Shareholder activism in Switzerland

An insight into the latest trends and developments

David Ledermann
Partner, Lenz & Staehelin

It's hard to believe that 25 years ago there was no federal statute in Switzerland regulating public takeovers. High-profile shareholder activist campaigns that played out in 2018 and 2019, the recent efforts of Swiss legislators to bring to a close the decade-old process of modernising the code governing corporations limited by shares, signal a major change in both public and regulatory attitudes to corporate behaviour.

Back in 1995, the impetus behind the adoption of the Stock Exchange and Securities Trading Act (an act that has now been abrogated by the entry into force on 1 January 2020 of the Financial Institutions Act (FIA) after partial abrogation on 1 January 2016 following the entry into force of the Financial Market Infrastructure Act (FMIA)) was the recognition that since the end of the Cold War, Switzerland could no longer rely solely on its reputation for political stability and for being an investor 'safe haven'. It needed to adjust to rapid technological developments and increased competition among financial centres and modernise its legal framework by promoting transparency and clear governance rules, notably in public takeover situations.

The rapid growth of institutional investors following the introduction in Switzerland in the mid-80s of a comprehensive mandatory pension fund system (with an ever-growing appetite for safe, revenue-generating investments) also contributed, and arguably still contributes significantly, to the development of a legal framework promoting transparency, good governance and permitting shareholder activism. In 2018, the investments of all Swiss pension fund institutions represented 115 per cent of Switzerland gross domestic product – approximately CHF770billion.

The Sika/Saint-Gobain battle

Shareholders' activism in Switzerland was initially focussed on corporate control before expanding to the issues of good corporate governance and executive compensation (with corresponding evolution of the legal framework along the way). Shareholders' activism in connection with change of control or corporate amalgamation still makes up the bulk of the recent high-profile cases.

Take the case of Sika, a construction chemicals manufacturer based in the Canton of Zug with a market capitalisation of CHF25billion (January 2020 figure). The Burkhart family who owned around 16 per cent of the company and 52 per cent of the voting rights because of the dual-class capital structure of Sika, attempted to secure a control premium over the SIKA trading price by selling Sika's competitor Saint- Gobain the family investment vehicle holding the Sika shares. It was an attempt that the board of directors of Sika and the remaining shareholders opposed.

The board of directors of Sika argued that under Sika's articles of association, the contemplated transfer was subject to the consent of the board, which was further entitled to limit the voting right of the Burkhart family investment vehicle to five per cent in such a situation – in effect preserving the status quo, blocking any attempt to replace the board of directors with more pliable members and preventing the contemplated transfer to going forward. After a judicial battle of more than three years (during which the market value of the Sika shares continued to appreciate), the matter was settled out of court. Saint-Gobain never gained control of Sika (but did make a profit out of the whole transaction), thereby preserving the independence of Sika (the avowed goal of the independent members of the board of directors). More importantly, from a shareholder activist perspective, the dual-class capital structure, the transfer restriction clauses in the articles and the ability to limit the voting rights of an acquirer to five per cent of the voting rights (all measures meant to entrench the majority shareholder but which ultimately backfired) were eliminated in favour of retaining a single class of registered shares without any transfer restriction.

Panalpina takeover

The case of Panalpina is another emblematic case where provisions in the articles of association designed to entrench the historical controlling shareholder were, this time, ultimately not sufficient to preserve the independence of the company from an acquirer. In January 2019, Danish company DSV made a $4billion share and cash offer for Swiss logistics group Panalpina, a 24 per cent premium of the closing share price (which actually was not such a great offer, onsidering that in 2018 the Panalpina shares had lost 25 per cent of their value). »

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The initial offer was rejected by the controlling shareholder of Panalpina, the Ernst Göhner Foundation (EGF) with 46 per cent of the share capital. That ignited criticism from activist investors Cevian Capital and Artisan Partner Fund that a provision of Panalpina's articles of association limiting the voting rights of any shareholder with more than five per cent of the share capital to five per cent of the voting rights and from which EGF was notably exempted, was giving EGF a *de facto* veto right on any acquisition proposal: as any acquirer would make a condition of its offer the elimination of such restrictive provision in the articles, and as such elimination would require a resolution of the shareholders' meeting, EGF would be able to control such a resolution.

Although EGF and Panalpina attempted to respond to these criticism by proposing to remove the restrictive provision in the articles (although even without such provision a shareholding of 46 per cent was very likely to leave EGF with a controlling stake), ultimately the pressure of the market was too strong. DSV improved its initial offer twice and eventually presented a $4.6billion all-share offer, which was supported by the board of directors of Panalpina, EGF Cevian Capital and Artisan Partner Fund. Interestingly Cevian Capital initially opposed the proposal of EGF to remove the five per cent voting right restriction, arguing that such restriction should apply to all shareholders, including EFG, and threatening legal action. It is generally considered that the efforts of Cevian Capital and Artisan Partner Fund were a key factor in securing an improved offer from DSV, which the independent members of the board of Panalpina could eventually not oppose.

Sunrise and UPC merger

Another interesting case is the aborted Sunrise/UPC merger transaction where minority shareholders thwarted the plans of Sunrise management to acquire cable operator UPC Switzerland from Liberty Global. On 27 February 2019, Sunrise announced that it had agreed to purchase UPC Switzerland for CHF6.3billion (consisting of CHF3.6billion in assumed debt and CHF2.7billion cash payment to Liberty Global) to be financed through a CHF4.1billion rights issue, which required shareholders' approval.

After its representatives on the board of directors of Sunrise had initially approved the contemplated acquisition of UPC Switzerland, Freenet, a German mobile operator and the largest shareholder of Sunrise soured on the deal, resulting in an announcement in August 2019 that it would vote against the CHF4.1billion rights issue proposed by Sunrise management on the grounds that the price tag was too high and that Sunrise would fare better without acquiring UPC. This generated a fierce response from Sunrise with public accusations that Freenet representatives on the board of directors of Sunrise had been obstructive, made requests which were either inappropriate from a governance standpoint or downright illegal and breached their fiduciary duty, which resulted in the fairly drastic decision to exclude Freenet board representatives from any subsequent board discussion on the Sunrise/UPC transaction.

With its reference shareholder pretty much alienated, Sunrise decided in September 2019 to improve the terms of the transaction for Sunrise existing shareholders by reducing the offer rights from CHF4.1billion to CHF2.8billion, relying on more debt (and therefore reducing the dilution of existing shareholders). With activist shareholders such as Germany's Active Ownership and Axxion coming out against the transaction, and proxy advisor ISS recommending to vote against it, Sunrise came to the realisation a few days before the appointed shareholders' meeting of 23 October 2019 that there was no majority supporting the transaction. It then took the highly unusual (and legally questionable) route of calling off the shareholders' meeting, which triggered some virulent reactions from activist shareholders as Axxion had requested (and obtained) that, in addition to the vote on the UPC transaction, the dismissal of the chairman of the board and another board member be part of the meeting's agenda.

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By calling off, the board of Sunrise deprived its shareholders of the right to exercise their votes in a duly called shareholders' meeting. The highly unusual move probably saved Sunrise from some very public embarrassment but ultimately Freenet and its activist shareholders allies won with the transaction abandoned (at the cost of a CHF50million break fee for Sunrise). The chairman and vice-chairman of the board of Sunrise announced that they would not seek re-election to the board in 2020 and the CEO of Sunrise resigned with immediate effect on 3 January 2020.

Revised obligations

While such high-profile cases were proceeding in 2018 and 2019, the process of revising the section of the Swiss Code of Obligations governing the corporation limited by shares (société anonyme/aktiengesellschaft) was slowly reaching its conclusion, more than 13 years after its initiation. The revision, which is expected to enter into force not earlier than 2021, is certainly an improvement over the current law in a number of aspects, such as the simplification of the incorporation process, a greater flexibility in increasing and decreasing the stated capital of the company, in convening shareholders' meetings, and in passing shareholders' resolutions. With respect to governance and shareholders' rights, the improvements are much more modest and are essentially limited to publicly listed companies with a lowering of the shareholding threshold required by law for shareholders to add an item to the agenda of a shareholders' meeting or to request the summons of an extraordinary shareholders' meeting.

Currently, a shareholder or group of shareholders must have at least 10 per cent of the stated capital of the company or shares aggregating to CHF1million in par value to be able to request that an item be added to the agenda of a shareholders' meeting or to request the summons of an extraordinary shareholders' meeting. Under the draft legislation, such threshold will be reduced for listed companies to one per cent or three per cent (the two legislative chambers of the Swiss parliament are still to agree on the figure) of the share capital or voting rights to add an item to a shareholders' meeting agenda and five per cent to request the summons of an extraordinary shareholders' meeting.

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Shareholders are putting pressure on listed companies

While this looks like a significant improvement, in practice many large listed companies have already provided in their articles of association for lower thresholds. In the example of Sunrise above, the threshold set forth in the articles of association to request that an item be added to the agenda is set at one per cent and the threshold to request the summons of an extraordinary shareholders' meeting is set at three per cent. Consequently, it is not expected that the entry into force of the revision will significantly increase shareholder activism in Switzerland.

Diversity on boards

On the sensitive governance issue of the representation of women within the board of directors and at the level of senior management of Swiss companies, the revision contains only modest proposals, which will apply only to listed companies. Since 1981, Switzerland's constitution mandates that men and women must be treated equally, which means not only promoting equal legal rights for men and women but also actual equality (*de facto*) in all domains such as family, education and labour. Almost 40 years later, male/female parity on the board of directors and at the level of senior management of Swiss companies is far from being achieved. Within the 100 largest Swiss companies, female senior executive represents less than 10 per cent of senior management and female board members represent only 20 per cent of all board membership.

In its current state (which is not expected to change), the revision does not provide for any mandatory level of representation for women (quota) or any mandatory steps, objectives or organisational measures to improve the representation of women on the board of directors and at the level of senior management. The draft legislation simply provides that if the representation of women on the board of directors and at the level of the senior management is below 30 per cent and 20 per cent, respectively, a Swiss listed company will be required to explain in its annual report to the shareholders why these minimum thresholds have not been satisfied and what measures are being taken to remedy this situation in the future. It remains to be seen whether this 'comply or explain' method, inspired by the Swiss Code for Best Practice of Corporate Governance (a set of guidelines issuedby the trade association Économiesuisse) will trigger a substantial increase in women representation in Swiss listed companies, but there are precedents where such an approach has yielded rapid changes (the drastic reduction of executive members on the board of Swiss listed companies comes to mind).

Human rights and the environment

The other governance topic heavily debated now in Switzerland, is the issue of the responsibility of Swiss companies for violation of human rights and/or environmental abuse committed outside of Switzerland either directly or through entities belonging to or controlled by such Swiss companies.

This debate revolves around a constitutional initiative that was filed with the Swiss authorities in October 2016, aimed at holding Swiss companies accountable for such violation of human rights and/or environmental abuse. At first the initiative did not seem to get any public traction and the Federal Council proposed a year later to simply dismiss the initiative without any counterproposal. However, with the issues of climate change and related social and environmental responsibility of multinationals making more and more headlines, one of the two chambers of the Swiss parliament decided to prepare draft legislation to address the concerns of the constitutional initiative, while limiting its initial scope.

Where the constitutional initiative provided that all Swiss companies (with a limited exemption for small and mid-sized companies) could be held liable for violation of human rights and environmental abuse committed outside of Switzerland either directly or through entities belonging or controlled by them, the parliament counterproposal would only apply to Swiss companies with more than 500 employees and more than CHF80million of turnover. The draft legislation also limits the liability of Swiss companies to situations resulting in loss of life, physical harm or property damage and provides that such companies would not be held liable in such situations if they can demonstrate that they were in compliance with applicable local legislation or were not in a position to direct the actions of the controlled entity responsible for the actual violation of the relevant legislation.

In the summer of 2019, the Swiss government came up with its own counter-proposal to the constitutional initiative – a project that is significantly more favourable to Swiss business than the parliament counter-proposal as it completely eliminates any specific liability provision, preferring an approach where Swiss listed companies would only be required to publish annual reports on their compliance with human rights and environmental legislation in the foreign countries where they operate.

The Swiss government proposal has been adopted by the other chamber of the parliament and it seems unlikely that the two chambers of the parliament will ever agree on a legislative counter-proposal to the constitutional initiative. It is therefore expected that the initiative will be submitted to the people's vote at the end of 2020. Irrespective of the result of such a vote, we can expect in the future increased shareholder activism in Switzerland in the fields of social and environmental responsibility.

Swiss banks are already facing significant pressure for their role in financing the fossil fuel industries, and activist shareholders will certainly be pushing for Swiss listed companies to report on their efforts to conduct their business in a way that promotes rather than prevents the achievement of the United Nations Sustainable Development Goals (SDGs).