

## **Gesellschaftsrecht**

**9 January 2017**

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**Duration:** 120 minutes

- Please check the number of pages at the beginning as well as at the end of the exam. The examination contains 1 page and 4 questions.

### **Notes on marking**

- When marking the exam each question is weighted separately. Points are distributed to the individual questions as follows:

Question 1            25 %

Question 2            30 %

Question 3            20 %

Question 4            25 %

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Total                    100 %

**We wish you a lot of success!**

**Question 1 (25%)**

To whom does the Board of Directors owe a duty? Critically examine this statement in the context of the main theories of the corporation. What is the content of these duties and how are they interpreted and applied in the modern corporation?

**Question 2 (30%)**

MNC Corp was a multinational corporate group with subsidiaries in several foreign jurisdictions including the US/Delaware, the United Kingdom and with its group headquarters in Switzerland. The MNC Corp board of directors had been considering whether to embark on a global expansion strategy but had not publicly disclosed this. A short time thereafter, XYZ purchased 10% shares of the MNC Corp's Swiss parent company with a view to selling its holdings in a few years to take advantage of record high share prices in the stock market. A short time after XYZ had purchased its shares, the MNC Board announced that it would embark on the expansion strategy in foreign countries to increase its sales and market share. After MNC Corp announced its new strategy, its share price dropped by 30%. As the group's largest shareholder, XYZ was concerned that MNC's expansion strategy was causing its low share price. XYZ wants the MNC Board to change its strategy, including reversing the expansion strategy in foreign countries. The MNC Board believes that the expansion strategy will be profitable for the group over the longer term and that the share price will eventually increase to reflect this.

You are the legal adviser to XYZ. What is the legal rationale in corporate law for XYZ to argue that MNC Corp should change its strategy according to XYZ's wishes? Does it matter that the new strategy has apparently caused the share price to decline? What are some of the specific legal remedies that XYZ can use to pressure the MNC Board to change its strategy? In answering these questions, you may (but are not required to) mention possible remedies under Swiss, UK, US or EU law.

**Question 3 (20%)**

Explain according to what rule of the EU a shareholder having acquired a controlling stake in a corporation must provide equal treatment to minority shareholders.

**Question 4 (25%)**

Discuss some of the challenges for multinational companies in addressing the concerns and interests of stakeholders. Should multinational companies have a legal duty or other responsibility to ensure that their foreign subsidiaries comply with host country laws and with international norms of human rights and environmental standards?

## Model Answers Gesellschaftsrecht II HS 2016

Question 1	Points
Duties of directors and theories of the corporation	
To whom does the Board of Directors owe a duty?	6.5
<ul style="list-style-type: none"> <li>• Recognize that directors are elected by shareholders to oversee the company</li> </ul> <p><b>Discuss to whom a duty is owed:</b></p> <ul style="list-style-type: none"> <li>▪ <i>Board</i></li> <li>▪ <i>Company</i></li> <li>▪ <i>Shareholders</i></li> <li>▪ <i>Shareholders &amp; company</i></li> <li>▪ <i>Stakeholders (+Pigou &amp; externalities)</i></li> <li>▪ <i>Creditors</i> [+shareholders (common vs preferred) vs bondholders (claims during operation &amp; liquidation)]</li> </ul> <p><b>Either decide on theory supporting argument:</b></p> <ul style="list-style-type: none"> <li>• Primarily the duty is owed to the <b>company</b> as a separate entity;</li> <li>• An argument for this would be that in the corporate law <b>contractual model</b>, interests of shareholders are <b>equated with the interests</b> of the company, management acts in <b>best interest of the company</b>.</li> <li>• +principle of equal treatment can be mentioned and the possible conflicts arising when company interests clash with equal treatment</li> </ul> <p><b>Or construct alternative theories and arguments, leading to extended/alternative solutions (if well argued):</b></p> <p>The constituency or stakeholder model: Extension of duties to stakeholders and others as well (society, Bondholders etc.)</p> <ul style="list-style-type: none"> <li>• Enterprise model</li> <li>• +bonus points if various situations in different jurisdictions are used to support arguments</li> </ul>	<p>(1.5)</p> <p><b>Either:</b></p> <p>(2)</p> <p>(1)</p> <p>(2)</p> <p><b>OR:</b></p> <p>(3)</p> <p>(2)</p> <p>Bonus</p>
Discuss the theories of the firm with regards to the question to whom the BoD does owe a duty (can be incorporated into section above):	4.5
<ul style="list-style-type: none"> <li>• <b>Contract theories</b> <ul style="list-style-type: none"> <li>○ Companies arise from a nexus of contracts (private law; minimal state regulation)</li> <li>○ Duties are owed to the contractual parties</li> </ul> </li> <li>• <b>Concession theories</b> <ul style="list-style-type: none"> <li>○ State created and public regulation</li> <li>○ Duties are owed to the state (corresponds to the stakeholder model)</li> </ul> </li> <li>• <b>Communautaire theories</b> <ul style="list-style-type: none"> <li>○ The companies are a mere instrument of the state</li> </ul> </li> </ul> <p>Duties are owed to the state (corresponds to the stakeholder model)</p>	<p>(1.5)</p> <p>(1.5)</p> <p>(1.5)</p>
<ul style="list-style-type: none"> <li>• Describe how the fiduciary relationship might differ from a purely contractual relationship and how this impacts duties in a corporate law structure (the points made in this section are also a logical consequence of the principal-agent problem and/or of <b>costs</b> incurred by contracting, therefore the student can integrate these points into the discussion of contractual theories and/or into the description and consequences of the principle-agent problem)</li> </ul>	2
<ul style="list-style-type: none"> <li>• Fiduciary relationship should have a greater scope than contractual relationship</li> <li>• Fiduciary principles necessary to complete <b>imperfect contracts</b>: How to devise a complete contract to take account of investor's <b>wealth maximisation</b> objective while achieving <b>agent's objectives</b> (financial &amp; non-financial compensation)</li> </ul>	<p>(0.5)</p> <p>(1.5)</p>
<ul style="list-style-type: none"> <li>• Describe the emergence of a <b>Principal-agent Problem</b>, and how this is interconnected with director's duties.</li> </ul>	5
<ul style="list-style-type: none"> <li>• The core problems that result in the principal-agent problem are:</li> </ul>	(2)

<ul style="list-style-type: none"> <li>○ <b>Interests are misaligned</b> (as self-interested rational agents, shareholders seek the maximization of their own wealth, the director, however, will be equally self-interested and might prioritize the maximization of his own wealth as opposed to acting fully in the interest of the shareholders)</li> <li>○ <b>Informational asymmetries</b> (The agent usually as an information advantage over shareholders, which means the principal cannot fully ensure that the agent is acting in the principal's best interests)</li> <li>● The duties of directors are a consequence of this problem and aim to mitigate agency problems</li> </ul>	(2)
● Describe the various duties:	7
● Duty of care: Director must act in affairs of the company as a prudent person would in the management of his own affairs of equal gravity	(1)
● Duty of loyalty: Shareholder wealth maximization as the primary objective	(1)
○ (Duty of equal treatment: Equal treatment to all shareholders)	(0.5)
● Duty to avoid: Conflicts of interest	(1)
● Duty to disclose: Conflicts & material interests	(1)
● Describe business Judgement rule and how it relates to duties:	
○ Good faith decision will not be second guessed by courts	(0.75)
○ No liability if judgement is negligent	(0.75)
○ <b>Rationale:</b> personal liability and constant judicial review would cause directors and managers to be more cautious and consequently lower shareholder wealth	(1)
○ + <i>Smith v. Van Gorkom</i> <sup>1</sup>	
<b>Total:</b>	<b>25</b>

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<sup>1</sup> Decided that business judgment rule only applies to decisions that are 'informed decided that business judgment rule only applies to decisions that are 'informed'.

<b>Question 2</b>	
<b>Part 1: Describe legal rationale</b>	
<b>Discuss initial situation and mention core problem of question (if not already mentioned in question 1, otherwise reference sufficient)</b>	1.5
<ul style="list-style-type: none"> <li>• Berle &amp; Means <ul style="list-style-type: none"> <li>○ Dispersed shareholder body</li> <li>○ Principal-agent Problem <ul style="list-style-type: none"> <li>▪ Aligning interests (wealth maximization &amp; compensation)</li> <li>▪ Informational asymmetries</li> </ul> </li> </ul> </li> </ul>	(0.5) (0.5)
<b>Discuss situation of control in the corporation and the relative voting power of XYZ</b> <b>Describe the consequences this has on the course of action of XYZ</b>	(0.5)
<ul style="list-style-type: none"> <li>• <b>Describe the general options shareholders have according to Hirschmann:</b></li> </ul>	3
<ul style="list-style-type: none"> <li>○ <b>Exit:</b> sell shares</li> <li>○ <b>Voice:</b> raise issues with company</li> <li>○ <b>Loyalty:</b> support actions of the board</li> </ul>	(1) (1) (1)
<ul style="list-style-type: none"> <li>• <b>Discuss the situation for XYZ <i>in casu</i>,</b></li> </ul>	1.5
<ul style="list-style-type: none"> <li>○ XYZ: multinational corporation</li> <li>○ Movement of the share price (fluctuations, volatility)</li> </ul> <p>+Optionally draw a parallel to jurisdiction and legal consequences (since it is unclear, on which exchange MNC Corp is listed, assumption can be made that it is the SIX Swiss exchange, or, if arguments are made that support this, other exchanges.)</p>	(0.5) (1) bonus
<ul style="list-style-type: none"> <li>• <b>XYZ might argue that the management is supposed to act in the best interest of the company and that the expansion strategy is not in the interest of the company.</b></li> </ul>	4
<p>Discussion of shareholder interests versus strategy of the board (often implied to be short-term stock performance versus long-term interests of the company) need to be incorporated into discussion, as well as a reference to question 1:</p> <ul style="list-style-type: none"> <li>• Describe fiduciary duties of the board <ul style="list-style-type: none"> <li>○ Discuss who has short-term vs long-term interests in mind (&amp; the dilemma of long-term company vs short-term share price fluctuations)</li> </ul> </li> </ul> <p>+ Mention the readings/academic discussion between Martin Lipton vs Lucian Bebchuk ('the long-term effects of hedge fund activism' vs 'bite the apple, poison the apple, paralyze the company, wreck the economy')</p>	(4)
<b>Part 2: Discuss legal remedies and principles</b>	
<ul style="list-style-type: none"> <li>• Describe Minority legal remedies, optionally incorporate different jurisdictions</li> </ul>	
<b>Generally (i.e. in most jurisdictions) the shareholder has the following options:</b>	5
<ul style="list-style-type: none"> <li>▪ Information</li> <li>▪ Inspection</li> <li>▪ Convocation</li> <li>▪ Agenda Item at the shareholder's meeting (might be tied to a 'minimum stake requirement')</li> <li>▪ (Audit)</li> <li>▪ Voting out the Board of Directors (If shareholder is sufficiently influential or via proxy votes)</li> </ul>	(1) (1) (1) (1) bonus (1)
<ul style="list-style-type: none"> <li>○ <b>In addition, the shareholder can generally take some form of the following legal actions:</b></li> </ul>	5
<ul style="list-style-type: none"> <li>▪ Challenge resolution in court</li> <li>▪ Liability of directors (+especially in regards to prospectus requirements and the disclosure of inside information, or even market manipulation, in connection with criminal behaviors)</li> <li>▪ Liquidation of the company</li> </ul>	(1) (1.5) (0.5)

<p><b>Specific legal remedies:</b></p> <ul style="list-style-type: none"> <li>• <b>CH:</b> <ul style="list-style-type: none"> <li>○ <b>General:</b> <ul style="list-style-type: none"> <li>▪ Information and Inspection</li> <li>▪ Convocation and Agenda Item</li> <li>▪ An ordinary audit must be carried out if shareholders who represent at least 10 per cent of the share capital so request</li> <li>▪ Right to Instigate a Special Audit</li> </ul> </li> <li>○ <b>Rights of Action:</b> <ul style="list-style-type: none"> <li>▪ Challenging Resolutions of the General Meeting but <b>not</b> resolutions of the BoD)</li> <li>▪ Liability for administration, business management and liquidation (only if 'direct damages' are incurred by shareholder → share price represents 'indirect damages')</li> <li>▪ Winding up of the company</li> </ul> </li> </ul> </li> <li>• <b>UK:</b> <ul style="list-style-type: none"> <li>○ <b>Claim for market abuse</b> <ul style="list-style-type: none"> <li>▪ via regulator</li> <li>▪ public interest, not shareholder interest</li> <li>▪ suit for drop in shareholder value loss in connection to information (BoC)</li> </ul> </li> <li>○ Unfair prejudice petition</li> <li>○ Derivative claims</li> <li>○ Petition for 'just &amp; equitable' winding up of company</li> </ul> </li> <li>• <b>US:</b> <ul style="list-style-type: none"> <li>○ Class action suit (?)</li> <li>○ Other possible remedies (?)</li> <li>○ Delaware (?)</li> </ul> </li> </ul> <p>+any other remedies mentioned (to be examined on a case-by-case basis)</p>	<p><b>(10)</b> (Points given, if student chooses to describe remedies of specific jurisdiction instead of general remedies)</p>
<p>• <b>Apply concepts to case in question (Analysis/conclusion):</b></p>	<p>10</p>
<ul style="list-style-type: none"> <li>○ <b>Discuss core problem:</b></li> <li>○ disclosure of information <ul style="list-style-type: none"> <li>▪ At what time?</li> <li>▪ When is information relevant?</li> <li>▪ Is Information of interest to shareholders?</li> </ul> </li> <li>○ Misreporting &amp; liability of directors</li> <li>○ Timely reporting vs stability of stock price (EU Market Abuse directive: 'timely manner')</li> <li>○ Material information vs internal decisions</li> <li>○ Conclusion: legitimacy of board's behavior <i>in casu</i></li> <li>○ Prospectus requirement (in various jurisdictions)</li> </ul>	<p>(5)</p> <p>(2)</p> <p>(1)</p> <p>(1)</p> <p>(1)</p> <p>bonus</p>
<p>Total:</p>	<p>30</p>

Question 3	Points(20)
EU Directive 2004/25/EV (21. April 2004) on takeover bids [TOD]	1
Purpose: <ul style="list-style-type: none"> <li>• Minimal harmonisation in the national laws of the MS</li> <li>• Minimum level of the protection of minority shareholders: Obligation to offer the same deal to minority shareholder</li> <li>• Explain that typically the premium is paid to some shareholders to <b>obtain control</b>. The premium typically implies a level somewhat <b>higher than the market price</b>; under the TOD the premium has to be offered also to minority shareholders. This refers to what the concept of «<b>equitable price</b>» means – <b>Obligation to share some of the gains</b> of the gains of the control transaction.</li> </ul>	1 1 3
<ul style="list-style-type: none"> <li>• The percentage of voting rights that confers control is defined by the national laws</li> <li>• Typically a threshold around 30% because:               <ul style="list-style-type: none"> <li>▪ in listed companies it is possible to acquire control with less than 50% of the votes</li> <li>▪ due to the dispersion of the shares and the number of shareholders present at the general meeting</li> </ul> </li> </ul>	1 1 1 1
Provisions to protect minority shareholders: <ol style="list-style-type: none"> <li>1. Mandatory bid rule (Art. 5 TOD)</li> <li>2. Sell-out right (Art. 16 TOD)</li> </ol>	0.5 0.5
1. Explaining the content of Art. 5 TOD: Rules imposing the requirement of making a mandatory bid at an equitable price whenever a natural or legal person gains control of a listed company. = Possibility for the minority shareholders to exit and take advantage of the equitable price	0.5 0.5
Pointing out that that <b>National legislatures</b> are given the possibility of evading the minimum protection standards of the Directive <ul style="list-style-type: none"> <li>- rules in the national law may derogate from the mandatory bid rule(MBD)</li> <li>- national supervisory authority may be authorised to waive the MBD</li> <li>- national supervisory authority may be authorised to adjust the price</li> <li>- <b>exemption</b> if the original voluntary bid was made to all the shareholders for all the shares. In this case, the bidder can obtain control from the voluntary bid and will not have to offer to buy the remaining shares</li> </ul>	0.5 0.5 0.5 2
2. Sell-out right: <ul style="list-style-type: none"> <li>▪ Right of the minority</li> <li>▪ MS shall ensure that a holder of remaining securities is able to require the offeror to buy his securities at a fair price under the same circumstances as under the squeeze-out rule</li> <li>▪ Protection of the remaining shareholders as               <ul style="list-style-type: none"> <li>○ They have a right to exit and</li> <li>○ They can exit by selling their shares at a fair price.</li> </ul> </li> <li>- Pointing out the necessity of this provision with referring to the possible abuse by the new controller and the possible depreciation of the market price of the shares of the minority shareholders</li> <li>▪ -Pointing out that the sell-out right can only be asserted if a voluntary or a mandatory bid is made and that both bids are easily avoidable</li> </ul>	0.5 0.5 0.5 0.5 2 0.5
Other relevant aspects (additional points):	Only up to max. 20 points in total for Q.3
3. <i>The Squeeze-out right (Art. 15 TOD) is a right of the offeror (not the minority shareholders).</i>	0.5
<i>Primarily It allows the offeror to gain 100% of the equity. Threshold 90%-95%</i>	0.5
<i>In the second instant it promotes the protection of minority shareholders as it gives them a second chance to exit and sell their shares at a fair price</i>	2

Question 4	Points (25)
<p>1. Discuss some of the challenges for MNC's in addressing the concerns and interests of stakeholders.  <i>(Discuss whether stakeholder interests should be considered. Justify argument with the company models)</i></p>	7.5
<p>2. Should MNC's have a legal duty or other responsibility to ensure that their foreign subsidiaries comply with host country laws and with international norms of human rights and environmental standards?  <i>The candidates are required to spot the main issue on separate legal entity and the herewith relevant aspects. They should be able to convey a thorough discussion with pro- and contra-arguments regarding the imposition of duties on MNC's and its consequences.</i></p>	(17.5) See below
<ul style="list-style-type: none"> <li>• Discuss the doctrine of corporate personality and its relevance for the relationship between a parent company and its subsidiary <ul style="list-style-type: none"> <li>▪ A Company is a separate legal entity, with a personality separate from its shareholders</li> <li>▪ Creditors of an insolvent company cannot claim outstanding debts of the company from its shareholders → idea of limited liability. Also, shareholders are not bound by contractual agreements made by the company versus third parties. (refer at least one case in UK or US jurisdiction or Art. 680 para. 1 of the Swiss Code of obligations)</li> <li>▪ Explain that that separate legal principle also applies to corporate groups: A parent company is a company that owns or controls another company, the subsidiary. Point out that the parent is a shareholder of the subsidiary and as such it cannot principally be made liable for debts of its subsidiary according to the separate legal entity principle.</li> </ul> </li> <li>• Discuss the piercing of the corporate veil as an exception to the separate legal entity principle.</li> </ul>	10
<ul style="list-style-type: none"> <li>• Discuss the general pros and cons for the liability of parent companies with regard to their subsidiaries</li> </ul> <p><u>Pros for the liability of parent companies:</u></p> <ul style="list-style-type: none"> <li>- The parent company receives the profits generated by its subsidiaries and should thus be responsible for damage created so the profits could be generated.</li> <li>- A parent company has control over the subsidiary and can thus substantially influence the subsidiary and decide about its course of business. As such, it has also the power to prevent damage caused by the subsidiary to the employees and environment (e.g. implementation of security measures in production facilities)</li> <li>- The latent risk of the parent company if it would become directly liable would encourage the parent to carry out thorough corporate social responsibility.</li> </ul> <p><u>Cons of the liability of parent companies:</u></p> <ul style="list-style-type: none"> <li>- Piercing the corporate veil contradicts the fundamental principle of separate legal entity and the limited liability principle (UK Law: Adams v. Cape Industries; wider application in CH if parent is de facto organ of the subsidiary)</li> <li>- As MNC's face a risk of damage to its reputation, and would hence be forced to monitor and control the subsidiary, legal provisions are not needed</li> <li>- Shifting the liability towards the shareholders might discourage business and investment</li> </ul>	5



<ul style="list-style-type: none"> <li>• Discuss the ongoing law revision in Switzerland on responsible business <ul style="list-style-type: none"> <li>- Outline the content of the Swiss initiative on responsible business <ul style="list-style-type: none"> <li>- Mandatory due diligence of parent companies on subsidiaries based abroad: 1. Obligation to identify the potentially negative impacts, 2. Take effective measures to address them, 3. Report on the violations identified and on the measures taken</li> <li>- Liability provisions: Exemption from liability when the company credibly demonstrates that adequate due diligence was carried out and that all necessary measures have been carried out to prevent violations.</li> </ul> </li> <li>- <u>Pros:</u> <ul style="list-style-type: none"> <li>- Swiss Law already contains the idea of responsibility of the parent company if it is acting as a shadow director.</li> <li>- Liability for the conduct of business partners in control of the Swiss company (business partners under control are set equal to controlled subsidiaries)</li> <li>- Other justifiable arguments accepted</li> </ul> </li> <li>- <u>Cons:</u> <ul style="list-style-type: none"> <li>- If Swiss law ends up being stricter as the national laws of its neighbor states, it will suffer a competitive disadvantage with regard to its attractiveness as a location of holding companies (regulatory arbitrage)</li> <li>- Vague definition of control (if definition too broad, impossibility to carry out due diligence)</li> <li>- Liability for the conduct of business partners in control of the Swiss company (this goes further than the existing Swiss Law)</li> <li>- Issues relating to international litigation and the enforcement thereof</li> <li>- Other justifiable arguments accepted</li> </ul> </li> </ul> </li> </ul>	<p>2.5</p>
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