaction No application of the EU Takeover Directive because a national derogation from the mandatory bid rule applies Shareholder D = Minority shareholder No general right of equal treatment - Shareholder D cannot require to be shared the gains from the control transaction - Shareholder D cannot require to be offered the same premium over the market price	3
<b>b) Principle of equal treatment under EU law - under specific circumstances</b>	
Application of the EU Takeover Directive Application of the mandatory bid rule Acquisition of control Definition of control by the Member states - around 30% of the voting rights in most Member states	2
Discussion of how the mandatory bid rule relates to equal treatment of shareholders Selling control at a premium over the market price = control transaction Obligation to share the gains from the control transaction by offering an equitable price to minority shareholders Equal treatment between controlling shareholders and minority shareholders Definition of equitable price by the Member states	2
Analysis Mr A's sale of 52% of the voting rights = control transaction Discussion of whether 52% = control Application of the mandatory bid rule in this particular case Shareholder D = minority shareholder Right of equal treatment - Shareholder D's right to be offered an equitable price - Shareholder D can require to be offered the 40% premium over the market price	3
<b>c) Pros and cons of a corporate law system that requires equal treatment</b>	
Pros: - Legal protection of minority investors - Importance of deterring value-decreasing control transactions such as looting and mismanagement - Any other relevant aspect	2
Cons: - View that control is a valuable asset in the company - Importance of not deterring value-increasing control transactions - Importance of the discretion of controlling shareholders and controlling boards of directors - Any other relevant aspect	2
<b>Subtotal Question 4</b>	<b>18</b>