



# Grasping the Nettle of Shareholder Activism

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## Key Take-aways

- 1.** Given Swiss companies' outlook and the Swiss model of shareholder accountability, virtually no Swiss companies, leaders in their industry or underperforming, are immune from activism.
- 2.** Boards need to put the company in the best position to handle activism successfully. This involves designing an action plan to manage multi-dimensional activist campaigns.
- 3.** Risks of proxy contests are high. Boards need to be cognizant of the levers that activists can pull to sway the electorate and of the challenges of ever-more popular settlement agreements.

Statistics on activist campaigns in 2019 paint a picture of intense activity. They also reflect an increasingly complex and multidimensional challenge involving an array of actors, including the juggernaut index funds, top-tier activist investors, institutional investors and proxy advisors, who seek to bring to bear their influence on companies. In the face of relentless pressure from stakeholders, it is more important than ever for boardrooms to be well prepared. This briefing discusses select trends and key considerations for the boards of Swiss public companies.

## 1 Should Swiss boards be concerned by shareholder activism?

Given their inherently global or regional outlook, Swiss public companies are grappling with activism from many fronts. U.S. top tier activists have launched headline-grabbing activist campaigns targeting Swiss companies. In addition, statistics show that even more often European companies face home-grown activism by European activist funds.

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### **Activists look at Switzerland as a favorable ground to launch campaigns given the rigorous model of shareholder accountability.**

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Among other key features, director's term of office cannot exceed one year (prohibiting classified boards)<sup>1</sup>. In addition, shareholders have sole privilege to elect the directors and (except in the case of vacancy) the chairman and members of the compensation committee. Executive compensation is also subject to a binding "say-on-pay" vote.

The bottom line is that virtually no Swiss companies, leaders in their industry or underperforming, are immune from activism.

## 2 What can the board do to prepare for shareholder activism?

As part of their governance duties, boards need to put the company in the best position to handle shareholder activism successfully. Guidance needs to be tailored for each company in light of a range of considerations, including its business cycle, footprint, shareholder base and industry, but it can generally be distilled in a two-prong strategy.

First, boards need to be informed. The scope of action

is wide ranging.

Boards should be informed of proxy advisors' processes and recommendations, sell-side analyses, ESG trends and the policies of large institutional investors. They should monitor their shareholder base and how it evolves and keep an active channel of communications with large shareholders. Boards need to review and benchmark their corporate practices. They also need to continuously evaluate their capital structure and allocation or return of capital.

Second, boards should design a detailed action plan to successfully manage multi-dimensional activist campaigns. This involves pre-defining a team combining various skills (including management, IR/PR and legal), and a map to mounting the company's defense. This typically involves defining the parameters of any response to non-public activism, including any potential private engagement with the activist, outreach to large shareholders and an assessment of any duty to disclose, as well as the parameters of any responses to public attacks and how to conduct a public campaign.

Nowadays, activist campaigns will not automatically translate into a public tussle (a lot of active engagements play out behind the scene), but the board should approach any bout of activism keeping in mind that it may become public and so control and structure all interactions with the activist.

## 3 Are the boards of Swiss public companies exposed to proxy contests?

In a proxy contest, the activist may seek to replace all or a majority of the board (and present a "control slate") or seek to get appointed a minority of candidates (a "short slate").<sup>2</sup>

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### **Exposure to the risk of proxy contests is high.**

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Not only will the board, the chairman and members of the compensation committee be up for re-election every year, but Swiss pension funds, which may hold a substantial portion of the share capital of Swiss companies, are required to vote on governance matters.<sup>3</sup> Some large institutional investors are self-reliant in making voting determinations but many are thought to align their votes with the recommendations of proxy advisors. This can be a powerful lever that activists can pull to sway the "electorate".

Additionally, even if the activist does not succeed in replacing the incumbent directors, it can still score a meaningful victory by getting the shareholders to reject the proposed compensation of the board and management and send the directors back to the drawing board to come up with a more

palatable compensation package.

As an offsetting factor, it is sometimes thought that Swiss boards have the upper hand in a proxy contest because they control the shareholder register and they are not required to disseminate "proxy materials" of the dissident to the shareholders (in effect the board controls the notice and related chairman letter and disclosure that get disseminated to each shareholder ahead of a general meeting). That advantage however becomes increasingly mitigated by the prevalence of electronic and social media, which can be used as platforms to launch activist campaigns. In addition, it should be kept in mind that the on-going reform of Swiss company law is expected to give greater access to the company's books and records to shareholders owning a threshold stake in the company.

## 4 Is a settlement possible?

A lot of proxy contests in the United States settle before a shareholder vote (to the point that institutional investors will voice their concern if the board appears to succumb too easily to an activist's demands). Settlement agreements have also started to emerge in Europe.

A settlement typically contemplates, among other things, the appointment of one or more directors to the board (as long as the activist holds a minimum threshold ownership of shares)<sup>4</sup>, a standstill (the activist agrees to refrain from initiating or participating in further campaigns or public disparagement, calling a shareholders' meeting, litigating, requesting to inspect books and records or acquiring further shares), and the reimbursement of expenses (which can be significant).

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**While a settlement can save time and expenses and spare the company a long and bruising public campaign, it is only the "end of the beginning" for the board.**

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As the activist will be brought under the tent, the board needs to engage in advanced organizational preparations to ensure that the boardroom can function properly and the arrival of the new directors (once elected by the shareholders) is not going to have a chilling impact on the flow of information or disrupt the proper functioning of the board. Among other things, the board will have to scrutinize its internal policies, codes and guidelines, particularly on confidentiality, the size and composition of committees and information flow with management (all within the framework of Swiss legal requirements), keeping in mind that the new directors may pursue an agenda.

## 5 Conclusion

More than ever, activism has become an important consideration for the boards of Swiss public companies. Support by large institutional shareholders and shareholder accountability make it critical for the boards to conduct self-assessment exercises and be prepared to engage with activists in order to increase the odds of handling appropriately any form of activism that may surface.

<sup>1</sup> A classified board is made up of different "classes" of directors, with each class coming up for election in successive years.

<sup>2</sup> These are very different strategies (assessed under different methodologies by the proxy advisors, such as ISS and Glass Lewis). The activist can start with a control slate but settle for a short slate.

<sup>3</sup> It is worth noting that in many cases, institutional investors around the world are similarly required to vote their shares on the basis of their fiduciary duties to their own investors.

<sup>4</sup> As the shareholders of a Swiss company have sole privilege to appoint directors, a settlement cannot provide for the appointment of dissident-nominated directors, but it can provide for the nomination of a director candidate with the support of the board (as in the case of the Transocean settlement agreement) or some other form of (interim) arrangement, such as the appointment of a board observer.

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