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Shareholders' agreements for closely held companies under Swiss law

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Introduction

Swiss company articles and organisational regulations do not legally bind shareholders to do more for a company beyond paying their share subscription price and notifying the company about shareholdings, related beneficial owners and direct or indirect share transfers (Articles 680, 697i, 697j and 697k of the Code of Obligations).

In such circumstances, shareholders of closely held companies often mutually agree on additional contractual rights and duties. As a matter of company law, the company itself cannot be a contract party to a separate shareholders' agreement. Apart from that legal restriction, such shareholders' agreements usually benefit from the contractual freedom of the parties in Switzerland (ie, the content of the agreement is limited only by general principles of Swiss law).

The courts may, for example, recharacterise such shareholders' agreements as contrary to the principle of good faith under Article 2 of the Civil Code, or as abusive under Article 27(2). No person may surrender his or her personal freedom or restrict his or her use to an extent that would infringe Swiss law or be regarded as immoral. A recent Federal Court decision (4A_45/2017, June 27 2017) has once again confirmed this.

Facts

Three shareholders incorporated a new Swiss company in 1985 and entered into a shareholders' agreement, pursuant to which they were all entitled to become members of the company board. In addition, one shareholder was promised compensation if the remuneration of another shareholder – who was responsible for day-to-day management – exceeded certain thresholds. For all cases of share transfer, contractual rights of first offer and first refusal were foreseen in favour of the other shareholders and the shareholders' agreement stated that this was to be valid indefinitely (ie, there were no contractual termination rights). Contractual penalties were foreseen as a consequence of any breach.

In 1998 the shareholders started negotiations regarding an amendment and the restatement of certain clauses in their shareholders' agreement, but failed to agree. For this reason, in 1999 one of the three shareholders (the defendant) unilaterally terminated the shareholders' agreement in writing after the third shareholder sold his shares to the defendant, so that the defendant held 66% of the company's shares, and subsequently retired from the company's operative management in 2002. The second remaining shareholder (the plaintiff) disagreed with this unilateral termination of the shareholders' agreement. He asked for specific performance under the agreement and over the 15 years following the unilateral termination repeatedly requested to be elected to the company's board, always without success.

However, in 2013 the plaintiff finally started proceedings before the Appenzell Outer Rhodes Cantonal Court to seek:

- remedy for the three subsequent breaches of the shareholders' agreement by the non-election of the plaintiff to the board;
- the agreed contractual penalty;
- to legally bind the defendant to elect the plaintiff to the company's board; and
- to allow the plaintiff contractual participation in the defendant's retirement payment.

This first-instance court approved the plaintiff's claims. On appeal, the cantonal Appenzell Outer Rhodes Supreme Court upheld the first-instance decision. As a result, the defendant brought the case to the Federal Supreme Court for violation of Article 27(2) of the Civil Code and Articles 19(2) and 20 of the Code of Obligations.

Federal Court decision

In the new decision, the Federal Court confirmed that under Swiss law a contract cannot be validly concluded for an indefinite period. Based on all prevailing circumstances, contract terms and other contractual clauses which infringe the personality rights of one contract party are penalised by full or partial invalidity under Articles 19(2) and 20 of the Code of Obligations and Article 27(2) of the Civil Code. The permitted contract duration is shorter for recurring contractual obligations compared to contractual waivers, which forbid only a specific action by a contract party. The imbalance between the rights and duties of one contract party with those of one or several other contract parties should also be considered.

The Federal Court held that long-term commitments in a shareholders' agreement may be admissible if they are linked to the shareholder quality of a contract party and such a contract party may transfer its shareholding on fair, not overly onerous terms and conditions. However, a long commitment of one party to a shareholders' agreement must be recharacterised as excessive and invalid if such a party's succession planning cannot be realised without affecting its economic freedom, or if its clauses clash with a shareholder's personal field of activity.

In this case, the court found it decisive that, pursuant to a contractual clause in the shareholders' agreement, all heirs of the defendant's shares who were also active within the management of the company would be contractually bound to pay the plaintiff compensation if their remuneration exceeded certain thresholds. This would make their succession to the company's shares unattractive, although such shareholding continuity within the same family may otherwise be beneficial for a company.

The court concluded that over the 30 years following the conclusion of the shareholders' agreement (ie, one generation later), the defendant would still be practically barred from transferring his company shares to his two sons for as long as they remain active in the company and unable to elect them to the board as his successors.

For these reasons, the court regarded the defendant's personal freedom to plan his succession for the company's shares and management to be excessively restrictive and declared the shareholders' agreement invalid pursuant to Article 27(2) of the Civil Code and Article 20 of the Code of Obligations from 2013 onwards.

Under the applicable statutory limitation term of 10 years, the participation of the plaintiff in the defendant's retirement payment was held to no longer be due, because the plaintiff had waited from 2002 to 2013 to begin the collection proceedings. However, the three contractual penalties regarding the earlier non-election of the plaintiff to the board were held to be due.

Comment

Irrespective of whether specific performance is sought only for certain contractual clauses of the shareholders' agreement with no contractual termination provision, a Swiss court must consider all its effects under Swiss law before reaching a decision regarding whether its term is excessive under Article 27(2) of the Civil Code and Article 20 of the Code of Obligations.

As a result, a shareholders' agreement may become invalid over time (particularly so more than one generation later) if one original contract party is exposed to the arbitrariness of the counterparty and its economic freedom is abolished or restricted to such an extent that it endangers its economic existence or must otherwise be regarded as excessive based on all circumstances of the particular case (eg, if a shareholder cannot plan his or her succession for the company's shares and management more than one generation later).

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