

# Presentation



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## Minority shareholder protection

Why it should be a priority for listed companies  
and how to properly achieve it

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# Overview

- “Exit” and “voice”
- Reasons for minority shareholder protection in listed companies
- Measures for minority shareholder protection in listed companies
- The independent director committee (IDC) in particular: the Alcon case
- Takeaways

## “Exit” and “voice”

- Two key mechanisms for minority shareholder protection (A. Hirschman)
  - “Exit”: actual or threatened liquidation of the investment (monetary)
  - “Voice”: exercise influence in the company (voting)
- “Exit” compensates “voice”?
- Minority shareholder protection unnecessary for listed companies? No...



# Reasons for minority shareholder protection in listed companies (I)

- Protection from whom?
  - Atomized shareholder structure (US and UK) → Strong management
  - Controlling shareholder (rest of the world) → Strong shareholder
- Protection from what and why?
  - Going public for funding (access capital market)
  - Investors require return on investment
  - Controlling shareholder → threat of private benefits of control (value that does not accrue to all shareholders on a per share basis, but instead is captured by controlling shareholder)
  - Investors discount for private benefits of control



# Reasons for minority shareholder protection in listed companies (II)

- Example for private benefits of control:
  - Stock trades at \$ 8 per share, but large block (40%) is sold OTC at \$ 14 per share. Difference of \$ 6 consists of two components:
    - Expected value increase under new owner / management
    - Private benefits of control expected by new owner
  - Day after sale is announced, stock jumps from \$ 8 to \$ 10 per share
    - Expected value increase: \$ 2
    - Private benefits of control: \$4
  - Normalize for company value [ $0.4 \times ((14-10) \div 10) = 0.16$ ] → Control premium of 16% (A. Dyck / L. Zingales: Ø ~15%, Sweden 1%, Brasil 65%)
- Conclusion
  - If companies have controlling shareholder → Threat of private benefits of control
  - The bigger the threat of private benefits of control → the bigger the discount
  - The bigger the discount → the lower the company value & the higher financing cost
  - **Company has a valid interest in measures protecting the “exit” for minority shareholders → once “exit” is protected, “exit” compensates “voice”**



# Measures for minority shareholder protection in listed companies

- Institutions preventing / reducing private benefits of control
  - General legal environment (mandatory laws; efficiency of courts)
  - Adequate additional minority shareholder protection measures
- Adequate additional measures (protecting “exit”)
  - Increase disclosure (public level)
  - “Majority of minority”-approval (shareholder level)
  - Independent directors’ committee “IDC” (board level)
  - Approval for contract (management level)
  - Only for sensitive area (dealings with controlling shareholder)
- Less adequate additional measures (protecting “voice”)
  - Voting right limitation (e.g., 5% clause)
  - Right to call shareholders’ meeting / request agenda item
  - General supermajority requirements (e.g., 90% for change of purpose)
  - Right to dividend (e.g., distribution of certain percentage of profit)

# IDC – Alcon case

- 1977: - Nestlé acquires 100% of Alcon (US company)
- Transfer of headquarters to Switzerland (Swiss company)

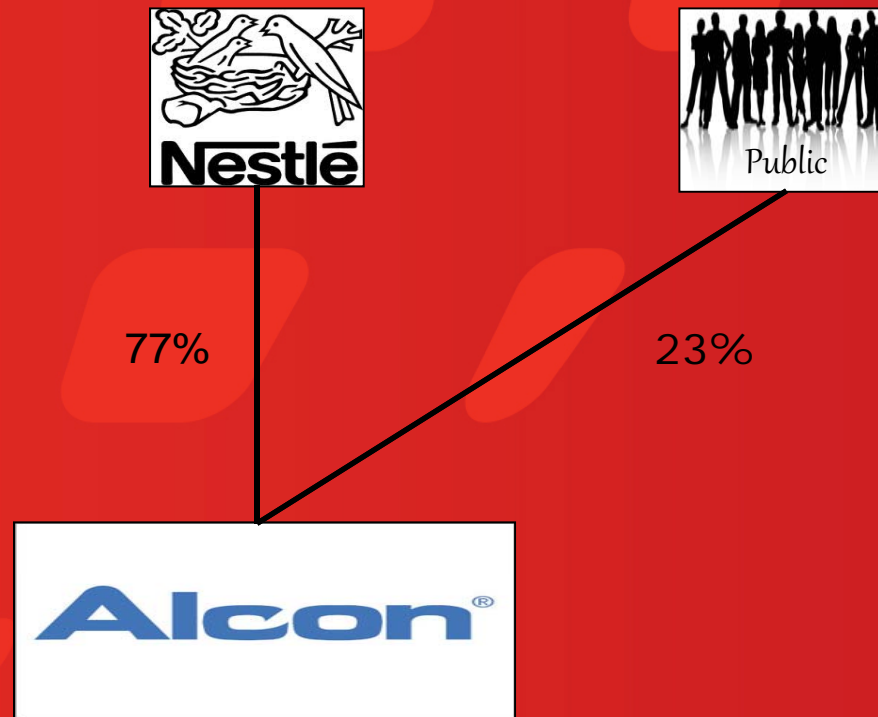


100%



# IDC – Alcon case

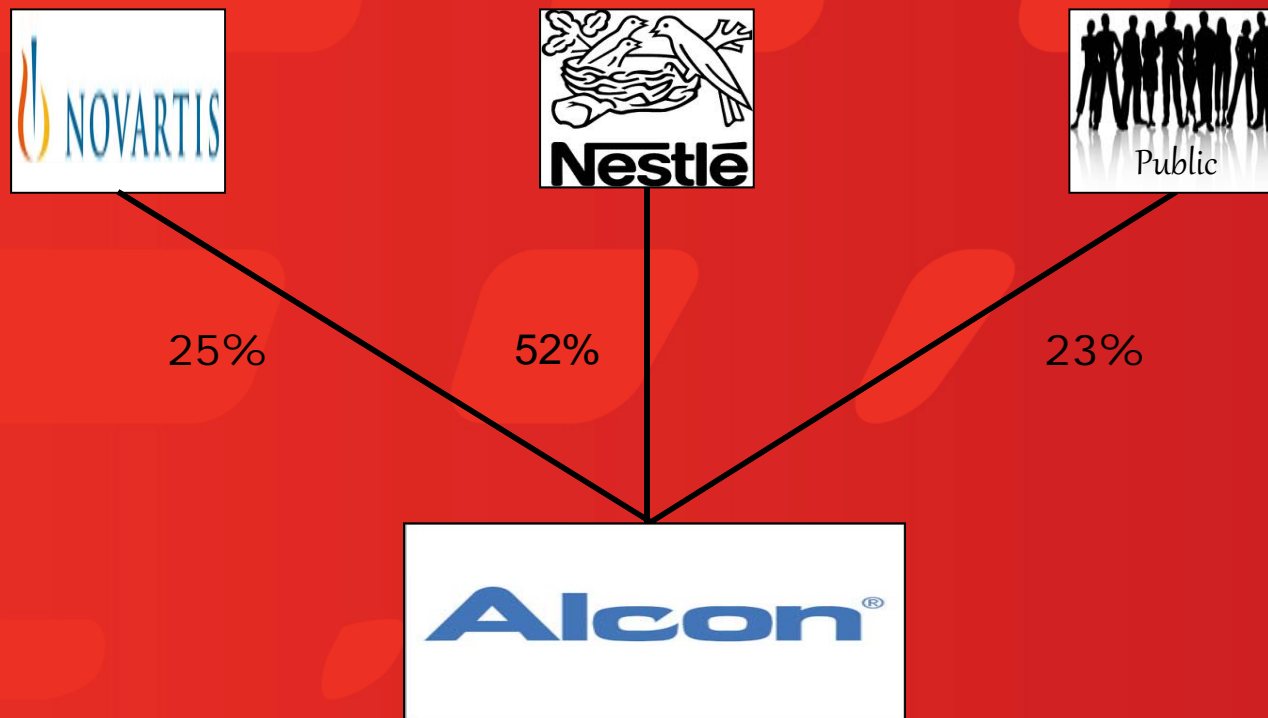
2002: Nestlé spins-off 23% of Alcon → Swiss Company with NYSE Listing





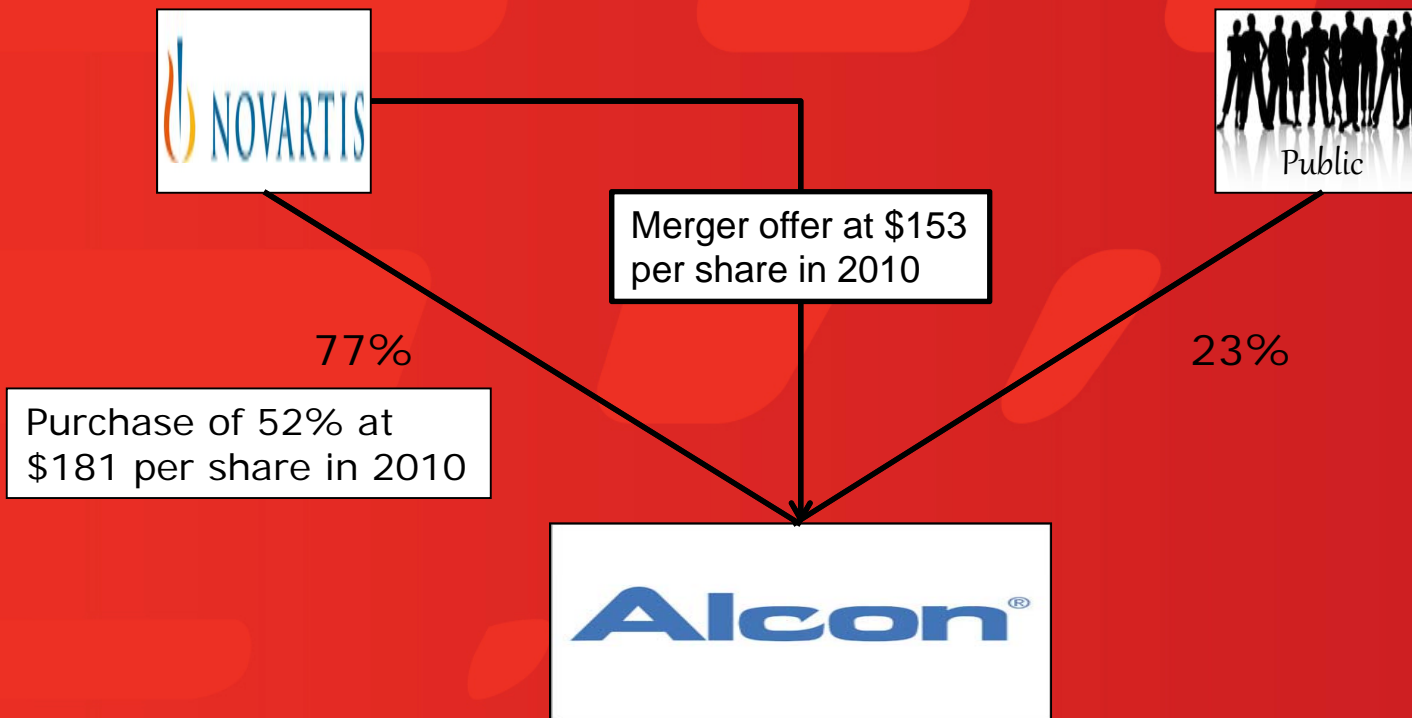
# IDC – Alcon case

- 2008: - Nestlé sells 25% of Alcon to Novartis for \$ 142 / share (\$ 11 bn)
- Call / Put option for remaining 52% of Alcon



# IDC – Alcon case

- 2010: - Nestlé sells 52% of Alcon to Novartis for \$ 180 / share (\$ 28 bn)
- Novartis offers merger with Alcon for \$ 153 / share



# The IDC – Alcon case

- **Implementation on three levels**

- **Articles of incorporation**

- Approval of shareholders' meeting
- Art. 23 (Resolutions): *"In order to pass resolutions, at least a majority of the members of the Board of Directors must be present, subject to additional provisions in the Organizational Regulations"*.

- **Organisational regulations**

- Approval of board
- Art. III, Sec. 1 (Organisation of the board): *"The Board is comprised of three classes of directors [...] serving staggered terms. The Board shall determine the classes of its members; provided, however, that each class shall include one independent director"*.



# The IDC – Alcon case

- **Organisational Regulations (continued)**

- Art. V, Sec. 5 (Board Committees, Independent Directors Committee): *"If any of the following transactions is proposed to be taken by the Company, the Board shall form a special committee of no less than three independent directors as defined under the NYSE Rules who shall be responsible for protecting the interests of the minority shareholders of the Company. The Board shall only resolve such matters if a majority of the members of Independent Director Committee so recommends. Such matters are*
  - *a proposed merger, takeover, business combination or related party transaction of the Company with the Majority Shareholder or any group company of the Majority Shareholder;*
  - *a proposed bid for the shares of the Company by any entity owning a majority of the Company's outstanding voting rights;*
  - *a proposed repurchase by the Company of all the shares not owned by an entity owning a majority of the outstanding voting rights of the Company; or*
  - *any change to the powers and duties of the Independent Director Committee."*
- Art. XI, Sec. 3 (Final Provisions): *"The Board shall review these Regulations from time to time [...] Any amendment affecting the powers and duties of the Independent Director Committee shall only be valid if approved by a majority of the members of such committee."*



# The IDC – Alcon case

- **IDC-Charter**

- Approval of CG-Committee and board
- Mission Statement: *“The purpose of the Independent Director Committee [...] is to serve as a disinterested body with respect to transactions that relate to the Company, to the shares of the Company or to related party transactions involving one or more major shareholders of the Company (such transactions hereinafter referred to as “Special Transaction”) with a view to protect the interests of both the Company and the minority shareholders of the Company”.*
- Committee Authority and Responsibilities (among other): *“The Committee shall have the authority, without having to seek Board approval, to obtain, at the expense of the Company, advice and assistance from internal or external legal, accounting, financial or other advisors as it deems advisable, and to retain and terminate such advisors without seeking Board approval”.*



# The IDC – Alcon case

- **One year battle (“battle of expert opinions”)**

- Strong position of IDC → own website, advisors (legal, financial, PR)

- Weak spot “Financing” → fully depending on the Alcon board

- Creation of Alcon Litigation Trust (\$50m)



# Takeaways

- **Minority shareholder protection is in the interest of the company**
  - Increases company value / reduces financing cost
- **Protection should focus on “exit” (rather than “voice”)**
- **Protection on different levels**
  - Shareholders (e.g., “majority of minority”)
  - Board (e.g., IDC)
  - Management (e.g., approval by IDC)
- **IDC**
  - Implementation on all levels (Articles, OrgReg, Charter)
  - One identified weak spot: financing

**Thank you**

