

WHEN SHAREHOLDERS CHOOSE NOT TO MAXIMIZE VALUE: THE UNION BANK OF SWITZERLAND'S 1994 PROXY FIGHT

by Claudio Loderer and
Pius Zgraggen,
Universität Bern*

The staid Union Bank of Switzerland, in a very close vote, won the support of its shareholders in its battle against an attempt by dissidents to guide the way the nation's biggest bank is run. The special shareholder vote, held in a packed Zurich sports hall, was one of the most keenly awaited events in recent Swiss financial history.

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This paper examines the fight over a share reunification plan pitting Union Bank of Switzerland (UBS), the largest Swiss bank and a global leader in asset management, against BK Vision, a financial firm in which Martin Ebner, a Swiss financier, had a substantial participation. UBS had two classes of voting stock at the time: bearer stock and registered stock. A share in either class had one vote, but a registered share had a claim to future payoffs that was one-fifth that of a bearer share. For the same amount of money, registered shares therefore conferred more voting power than bearer shares. On September 29, 1994, having realized that BK Vision was accumulating a threatening number of registered shares, UBS's board decided to submit to shareholders a proposal that would extinguish the registered shares and substantially dilute Mr. Ebner's theoretical voting power.

The purpose of the analysis is to document that not all shareholders identify with a policy of share-price maximization even when they know the consequences of favoring alternative courses of action. This can happen because of conflicts between the interests

of shareholders *within the same firm*. In the case of UBS, the majority of the holders of registered stock ended up voting for a plan that caused them to lose, during the three trading days following its announcement, 11% of the value of their shares—and eventually cost them almost twice as much. Most of these shareholders were apparently UBS employees (afraid that a victorious Mr. Ebner would restructure their jobs out of existence) as well as shareholders with business ties to UBS. More predictably, the holders of bearer stock overwhelmingly supported the plan on the assumption that it would redistribute wealth to them.

In perfect markets, shareholders all agree on optimal investment policy: take all projects with positive net present value and, when forced to choose, pick the project with the highest net present value. In the presence of information and transaction costs, however, shareholder unanimity is compromised. When some shareholders have claims against the firm in addition to their shares (they may be firm employees, suppliers, consultants, creditors, debtholders, or customers), the same policy decision can increase the wealth of one group of shareholders while reducing

*We talked with various people, including current and former officers of Union Bank of Switzerland and BZ Bank. For obvious reasons, some of them wish to remain anonymous. Various pieces of information were collected from the daily newspaper *Neue Zürcher Zeitung*. Listing all the articles used would clutter the text unnecessarily, but we would be glad to provide the appropriate references to the

interested reader. We are grateful to an anonymous referee, Thomas Lys, Kurt Schiltknecht, Roger Trunz, and, particularly, Roger Kunz for detailed comments. Stock return data were kindly provided by BZ Bank and Union Bank of Switzerland.

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the wealth of another. Conceivably, one group of shareholders might even be tempted to appropriate wealth from other groups—something which, in perfect markets, can be prevented contractually.

Shareholder disagreement represents a situation that management can use to serve its own ends—for example, to fend off an unwanted takeover. How serious such conflicts are is a matter for debate. The empirical literature has examined this issue in the context of shareholder voting patterns. But, although institutional shareholders with business ties to the firm tend to support management's proposals,² the evidence is fairly inconclusive.³

The paper is organized as follows. The first section provides institutional details and background information on the players. Section two analyzes the events preceding the reunification proposal. Section three examines the proposal and its impact on the value of UBS's stock classes and BK Vision's stake. Section four investigates the strategies followed by the two players in the proxy fight. Section five then studies how stockholders voted and how that vote affected the value of UBS, its two stock classes, and BK Vision's stake.

INSTITUTIONAL FRAMEWORK AND PLAYERS

A Swiss corporation may issue bearer shares⁴ and registered shares. For bearer (I, from *Inhaber*) shares, possession of the certificate is sufficient evidence of title, the transfer of such shares being made by simple delivery. Registered (N, from *Namen*) shares are transferred by endorsement. The name of the purchaser must be entered in the corporation's share register.⁵ Payoffs (dividends, etc.) to N and I shares are proportional to par value. In general (as in the case of UBS), each share has one vote.

The corporate charter can limit shareholders' voting power in two ways: first, by limiting the total number of votes any one shareholder (or shareholder alliance) can cast (5% of the total shares

outstanding in the case of UBS); second, by capping the number of N shares any one shareholder (or shareholder alliance) can vote (5% of all N shares outstanding for UBS). The board can retroactively deny holders of N shares the right to vote if they provide false information at the time of registration.

During the time considered, no law forced individual shareholders to disclose their holdings. Companies were required, however, to disclose the identity of major shareholders they knew about. Major shareholders were defined as those who controlled more than 5% of the votes or more than the cap specified in the corporate charter.

Union Bank of Switzerland

In terms of book value of equity, UBS in 1993 was the largest universal bank in Switzerland. It had 27,500 employees worldwide (78% of them in Switzerland). According to *International Fund Strategies*, UBS's private banking division managed \$300 billion in 1994, which made it one of the leaders in asset management globally, second only to Nippon Life Insurance and ahead of Fidelity, Prudential, and Dai-ichi Mutual Life Insurance.

On January 3, 1994, UBS's capital structure was as shown in Table 1. N shares accounted for the majority of votes (51%) while contributing only 20% of the market capitalization. Since each share had one vote, it was cheaper to obtain a voting right by buying an N share (for SFr. 325) than by buying an I share (for SFr. 1,354). This may be why N shares, when adjusted to reflect the same par value, sold at a premium to I shares of 20% (= $SFr.325 \times 5 / SFr.1,354$).⁶

UBS first issued N shares in 1975 as a stock dividend to I shareholders to ward off unwanted acquirers and to meet provisions in the banking law requiring that Swiss banks be able to prove they are controlled by Swiss nationals. Since there was no

2. See James A. Brickley, Ronald C. Lease, and Clifford W. Smith, Jr., "Ownership Structure and Voting on Antitakeover Amendments," *Journal of Financial Economics* 20 (1988); and Karen Van Nuys, "Corporate Governance through the Proxy Process," *Journal of Financial Economics* 34 (1993).

3. Studies of U.S. proxy contests include Peter Dodd and Jerold B. Warner, "On Corporate Governance: A Study of Proxy Contests," *Journal of Financial Economics* 11 (1983); Harry DeAngelo and Linda DeAngelo, "The Role of Proxy Contests in the Governance of Publicly-held Corporations," *Journal of Financial Economics*, 23 (1989); John Pound, "Proxy Contests and the Efficiency of Shareholder Oversight," *Journal of Financial Economics* 20 (1988); and Van Nuys (1993). Rather than shareholder disagreement, these papers focus on the impact of these contests on shareholder wealth (Dodd and Warner, 1983; DeAngelo and DeAngelo, 1989)

or on inefficiencies in the system of proxy-vote solicitation (Pound, 1988). Van Nuys (1993), however, does examine voting behavior in the 1989 Honeywell proxy solicitation case.

4. Bearer shares can be voting or nonvoting. In the period under consideration, UBS had only voting bearer shares.

5. This is taken almost verbatim from Nedim Peter Vogt and Rolf Watter, *Mergers and Acquisitions in Switzerland* (Helbing & Lichtenhahn, Basel, Switzerland, 1995).

6. Dividends were paid in proportion to par value. Since I shares had five times the par value of N shares, the relative (par-value adjusted) price differential is computed as the ratio of five times the price of one N share divided by the price of one I share, minus one.

When some shareholders (such as employees, suppliers, creditors, or customers) have claims against the firm in addition to their shares, the same policy decision can increase the wealth of one group of shareholders while reducing the wealth of another. Management can use such shareholder conflicts to serve its own ends.

TABLE 1

Stock Category	Number of Shares	Par Value	Market Value	Proportion of Votes (2)/43,550,000	Proportion of Market Value (2)×(4)/36,071,000,000
(1)	(2)	(3)	(4)	(5)	(6)
I shares	21,300,000	SFr. 100	SFr. 1,354	48.91%	79.95%
N shares	22,250,000	SFr. 20	SFr. 325	51.09%	20.05%
Total	43,550,000	SFr. 2,575,000,000	SFr. 36,071,000,000	100.00%	100.00%

mandatory disclosure of share ownership at the time, the only way for a firm to prove the identity of at least some of its shareholders was to have registered shares. As for foiling takeover attempts, most corporate charters at the time entitled corporate boards to refuse to register unwanted shareholders. Hence, by issuing N shares and refusing to register unwanted shareholders, the UBS board could discourage unfriendly takeovers.

BK Vision

BK Vision, a company traded on the Zürich stock exchange, is part of BZ Gruppe Holding (BZGH). Two-thirds of BZGH's capital is controlled by BZ Bank Zürich's management. BZ Bank Zürich's CEO is Martin Ebner, who is also Chairman of the board of BZGH. By all indications, he controlled a substantial fraction of BZGH's votes, although the exact amount is unknown. According to its corporate charter, BK Vision aims to create value for its shareholders by buying and managing stakes in banks and other financial firms.

When BK Vision was incorporated in October 1991, its portfolio had a value of SFr. 538 million. The portfolio at the time consisted of the stocks of five Swiss banks, and most of the money (63.4%) was invested in Union Bank of Switzerland stock. The UBS block represented 4.4% of all UBS N shares and 1.4% of all UBS I shares.

BACKGROUND EVENTS

This section describes the BK Vision actions that could have provoked the share reunification plan. In particular, it shows how BK Vision accumulated a significant block of shares in UBS, how it attempted

to force policy changes at UBS, and what goals it might have been pursuing.

BK Vision's UBS block grew over time. By the end of August 1994, its block of N shares had reached 4,005,000 (or 18% of the N shares outstanding), and its I shares numbered 639,000 (or 3% of the I shares outstanding). On that date, BK Vision's portfolio consisted of only two companies: UBS (81.5% of portfolio value) and Zürich Versicherungs-Gesellschaft.

In these circumstances, BK Vision could no longer vote all the UBS shares it now owned. Because of the cap on the number of total votes any shareholder could cast and the number of N shares any shareholder could vote, BK Vision could vote all its I shares but only 28% of its N shares.

Why would BK Vision want to buy shares it could not vote? One possible reason is that it wanted to establish a toehold to finance a subsequent tender offer for UBS shares. A tender offer sometimes requires buying out shareholders for a price higher than the expected post-takeover price.⁷ Under these circumstances, a toehold (and its associated gains from share appreciation) could be necessary to enable BK Vision to pay such an offer price and still benefit from the acquisition.

But that does not explain why BK Vision would want to accumulate *N shares*. Any share category would do. BK Vision obviously wanted the votes associated with N shares. Various possible reasons can be conjectured (and in fact BK Vision's plan might have been consistent with several of these reasons simultaneously).

(1) One reason to accumulate nonvoting N shares could be to place them with similar-minded investors not subject to voting restrictions.

(2) A second reason is that the nonvoting status was reversible. The board could grant exceptions

7. This could be necessary to convince free-riding shareholders to tender their shares. Bradley (1980) discusses front-loaded two-tier bids as a possible solution to the free-rider problem arising in this situation. (See Michael Bradley, Interfirm tender offers and the market for corporate control, *Journal of Business* 53 (1980).

Bagnoli and Lipman (1988) analyze a single-raider model with infinitely many stockholders. See Mark Bagnoli and Barton L. Lipman, "Successful Takeovers without Exclusion," *The Review of Financial Studies* 1 (1988).

from the provisions limiting the number of N shares any one shareholder can vote.

(3) A further possibility was to put UBS in play and hope to sell the block of shares to a third party interested in taking over UBS.

(4) Yet another possibility was to make life difficult for UBS in an attempt to greenmail it. Greenmail, however—in the sense of a targeted share repurchase by UBS for a price above the market—is not possible in Switzerland. The law requires the firm to treat all its shareholders equally. But the law would not apply if UBS bought the whole company, BK Vision, rather than just its UBS holdings.

Making life difficult would mean making it hard for UBS to pass resolutions requiring a qualified majority of votes. According to corporate law, “important” decisions require a two-thirds majority of the votes cast at the meeting and 50% of the aggregate par value represented there. Important decisions include, among other things, changes in the provisions regulating the transferability of N shares, the limitation or voiding of shareholders’ preemptive rights, the issue of warrants and convertible bonds, the creation of authorized capital, and mergers into other companies. By buying shares it could not vote, BK Vision could reduce the number of votes it needed to reach the 33% minority necessary to block these decisions. Accumulating nonvoting N shares would make sense in this strategy if, for every three shares bought that it could not vote, fewer than one would be voted to support BK Vision’s cause. Otherwise, it would be better to leave these votes in the market.

Besides establishing a position that would enable it to affect management decisions, BK Vision pursued other avenues in its quest to gain some degree of effective control over UBS. In particular, it tried to affect UBS’s board size and composition. The law stipulates that stockholders holding shares with a cumulative par value of at least SFr. 1 million have the right to table motions at a stockholder meeting. Using that provision, BK Vision introduced a proposal aimed at reducing the board size to 9 from the then 21 (and a maximum possible of 25). This proposal was put to a vote at the April 1994 stockholders’ meeting. BK Vision also proposed that directors be voted on individually rather than as a group. Both proposals were defeated, but they drew the support of about 40% of the votes, a surprisingly large number.

THE SHARE REUNIFICATION PLAN

The accumulation of shares by BK Vision did not go unnoticed at UBS headquarters. On September 29, 1994, after a three-hour meeting, the UBS board struck back. After the Zürich Stock Exchange had closed, it disclosed a proposal that would replace the current I and N shares with new I shares with a par value of SFr. 10. One original I share was to be split into 10 new I shares; more importantly, one original N share was to be split into 2 new N shares, which would then be swapped, one-for-one, into new I shares. The board also proposed to drop the 5% cap on the total number of votes any one shareholder could cast. As shown later, the plan redistributed wealth from the holders of N shares to the holders of I shares, making the latter the apparent beneficiaries of the capital restructuring.

To examine the wealth redistribution, Table 2 juxtaposes the then current capital structure with the proposed one. The theoretical unitary share price under the proposal (SFr. 126.61) is computed by dividing total current market capitalization by the number of shares outstanding under the new capital structure.

Under the plan, every original I share ended up with 10 new I shares (and votes), whereas every N share received only 2 new I shares (and votes). Original I shares thus gained voting power in relation to original N shares. As shown in Table 3, they went from the 49% of the votes they then controlled to 83%. The wealth redistribution occurred because the new shares were allocated on a par-value basis, but share prices were not proportional to par value.

As also shown in Table 3, the fraction of equity value claimed by I shares increased from 78% to 83%, which is why I shareholders appeared to benefit from the proposal. The claim held by N shareholders falls by the same amount. As a group, N shareholders lost 5% of total market capitalization, or (assuming an unchanged total market capitalization) SFr. 1.6 billion. Moreover, because BK Vision held a much larger percentage of N than I shares, this transfer of wealth from N to I shareholders was likely to reduce the value of BK Vision’s holdings of UBS stock.

The above wealth-redistribution arguments assume that the proposed reunification plan would not affect the aggregate market value of equity. In reality, that was unlikely to be the case. First of all, the plan increased the funds necessary to establish a given block of votes in UBS. At the time, ignoring the caps

Increased liquidity and prevention of a control change, as the board explained in its letter to stockholders, were the reasons for the share reunification plan. The benefits from increased liquidity, however, would seem to be small in comparison with those related to a lower probability of a control change.

TABLE 2

	Current Capital Structure	New Capital Structure
OLD N SHARES:		
Number	22,250,000	—
Par value	SFr. 20	—
Price on 9.27.1994	SFr. 329	—
OLD I SHARES:		
Number	21,300,000	—
Par value	SFr. 100	—
Price on 9.27.1994	SFr. 1,187	—
NEW I SHARES:		
Allocated to original N shareholders	—	44,500,000
Allocated to original I shareholders	—	213,000,000
Total number of shares	43,550,000	257,500,000
Total par value	SFr. 2,575,000,000	SFr. 2,575,000,000
Market value of equity	SFr. 32,603,350,000	SFr. 32,603,350,000
Theoretical unitary share price	—	SFr. 126.61

TABLE 3

	Current Capital Structure	New Capital Structure
ORIGINAL N SHARES:		
Fraction of par value	17%	17%
Fraction of votes	51%	17%
Fraction of equity value	22%	17%
ORIGINAL I SHARES:		
Fraction of par value: I	83%	83%
Fraction of votes: I	49%	83%
Fraction of equity value: I	78%	83%

imposed by the corporate charter, the fraction of votes controlled by BK Vision was 10.7%. The proposal made all the shares owned by BK Vision votable. It therefore raised the fraction of votes BK Vision could cast from 5% to 5.6%. But, in order to reestablish a voting block of 10.7% under the new capital structure, BK Vision would have had to invest an additional SFr. 1.65 billion in UBS shares. Increased funding requirements could make it difficult for BK Vision to pursue its plans. As a consequence, the probability of a control change fell and the value of the voting right dropped, depressing the share prices of both N and I stock. On the other hand, by removing all the restrictions on the transferability of shares, the plan could also have had the effect of increasing

the liquidity of both N and I shares—and higher liquidity, all else equal, would mean higher values.

And increased liquidity and prevention of a control change, as the board explained in its letter to stockholders, were the reasons for the share reunification plan. Other firms had gone through similar capital restructurings, and there was evidence of benefits in the form of lower bid-ask spreads and higher trading volume.⁸ The benefits from increased liquidity, however, would seem to be small in comparison to those related to a lower probability of a control change.

Overall, there was little doubt the plan would make the holders of N shares worse off. I shareholders would seem to be the beneficiaries of

8. See Roger Kunz, "Vereinfachung der Grundkapitalstruktur und Liquidität der Beteiligungspapiere," *Finanzmarkt und Portfoliomanagement* 11 (1996).

TABLE 4

	Sept. 29, 1994	Sept. 30, 1994	Oct. 3, 1994	Sept. 29 - Oct. 3, 1994
BEARER SHARES (I)				
Cumulative excess return	2.13%	0.65%	-1.08%	1.70%
t-value	2.84	0.87	-1.45	1.31
REGISTERED SHARES (N)				
Cumulative excess return	-0.60%	-5.49%	-5.26%	-11.35%
t-value	-0.62	-5.61	-5.37	-6.70

wealth redistribution, but the net effect of the share reunification proposal for them was not obvious (because although the plan assigned them more voting rights, it also effectively reduced the value of those rights). Still, the board predicted benefits for stockholders as a group, mainly because the stock would be more liquid.

The proposal, which was backed unanimously by the board members, would have to be voted on in two months, on November 22, at a special shareholders' meeting. From a legal standpoint, it was not clear whether a simple majority or a qualified majority would be necessary to pass it. It was also unclear whether N shareholders had to approve a decision that would strip them of their voting privileges. In the absence of clear legal guidelines, UBS decided to play it safe and set a hurdle for acceptance of two-thirds of the votes cast and 50% of the par value represented at the meeting.

The share reunification plan *per se* did not come as a surprise. One unusual aspect of the share reunification plan, however, was that it would remove the *registered* shares. Other firms, such as Nestlé, that had preceded UBS in simplifying their capital structures had chosen to eliminate their bearer shares instead. The advantage of N shares over I shares is that they make it easier for managers to monitor takeover attempts. N shareholders have to be registered, whereas I shareholders can remain anonymous. UBS could have chosen instead to drop its registered stock to avoid the various shareholder registration procedures and save money.

But, having come this far in the process, there was no time for another solution. Ordinary stockholder meetings have to occur no later than six months after the end of the fiscal year. Had UBS chosen to eliminate its I shares instead, the administrative procedures to register these shareholders, many of whom were unknown (49% of the shares outstanding were I shares), could have taken more

than six months. And that could have made it difficult to hold the regular 1995 stockholder meeting within the legal time limit.

The Proposal's Impact on UBS's Share Prices

To measure the impact of the stock reunification proposal, we estimated the market model for the 200 trading days up to and including day 11 before the proposal was announced. The model was estimated for the two classes of stock (I and N) separately using the SPI (Swiss Performance Index) as a market index. Excess returns were then computed by deducting the market model predictions from the observed returns. We also investigated the price changes on the announcement day, Thursday, September 29, and the first two trading days thereafter. Since the announcement came after the trading close, the first opportunity for investors to react was Friday, September 30; the next opportunity was Monday, October 3.

As shown in Table 4, over the three-day interval examined, the proposal resulted in a moderate, statistically insignificant 1.7% increase in the price of I shares. In contrast, the price of N shares plummeted by 11.35%. This occurred even though, according to traders, UBS actively bought N shares to prevent a large price erosion or to prepare for the looming proxy battle. Thus, the plan clearly hurt the holders of N shares, thereby giving them strong incentives to oppose it.

The total market capitalization of UBS also fell. During the three days in question, the decline was -4.8% (unadjusted for market movements) and, of course, contradicted the board's claim that the plan would benefit shareholders as a group. The total drop in the market value of equity was SFr. 1.6 billion (\$1.3 billion at an exchange rate of SFr. 1.2 to the dollar). The value of BK Vision's UBS block declined by 9.8% (SFr. 204 million).

The event was partly anticipated. In fact, there was frantic trading in UBS stock on Thursday, Sep-

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tember 28, the day before the announcement. On that day, the volume of N shares soared to SFr. 146 million, eight times the level of Wednesday's trading. And the volume of I shares climbed to SFr. 155 million, almost triple the level of Wednesday. The abnormal trading activity led to a preliminary investigation of insider trading. The investigation was quickly dropped, however, on the argument that many investors knew about the forthcoming decision.⁹

The price decline of N stock fueled resentment against UBS top management. Attempts to quell the discontent were unconvincing at best. In an interview, the chairman of the board reacted by arguing that the only N shareholders to lose money were those who had bought during the past few months, at a time when the par-value-adjusted price differential between N shares and I shares had been positive and large. They had done so, he explained, against the recommendation of various financial analysts and in spite of the fact that UBS's restructuring plans had been mentioned earlier. None of the other holders of N shares lost money, he claimed, since they had bought their shares when they were selling at a discount from I shares (N shares sold at a par-value-adjusted discount from I shares from the time they were introduced in 1975 until the beginning of 1989). Separately, the CEO argued that N shareholders could not be considered victims, since N shares were issued for free in 1975.

The chairman also claimed that compensating N shareholders would be illegal, as it would amount to discriminating against I shareholders (according to corporate law, the board had to treat shareholders equally). The problem with this argument, however, is that there would have been ways to legally compensate N shareholders. UBS could have swapped N shares for I shares on the basis of prices observed a few days before the decision was announced, rather than par value. If so, no wealth redistribution would have occurred.

Probability That UBS Shareholders Would Vote for the Proposal

For several days after the proposal announcement (trading close, September 29), market participants appeared to think that the voting outcome was

a toss-up. To see this, note that we can write the value of one share of bearer stock after the proposal announcement as:

$$V_I = \pi \times V_I^{\text{old}} + (1 - \pi) \times 10 \times V_I^{\text{new}}, \quad (1)$$

where π is the probability that BK Vision would be able to defeat the proposal. If it did so, the current capital structure would remain unchanged and the value of one bearer share should go back to its pre-proposal level, V_I^{old} . In contrast, with probability $(1 - \pi)$, UBS would win, in which case the original I share would be swapped for 10 new bearer shares with value V_I^{new} . Similar arguments imply that the value of one original share of N stock can be expressed as:

$$V_N = \pi \times V_N^{\text{old}} + (1 - \pi) \times 2 \times V_I^{\text{new}}, \quad (2)$$

If BK Vision won the proxy fight, the price of one N share would go back to its pre-proposal value. If UBS's proposal was approved instead, one N share would be swapped for two new bearer shares with value V_I^{new} .

Solving the system of equations (1) and (2) yields the market's estimate of the probability that BK Vision would be able to defeat the proposal:

$$\pi = (V_I - 5V_N) / (V_I^{\text{old}} - 5V_N^{\text{old}}) \quad (3)$$

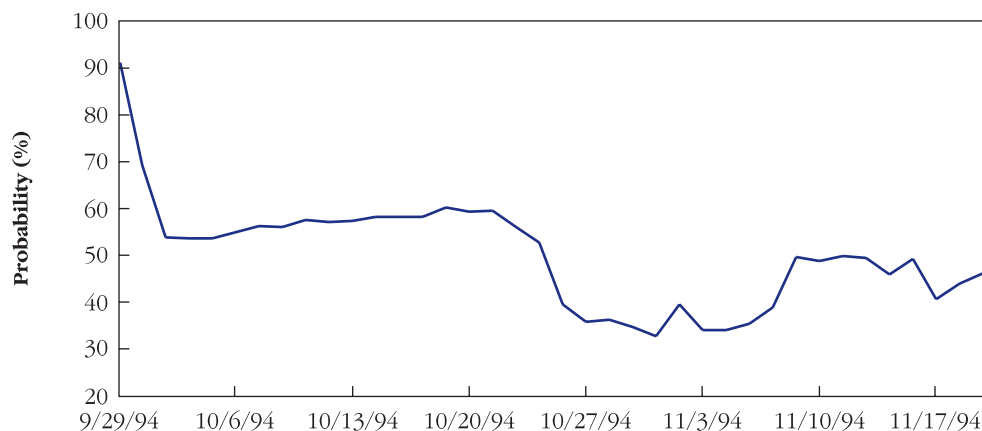
Inserting the pre-announcement and post-announcement values of bearer and registered shares quantifies this probability estimate. The result is reported in Figure 1 from the first day following the proposal announcement (September 30) until the last day before the special meeting of stockholders (November 21). As shown in the figure, apart from the first two trading days and for about two weeks from the end of October to the beginning of November, the market appeared to think that the contest was very close, as the probability estimates range between 40% and 60%. That seems to have corresponded to the general feeling of analysts during this period.

Interestingly, the model can also be solved for the expected share price, V_I^{new} , in case of proposal approval and the associated expected total market capitalization. On October 3, for example, right after the announcement of the proposal, that capitaliza-

9. According to the biweekly publication *Cash*, FONSA, a UBS fund, had sold a large part of its N shares a few hours before the decision was announced and had bought I shares instead. When asked about these transactions, the chairman

of UBS referred to the conclusions of the preliminary investigation and denied any illegality.

FIGURE 1
 PROBABILITY ESTIMATES
 THAT UBS'S BOARD SHARE
 REUNIFICATION PROPOSAL
 WOULD BE DEFEATED AT
 THE SPECIAL
 SHAREHOLDERS' MEETING
 OF NOVEMBER 22, 1994*



*The proposal was announced on September 29, 1994, after the trading close.

tion was SFr. 29 billion, 10% less than the total market capitalization observed on September 29, right before announcement. Market participants thus did not seem to share management's conviction that share reunification would boost stock prices.

THE PROXY FIGHT

This section investigates how the two contending parties, BK Vision and UBS, prepared for the special stockholder meeting of November 22.

BK Vision's Strategy

BK Vision appeared confident that the holders of N shares would not approve a plan that would strip them of their voting privileges. In fact, it asked UBS to hold a separate meeting of its N shareholders to approve the restructuring. This request would not make sense if BK Vision thought the majority of N shareholders would support the UBS proposal. UBS appeared to think along the same lines and refused to hold a separate shareholder meeting.

Of course, if the holders of N shares would in fact have voted against the reunification plan, UBS would have been unable to reach the qualified majority it needed, and the plan would have failed. On the strength of this conviction, BK Vision did not seem to buy any additional UBS shares for its own account. But, according to market observers, BK Vision did lobby known UBS shareholders to support its cause.

Besides relying on N shareholders to defeat the capital restructuring plan, BK Vision prepared to

challenge the plan's legality. At a press conference in October, Mr. Ebner announced that if the plan was approved, he would fight it in court on the argument that it penalized the N shareholders and therefore violated law mandating that shareholders be treated equally.

UBS's Strategy

Forward share purchases. There is little evidence that UBS repurchased shares in the spot market on its own account. According to corporate law, UBS could repurchase up to 10% of its equity capital (or, more precisely, it could not report more than 10% of treasury stock at the end of its fiscal year). In addition, it could hold its own shares in its role as market maker. Yet, on November 21, 1994, the total number of shares held by UBS on a consolidated basis (including the shares in its trading portfolio) was far less than 10%. UBS held 409,019 I shares and 101,540 N shares, which came to 1.2% of all shares outstanding. The reason for UBS's reluctance to buy spot shares on its own account might have been its inability to vote them.

Instead of buying shares directly, UBS seemed to favor a forwardbuying strategy. According to well-informed sources, UBS bought more than 20% of its registered shares forward. The Zürich pension fund illustrates these transactions. The fund had about 400,000-500,000 N shares in its portfolio. For diversification purposes, and because the fund manager was concerned that UBS would win the proxy fight, he decided to liquidate this position. He contacted both contending parties in an effort to extract the

**Even the I shareholders hurt themselves by approving the share reunification plan.
With hindsight, the redistribution benefits from the plan for I shareholders were not
sufficient to offset the losses from a reduced probability of a control change.**

best deal. Some of the shares were eventually sold for cash and some were sold forward; all were sold to UBS. The forward sale was for about 200,000 shares, with a maturity date after the stockholders' meeting. One can only speculate why the sale was forward. If UBS could assume the shares would be voted in its favor, it did not make sense to actually buy them spot because they could not be voted. In contrast, a forward transaction would hedge the pension fund against the risk of a price decline and at the same time guarantee UBS the votes it needed.

Another one million N shares were bought on October 28 from an individual investor (Mr. K.) in two similar forward transactions (250,000 shares for December 15, 1994 delivery and 750,000 shares for June 21, 1995 delivery). Here, too, the investor talked to both contenders and sold to the highest bidder, UBS. The legality of this deal was later hotly contested in court. BK Vision argued, among other things, that UBS had paid a premium (something illegal) in return for Mr. K.'s supporting vote. UBS denied having paid anything for Mr. K.'s vote. On close analysis of its own court filings, however, UBS does appear to have paid more than a market price for Mr. K.'s shares. UBS stated, for instance, that it paid SFr. 312.50 per share for the 250,000 share block. This forward price is arrived at by compounding the spot price observed on October 17 (SFr. 311) with an interest rate of 4% and deducting transaction costs.¹⁰ But, since the pre-meeting share price included a premium for the right to vote on the share reunification plan, and since this voting right expired after the meeting, the correct forward price should be computed with a spot price net of the voting right value.

Thus, by its own admission, UBS did pay for Mr. K.'s voting rights. As it turns out, the value of one such voting right was about 1.4% of the price of one share of N stock. Surprisingly, however, BK Vision failed to recognize UBS's implicit admission of having paid an excessive price, or chose not to act on it.

Interestingly, it would appear that the repurchases focused on N shares, on the assumption that N shareholders had reasons to oppose the plan and that I shareholders would approve it.

Securities lending. UBS also lent shares to investors through its affiliate UBS Mitarbeiter-

Beteiligung AG (MAB). This affiliate was established to hold shares for an employee compensation plan. In 1993, it held about 1.5 million registered shares. Securities lending is a fairly common practice in banking, and it arises among other things in connection with the need to cover short positions. During later court proceedings the bank admitted that it lent its securities in order to be able to vote shares that it or MAB could not vote.

Lobbying shareholders. UBS courted shareholders to vote for its proposal and apparently succeeded in obtaining the support of firms and individuals with which it had business ties. According to well-informed sources, for instance, a French corporation holding a well-diversified portfolio of assets worth SFr. 600 million liquidated its holdings to buy N shares of UBS.

One special category of shareholders was UBS's own employees, who held more than 10% of the N shares. They were also contacted by senior management. After a first letter from the bank's Chairman and another from its CEO informing them about the share reunification plan, they received a second one warning that many employees had not yet granted a proxy to be represented at the shareholders' meeting, and stressing that granting such a proxy was of utmost importance (since the meeting was during working hours, most employees would probably be unable to attend). The letter pointed out that, even though Mr. Ebner had never said so explicitly, it was "clear" that a victorious BK Vision would significantly reduce the number of branch offices, and cut jobs. Both the Chairman and the CEO acknowledged the financial loss incurred by UBS's employees as holders of N shares. The loss, they argued, was nominal (in the sense of unrealized) and slight, particularly when taking into account the subscription price paid.

One aspect of relevance here was the employees' potential concern for voting secrecy. In principle, top management could find out whether and how each employee had voted. Presumably, other shareholders with business ties to UBS had the same concern. After the vote, UBS's Chairman admitted that voting secrecy could not be guaranteed but that precautionary measures had been put in place to exclude this possibility.

10. UBS claimed to have drafted the purchase proposal on October 18 based on the spot price observed on October 17, namely SFr. 311. Interestingly, by October 28, the date the deal was allegedly sealed, the share price had declined

to SFr. 273. The forward price of SFr. 312.50 can be computed by compounding the spot price of SFr. 311 at an annual rate of 4% for the period between October 18, 1994 and December 15, 1994 and deducting transaction costs.

TABLE 5

	Number of votes	Percentages of votes present
Votes outstanding	43,550,000	—
Votes present at the meeting	31,633,301	100.0
Necessary majority	21,088,867	66.7
Shares not voted (abstentions)	212,367	0.7
Void ballots	1,150,976	3.6
Votes in favor	21,154,317	66.9
I shares	12,595,967	39.8
N shares	8,558,350	27.1
Votes against	9,115,641	28.8
I shares	2,911,297	9.2
N shares	6,204,344	19.6

TABLE 6

	Nov. 22, 1994	Nov. 23, 1994	Nov. 24, 1994	Nov. 22-24, 1994
BEARER SHARES (I)				
Cumulative excess return	-0.79%	-1.55%	-1.59%	-3.93%
t-value	-0.67	-1.32	-1.35	-1.93
REGISTERED SHARES (N)				
Cumulative excess return	-2.65%	-4.71%	-2.60%	-9.96%
t-value	-1.39	-2.47	-1.37	-3.02

THE OUTCOME

A record 6,700 shareholders eventually gathered for the stockholders' meeting. Of the 43,550,000 votes outstanding, 73% (31,633,301) were represented. Historically, attendance had been less than 50%. The outcome of the vote is shown in Table 5. To pass, the plan required a two-thirds (66.7%) majority of the votes and an absolute majority of total par value. As shown in the table, 66.9% of the votes (just 65,450 more than necessary) went to the plan. The share reunification plan was therefore narrowly accepted. More than one million ballots were void, and 212,000 votes represented at the meeting were not cast.

The vast majority of I shareholders (81%) supported the plan. They probably expected to benefit from its redistribution effects. But, as we have argued, it was not obvious that the plan made them better off. It did redistribute voting rights to them, but it also reduced the benefits of a control change. In fact, investors at large were rather skeptical, as

evidenced by the lackluster reaction of I stock prices when the plan was announced.

More surprising, however, is that 60% of the N shares represented at the meeting also supported the plan, even though it clearly hurt them. Note, however, that BK Vision could not vote 2,892,500 N shares. Had it been able to vote them, it would have carried the majority of the N shares and defeated the proposed plan.

The Impact on UBS Share Prices

To examine the impact of the vote on the price of UBS shares, we performed an event test similar to that used to analyze the impact of the plan's announcement. In Table 6 we report the excess returns on Tuesday, November 22 and the two days thereafter. Although the meeting took place on November 22, the vote came after the market closed.

As shown in the table, the decision was bad news for both classes of stock. Apparently, market

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participants concluded that a control shift was less likely, which hurt both classes of shareholders. Specifically, over a three-trading-day interval starting with the day of the stockholders' meeting, I shares experienced a cumulative, uncompounded excess return of -3.93%; N shares of nearly -10%. (Both returns are statistically significant with confidence in excess of 0.95.) If we add to these returns those computed for the three-trading-day announcement interval, we obtain an aggregate return of -2.23% for I shares and -21.31% for N shares.

Thus, even I shareholders hurt themselves by approving the share reunification plan. With hindsight, the redistribution benefits from the plan for I shareholders were not sufficient to offset the losses from a reduced probability of a control change. In fairness, this is not something I shareholders could have anticipated, although the weak aggregate announcement effect should have suggested indifference to, rather than overwhelming support for, the proposed plan. In contrast, the majority of voting N shareholders voted for a plan that imposed a cumulative (uncompounded) loss of 21%, a loss these shareholders should have anticipated, since the plan both redistributed wealth away from them and reduced the chances that the benefits of a control change would be realized.

According to press speculation, the voting majority of N shareholders consisted of current UBS employees, some institutional investors, and other banks. The average UBS employee was probably concerned that a BK Vision victory could at the very least speed up the restructuring process and endanger his job. Employees may well have felt that they had more to lose by opposing the plan than by approving it. Institutional investors, for their part, had come under pressure in the media to support the plan to prevent Mr. Ebner from laying off thousands of employees in his quest for a quick profit. Finally, the top management of other banks would seem to have had a vested interest in casting their proxies in support of UBS, since UBS's predicament today could easily become theirs tomorrow.

In monetary terms, and ignoring the adjustment for market movements, the total market capitalization of UBS fell SFr. 2.1 billion, or 6.97%, during the three days in question (\$1.8 billion at an exchange rate of SFr. 1.2 to the dollar). BK Vision's holdings of UBS stock declined by SFr. 167 million, or 9.33%. When combined with the losses observed during the announcement period, the total losses came to SFr.

3.7 billion and SFr. 371 million for UBS and BK Vision, respectively. Taking into account the days between the two events, UBS's total market capitalization fell by 10.6% (from September 28 until November 24). This compares to +2.0% for Credit Suisse Holding and -2.6% for Swiss Bank Corporation, the other two large Swiss banks, during the same period.

CONCLUSIONS

As the case discussed in this paper shows, shareholders do not always act in ways that maximize their share price. In the case examined, the holders of bearer stock overwhelmingly supported a plan that redistributed wealth from the holders of registered stock. More surprisingly, the holders of registered stock also supported the plan, although they knew it would drastically reduce the value of their holdings.

The extent of shareholder disagreement cannot be assessed with a case study, but the paper shows that the disagreement can be substantial. And it should be stressed that disagreement here arises not so much as a result of different predictions about the plan's likely consequences, but rather as a result of different financial incentives for the involved players.

The UBS proxy fight is a landmark in Swiss corporate governance history. Until recently, Switzerland's economy was dominated by cartels, with closely overlapping boards of directors. Hostile takeovers were essentially unheard of, and criticism of management by shareholders was highly unusual and thoroughly unappreciated. Mr. Ebner's activities have had the merit of stimulating public debate about shareholders' rights and shareholder activism. Also, they have contributed to making shareholder value a politically correct goal for firms to pursue and made it more acceptable for shareholders to criticize management. As a result, public opinion holds managers more accountable for their decisions. Finally, Mr. Ebner's actions encouraged other shareholders to take a more critical view of officers and directors. CEO dismissals for subpar performance, like those witnessed at General Motors, Sears, American Express, Kodak, and AT&T, are still difficult to imagine. But they have become more likely. Interestingly, in current ads to attract investors for his BZ Bank, Mr. Ebner claims that Switzerland is the first European country in which shareholder value has had a lasting impact as a management criterion.

Events involving proxy fights and shareholders with conflicting interests have been observed before in other countries, including the U.S. But a case very like the one discussed here would probably not have been possible in the U.S. A share reunification plan that significantly harmed one class of shareholders could hardly be proposed in the U.S., or at the very least the firm would have to indemnify the affected shareholders. In fact, in the case under consideration no compensation was offered, with the paradoxical argument that corporate law mandates that all stockholders be treated the same. In the U.S., the same law would probably have been invoked quite differently, namely to argue that compensation was necessary to prevent unequal treatment of stockholders in the first place.

EPILOGUE

As it had threatened repeatedly before the meeting to do, BK Vision went to court. First, it asked the commercial court to block registration of the share reunification decision. Second, it requested a special audit of share transactions UBS had engaged in, and of decisions UBS had made before the meeting. Third, it brought suit to invalidate the share-reunification decision based on the argument, among others, that it discriminated against N shareholders and was made possible by voting shares that should not have been voted. These shares included those

held by UBS investment funds (which, according to BK Vision, should have been treated as treasury shares and disallowed from voting). Fourth, BK Vision objected to UBS voting all its proxies, claiming these votes should have conformed to the 5% limit imposed on the votes any one shareholder could cast. Fifth, BK Vision sued UBS's board for SFr. 242 million in damages resulting from losses shareholders suffered on the shares bought by UBS before the meeting (the board had liability insurance). Finally, BK Vision sued UBS's CEO and other executives for forgery, among other things.

Three years later, on December 8, 1997, the boards of UBS and Swiss Bank Corporation announced plans to merge the two banks. The decision appears to have been unrelated to the control contest involving BK Vision. According to back-of-the-envelope calculations, the merger proposal announcement raised the value of BK Vision's holdings of N shares alone by some SFr. 400 million.

The legal dispute was settled out of court in 1998. Details of the settlement are not known. Following the UBS proxy fight, Mr. Ebner used the companies under BZ Gruppe Holding to buy significant stakes in other corporations he deemed undervalued, including ABB, one of the world's leading technology and engineering companies, and Algroup, a large player in the aluminum and packaging industries. In 1999, he joined ABB's board and became Algroup's COB.

■ CLAUDIO LODERER

is Professor of Financial Management at the Institut für Finanzmanagement, Universität Bern.

■ PIUS ZGRAGGEN

is a doctoral candidate at the Institut für Finanzmanagement, Universität Bern.