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From Defense to Shareholder Engagement and Response Manual

A defense manual historically was meant to be primarily a toolkit for a listed company to address a situation of an unfriendly takeover. However, the world has changed quite significantly since the early days of the defense manual. Tighter regulation and an enhanced focus on director's duties have made "surprise" unfriendly takeovers more difficult and less of a threat to target companies. However, new potential threats have arisen such as motions of activist shareholders, in particular if they are supported by proxy advisers. Moreover, today's prevalence of shareholder activism has highlighted the need for a constant dialogue and engagement with a company's shareholder base. In such dialogue, boards will be reminded that any defense that is solely in the interest of the board and management is doomed to fail. The changed risk landscape as well as the need for shareholder engagement necessitate a rethinking of the defense manual.

1 INTRODUCTION

1.1 The defense manual in a changed environment

In the past, the primary purpose of a defense manual was to serve as a toolkit for a listed company to be used in a situation of an unfriendly takeover. As such unfriendly takeovers could be launched with little or no prior warning, the defense manual was meant to prepare the listed company for such a surprise situation. Essentially, the manual provided for an emergency organization involving the chairperson of the board, members of the executive management but also external advisers that addressed various workstreams such as valuation, legal aspects and communication with a view to frustrating an undesired offer. External advisers would typically include investment bankers, lawyers and communication experts.

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The world has changed quite significantly since the heydays of the defense manual in the late 90s and early 2000s. The "laisser-faire" regimes with very limited rules on takeovers and takeover defense have given way to a highly regulated environment in most jurisdictions. On the target side, a more rigorous approach to board of director's' duties has made certain defense tactics such as the sale of "crown jewels" and most forms of "poison pills" virtually impossible. On the other hand, enhanced director duties or – more broadly – agents' duties vis-à-vis their principals has also mandated a more cautious stance on the offeror's side as to the risks and benefits of a potential takeover. As a result, a takeover offer without a prior due diligence review seems hard to realize in today's environment, a development which confers more power to the boards of directors of target companies and makes the implementation of unfriendly takeover offers more difficult.

While unfriendly takeovers have become less frequent, campaigns by activist investors have increased substantially.[1] Contrary to unfriendly takeovers, virtually every listed company can become the target of an activist campaign – even those with a stable majority shareholder. Finally, the phenomenon of shareholder activism highlights the need for a constant dialogue between the listed company's board or executive management and shareholders respectively the investor community at large. By doing so, the views of shareholders as to a company's strategy and performance including any dissatisfaction and willingness to exit the investment can be detected early and potential changes can ideally be implemented or at least be considered and consciously rejected. This can significantly reduce the risk of an activist campaign.

1.2 Impact of change

This changed risk landscape of listed companies should be reflected in a more modern version of a "defense" manual – in fact it should be reflected in the name of the manual itself. "Defense", i.e. the rejection of a change of control and the maintenance of corporate independence cannot be a goal in itself for a board of directors acting in the best interest of its shareholders. Takeovers – in particular when offering a sizeable premium on the traded stock price – will be perceived as beneficial for most shareholders and should not be prevented by a board of directors for the mere reason of keeping corporate independence. Of course, the board should consider the interests of all stakeholders – too often, however, boards have invoked fuzzy stakeholder interest while their only concern was the maintenance of power, position, and compensation. To avoid this perception, the "defense manual" of the old days should be renamed to something like "shareholder engagement and response manual", "shareholder manual" or a similar expression (hereinafter referred to as "Manual").

Obviously, merely changing the name of a document will not be sufficient to adapt it to a changed world. It should also address new phenomena like activism of shareholders, enhanced perception of the duties of care of boards of directors, the increasingly important role of proxy advisers and a changed risk profile of an unfriendly takeover.

2 CONTENT

2.1 General readiness

Broadly speaking, the Manual should ensure that a target company is in a state of readiness for any motion or proposal that comes out of its shareholder base or a third party contemplating to become a shareholder. This readiness starts with basic investor relation management measures and culminates in preparedness for the rare scenario of the private or public announcement of an unfriendly takeover.

[1] Compared to late 90s/early 2000s.

2.2 Investor relations agenda

Each listed company should have an investor relations agenda. Such an agenda sets out the events scheduled for the communication with shareholders and with investors at large such as participation in conferences, road shows, capital market days which should be in sync with the communication with analysts, rating agencies and other stakeholders. While such agenda is usually not part of the Manual, it should nevertheless address the topic and try to ensure that there is sufficient communication between the listed company and its shareholders.

2.3 Regular interaction with largest shareholders

The CEO, the CFO and in some instances also the Chairperson should meet the largest shareholders regularly and discuss strategy, performance and other issues that may be raised. Of course, a protocol is to be followed and no material non-public information may be shared in such meetings as a matter of principle. However, within these boundaries, meetings with major shareholders are deemed permissible, in particular also in light of the principle of equal treatment of shareholders. In such meetings, representatives of the listed company are well advised to listen to the suggestions and concerns voiced by shareholders as this could provide early warning signs for shareholder dissatisfaction, which is usually a fertile breeding ground for activist campaigns.

A company listed on a Swiss stock exchange knows at least those shareholders owning in excess of 3% of the issued shares (registered in the commercial register) individually or collectively as a group as this threshold triggers notification requirements (disclosure of major shareholdings). Of course, all shareholders who have requested to be entered in the share register of the company are also known to the company. However, such registration is not mandatory and there can be shareholders owning significant stakes slightly below the disclosure threshold that are unknown to the company. Against this background it seems advisable to also use third party service providers to identify shareholders using data not easily available to the company such as fund portfolio information.

2.4 Monitoring of disclosure of shareholdings and movements in share price

In order to remain alert and be able to react swiftly to any change in its shareholder constituency that may have an impact on strategy or board composition, the Manual should ensure that the company monitors carefully the disclosure notifications or major shareholders as well as any unusual movements in its stock price or trading volumes.

It should define levels of movements and volumes as of which members of the senior management (usually the CFO) should be alerted and involved, who may, after further assessment, bring such circumstances to the attention of the chairperson of the board. Depending on the materiality of the trading patterns and actors assumed or identified behind such patterns and potentially after consultation with advisers, the chairperson may then consult with the board and, if appropriate, resolve on certain measures such as an outreach to the investor identified.

2.5 Assessment of weaknesses an activist shareholder or a potential acquirer could exploit

The Manual should also strive to ensure that the company is aware of potential weaknesses an activist could exploit. These weaknesses usually relate to the strategy of the group (such as excess cash reserves, conglomerate (unfocused) business operations, failed M&A projects, etc.) or the composition of the board or of senior management. We recommend that these weaknesses are assessed from an outside view with the help of external corporate finance or strategy advisers and are

discussed at least annually and ideally in the context of a strategy discussion at board level.

2.6 Assessment of "weapons" of attack and defense

Obviously, any Manual should be drafted against the backdrop of the legal environment that the company is exposed to. This includes in particular potential weaknesses in the company's legal constitution (e.g. its articles of incorporation) and environment. For example, the company may have very limited means to refuse the registration of a shareholder with voting rights or may have very low thresholds to put an item on the agenda of a shareholder meeting. It should also be noted that as part of the recent Swiss corporate law reform shareholder rights have been strengthened and permissible thresholds to call shareholder meetings and submit agenda items have been lowered. Also, people involved with drafting or reviewing the Manual should be aware of the terms of outstanding instruments (in particular debt instruments), which may operate in favor of or as deterrent in case of a change of control.

The Manual should also create awareness of permissible "response" or "defense" tactics under applicable Swiss law, the company's articles of association (voting restrictions, etc.) and potential other instruments by which it is bound. These "response" tools to both an activist approach as well as a surprise offer to take the company private should either be part of the Manual (see below 3.3 and 3.4) or at least be addressed in one of the working groups of the response team (see below 3.2).

3 RESPONSE ORGANIZATION

A large part of the Manual is – as in the old days – still devoted to "defense", i.e. the response to a surprise takeover offer - nowadays also expanded to include a surprise activist campaign. This part is mainly about organization and workstreams in order to be prepared for any of the aforementioned scenarios.

3.1 Composition of response team

The "response" or "defense" team is typically under the leadership of the chairperson of the board of directors and includes the CEO, the CFO and the heads of group legal and investor relations (if not with the CFO) and potentially also the vice chairperson or the chair of the audit committee. The response team should be complemented by external members who contribute the necessary expertise, experience and outside view. Such external members would typically include a representative from the financial / M&A adviser (often an investment bank), from the external legal counsel as well as from the external communication adviser (PR/IR). The composition can be adapted on a case-by-case basis and in particular for smaller companies.

The goal of the response team is typically to establish a state of readiness to early identify and immediately respond to any activist or takeover approach and to recommend an overall response strategy and direction to the board of directors in respect thereof. Part of that involves keeping the board updated on proceedings and developments relevant for such state of readiness, being responsible for the preparation of any communication to shareholders and proxy advisers, as well as interaction with regulators, media contacts and other stakeholders, and exercising any other powers delegated by the board. Hence, the role of the response team is not to substitute the tasks of the board in case of an activist or takeover approach, but to assist it in effectively discharging its responsibilities in such scenarios.

3.2 Working Groups and work streams

The Response Team is often subdivided into certain working groups, the most common being "Communication & PR", "Business Strategy", "Financial" and "Legal & Regulatory". External experts in the respective areas would typically also be part of these working groups as advisers.

The Response Team also coordinates and administers certain workstreams. An example of typical workstreams and responsibilities could look as follows:

No.	Work Stream	Responsibility (Working Group)
1	Up-to-date strategy and SWOT analysis	Business Strategy
2	Ready-to-use financial information and valuation	Financial
3	Potentially interested parties (other than shareholders) and contacts	Communication & PR
4	Up-to-date shareholder analysis	Communication & PR [incl. IR]
5	Up-to-date shareholder contact lists (incl. proxy advisers)	Communication & PR [incl. IR]
6	Prepared scripts/documents / Dos/Don'ts – Defense Tools from Legal Perspective	Communication & PR / Legal & Regulatory

3.3 Approaches and communication

The Manual usually also briefly describes the main types of approaches by an activist and by a potential acquirer with a focus on an "unfriendly" approach by a potential acquirer. While it is true that unsolicited takeover offers have become rare, private unsolicited approaches to the board are still relatively frequent and should be dealt with in the Manual. Therefore, the Manual normally includes a brief overview of dos and don'ts in communication with a potential acquirer as well as prepared scripts for various scenarios. These are abstract but still meaningful enough to give first guidance to the response team and the board or its chairperson in case of an approach.

The Manual typically also includes prepared scripts for certain contingency scenarios. This would include leak contingency statements for discussions on a potential takeover offer/take private with various alternatives depending on the degree of detail that becomes known in the public domain.

Finally, the boundaries of communication set by insider trading, market abuse, ad hoc rules but also the dangers and consequences of acting in concert with other shareholders should either be briefly addressed in the Manual or at least dealt with in a Legal & Regulatory working group.

3.4 Legal background

The Manual usually includes a brief overview of the relevant legal framework covering aspects of takeover law, corporate law and certain securities laws aspects (such as market abuse and disclosure rules).

Takeover law and corporate law aspects would typically also cover a description of permissible defense tools that the company has available. This should also include company specific defense tools such voting restrictions in the articles, supermajority requirements or change of control provisions adverse to an acquirer.

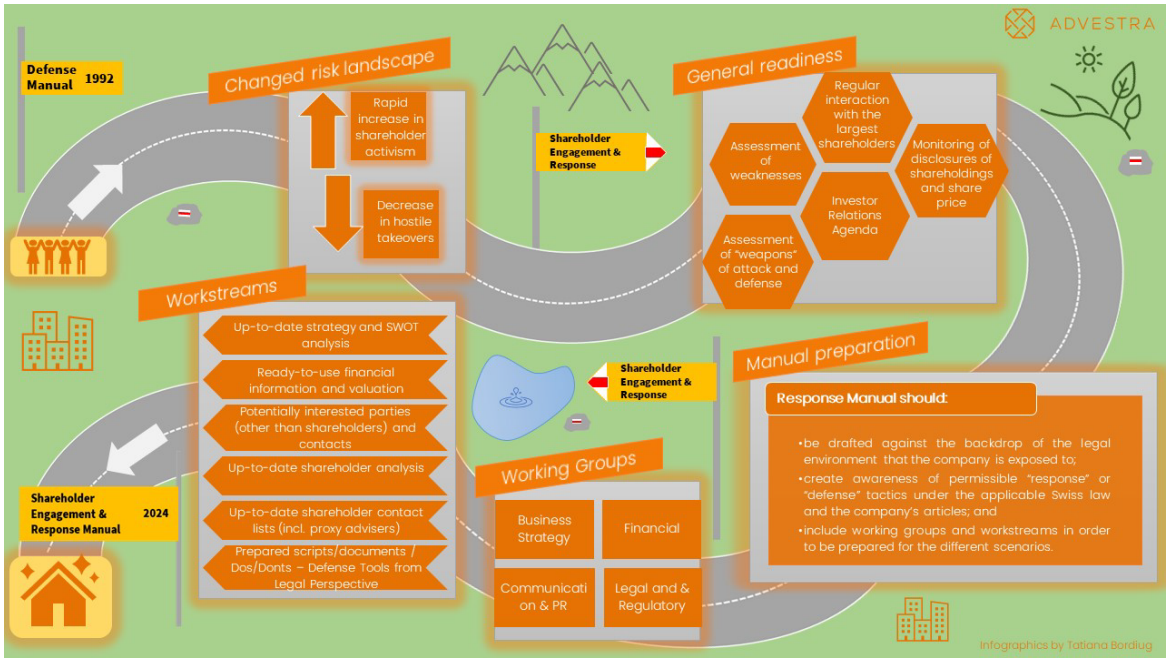
This includes a practical guidance on director duties when receiving an unsolicited bid, whether and when such bids have to be disclosed and other practical considerations.

4 CONCLUSION

In times of uncertainty and dissatisfaction of investors with prevailing stock price levels companies should be increasingly alerted to

approaches of activists or potential acquirers. Boards and managements too often are distracted by day-to-day issues or try to focus on imperative strategic issues but tend to neglect the rather theoretical and dry exercise of preparing for contingency scenarios. Many listed companies have at one point arranged for the establishment of a Manual but neglect the "maintenance" and update thereof. They risk a rude awakening.

SUMMARY



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