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Corporate litigation - guidance on court measures to remedy organisational defects

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Actions for organisational defects have become an important tool in shareholder disputes and boards should take heed that some recent decisions have taken a hard line over a lack of good governance.

1 WHY ARE THESE DECISIONS IMPORTANT?

1. Two recent court decisions by the Swiss Federal Supreme Court (the "**SupremeCourt**") have given corporates, shareholders, and creditors alike a good indication of what they can reasonably expect from claims to remedy a Swiss company's organisational defects under article 731b of the Swiss Code of Obligations ("**CO**").

2. These 2022 decisions confirmed the importance of good corporate housekeeping, including regular re-election of corporate bodies (board members, auditors, etc.). They also stress that public interest in a timely remedy of organisational defects generally outweighs the private interests of the company's shareholders.

2 THE SUPREME COURT DECISIONS

2.1 General remarks

3. Under Swiss law, a shareholder and/or creditor has the right to bring a court action against a company to address an organisational defect, including:

- lack or incorrect composition of a required corporate body;
- lack of a proper share register and/or ultimate beneficial owners (UBO) register;
- no properlegaldomicile; or
- issuing bearer shares without having equity securities listed on a stock exchange or organising them as intermediated securities.

4. Under article 731b CO, the court may order remedial actions, including:

- setting a deadline to re-establish compliance, under threat of dissolution of the company;
- appointing the required corporate body or an administrator; or
- dissolving and liquidating the company.

5. The Supreme Court confirmed that these statutory measures are exemplary but non-exhaustive – courts have vast discretion when choosing the appropriate measures but shall comply with the principle of proportionality.[2]

2.2 The decisions

6. In case 4A_147/2022, the shareholding was split between two shareholders, each holding 50 per cent. A dispute arose over financial aspects. The shareholder controlling the board of directors ("**BoD**") refused to provide the other shareholder with relevant business/financial information and held multiple general meetings without inviting the other. This resulted in all resolutions taken at such meetings, including the re-election of board members, being nullified. Due to a lack of proper re-election of board members, the company was in an organisational defect.[3]

7. In the remediation proceedings, one of the shareholders requested the dissolution and liquidation of the company (arguing that it was over-indebted and had had no business operations for years), while the other requested an auction of the shares between the shareholders to keep the company alive. The first instance court ruled to dissolve and liquidate the company (primarily agreeing that

the company had no real business operations anymore and no justification for its existence). It considered an auction ofshares (and other measures) insufficient to remedy the organisational defects and too long a process.

8. The Supreme Court confirmed this decision on appeal. While confirming that the principle of proportionality requires a court to choose the least intrusive remediation measure to remedy an organisational defect (and dissolution being the last resort{C}[4]{C}*)*,it upheld that the continued existence of the company was outweighed by the public interest in a rapid remedy of the organisational defect and the creditors' interest in safeguarding their claims.

9. In case 4A_222/2022, a dispute arose over business decisions made while the BoD was controlled by a shareholder holding 55 per cent of the shares. No shareholder meetings had been held for years and there had been no validly-appointed board member since 2019.

10. Two minority shareholders initiated court proceedings to remedy the organisational defect and requested a board seat (as set out in a shareholder agreement). The controlling shareholder argued that his term as board member had not lapsed and, alternatively, requested confirmation as a board member for six months, allowing him to call a general meeting where a new BoD could be elected. The court of first instance affirmed that the controlling shareholder's term as board member had lapsed. However, it rejected composing the BoD as stipulated under the shareholder agreement and reinstated the controlling shareholder as a temporary board member for six months, with the obligation to hold a general meeting remedying the organisational defects.

11. The Supreme Court confirmed that the provisions of a shareholder agreement do not need to be considered when deciding on the appropriate remedy to address an organisational defect and that, under article 731b CO, court proceedings are not intended to enforce specific interests of individual stakeholders but merely serve to address organisational defects. It also reconfirmed that the least intrusive measure should be chosen to remedy an organisational defect – one that interferes as little as possible with acompany's organisational structure. Accordingly, the appointment of new BoD should be left to the shareholders' general meeting.

3 TAKEAWAYS FOR SHAREHOLDERS

12. Actions for organisational defects have become a popular and important tool in shareholders' disputes, allowing a shareholder to put pressure on other shareholder(s) and/or the BoD (which is often controlled by one shareholder).

13. However, such actions can be unguided missiles and out of the claimant's control since the court has a wide discretion and is not bound by the party's requests. Dissolution/liquidation should always be the *ultima ratio* and shareholders should bear in mind that these actions are not designed to enforce *individual* employee, creditor or shareholder interests.

4 TAKEAWAYS FOR COMPANIES / BOARD MEMBERS

14. These cases confirm the importance of proper corporate housekeeping, with a regular calendar of general meeting and re-election. The term of board members and other corporate bodies should be carefully considered (a longer term is often preferrable).

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