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In a nutshell

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Company law revision / the Federal Council's proposal Return of benefits

At the end of 2005, the Federal Council fired the starting shot for a revision of company law by presenting a preliminary draft and an accompanying report. Back at the end of 2007, the Federal Council submitted a dispatch and a comprehensive draft, which also contained provisions of accounting legislation. Before the Federal Parliament, however, was even able to start deliberating company law, the popular initiative «against fat-cat salaries» was launched in February 2008. The effect of that was that the company law revision was placed on the back burner. The revision of accounting legislation was separated from the revision of company law. In the meantime, the new accounting legislation has come into force.

After the Swiss people had accepted the initiative «against fat-cat salaries», it was implemented with the Ordinance Against Excessive Remuneration in Listed Companies dated 20 November 2013 (the «Ordinance»). On 28 November 2014, the Federal Council reopened the discussion on reforming company law by submitting a new preliminary draft for consultation. This led to numerous, detailed opinions, and, having worked its way through them, the Federal Council adopted a dispatch on company law revision on 23 November 2016. It is to be expected that in the course of the forthcoming deliberations, the proposal will still undergo several amendments.

We have produced six articles in our «In a nutshell» series, in which we present the proposed changes. This particular «In a nutshell» deals with the return on benefits.

You can consult the other «In a nutshell» articles by choosing the appropriate links:
- Rules on establishing companies and capital **LINK**;
- General meeting and board of directors **LINK**;
- Unregistered registered shares and shareholders' rights **LINK**;
- Threat of insolvency, loss of capital and overindebtedness **LINK**;
- Implementation of Art. 95 para. 3 of the Federal Constitution and gender representation guidelines for listed companies **LINK**.

I. Return of benefits – Art. 678 of the Code of Obligations

Article 678 of the Code of Obligations is a provision to protect the company's equity resources; it institutes a special type of legal claim intended to recover benefits that ought not to have been paid by the company in favour of the shareholders, the members of the board of directors or their close associates. This claim is targeted notably at cases of underbilling or overbilling for goods and services. In a desire to tighten up corporate governance, the Federal Council wants, in particular, to improve the way the claim works. It has thus appreciably changed the content of Art. 678 of the Code of Obligations in its proposal to reform the law on limited companies.

II. Circle of persons subject to the obligation to return benefits

The first new point is that the proposal extends the circle of beneficiaries obliged to return benefits to everyone concerned with management; it thus covers the managers to whom the day-to-day business has been delegated, the company's de facto bodies provided for in its articles of association and also those individuals who, whatever their title may be, play a decisive role in management or liquidation matters. The Federal Council does not define the term of «close associates» of shareholders (or of the holders of participation bonds), members of the board of directors, persons concerned with management or members of the advisory board. Reference to «close associates» aims at avoiding ways of wriggling out of the obligation to return. This concept, the precise definition of which will have to be determined in each individual case, has been entrusted to the civil courts, which may seek inspiration in the rich tax case-law.

III. Object of the obligation to return benefits

Article 678 of the Code of Obligations is targeted on both manifest (or open) distributions of benefits and hidden ones. This distinction remains unchanged in the Federal Council's proposal:

A) Manifest distributions of benefits (Art. 678 para. 1 of the proposed amendment to the Code of Obligations)

Art. 678 para. 1 of the Code of Obligations opens the way for the return of dividends, shares of profits and other shares of profits or interest that do not satisfy the formal rules (notably in matters of competence) or the material rules (relative to the existence of freely available capital resources) governing their distribution. This principle remains anchored in the project, but the catalogue of benefits to be returned has been extended and adapted to the forms of remuneration proscribed by the project or subject to particular conditions following acceptance of the Minder initiative or the new accounting legislation (management remuneration (Art. 735a of the proposed amendment to the Code of Obligations); prohibited allowances (Art. 735c and 735d of the project); unjustified refund of the legal reserves arising from the capital or profit (Art. 671, 672 and 677a of the project)).

B) Hidden distributions of profits (Art. 678 para. 2 of the proposed amendment to the Code of Obligations)

The target here is hidden distributions of profits or financial advantages for which there is no commercial justification and which in accounting terms are not in the form of a distribution of profits.

In its current wording, Art. 678 para. 2 of the Code of Obligations presupposes the existence of two conditions for a benefit from the company to have to be returned: there must be a manifest disproportion between, on the one hand, the benefit received from the company and, on the other hand, (i) the performance rendered by the beneficiary and (ii) the company's economic situation. This latter condition, which has been a matter of academic controversy and the scope of which has recently been clarified by the Federal Court (in its judgment BGE 140 III 602), has not been included again by the Federal Council for the reason that «it would be impossible for a company's prosperity to justify a disproportion between the benefit and the performance to the detriment of the company» (dispatch, p. 125).

The criterion of «manifest» disproportion

between the benefit received from the company and the performance by the beneficiary is thus the only determining factor to assess the existence and the extent of a hidden dividend distribution subject to return. The right to recovery covers only that part of the benefit that is in manifest disproportion to the performance rendered and not the entirety of the benefit. Moreover, the underlying legal act remains valid.

The project does not define when the disproportion is manifest. The law is designed to sanction abuses when the benefit is not based on a reasonable economic justification or if it would not have been delivered at the same conditions to an independent third party (at arm's length). The Federal Council thus holds that disproportion cannot always be clearly identified, notably in complex remuneration systems (dispatch, p. 125).

Art. 678 of the Code of Obligations fits into the general framework of protective legal mechanisms to deal with cases of contributions in kind acquired for a price higher than their value when a company is established or increases its capital. The mission of Art. 678 of the Code of Obligations is all the more important given that the project suggests removing specific restrictions (Art. 628 para. 2) dealing with the (effective or envisaged) acquisition of tangible fixed assets.

IV. Subjective condition and extent of return of benefit

Art. 678 para. 1 of the Code of Obligations as it stands requires that the beneficiary acts in bad faith, in which it differs from the general provisions of unjust enrichment (in its Art. 62 ff.). This requirement would be removed in the project given the difficulty to demonstrate the bad faith of the beneficiary.

The extent of the return of benefit is rooted in the general provisions of unjust enrichment. A request for the return of benefit will not be possible if the beneficiary is able to show that he or she is no longer enriched at the time of the restitution, unless he or she has disposed of what he or she had received in bad faith or ought to have known when disposing of it that he or she might be required to return it (reference in Art. 678 para. 3 of the proposed amendment to the Code of Obligations to Art. 64 of the Code of Obligations). The beneficiary is therefore released from his or her obligation to demonstrate his or her good faith in order to successfully oppose the obligation to return benefits (dispatch, p. 125).

V. The legal rights of the creditors with respect to Art. 678 CO

Given the current state of the law, the capacity to act belongs to the company (acting through its board of directors) as well as to each shareholder individually. Action by the shareholders (which tends to lead to a transfer to the company) is justified considering the risk of a conflict or interests that may embroil the company's bodies or its main shareholders, who might have profited from the disputed benefit. From that perspective, Art. 678 of the Code of Obligations also aims at protecting the minority shareholders.

In positive law, Art. 678 of the Code of Obligations does not grant a right to creditors to take action for recovery. A general right for creditors to take action for recovery was included in the 2008 project but has been rejected by the Council of States. As a consequence, the Federal Council proposes to maintain a right for creditors to take action for recovery, but only in intra-group situations where the benefit is granted by the company within its own group. The reason for giving such right to creditors lies within the fact that the parent company is also very often the sole shareholder of the subsidiary, the liquidity of which are unduly transferred. It is important in such situations that independent creditors from outside the company have the right to take action before the company goes bankrupt.

VI. Action brought by the company

Article 678 para. 5 of the proposed amendment to the Code of Obligations states that the general meeting may decide to entrust the board of directors or a representative with the right to take action for recovery. The purpose is to avoid the shareholders having to bear the procedural costs directly.

VII. Statute of limitation

The five-year time bar provided for in Art. 678 para. 4 of the Code of Obligations is being replaced by a more detailed regime to be found in a new Art. 678a of the proposed amendment to the Code of Obligations. With the aim of aligning the deadline for taking action with the provisions on unjust enrichment (Art. 67 of the Code of Obligations), the project proposes a relative deadline of three years counting from the day when the shareholder or the company became aware of the right to recovery along with an absolute deadline of ten years counting from the date on which that right came into being. The three-year deadline is suspended, if appropriate, during the procedure for deciding and carrying out a special audit (now called a «special investigation» in the proposal).

Finally, Art. 678a para. 2 of the proposed amendment to the Code of Obligations states that if the action giving rise to a claim for recovery is the result of a criminal act, then the time bar on the claim for recovery action runs at least as long as the time bar on the criminal action. Once again, the intent here is to harmonise the regime governing actions for return of benefits with the general provisions applicable in liability matters.

VIII. Conclusion

The project to amend Art. 678 of the Code of Obligations, which makes provision for the return of benefits unduly distributed to the shareholders and the managing bodies, clarifies the scope of this action and rightly removes the link between the obligation to return benefits and the economic situation of the company. The removal of the requirement for the beneficiary to have acted in bad faith and the introduction of specific provisions about time barring allows a harmonization with the provision governing unjust enrichment and improves the legal certainty. The introduction of the rights for creditors to take action before the bankruptcy, even if limited to intra-group situations, remains a sensitive and controversial issue.

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