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Acting in Concert vs. Limitation of Voting Power

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The Commercial Court of the Canton of Zurich has recently confirmed that clauses limiting the voting power of a group of shareholders in the articles of association of Swiss listed companies must be narrowly interpreted by a board of directors. The court held, among other things, that shareholders acting in concert do not fall under such clauses in the absence of specific circumstances, irrespective of whether they may be considered a "group" for purposes of Swiss takeover laws.

Background

The articles of association of a number of Swiss listed companies contain limitations on shareholder voting rights. Most of such clauses allow the board of directors to limit the initial registration of a shareholder as shareholder with voting rights to a certain percentage (Type A clauses), typically to 3–5% of a company's total registered share capital. In theory, the limitations imposed by such clauses are derived from the idea of limited share transferability rather than voting rights restriction. In the case of listed companies, however, the limitations do not affect transferability, as an acquiring shareholder is in any case afforded with the economic rights of the acquired shares. In effect, the limitations imposed by such Type A clauses only impose restrictions on the transferability of voting rights. Other clauses are aimed at a (subsequent) limitation of the voting power of shareholders (typically up to the same percentage) at a shareholders' meeting (Type B clauses). In this case, the reasoning behind the implementation of such clauses is simply a general limitation of voting power.

Group Clauses

Basically all of the above-mentioned clauses, whether Type A or Type B, extend these limitations to groups of companies and similar groups (so-called "group clauses"). According to the model group clauses proposed by the task force of the Swiss exchanges, "*legal entities and partnerships which are bound among each other by capital, voting power, management or in a similar manner*" shall be deemed one shareholder for the purpose of the limitation. Further, these group clauses regularly contain wording which extends the relevant limitation to "*individuals, legal entities or partnerships that coordinate their activities with a view to circumvent the restriction*" (see the model clauses). These clauses therefore consist of two elements, the definition of a group for the purpose of the general limitation and a second part directed at the circumvention of the group definition. The group clauses of most Swiss listed companies are mostly drafted along the lines of the above-mentioned model clauses. These group clauses are generally accepted as valid, provided they comply with the model clauses.

Disclosure Requirements for Acting in Concert

Voting limitations and, in particular, group clauses are generally seen as effective "poison pills", a deterrent used by the board of directors to defend the company against a hostile takeover. The era of increased shareholder activism, however, has also resulted in group clauses being aggressively interpreted by the board as a defence against any attempt by minority groups of shareholders for 'voice' and change outside of a change of control situation. In that respect, some confusion has been created about the definition of a group under Swiss public takeover law and its definition for the purpose of the above-mentioned voting limitations. Under Swiss public takeover law, the holders of shares, options or similar rights above certain thresholds that coordinate some of their activities (and in particular their voting rights)

might, depending on the facts of the case, be under the obligation to disclose such coordinated activities as acting in concert by so-called "group notifications". Non-compliance with the disclosure requirements is considered a criminal offence and may result in significant fines.

In instances where prudent shareholders disclosed their concerted actions through a group notification, the boards of directors appeared to use the notification as evidence of the existence of a group for the purpose of limiting the exercise of voting rights.

Decision of Commercial Court

In a recent case, the Commercial Court of the Canton of Zurich had the opportunity to clarify some issues in connection with the application of voting limitations to groups of shareholders (Case No. HG070229/U). In this case, some shareholders of a listed company asked the chairman of the board to resign and the resolution was put on the agenda for the company's next ordinary shareholders' meeting. At the meeting, the board then imposed an overall limitation on the exercise of voting rights by the dissident shareholders and other shareholders with voting rights registered in the company's shareholders' register and adjusted the company's share ledger accordingly. The articles of association of the company contained both a Type A and a Type B clause, each combined with a group clause comprising a "circumvention element". The board claimed that due to various coexisting relationships among these shareholders comprising factual and contractual elements including shareholdings, management, asset management contract, place of work etc., they must be considered a group for the purpose of the voting limitations. To support its argument, the board also relied on the definition of a group under Swiss takeover law. The court's decision, which was not appealed, rejected this approach and held, among other things, that:

- The definition of a group under public takeover law must be clearly separated from the group definition in a group clause.
- The scope of a group clause must be interpreted on the exact wording of such clause.
- Group clauses must be interpreted narrowly.
- The use of group clauses in articles of association must be justified by the fact that the decision-making authority to vote the group's shares is effectively held by one person or one group of persons within the group; relationships among companies and individuals which do not have an equivalent effect on the decision-making process do not justify an application of group clauses.
- Shareholders acting in concert with regard to the exercise of their voting rights do not constitute a "circumvention" of a group clause, at least if such shareholders do not fully delegate their voting rights and if each shareholder retains the economic benefits and risks with regard to the shares it owns.

Conclusion

The Commercial Court's decision is in line with the prevailing view in legal doctrine, but it contains some strong reasoning in favour of shareholders' voting rights. In light of the court's decision, boards of directors may need to reconsider the previous application of their group clauses against groups of shareholders whose actions were considered unwelcome. Nevertheless, a wide and abusive interpretation of group clauses may still remain an attractive defensive measure for a board of directors. This is mainly because shareholders may have to spend money and wait to get a final decision on their case. In the case at hand, the voting limitations were imposed in April 2007, but the judgement was rendered in late autumn 2009. In future conflicts between the board of directors and groups of shareholders, a strong focus is therefore likely to remain on strategies beyond corporate litigation. In that respect, the commercial court's decision may play a major role in a board's assessment of reputational issues as well as the risk of personal liability.

The ww&p **News**Letter provides comments on new developments and significant issues of Swiss law. These comments are not intended to provide legal advice. Before taking action or relying on the comments and the information given, addressees of this NewsLetter should seek specific advice on the matters which concern them.

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