Under What Conditions can an Option Right be Enforced in a Shareholders Agreement?

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In a shareholders' agreement, an option right was granted to four brothers to keep a family business within the family. It proved useful when the fourth brother decided to grant a third party an emption right.

Judgment of the Federal Supreme Court of 22 June 2023

Case reference : 4A_25/2023

Facts

Albert (the "Plaintiff"), Benoît, Christian and Denis (together, the three "Defendants") are the four sons of Ernest and Fabienne.[1] The latter were also the owners of two family businesses, B. AG (the "Company") and C. AG (the "Second Company"). When Ernest and Fabienne divorced, Fabienne took over the shares of the Company, while Ernest took over a large majority of the shares of the Second Company.

In 2011, the four sons and their parents entered into a publicly notarized agreement governing the succession of their family businesses (the "Agreement"). Under the Agreement, (i) Ernest transferred his shares in the Second Company equally amongst his sons; (ii) Fabienne donated her shares in the Company equally amongst her sons, subject to a right of usufruct in her favor; and (iii) if a shareholder intended to sell his shares, those shares must first be offered to the remaining shareholders (brothers) at a preferential price (the "Option Right"). The relevant clause read as follows: "The current bearer shares [of the Company] are to be converted into nominal shares with restricted transferability. The shares are to be restricted in the sense that, in the event of a planned sale, they must be offered for purchase to the remaining shareholders and must also be taken up by them (call and put option). The price to be paid per share in this respect shall be determined on the basis of a valuation report to be prepared by E. […]; it [the price] shall amount to 75% of the value calculated by E. The shares are to be taken over by the remaining shareholders equally. Should one of the remaining shareholders not be willing to make such an acquisition, the other shareholders shall each have the right to acquire his portion equally. Should none of the remaining shareholders be willing to purchase, the shares shall be offered for sale to [Fabienne] – and, should the latter not buy – to [Ernest] on the basis of 75% of the value determined by E. Should he also not wish to buy, the remaining shareholders are obliged to take over the offered shares equally on the basis of 75% of the value determined by E."[2]

In 2018, the Plaintiff granted D. SA (the "Third Company"), which was owned by his father Ernest at the time, an irrevocable emption right over the Company shares that had been donated to him under the Agreement. Thereupon, in accordance with the Agreement, the Defendants communicated to the Plaintiff that they wish to exercise the Option Right over his Company shares equally. To that effect, Fabienne handed the shares of the Company that she had previously donated to the Plaintiff (the "Litigated Shares") over to the Defendants.

In 2019, the Plaintiff filed a claim before the First Instance Court of Zurich, where he essentially requested the court to (i) order the Defendants to return the Litigated Shares back to him, and (ii) acknowledge his ownership of the Litigated Shares. The Defendants sought to dismiss the claim and filed a counterclaim demanding the Plaintiff's consent to transfer the Litigated Shares. The First Instance Court found that the Plaintiff was indeed the owner of the Company shares, but it obliged him (in accordance with the Defendants' counterclaim) to give his consent to transfer the shares to the Defendants.

The Plaintiff filed an appeal against this decision to the Zurich Court of Appeal; the Defendants filed a cross-appeal. In its judgment, the Court of Appeal upheld the cross-appeal and affirmed that the Defendants had validly acquired the Litigated Shares upon exercising their Option Right. Therefore, the Plaintiff was no longer the owner of the Litigated Shares.

The Plaintiff challenged this ruling before the Federal Supreme Court.

Issue

In its ruling, the Federal Supreme Court analyzed a variety of legal issues, which can be grouped into two categories: (i) those relating to the interpretation of the Agreement; and (ii) those relating to the transfer of ownership of the Company's shares.

With regard to the first category, the Federal Court had to determine whether: (i) the Option Right provided for in the Agreement was legally binding; (ii) the Option Right actually constituted an emption right and not a right of first offer; and (iii) a case of "planned sale" which would trigger the Option Right had actually occurred. With regard to the second category of legal issues, the Federal Supreme Court had to determine whether (i) the transfer of movable property requires a "proprietary" contract; and (ii) a transfer of possession had actually taken place in this case.

Decision

The Federal Supreme Court confirmed the judgment of the Court of Appeal and thus rejected the appeal filed by the Plaintiff.

Turning first to the interpretation of the Agreement, the Federal Supreme Court confirmed the binding nature of the clause providing for the Option Right in favor of the brother-shareholders if one of them planned to sell his shares of the Company. The facts of the case showed that the parties intended this clause to be legally binding, and that all the essential points of the sale agreement triggered by the exercise of the Option Right had been agreed upon by the parties.

Secondly, the Federal Supreme Court confirmed that the disputed clause granted the other brother-shareholders a proper emption right, and not a mere right of first offer. Among other factors, the Federal Supreme Court noted that granting the Option Right in favor of the brother-shareholders better reflected the purpose of the Agreement, which was to ensure that the Company's shares remained within the family. Indeed, exercising the emption right enabled the Defendants to immediately enter into a share purchase agreement with the Plaintiff, conferring on them a greater protection than a simple right of first offer.

Finally, the Federal Supreme Court confirmed that the grant of an emption right to the Third Company – at the time solely owned by Ernest – did indeed constitute a case of a "planned sale" which could trigger the Option Right within the meaning of the Agreement. Indeed, even if a "planned sale" can be interpreted more or less broadly, conferring an emption right on a third-party company already constitutes the beginning of the execution of a possible sale, and therefore a "planned sale". If the parties intended the exercise of the Option Right by the other brother-shareholders to be conditional on the entry into a legally binding undertaking to sell the Company's shares to third parties, they would have stated this expressly in their Agreement. In this regard, the Federal Supreme Court considered decisive the fact that the Plaintiff had fundamentally lost control over the Litigated Shares by granting an emption right to the Third Company – which was not controlled by the Plaintiff – even if the Plaintiff pleaded that this transaction was part of internal family-restricted operations.

With regard to the issue of proprietary rights over the Litigated Shares, the Federal Supreme Court first noted that the transfer of movable property presupposes a valid cause (a *causa*, generally a contract) and a transfer of possession (*traditio*). On the other hand, the requirement of a "proprietary" contract ("*dinglicher Vertrag*" or "*contrat reel*", *i.e.* an agreement between the parties relating specifically to the transfer of ownership) is still subject to debate among legal scholars, even if such a requirement has been previously mentioned by the Federal Supreme Court in another case regarding a pledge agreement (see ATF 142 III 746). However, considering that the doctrinal debate about the necessity of a "proprietary" contract had no impact on the outcome of this case, the Federal Supreme Court declined to rule on this issue.

Finally, in order to decide whether or not the Plaintiff retained ownership of his shares of the Company, the Federal Supreme Court had to determine whether a transfer of possession of the Litigated Shares from the seller (*i.e.* the Plaintiff) to the acquirer (*i.e.* the Defendants) had indeed taken place.

According to Art. 922 para. 1 of the Swiss Civil Code ("SCC"), the transfer of possession may take place by delivery of the contractual goods to the purchaser. In this case, it was an undisputed fact that no physical delivery of the Litigated Shares had occurred, given that they remained under the control of Fabienne who held a right of usufruct over them. However, Art. 924 SCC provides for other means of transfer of possession without delivery of the goods (so-called substitutes to the

transfer of possession). In particular, Art. 924 para. 1 SCC provides that possession can be acquired without transfer when a third party remains in possession of the goods by virtue of a special title (transfer by way of delegation of possession, "*Besitzanweisung*" or "*délégation de possession*"). In such a case, the transfer of possession results from a simple agreement between the parties. In this case, the Defendants had successfully argued before the Court of Appeal that by granting them the Option Right in the Agreement, the Plaintiff had also expressed his will to transfer the possession of the Litigated Shares to them if they exercised the Option Right. Therefore, when the Defendants exercised the Option Right, they also immediately acquired possession of the Litigated Shares by application of the principle of delegation of possession, which directly resulted from the clause providing for the Option Right in the Agreement.

The Plaintiff tried to argue that the Agreement did not contain any provision concerning the transfer of possession over the Litigated Shares, but the Federal Supreme Court indicated that his consent to the transfer of possession was implicit in the Agreement. Indeed, the Agreement did not indicate that the acquisition of the Litigated Shares was subject to any other condition. Moreover, a different interpretation of the Agreement whereby the Plaintiff would have to expressly consent to the transfer of possession after exercising the Option Right would have enabled him to easily defeat the purpose of the Agreement and hinder the enforceability of the Option Right.

In light of all of these considerations, the Federal Supreme Court upheld the judgment handed down by the Court of Appeal and confirmed that the Defendants had indeed become the owners of the Litigated Shares.

Key takeaways

When parties enter into a contract which establishes a conditional option right to buy shares of a company, the parties must clearly define the conditions that can trigger the exercise of the option right as well as the steps to implement the valid transfer of the shares if the option right is exercised.

Comments

One of the challenges of shareholders' agreements lies in implementing the transfer restrictions contractually agreed upon by the parties, in particular, call options. This judgment sheds some light on one of the tools available to shareholders to enhance the practical enforceability of such rights: the transfer of possession of the shares without physical delivery.

As mentioned above, the Swiss Civil Code recognizes that one can transfer (physical) possession of a good by delivering it, but one can also transfer (virtual) possession of a good by a simple agreement between the parties involved. In the context of the transfer of shares represented in share certificates, this means that either (i) the transferor delivers the physical share certificates to the acquirer, or (ii) a third party previously holding the share certificates on behalf of the transferor agrees to hold such share certificates on behalf of the acquirer. While the first option requires an active step from the transferor, this is not necessarily the case for the second.

Implementing a transfer of shares simply by a virtual transfer of the possession over such shares can be advantageous for the acquirors of the shares, namely it makes it easier to carry out the transfer restrictions set out in the shareholders' agreement, by limiting the involvement of the transferor, at the time when the option right is exercised, and by transferring the burden of litigation on the unsatisfied transferor.

That being said, such mechanism should not be seen as a "one-size-fits-all" model that addresses all of the challenges arising from transfer restrictions in a shareholders' agreement. This mechanism raises various practical difficulties:

- First, having the shares incorporated in physical certificates (which is required for this mechanism to apply) is not practical and is becoming less and less common, in particular for companies with numerous shareholders. In this respect, shares are more generally represented as uncertificated securities or ledger-based securities. This limits the risk of share certificates being lost and the need to initiate the associated burdensome legal action in order to cancel the lost certificates and issue new ones.
- Second, identifying an appropriate third party to hold onto the share certificates may not always be as straightforward as was the case here (*e.* Fabienne kept the shares certificates). Indeed, while the third party was, in this case, the beneficiary of an usufruct over the shares (and a relative of the parties), this will not be the case in most situations. Accordingly, the parties will need to identify a third party they are all comfortable with and who would accept to act in such a capacity.
- Third, provided that a third party can be found, a third party acting as an escrow agent will likely request to enter into a standard escrow agreement, which will likely provide that, if the parties disagree on the release of

> the shares held in escrow, the escrow agent will only be obliged to release such shares upon a valid order of a court of competent jurisdiction. Accordingly, even if a call option is validly exercised, the escrow agent will not accept to release the shares to the acquirer unless and until a court orders it to do so.

These numerous challenges may thus bring the parties back to square one: difficulties in implementing the transfer restrictions set out in the shareholders' agreement.

As a result, although the transfer of property of the shares on which the buy option has been exercised by simple (virtual) transfer of possession may appear to be, at first glance, the magical solution to ensure the enforceability of share option rights in shareholders' agreements, it is not always necessarily the case.

Other sources presenting the case

Luca Bartolomei / Dario Galli / Markus Vischer, Rechtsgeschäftliche Eigentumsübertragung an Aktien ohne separates Verfügungsgeschäft?, *in* digitale Rechtsprechungs-Kommentar (dRSK), published on January 23, 2024 (https://www.walderwyss.com/assets/content/publications/Rechtsgeschaeftliche-Eigentumsuebertragung-an-Aktien-ohne-separates-Verfuegungsgeschaeft.pdf)

[1] Fictional names were used for the purpose of clarity.

[2] The original German clause read "Die derzeitigen Inhaberaktien B. sollen in vinkulierte Namenaktien umgewandelt werden. Die Aktien sollen in dem Sinne vinkuliert sein, dass sie bei einem geplanten Verkauf den übrigen verbleibenden Aktionären zum Kauf angeboten und von diesen auch übernommen werden müssen (Call- und Put-Option). Der pro Aktie diesbezüglich zu bezahlende Preis bestimmt sich auf der Basis eines durch die E. auszuarbeitenden Bewertungsgutachtens, das nach analogen Grundsätzen erstellt wird, wie die in Nachachtung dieser Vereinbarung in Auftrag gegebene E.-Bewertung; er beträgt 75 % des durch die E. errechneten Wertes. Die Aktien sind durch die verbleibenden Aktionäre je zu gleichen Teilen zu übernehmen. Sollte einer der verbleibenden Aktionäre nicht zu einem solchen Erwerb bereit sein, so haben die übrigen verbleibenden Aktionäre je zu gleichen Teilen das Recht zum Erwerb dieser Quote. Sollte keiner der verbleibenden Aktionäre zum Erwerb bereit sein, so sind die zu verkaufenden Aktien vor einem Verkauf an Dritte auf der Basis von 75 % des durch E. ermittelten Wertes an F.A. – und, sollte diese nicht kaufen – an E.A. sen. zum Kauf anzubieten. Sollte auch er nicht kaufen wollen, so sind die verbleibenden Aktionäre verpflichtet, die angebotenen Aktien auf der Basis von 75 % des durch E. ermittelten Wertes zu gleichen Teilen zu übernehmen."