THE SHAREHOLDER RIGHTS AND ACTIVISM REVIEW

FOURTH EDITION

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This article was first published in September 2019
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ACKNOWLEDGEMENTS

The publisher acknowledges and thanks the following for their assistance throughout the preparation of this book:

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In the years since the last financial crisis, shareholder activism has been on the rise around the world. Institutional shareholders are taking a broad range of actions to leverage their ownership position to influence public company behaviour. Activist investors often advocate for changes to the company, such as its corporate governance practices, financial decisions and strategic direction. Shareholder activism comes in many forms, from privately engaging in a dialogue with a company on certain issues, to waging a contest to replace members of a company’s board of directors, to publicly agitating for a company to undergo a fundamental transaction.

Although the types of activists and forms of activism may vary, there is no question that shareholder activism is a prominent, and likely permanent, feature of the corporate landscape. Boards of directors, management and the markets are now more attuned to and prepared for shareholder activism, and engaging with investors is a priority for boards and management as a hallmark of basic good governance.

Shareholder activism is a global phenomenon that is effecting change to the corporate landscape and grabbing headlines not only in North America but also in Europe, Australia and Asia. Although shareholder activism is still most prevalent in North America, and particularly in the United States, almost half of the publicly announced activism campaigns in 2018 targeted non-US companies. This movement is being driven by, among other things, a search by hedge funds for new investment opportunities and a cultural shift toward increased shareholder engagement in Europe, Australia and Asia.

As both shareholder activists and the companies they target have become more geographically diverse, it is increasingly important for legal and corporate practitioners to understand the legal framework and emerging trends of shareholder activism in the various international jurisdictions facing activism. *The Shareholder Rights and Activism Review* is designed as a primer on these aspects of shareholder activism in such jurisdictions.

My sincere thanks to all of the authors who contributed their expertise, time and labour to this fourth edition of *The Shareholder Rights and Activism Review*. As shareholder activism continues to diversify and increase its global footprint, this review will continue to serve as an invaluable resource for legal and corporate practitioners worldwide.

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Sullivan & Cromwell LLP  
New York  
August 2019
Chapter 1

AUSTRALIA

Quentin Digby and Timothy Stutt

I OVERVIEW

The past 18 months have seen an intense, and growing, focus on corporate culture and accountability in Australia, which has in turn driven increasing activism at listed Australian companies, particularly in the financial services sector. As opposed to hedge fund activism focused on extracting economic gains, or retail shareholder activism focused on environmental, social and governance (ESG) issues, a lot of the recent developments in shareholder activism in Australia have been driven by large, erstwhile ‘passive’, institutional investors manifesting their displeasure at a perceived lack of accountability within their portfolio companies.

In large part, this focus on corporate culture and accountability has been driven by systemic failings in risk management and compliance, which were highlighted by the recent Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (the Financial Services Royal Commission). The Financial Services Royal Commission, which was conducted through public hearings, generated significant media attention and captured the attention of the Australian investment community and the community at large. Particular criticism related to how Australian financial services companies manage non-financial risk and the lack of responsiveness of some companies’ remuneration systems to poor risk outcomes or corporate culture.

While Australia’s banks remain very profitable and among the most prudentially sound financial institutions globally, external stakeholders ranging from regulators and the government through to institutional investors expressed concern at the apparent failings in oversight and the lack of attention to retail customer interests. This has been a significant contributing factor to three of the four major Australian banks receiving large protest votes against the adoption of their remuneration reports and has coloured much of the continuing public dialogue around governance, corporate accountability and stakeholder expectations over the past year.

II LEGAL AND REGULATORY FRAMEWORK

The Australian regulatory framework is conducive to activist campaigns with clear statutory rights afforded to shareholders in respect of accessing the company’s register of shareholders and contacting its shareholders, nominating and removing directors, and requisitioning

1 Quentin Digby is a partner and Timothy Stutt is a senior associate at Herbert Smith Freehills. The authors would also like to acknowledge the assistance of Barry Wang, solicitor, and Emily Mackay, paralegal, at Herbert Smith Freehills.
resolutions and calling shareholders’ meetings. Further, Australian listed companies are not permitted to have ‘poison pills’ and almost universally have a single class of ordinary voting shares, as required by the Australian Securities Exchange (ASX). However, in spite of this, there are certain defences and structural advantages available to boards and management of listed companies in Australia when responding to activist campaigns.

i Contacting shareholders

Under the Corporations Act 2001 (Cth) (the Corporations Act), companies are required to allow anyone to inspect their register of shareholders. The Corporations Act also provides a process for people to request copies of the register of shareholders. This statutory right is commonly used by shareholder activists to gather shareholders’ contact details to write to them regarding activist proposals or to solicit votes in respect of upcoming shareholders’ meetings.

By accessing the register (or obtaining a copy of the register), a person would obtain each shareholder’s name and address, as well as details regarding his or her holding in the company (Section 169 of the Corporations Act). At present, the information does not include email addresses as these are not prescribed details for inclusion in the register under Section 169. A law reform proposal was introduced in 2017 to include email addresses on company registers. However, the Australian Senate rejected the draft legislation in its proposed form and the proposal has stalled for the time being (see Section V).

It is an offence to use information about a person listed in the register to contact or send material to him or her, unless the use or disclosure of that information is relevant to the shareholding of that person or to the rights attaching to the shareholding (Sections 177(1) and (1A) of the Corporations Act). However, in most cases, activist proposals will comply with this requirement as they would typically be relevant to the exercise of votes by shareholders. Where shareholder activists send material to shareholders that is inaccurate or that the company’s board considers is misleading, there are a number of avenues open to the board, including taking action against the activists for engaging in misleading or deceptive conduct or, potentially, defamation.

The register of shareholders only contains the names and details of the legal holders of shares (i.e., not the underlying beneficial holders). This can create a significant barrier to shareholder activists contacting shareholders, as it means that they are reliant on the timely relay of information by intermediaries and custodians. A separate register of relevant interests held in the company’s shares, including beneficial interests, is also required to be kept by the company under the Corporations Act. However, these registers only contain information regarding shareholders’ beneficial interests where it has been specifically requested by the company pursuant to a ‘tracing’ notice and the data is often not helpful to shareholder activists or other users (as companies are only required to share the raw data and not their internal analysis of underlying beneficial interests, which provides a greater insight into the company’s ownership).

Of course, as a substitute for corresponding with each shareholder, activists typically limit their direct engagement to the key underlying institutional shareholders and then rely on print and social media for indirect engagement with the balance of the register, including retail shareholders (as well as to exert pressure on the board).
ii Calling shareholders’ meetings

It is relatively straightforward for shareholder activists to call or requisition a meeting of shareholders under the Corporations Act to formally consider and vote on activist proposals. The Corporations Act also includes a process for shareholders to requisition additional resolutions for consideration at an upcoming scheduled shareholders’ meeting.

Shareholders holding 5 per cent of the votes in a company can requisition a shareholders’ meeting under Section 249D of the Corporations Act. Where a meeting is duly requisitioned according to this process, the company’s directors are required to convene the meeting within two months of the requisition and the company must meet the relevant costs of holding it. A shareholder request for these purposes must be in writing, state any resolution to be proposed at the meeting, be signed by the members making the request and be properly given to the company. Failure to follow these procedural requirements can invalidate the requisition and companies can, and commonly do, refuse to convene meetings where they are not complied with. The directors may also refuse to convene the requisitioned meeting where the subject of the meeting is a matter that is not validly within the power of shareholders.

Where a meeting is requisitioned using the process in Section 249D, decisions regarding the content of the notice of meeting will be determined by the board of the company (as in the normal course). However, shareholders holding 5 per cent of the votes or at least 100 shareholders are entitled to request that a statement be included with the notice of meeting setting out their views (Section 249P), and there are limited grounds on which companies may refuse to comply with this requirement. Companies may refuse the request where the statement is more than 1,000 words long or defamatory. Although the shareholders would be requisitioning the meeting, almost without exception the company’s chair would have the right to chair the meeting under the company’s constitution. Accordingly, companies are able to control the conduct of proceedings of the meeting, including any debate on an item of business, subject to the usual rules regarding the conduct of meetings and duties of the chair.

The Corporations Act also includes an alternative process for shareholders to convene a meeting, in which case they would be in a position to determine the time and venue of the meeting and the content of the initial notice of meeting, but also be liable to pay the expenses of calling and holding the meeting themselves (e.g., printing, postage and venue costs). Under Section 249F, shareholders with at least 5 per cent of the votes that may be cast at a general meeting of the company may call, and arrange to hold, a meeting. Calling a shareholders’ meeting according to this process provides activists with a strategic advantage in that they can control the timing and location of the meeting (subject to the overriding requirement that it be held at a reasonable time and place), as well as the content of meeting materials, including the notice of meeting. Again, the chair of the company is likely to be able to chair the meeting under the company’s constitution and control the conduct of the meeting. Despite its advantages for shareholder activists, this alternative process is infrequently used in Australia given the considerable costs it can entail for the convening shareholder.

iii Requisitioning additional resolutions for scheduled shareholders’ meetings

Where there is already a shareholders’ meeting in contemplation (e.g., the company’s annual general meeting (AGM)), an alternative process, commonly used by retail shareholder activists, is to requisition additional resolutions for consideration at that upcoming meeting. Under Section 249N of the Corporations Act, 100 shareholders or shareholders with 5 per cent of the company’s votes may give a company notice of a resolution that they propose to move at a general meeting.
Similar to requisitioned meetings, the notice must be in writing, set out the wording of the proposed resolution and be signed by the members proposing to move the resolution. The company does not need to give notice of the resolution if it is more than 1,000 words long or defamatory. However, it is otherwise required to give notice to shareholders that the resolution will be considered at the next general meeting that occurs more than two months after the notice is given and, provided it is received in time, the company must meet the costs of giving shareholders notice of the requisitioned resolution.

Because this process allows for 100 shareholders (with shareholdings of any size) to requisition resolutions, it is the preferred mechanism for social and environmental shareholder activists to agitate for changes in company’s operations and policies. With the power of social media increasing, what was once a significant logistical hurdle has become a far simpler requirement for social and environmental activists to meet. As a result, campaigns from groups such as the Wilderness Society and the Australasian Centre for Corporate Responsibility (ACCR) have become relatively common for ASX-listed companies.

As a matter of procedure (though it can also be relevant to strategy), where a requisition is received from a shareholder, irrespective of whether it is valid, the company is required to make an ASX release within two business days. This creates significant timing pressure for companies in developing their response strategy to a requisition.

Under Australian law, the board can dismiss a requisitioned resolution if it purports to direct the board how to exercise its powers of management (as set out in its constitution). Generally, to supplant the powers vested in the board, such ‘directions’ would be required to be enshrined in the constitution (with a special resolution requisitioned to amend the constitution for that purpose). This position has been confirmed by the Full Court of the Federal Court of Australia, although there have also been calls from the Australian Council of Superannuation Investors (ACSI) for regulatory reform to enable requisitioned non-binding advisory resolutions to be permitted.

iv Nominating and removing directors

Australian companies typically have very low thresholds in their constitutions for shareholders to nominate a person for election to the board of the company. Unlike other comparable jurisdictions, Australian law does not mandate a threshold level of shareholder support for an external candidate to be nominated to the board of a listed company. In most cases, a single shareholder (with a holding of any size) will be able to nominate a person for election to the board of a company and need only comply with the specific timing requirements in the relevant company’s constitution.

Because of the simplicity of this nomination process (which requires no minimum baseline level of support), it has occasionally been used by shareholder activists in place of requisitioning resolutions as a platform to advance criticisms of the company or agitate for changes to the company’s processes or operations. For the company, an external nomination can involve additional expense and distraction beyond what would otherwise be required with a requisitioned resolution or statement. In particular, additional care and attention is required, from a governance perspective, in dealing with any director nomination.

3 See Australian Council of Superannuation Investors, Shareholder Resolutions in Australia (research report), 2017.
The external candidate will typically be elected if he or she secures a simple majority of votes cast at the shareholders’ meeting, unless the company is at its constitutionally mandated maximum board size. Where the company is at its maximum number of directors, the candidate will need to outpoll one of the incumbent directors standing for re-election at the meeting.

The Corporations Act also sets out a specific process for shareholders that wish to remove a director from the board of a public company. This process applies regardless of anything in the company’s constitution, though in some cases the constitution may provide additional avenues for removing directors.4

To validly requisition a resolution to remove one or more directors, the shareholder must give notice of its intention to move the resolutions and comply with the process for requisitioning a resolution (outlined in subsection iii). The notice of intention must be given to the company at least two months before the meeting is to be held (Section 203D(2) of the Corporations Act). The company must give the relevant director or directors a copy of the notice as soon as practicable after it is received and the director is entitled to put his or her case to shareholders by giving the company a written statement for circulation to members and speaking to the motion at the meeting.

v Other avenues available to activist shareholders
Public listed companies in Australia are required under the ASX Listing Rules to hold an election of directors each year at their AGM and this provides an opportunity for activist shareholders to lodge a protest vote against particular directors or block the re-election of incumbent directors to agitate for board succession.

Australian listed companies are also required to put an advisory resolution to their shareholders for adoption of the remuneration report at each AGM and, in recent years, this has been co-opted by some activist shareholders as a protest mechanism against the company’s current management or operations (i.e., for issues outside of executive remuneration). Additionally, where a company receives an against vote of at least 25 per cent of the votes cast in two consecutive years (receiving ‘two strikes’), a board spill resolution must be put to shareholders that, if passed, will require that the non-executive directors of the company stand for re-election at a special ‘board spill meeting’ of the company if they wish to continue in office. Although intended to address issues related to the remuneration practices of companies, this mechanism is open to abuse by shareholder activists as an indirect means of suggesting a spill of the board and placing pressure on the company’s directors. The two strikes rule can also be practically difficult for directors from a duties perspective, given that it essentially relies on directors being influenced by factors extraneous to the core principle of what is in best interests of the company.

In extreme circumstances, shareholder activists may bring derivative proceedings against the company’s directors under Section 236 of the Corporations Act (being a claim brought on behalf of the company) or seek court orders to address conduct that is oppressive to shareholders under Section 233 of the Corporations Act.5 Although these types of proceedings rarely proceed to trial in Australia, hostile shareholder activists will occasionally put the

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4 See, for example, the recent case of State Street Australia Ltd in its capacity as Custodian for Retail Employees Superannuation Pty Ltd (Trustee) v. Retirement Villages Group Management Pty Ltd [2016] FCA 675.

5 See, for example, the case of RBC Investor Services Australia Nominees Pty Limited v. Brickworks Limited [2017] FCA 756.
company on notice that they are contemplating such proceedings as a means of encouraging the swift resolution of issues under negotiation. In some cases, proceedings may be instituted; however, this is a high-stakes manoeuvre for activist shareholders as the courts have the power to award costs against the party bringing the action (including full costs indemnification, where appropriate). The Corporations Act includes a process for shareholders or persons bringing derivative actions to apply to the court for access to the company’s documents. Although any such application must be made in good faith and for a proper purpose, it can be used by shareholder activists to help them build a case against the incumbent board or management, including as a way to build their case for instituting a derivative action.

vi Considerations for boards in responding to activist campaigns

In responding to any activist campaign, the board of the relevant company must have regard to their duty to act in the best interests of the company and for proper purposes. Relevantly, under the principles set out in the Advance Bank case, limitations are placed on the board’s use of company funds to ‘campaign’ in relation to contested director elections.

It is relatively unusual in Australia for high-profile companies to be subject to contested director elections involving shareholder mail-outs and extensive lobbying by activist investors. For that reason, the legal limits on how companies can respond to such campaigns are not well defined. However, case law in Australia (including the Advance Bank case) does allow for:

a directors to make recommendations to shareholders where they genuinely believe that it is desirable for shareholders to know their views on matters before the meeting; and

b the communication to shareholders of information that is material to their decision on how to vote on the external nomination or shareholder-requisitioned resolutions.

Directors have a duty to provide shareholders with any material information they have in relation to a shareholder activist proposal to ensure that voting proceeds on an informed basis. This permits the directors to rebut inaccurate aspects of activist proposals or present counterarguments for consideration by shareholders (i.e., informing shareholders). It will not, however, extend to the board telling shareholders how to vote on proposals (i.e., urging shareholders) or engaging in debates over issues of personality.

The board’s toolkit for responding to a contested director election scenario or other activist proposal would typically include the following:

a formulation of a board recommendation in relation to the external nomination or shareholder requisition;

b high-level meetings between directors and substantial shareholders;

c the sending of specific hard copy or email communications to shareholders; and

d establishment of a shareholder hotline to receive inbound calls from shareholders to answer questions regarding the external nomination or shareholder-requisitioned resolutions.

In some cases, companies may also engage a proxy solicitation firm to make outbound calls to shareholders. This involves a higher level of risk from an Advance Bank perspective, unless it is strictly limited in scope to ensuring that shareholders are aware of the issue (and the relevance of their vote) and the costs involved are reasonable. However, depending on the intensity of

the activist campaign, the company may be justified in taking more assertive steps to ensure that shareholders are receiving balanced and accurate information, including the use of proxy solicitation firms.

III KEY TRENDS IN SHAREHOLDER ACTIVISM

i Increased focus on ESG matters

Climate change has long been a focus during questions at AGMs for listed companies in the insurance, energy and resources sectors in Australia. However, in the past few years, Australia has increasingly seen requisitioned resolutions concerning ESG matters brought by environmental or social activist groups at companies’ AGMs and this trend has continued during the most recent AGM season.

Ahead of the AGMs for oil and gas producers, Santos and Woodside, resolutions were attempted to be requisitioned to amend the companies’ constitutions and to request additional disclosure concerning alignment of the businesses with the Paris Climate Agreement and emissions targets (as well as a review of the companies’ positions, oversight and processes relating to public policy advocacy). Both the resolutions were able to be rejected as the activist group had not complied with the Corporations Act’s procedures for requisitioned resolutions (see Section II.iii).

Other examples of prominent Australian listed companies that received requisitioned resolutions in the past 12 months include:

a energy provider and retailer Origin: Origin received requisitioned resolutions to amend its constitution, to expand its measurement and reporting of methane emissions and to disclose details about the process for seeking consent of the traditional owners of the land for a proposed project;

b coal-miner Whitehaven: Whitehaven received requisitioned resolutions to amend its constitution and to implement disclosure about climate-related risks in accordance with the recommendations of the Financial Stability Board’s Task Force on Climate-related Financial Disclosures;

c international air carrier Qantas: Qantas received requisitioned resolutions to amend its constitution and to implement heightened human rights due diligence and policies regarding deportation of refugees and asylum seekers on the airline’s services; and

d national supermarket retailer Woolworths: Woolworths received requisitioned resolutions to amend its constitution and requesting it to reach an agreement with the National Union of Workers to introduce a pre-qualification programme ostensibly directed at labour hire providers’ compliance with labour and human rights standards in Woolworths’ supply chain.

In all cases, the requisitioned resolutions failed to be passed by shareholders at the relevant companies’ AGMs.

ii Increased prominence of overseas ‘economic’ activists in the Australian market

Traditionally, the Australian experience with shareholder activism has been homegrown and marked by strong activism at the retail level – in particular, small shareholders relying on mechanisms in the Corporations Act to provide them with a platform to agitate for social or environmental change (see above).
However, American-style hedge fund activism has become increasingly prominent in the Australian market. As well as Elliott Management’s very public campaign against BHP, launched in April 2017, there are a number of other activists in the region that have been generating significant media attention – including value campaigns targeting Australian firms launched by Lone Star Value Management, Janchor Partners, Coliseum Capital Management and Elliott Management, and short campaigns against Australian companies launched by firms such as Glaucus and Viceroy Research.

The emergence of offshore shareholder activists with access to larger pools of capital has resulted in a broader range of targets for activist campaigns. A few years ago, the vast majority of activist campaigns against Australian companies were waged against small-cap companies. However, recent campaigns have targeted much larger companies, such as BHP (BHP Group Limited market cap: A$121.6 billion; BHP Group Plc market cap: £41.3 billion), Iluka Resources (market cap: A$4.5 billion) and Aveo (market cap: A$1.2 billion). This trend is expected to increase as offshore investors gain confidence and become more active in the region.

### iii Continued strength of strategic campaigns by local activists

Despite their recent increased prominence, hedge fund activism and other forms of economic activism are not new phenomena in Australia. Activist Insight data suggests that there was a 10 per cent increase in 60 Australian listed companies facing activist board-related demand in the 12 months ending 5 April 2019 (as compared with the prior corresponding period). Activist shareholders, such as Sir Ron Brierley and Dr Gary Weiss, have been in the market for decades through various investment vehicles, and prominent local activist shareholders include Allan Gray, Mercantile Investment (which is Brierley-linked), Merlon Capital, Ariadne (which is Weiss-linked), MH Carnegie, Sandon Capital, Thorney Opportunities, and the local branches of Lazard Asset Management and Aberdeen Asset Management.

Activist campaigns by local investors continue to be very effective, reflecting local market knowledge and an ability to swiftly seize strategic opportunities. In line with the overall trend for offshore activists, it appears momentum is continuing and, indeed, increasing with recent campaigns from onshore funds, such as Merlon (in relation to financial services institution AMP), Sandon Capital (in relation to Watpac, Iluka Resources and BlueScope Steel) and Perpetual (in relation to Brickworks).

### iv Characteristics of shareholder activist campaigns in Australia

Similar to the United States and the United Kingdom, hedge fund or economic activists operating in Australia typically seek to make an economic gain on an investment (usually in the short term) through means that are not aligned with the current strategy of the company. Common activist goals include the following:

- **a** persuading companies to make a capital return or pay a special dividend;
- **b** changing the business strategy (which the activist may seek to effect through a change in management or board composition);
- **c** restructuring or selling a significant asset; or
- **d** putting the company ‘in play’ or seeking to extract a higher price in a change of control situation.

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7 Market capitalisations presented as at 8 July 2019.
8 Activist Insight, 9 April 2019.
Some activists may also ‘bet against’ companies that they perceive to be overvalued, looking to encourage a downward correction in the share price so they can close out a short position at a profit.

Though opportunities are most often identified by shareholder activists based on their own investment theses and research, in some cases they may be the result of institutional shareholders making a ‘request for intervention’. Requests for intervention are most often made in respect of Australian companies with high levels of passive ownership through superannuation and pension funds, given those investors are often prevented from effecting changes at their portfolio companies themselves owing to resourcing and reputational considerations.

Until recently, the vast majority of activist campaigns in Australia have been conducted ‘behind closed doors’, with private approaches made by shareholder activists to companies’ boards. Where the activist holds a significant stake, or is aligned with the board and management on a particular issue, it is common for the board to reach an understanding or negotiated outcome with the shareholder, in which case the matter would not usually become public. Often, at this stage, the activist would privately engage with members of the investment community (institutional shareholders, other significant investors and analysts) to build momentum for change and increase pressure on the company’s board.

In Australia, it has historically been rare for shareholder activists to take the next step of publicly advocating for their proposed course of action (e.g., through white papers, open letters to the board, their own website or the media). However, recent activist campaigns have borrowed more heavily from the American hedge fund activist playbook, with tactics including the following:

- Publicly criticising the board, individual directors and management;
- Forming informal investor alliances and voting blocs;
- Proposing or supporting candidates for appointment to the board;
- Advocating for (or formally proposing) removal of existing directors;
- Requisitioning shareholder resolutions and members’ statements;
- Requisitioning extraordinary general meetings of shareholders; and
- Encouraging unsolicited offers for the company or its assets.

v Limitations on collaboration by shareholder activists

Under the Corporations Act, investors may become ‘associates’ for takeover and substantial holding notice purposes where they act together in relation to a common portfolio company. This provides an important protection for Australian companies in respect of the ‘wolf pack’-type tactics sometimes seen in the United States, as it prevents shareholder activists from taking control of a company if other shareholders are uninformed about this passing of control and are not given any opportunity to obtain a control premium (or other benefits that would be paid if control were to pass legitimately).

Under the Corporations Act, an investor can become an associate of another investor if they propose to:

- Enter into, or have already entered into, a relevant agreement with the other investor for the purpose of controlling or influencing the composition of the entity’s board or the conduct of the entity’s affairs; or
- Act, or are acting, in concert in relation to the entity’s affairs.
As stated by the Australian Securities and Investments Commission (ASIC) in regulatory guidance, investors concerned about common issues may become associates or be regarded as having entered into a relevant agreement for the purposes of the takeover or substantial holding provisions. This is because these provisions are not only concerned with the power of individual investors in relation to the voting and disposal of shares in companies, but also the aggregated voting power of groups of investors who are either related or associated with each other in relation to some aspect of the entity’s affairs. Depending on the aggregated voting power of the group, investors acting collectively in this way may be required to lodge substantial holding notices relating to the group, be prohibited from acquiring further interests in the entity under the takeover prohibition in Section 606 of the Corporations Act or even breach the takeover provisions.

The regulatory guide also clarified the circumstances in which investors acting collectively will and will not be taken to be associates for the purposes of the takeover and substantial holding notice provisions of the Corporations Act. Conduct that is permissible and unlikely to cause issues includes holding discussions with other investors, making recommendations to other investors in relation to voting, and making individual or joint representations to the company’s board. Conduct that is likely to raise issues with associateship includes jointly signing requisitions for shareholders’ meetings or resolutions, formulating joint proposals in relation to board appointments or strategic issues, accepting inducements to vote or act in a specific way, agreeing on a plan concerning voting or limiting their freedom to vote (e.g., by granting another investor their irrevocable proxy).

Another aspect that is unique to Australian law, especially relative to the United States, that renders wolf pack tactics high-risk is the country’s broad insider trading rules that apply in relation to trading while in receipt of any material information in respect of a company (irrespective of whether it was sourced from a company insider). Prohibitions on ‘tipping’ similarly apply in relation to any material information regardless of its source. Knowledge of an activist hedge fund’s intent to target a company on governance grounds could, in the context of a clear track record of being able to force a significant corporate transaction, constitute materially price sensitive information.

IV RECENT SHAREHOLDER ACTIVISM CAMPAIGNS

i AMP
Following criticisms levelled against it by the Financial Services Royal Commission, financial services institution AMP had a high level of turnover of key personnel in 2018 and 2019 and sought to undertake a 12-month portfolio review with a view to re-aligning the business with its core wealth management operations. The portfolio review culminated in the sale of AMP’s life insurance business to British-based Resolution Life for A$3.45 billion, announced in October 2018.

The sale of AMP’s life insurance business proved to be contentious with several of AMP’s institutional shareholders who were critical of the price achieved and aggrieved that the company had not voluntarily sought shareholder approval for the sale. In the lead up to AMP’s 2019 AGM, there was continued vocal opposition in relation to the sale and there was speculation that activist shareholders were planning to protest against the re-election

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9 ASIC, Regulatory Guide 128: Collective action by investors (June 2015), [7]–[8].
of several of AMP’s directors in relation to both the sale and the overarching turbulence at the company over the previous 12 months. During the campaign, AMP emphasised the company understood investors’ frustration over the drop in AMP’s share price and reassured investors that the right decisions were being made to put the business on a stronger footing.

Ultimately, AMP’s shareholder engagement and reassurance was successful, with two influential proxy firms, Ownership Matters and CGI Glass Lewis, recommending shareholders support the re-election of all directors. At the AGM, resolutions concerning the company’s remuneration report and re-election of its directors passed comfortably. AMP also avoided a second strike on its remuneration report and no resolution for shareholders to vote on a board spill was therefore triggered.

ii National Australia Bank

Similar to the other ‘Big Four’ Australian banks, National Australia Bank (NAB) was thrust into the spotlight by the Financial Services Royal Commission in relation to executive accountability for its risk and compliance outcomes, and the extent to which they were reflected in the bank’s executive remuneration structure. In this context, NAB announced a new remuneration scheme, which sought to combine short and long-term incentives and included a 15 per cent pay reduction for executives.

The new remuneration scheme was not well-received by NAB shareholders and, at their 2018 AGM, NAB received its first strike against its remuneration report with 88.43 per cent of shareholders voting against the resolution. To date, this is the largest vote received by an ASX 300 company against a remuneration report in Australia. Particular criticism from investors included that the combined short and long-term incentive structure over-emphasised short-term performance and that, in the context of the criticism against NAB at the Financial Services Royal Commission, the proposed reductions to pay and incentives were not adequate.

Reflecting on the result, NAB announced that it understood shareholders’ feedback and would redesign the remuneration scheme to better reflect stakeholder expectations and ensure it provides the right balance of financial metrics, customer outcomes and the management of non-financial risks over the long and short-term.

Apart from NAB, other banks that received strikes on their remuneration reports at their most recent AGM included ANZ and Westpac.

iii Woolworths

In the lead-up to Woolworths’ 2018 AGM, the ACCR and the Labour Union Co-operative Retirement Fund assisted over 100 shareholders to requisition a two-limbed resolution that proposed to amend the company’s constitution to allow shareholders to requisition advisory resolutions and then, in turn, requisition a resolution requesting the board to reach an agreement with the National Union of Workers to implement a labour hire providers’ pre-qualification programme directed at their compliance with labour and human rights standards. The object of the resolution was ostensibly to ensure that Woolworths fulfilled commitments made prior to its 2017 AGM, in response to a similar requisitioned resolution also put by the ACCR. Two other resolutions were also requisitioned, which related to trade union involvement in worker rights education activities and grievance resolution procedures, and ongoing disclosure to shareholders about the company’s domestic fresh food supply chain.

Woolworths responded to the requisitioned resolution by outlining the considerable steps it had taken to better understand and manage labour and human rights risks in its
supply chain, and recommending that Woolworths shareholders vote against the two-limbed resolution. Ultimately, the constitutional amendment resolution was overwhelmingly defeated (with 94.21 per cent of votes against it) and so the labour hire compliance programme resolution was not put to the meeting (though it had support of 14.92 per cent of the proxies submitted in advance of the meeting). In the chair’s address, Woolworths reiterated it is committed to putting in place the right protections for workers within its supply chains.

V REGULATORY DEVELOPMENTS

i Fourth edition of the Corporate Governance Principles and Recommendations

On 27 February 2019, the ASX Corporate Governance Council released the final version of its fourth edition of the Corporate Governance Principles and Recommendations (the Fourth Edition Principles). The Fourth Edition Principles are planned to come into effect for listed entities’ first full financial year commencing on or after 1 January 2020. There are a number of aspects of the Fourth Edition Principles that have the potential to catalyse further activism against ASX-listed companies, including a recommendation for ASX 300 entities to have a target of at least 30 per cent of directors of each gender on their boards and additional commentary on the disclosure of material exposure to environmental or social risks by companies (including a statement that companies that believe that they do not have such exposure are now expected to benchmark their disclosure practices against those of their peers and entities that do have such exposure are encouraged to consider implementing the recommendations of the Financial Stability Board’s Task Force on Climate-related Financial Disclosures). The recalibrating of expectations on social and environment practices under the Principles, including the enhanced disclosure that is expected to become typical market practice, is likely to catalyse continued activism in relation to these issues.

ii Modern slavery legislation

In 2017, the Joint Standing Committee on Foreign Affairs, Defence and Trade conducted an inquiry on enacting modern slavery legislation in Australia. On 29 November 2018, the Modern Slavery Bill 2018 (Cth) was passed by the Australian parliament and on 1 January 2019 the Act commenced. Among other things, the regime requires organisations with annual consolidated revenue of at least A$100 million to publish an annual modern slavery statement that contains information about the modern slavery risks in their supply chains, and their due diligence and remediation processes to assess and address those risks. Companies will prepare their first modern slavery statements in respect of their first full financial year commencing after 1 January 2019 (with six months to prepare and file the report).

In parallel, in June 2018, the Modern Slavery Act 2018 (NSW) (the NSW Act) was passed by the New South Wales parliament. The NSW Act provides for a similar obligation for commercial organisations with an annual turnover of A$50 million or more to prepare a modern slavery statement on the steps taken to ensure that their goods and services are not produced in supply chains in which modern slavery is taking place. The NSW Act also provides for the creation of a publicly available register that identifies organisations whose goods or services are or may be produced in supply chains in which modern slavery is or may be taking place.

Although the federal legislation is now in effect, the NSW Act is not. The relevant minister has indicated that the NSW Act will be referred to a parliamentary committee where it will be reconsidered, which may result in further amendments.
The modern slavery legislation in the form proposed by the federal and New South Wales governments will improve reporting standards in relation to human rights risks, which is a current area of focus for shareholder activists, as demonstrated by the ACCR’s campaign against Woolworths. At this stage, it is unclear whether the increased disclosure on these issues will take the heat out of related activism or whether the transparency will prompt the targeting of slow adopters for activist action.

iii Introduction of a bill providing access to shareholders’ email addresses
On 14 June 2017, former Senator Nick Xenophon introduced a bill into Parliament to amend the Corporations Act to require companies’ registers of shareholders to include email addresses for each shareholder. At present, only shareholders’ names, physical addresses and shareholding information form part of the register.

The Bill has still not been passed almost two years on, and there are no indications to suggest that it will become law in the foreseeable future.

VI OUTLOOK
As outlined above, the Australian regulatory regime is facilitative to shareholder activism and an increasing number of companies are being targeted by activist campaigns, particularly in relation to ESG matters. We expect that these trends will continue in the future given the current focus on corporate accountability in Australia and the continued public dialogue regarding social responsibility and ESG stewardship.

In relation to economic activism, offshore activists will continue to disrupt the traditional practice of behind closed doors activism in Australia, and a lack of responsive reaction by boards to private approaches will increasingly be met with more overt aggression and publicly hostile campaigns. However, most Australian boards have recognised the importance of strategic preparation, self-assessment and challenge as the most effective approaches to pre-empting and responding to activist campaigns.

The trend towards greater collaboration and engagement between traditionally passive superannuation long-term investors and activist funds is expected to continue. Partially offsetting that trend will be the support and acceptance of BlackRock’s calls for greater focus on long-term value creation and its tempering of support for overt activist tactics marked by short-termism.
Chapter 2

AUSTRIA

Sarah Wared

I OVERVIEW

Globally, last year was record-breaking and saw a significantly increased number of investors employing activism as a tactic. Over 30 per cent of campaigns launched in 2018 by activist shareholders were merger and acquisition (M&A)-driven, with pushing for a sale being the most common objective.\(^2\)

In Austria, a long and stable tradition of shareholder activism does not exist yet and shareholder activism campaigns can be categorised into many different types. A significant number of listed Austrian companies are controlled by one shareholder or a group of shareholders, which is one of the main reasons why shareholder activism has played a less pronounced role in Austria as compared with shareholder activism on a global level. However, in recent years, the number of activist campaigns has increased in Austria and activist shareholders of listed companies have actively sought to directly or indirectly generate profit for themselves or other shareholders by focusing mainly on the profitability and valuation of public companies.

Generally, activist shareholders concentrate on corporate structure and strategy, and restructuring measures: takeover bids, composition of management and supervisory boards; return of value to shareholders (e.g., share buy-backs and additional dividend payments); and acquisitions, merger proposals and opposition to delistings.

Activist shareholders take advantage of the possibilities provided to them by law, such as requesting the convocation of a shareholders’ meeting or inclusion of items on the agendas of shareholders’ meetings, the possibility of contesting shareholder resolutions and having the share exchange ratio in a corporate restructuring examined by a court.

It is likely that public companies will be required to deal with activist campaigns when they:

\(a\) have many free-float shares;

\(b\) are facing a disappointing share price;

\(c\) have non-active institutional shareholders;

\(d\) experience low shareholder attendance at shareholders meetings;

\(e\) encounter takeovers; or

\(f\) have proposed restructuring measures.

\(^1\) Sarah Wared is a partner at Wolf Theiss.

\(^2\) 2018 Review of Shareholder Activism, Lazard.
In line with the global market trend, it can be expected that Austria will see more activism in the future. In particular, the EU Shareholder Rights Directive II (2017/828) (SRD II), amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement, aims to improve the participation of shareholders and may foster shareholder activism in the future. Additionally, shareholders of public companies are increasingly influenced by proxy advisers who support the campaigns of activist shareholders. Activist campaigns may result in changes to the strategy and structuring of public companies when dealing with essential corporate transactions.

II LEGAL AND REGULATORY FRAMEWORK

In past years, the main jurisdiction for shareholder activism has been and remains the United States, where activist shareholders employ the receptive legal frameworks available to them to reach their goals. In Austria, there are various legislative and regulatory frameworks with respect to shareholder rights, shareholder activism and shareholder engagement. The principal sources of law in this regard are found in the Stock Corporation Act, the Stock Exchange Act and the Takeover Act.

i Shareholder rights

Apart from basic shareholders rights, such as the entitlement to dividends and disposal of their participation in a company, shareholders are entitled to other essential rights that foster shareholder activism and provide an environment for activists.

Irrespective of their percentage of shareholdings in a company, the rights of shareholders include entitlement to participate and speak at shareholders’ meetings as well as ask questions and receive answers with respect to the items on the agenda; exercise their voting rights; and challenge a resolution of the shareholders in court.

Rights of minority shareholders holding at least 1 per cent of a company’s share capital include the entitlement to submit motions with respect to the items on the agenda of shareholders’ meetings; and request a review by the Takeover Commission of the amount of the offer price with respect to mandatory tender offers and voluntary tender offers within three months of the publication of the results of a takeover offer.

Rights of minority shareholders holding at least 5 per cent of a company’s share capital include the entitlement to request the following:

- convocation of a shareholders’ meeting;
- inclusion of items on the agendas of shareholders’ meetings;
- audit of the annual accounts by a different auditor for good cause; and
- convocation of a shareholders’ meeting by shareholders of an acquiring company in the course of a simplified merger.

Rights of minority shareholders holding at least 10 per cent of a company’s share capital include the entitlement to request dismissal of a member of the supervisory board for good cause; and that a claim be made against shareholders, the management board, supervisory board or third party to the extent the claim is not obviously unfounded.

Rights of shareholders holding at least 20 per cent of a company’s share capital include the entitlement to object to the waiver or settlement of claims against founding shareholders, the management or supervisory board members.
Shareholders holding more than 25 per cent of a company’s share capital present at a shareholders’ meeting may object to amendments of the articles of the company (including capital measures); and measures excluding shareholder subscription rights.

Shareholders holding at least 30 per cent of a company’s share capital have the right to elect an additional supervisory board member, if three or more members of the supervisory board are elected in one shareholders’ meeting and one candidate got at least one-third of the votes in all prior elections without being successfully elected. In that case, the unsuccessful candidate having received the one-third vote in prior elections will be declared as elected without any further votes.

ii Shareholder obligations

Though shareholder rights under the Austrian legal and regulatory framework are far-reaching, the obligations of shareholders are limited.

Generally, shareholder attacks are considered legal in an activist campaign to the extent shareholders comply with the required disclosure and compliance obligations and avoid including incorrect or inaccurate information in their disclosures.

Certain Austrian fiduciary duties applying to shareholders of public companies may be relevant in some activist campaign situations. Although fiduciary duties are most clearly recognised with respect to partnerships, they are also applicable to a certain extent in the case of stock corporations and limited liability companies. With respect to stock corporations, there is a fiduciary duty to avoid the abusive exercise of voting rights and fiduciary duties of this sort are binding regarding all shareholders; namely, they are applicable to the controlling shareholders to the same extent as to the minority shareholders. Fiduciary duties need to be carefully considered in the context of specific situations such as the decisions of the shareholders in the course of shareholders’ meetings and the potentially excessive use of discretionary powers.

iii Corporate constitution

Public companies may have a one or two-tier management system depending on the legal form of the entity: a stock corporation is required to have a two-tier management system consisting of the management board and the supervisory board, whereas a Societas Europaea can have either a one or two-tier management system.

The responsibility of the management board is to manage the company in the best interest of the company considering the interest of the shareholders, employees of the company and the interests of the public. From a pure legal perspective, the management board of a stock corporation is not required to follow instructions of the shareholders or the supervisory board.

The management board members of a stock corporation are appointed by the supervisory board for a maximum term of five years and can be reappointed after the expiry of their term. The supervisory board may revoke the appointment of a member of the management board for a good cause prior to the expiry of the member’s term. In particular, an inability to manage the company properly and rescission of confidence by the shareholders’ meeting based on objective reasons will constitute good cause.

The supervisory board of a stock corporation consists of at least three members. The articles of association may stipulate a higher number of supervisory board members. The
supervisory board members of a stock corporation are appointed by a resolution of the shareholders’ meeting for a specified term. The appointment may be revoked without cause by a resolution of the shareholders’ meeting with a three-quarters majority of the votes cast.

With respect to takeover scenarios, the management and supervisory boards of public companies are subject to the neutrality rule: they are required to not take any measures that could impair the opportunity of shareholders to make a free and informed decision with respect to the takeover offer unless the board measures are based on a pre-takeover obligation or a shareholders’ meeting resolution passed following the intention of the offeror to make a takeover offer. The management and supervisory boards are required to obtain the consent of the shareholders’ meeting for any measure (save for obtaining alternative offers) that could adversely affect the takeover offer (e.g., issuance of securities that could impede the bidder from acquiring control, sale of material assets of the company or acquisition of other companies).

iv Disclosure requirements

Activist shareholders, like all shareholders, are required to comply with the prescribed disclosure system when building a stake: a shareholder of a listed company is required to publicly disclose its shareholdings to the Austrian Financial Market Authority, the stock exchange and the issuer, if it – directly, indirectly or through financial instruments or derivatives – reaches, exceeds or falls below 4, 5, 10, 15, 20, 25, 30, 35, 40, 45, 50, 75 or 90 per cent of the voting rights. The articles of association may contain an additional disclosure threshold at 3 per cent, which will need to be published on the website of the issuer and, additionally, the Austrian Financial Market Authority will need to be informed. A shareholder is required to disclose immediately, and in any event within two trading days, each time a relevant threshold is triggered.

If a shareholder does not comply with the mentioned disclosure obligations, voting rights attached to the shares not disclosed will be automatically suspended. The articles of association of the company may also extend the suspension of voting rights to all voting rights of the shareholder breaching the required disclosure obligation.

Activist shareholders wishing to build up stock and deal in shares must also consider restrictions on dealing on the basis of inside information.

v Acting in concert

Pursuant to Section 1(6) of the Takeover Act, parties acting in concert are as follows:

natural or legal persons who, on the basis of an arrangement, cooperate with the bidder in an attempt to obtain control of or exercise control over the target company, especially by coordinating the way in which they exercise their voting rights, or natural or legal persons who cooperate with the target company, on the basis of an arrangement, to frustrate the successful outcome of a takeover offer.

Parties acting in concert are required to launch a mandatory tender offer. Generally, under Austrian law, control is presumed by a shareholding representing, directly or indirectly, at least 30 per cent of the voting rights, although the control concept with respect to acting in concert pursuant to Section 1(6) of the Takeover Act is not subject to such a formal definition. The Takeover Commission considers a range of factors indicating an aim to control when determining whether shareholders are acting in concert.
Acting in concert ‘arrangements’ can involve legally enforceable and binding arrangements as well as unenforceable and non-binding long-term and individual arrangements. Therefore, the term arrangement can even encompass non-binding, non-written communication on the basis of which it can be assumed that the parties will act in accordance with their communications.

Shareholders of public companies may give advice to each other and consult with respect to company matters without being deemed to be acting in concert, but such communications may conflict with takeover regulations in certain cases. From a practical perspective, a challenge encountered with the acting in concert concept is to prove that the parties in fact acted in concert at a shareholders’ meeting by exercising their voting rights. One indicator is when shareholders belong to the same group of companies or participate in arrangements regarding the election of supervisory board members. Generally, an arrangement can be assumed when shareholders vote the same way regarding all shareholder decisions relating to control. In this context, proxy advisers may play a relevant role (e.g., regarding the appointment and removal of supervisory board members) because interactions with the same proxy adviser by different shareholders may be scrutinised by the Takeover Commission as an indication of acting in concert.

The Takeover Commission has found that activist shareholders were acting in concert with another shareholder and violated their mandatory offer obligation because they were seeking the implementation of a transaction that would fundamentally change the corporate culture of the company.

A mandatory tender offer can also be triggered by way of ‘creeping in’; namely when a person who has a controlling interest, which is not more than 50 per cent, acquires at least another 2 per cent of the voting rights within 12 months.

vi  Structural defences

Preventative defensive measures available to public companies outside Austria should also be considered in Austria, in particular measures that have been effective in other jurisdictions. In particular, the business model, shareholder structure and voting system as well as the critical shareholders of a target company should be considered and analysed in the context of potential activist attacks. The articles of association may, for example, be amended to lower the statutory threshold disclosure mentioned above to 3 per cent, giving the company more advance warning of an activist’s posturing. Public companies may introduce a takeover offer requirement of less than 30 per cent, and introduce higher voting thresholds or additional voting requirements than required by law to implement activist objectives.

Best practices would include the advance preparation of manuals setting out in detail any relevant internal (e.g., nomination of specific team members responsible for the determination of a response strategy) and external (e.g., communication regarding media and instruction of advisers) steps to be taken in response to a shareholder campaign.

III  KEY TRENDS IN SHAREHOLDER ACTIVISM

Globally, shareholder activism has seen a substantial increase in recent years and has long been a feature of the US market. Strategies and objectives of activist campaigns follow different approaches, and specific categories of activist shareholders have not yet fully established
themselves in Austria. In certain cases, activist shareholders aim for short-term profit, whereas other activists take medium to long-term perspectives by trying to create value and change the management of a company.

i Activism driven by specific transactions

As outlined above, shareholder activism in the Austrian market has no developed tradition, and activists do not, for example, mainly focus on the performance and remuneration of the management board as is the case in some other jurisdictions where executive remuneration as an inappropriate cost factor is often raised by activists in the course of campaigns. Different types and objectives exist with respect to activist campaigns. A noteworthy number of activist campaigns have been driven by specific situations such as proposed public or private M&A and other corporate transactions. Some activists aim to push the management board to run the business in a more efficient way so as to increase the valuation and share price of the company.

Generally, activist campaigns have been seen in connection with corporate measures that are subject to an offer of adequate compensation such as mergers, squeeze-outs or other reorganisations. Activist shareholders try to gain more benefit from such transactions by challenging the compensation offered to the shareholders. In contrast with other claimants, activist shareholders are usually not aiming to hold up or block corporate transactions by using their shareholder rights in shareholders’ meetings. Activist shareholders request an examination of the share exchange ratio with respect to a merger with the aim of becoming entitled to further compensation without blocking the implementation of the corporate transaction as such. The majorities required to implement particular corporate transactions provide the basis for shareholder campaigns. Activist shareholders buy and sell shareholdings in line with the type of corporate transaction they want to influence.

An activist shareholder may also aim to put pressure on the management board to undertake an acquisition or otherwise distribute value to its shareholders.

ii Litigation as part of the strategy

Activist shareholders may use litigation as part of their strategy. They use the right at a shareholders’ meeting to request the appointment of special auditors to examine the management of the company. If the shareholders’ meeting opposes this request, a special audit can be requested by application to a court by a shareholder holding 10 per cent of the share capital. The applicant is required to have held its shares for at least three months prior to the shareholders’ meeting and continue to hold them until a decision with respect to the special audit has been made by the court. A shareholder holding at least 5 per cent of the share capital is entitled to request that a claim be made by the company against shareholders, the management or supervisory board, or a third party based on a report of the special auditor. To the extent petitioned claims are not obviously unfounded, a shareholder holding at least 10 per cent of the share capital is entitled to request to claim against shareholders, the management board, the supervisory board or a third party.

Activist shareholders may challenge resolutions of the shareholders to put the management board of the company under pressure to the extent the effectiveness of the resolved matter is subject to registration in the Commercial Register (e.g., an amendment of the articles of associations or capital increases). This approach may impede the implementation of the resolved matter as the Commercial Register may suspend the proceedings in certain cases.
iii Support by proxy advisers

As part of the strategy of activist shareholders, an interaction with proxy advisers may be relevant to a certain extent. For example, activist shareholders were supported by proxy advisers at the shareholders’ meeting of conwert Immobilien Invest SE with respect to the management board candidates of the major shareholders. Considering that proxy advisory services have entered the Austrian market, activist campaigns can be expected to often turn to them as they seek majorities at shareholders meetings.

iv Use of media

A practice that has become more common among activist shareholders in Austria is the use of informal measures and strategies, which are common in other jurisdictions, to increase their influence beyond their proportionate shareholding and put pressure on the management and supervisory board of public companies; for example, submitting open letters to the management board and using the media to disclose publicly their dissatisfaction with the management board. Well-advised activist shareholders will carefully review the legal basis of such measures before the information is disclosed. By using the media, activist campaigns may have an impact on the share price and help to win other shareholders of the company to support the campaign or parts of the campaign.

IV RECENT SHAREHOLDER ACTIVISM CAMPAIGNS

In recent years, the number of campaigns run by activist shareholders has increased slightly. The following campaigns may be of particular interest.

i Petrus Advisers, Immofinanz AG and CA Immobilien

Petrus Advisers tried to put pressure on the management board of Immofinanz AG by publicly voicing its dissatisfaction with the management’s strategy by issuing an open letter dated 14 March 2017 to the board. In the letter, Petrus Advisers in particular requested the sale of a Russian business and non-core assets, a share-buy-back and the submission of a cash offer to the shareholders of CA Immobilien.

Furthermore, Petrus Advisers expressed its dissatisfaction with the performance of the company and the development of the share price of Immofinanz AG, stating that the trading share price should be more than doubled.

Immofinanz AG responded that it was also dissatisfied with the performance of the company and that the requests of Petrus Advisers had either been partially or completely fulfilled.

ii Merger of CA Immobilien and Immofinanz AG

In 2018, the real estate companies Immofinanz AG and CA Immobilien again came under the attack of the activist shareholder Petrus Advisers with respect to the merger of the companies. Immofinanz AG and CA Immobilien planned to merge, but the plan fell through following pressure by Petrus Advisers, which expressed its dissatisfaction in an open letter on 27 November 2017 and requested the termination of any further discussions with respect to the merger. The activist shareholder stated that if a 75 per cent majority with respect to the
merger could not be achieved, any further use of funds in connection with the merger would be unacceptable and claims for damages would be asserted. Following this pressure by the activist shareholder, the two companies terminated their merger plans.

iii  

Opposition to BWT AG’s delisting

The manufacturer of water treatment systems BWT AG was criticised by activist shareholders opposing its delisting. They claimed that the structure of an envisaged merger of BWT AG into a newly established company and subsequent delisting was not legally permitted.

The activist shareholders stated that the structuring chosen by the core shareholder of BWT AG ‘solely serves for the purpose to enforce the legally not permitted delisting from the stock exchange against the will of the remaining shareholders’ and that in any case a review proceeding should be initiated.

In 2017, the Austrian Supreme Court decided that a merger for the purposes of delisting is abusive.

The envisaged merger was preceded by a voluntary takeover offer. The core shareholder published a voluntary takeover offer for all BWT AG shares, which resulted in only limited take-up and was insufficient to initiate a squeeze-out that would leave him as the company’s sole shareholder.

In August 2018, the annual general meeting of BWT AG resolved upon the request of the majority shareholder to squeeze out the minority shareholders against payment of cash compensation. The envisaged merger has not been implemented.

V  

REGULATORY DEVELOPMENTS

The following recent development may have an impact on campaigns of activist shareholders.

The SRD II, which is intended to improve shareholder participation in listed companies, needs to be implemented into national law. The directive addresses the identification of shareholders and the role of intermediaries (e.g., proxy advisers); the remuneration of the management board members (say on pay); and related party transactions. In particular, the improved transparency with respect to management remuneration may foster shareholder activism.

Existing regulations already provide for certain rules with respect to the compensation of the management board. The supervisory board is required to ensure that the compensation of the members of the management board reasonably corresponds to their duties and benefits, and a company’s position and overall remuneration levels. Compensation is required to provide for long-term incentives in line with the sustainable development of the company.

The SRD II and the ministerial draft supplement existing regulations without any substantive requirements with respect to remuneration. All that is introduced is a general concept of shareholders’ participation in the remuneration of board members. It contemplates a shareholder vote on the general remuneration policy at least every four years and an annual vote on the current remuneration report.

The ministerial draft does not intend to change the existing governance structures of a stock corporation and the supervisory board remains the responsible body for the remuneration of the management board. Shareholders will have an advisory, incontestable vote with respect to the remuneration policy and the remuneration report. The supervisory board will set up a remuneration policy pursuant to the new rules. The remuneration policy is detailed compared with the guidelines currently provided under Austrian law, and needs to
consider and explain the company’s strategy and its long-term development as well as contain a description of the fixed and variable components of the remuneration to be granted to the members of the management board.

The remuneration of the members of the supervisory board will also be subject to the new requirements.

Generally, the remuneration policy is subject to the recommending vote of the shareholders at least every four years or upon the occurrence of an essential change. Notwithstanding the vote being of a recommending and unappealable nature, the vote on the remuneration policy will have an essential practical impact considering that the supervisory board members are appointed by the shareholders.

Additionally, the management and supervisory boards are required to prepare an annual remuneration report with respect to the remuneration in the previous year, which needs to be submitted to the annual general meeting for a vote.

The mentioned voting rights of the shareholders in connection with the remuneration may increase the influence of activist shareholders on public companies to a limited extent.

VI OUTLOOK

First, because of the envisaged implementation of SRD II into national law, shareholder activism may play a greater role in the future. Notwithstanding the non-binding character of the votes, the shareholder votes may have an impact on the composition of management remuneration considering that the supervisory board is the competent body with respect to remuneration and thereby increase the influence of activist shareholders on public companies. Consequently, activist shareholders will most likely take advantage of the possibilities based on the mentioned new law in addition to the possibilities currently provided to them by corporate law (e.g., contesting shareholder resolutions and requesting shareholder meetings).

Second, shareholders of listed companies make more and more active use of their rights resulting in, among other things, a higher number of opposing votes in the elections of supervisory board members. Increasingly, proxy advisers are instructed to advise with respect to the strategies of shareholders. Such proxy advisers increasingly support the campaigns of activist shareholders.

Besides recent developments in the Austrian market, some companies are considering the implementation of preventative defensive measures, in particular measures that are effective in other jurisdictions are often considered.

In the long term, shareholder activism may have a positive impact on transparency and efficiency of public companies from a shareholder perspective considering that the majority of campaigns run by activist shareholders are value-driven. However, for a number of structural market reasons, it is unlikely that shareholder activism will reach the level currently seen in, for example, the United States.
Chapter 3

FRANCE

Jean-Michel Darrois, Bertrand Cardi and Forrest G Alogna

I 
OVERVIEW

If Brexit occurs, Paris will become the most significant securities market in the European Union.

France has a long-standing and vigorous tradition of activism. Historically, French activism has involved a variety of local actors, including financial investors, but also industrial concerns. More recently, and consistent with worldwide trends, activist profiles have become increasingly international, generally comprising professional hedge fund activists, including prominent activists from the United States and the United Kingdom. As in other major jurisdictions, it has also observed an increasing willingness of traditional investment funds to align themselves with activist funds or to even ‘go activist’ in certain cases. The amounts deployed by US and European activists against European targets fell in 2018 from the record-breaking amounts of 2017, but nonetheless reflected an ongoing significant increase compared with prior years.2

French and European laws and regulations furnish both the activist and the target company’s board and management with a variety of tools. As discussed below, French shareholders enjoy significant rights, such as the right for holders of as little as 0.5 per cent of a company’s shares to include proposed resolutions in the ‘proxy’ materials circulated by the company to shareholders. In addition, directors may be removed and replaced by a simple majority at any shareholders’ meeting. For the defending company, French law provides stringent disclosure requirements on stake-building, and French law’s expansive concept of a company’s corporate interest may provide a strong basis for a board of directors and management to resist an activist’s purely short-term financial strategy when appropriate.

II LEGAL AND REGULATORY FRAMEWORK

i Threshold crossing

The current primary disclosure obligations require that any person acting alone or in concert with others that comes to hold more than 5, 10, 15, 20, 25, 30, 33.3, 50, 66.6, 90 or 95 per cent of the share capital or voting rights in a listed company, report the crossing of these ownership thresholds (in either direction) to the company and the Autorité des marchés

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1 Jean-Michel Darrois is the founding partner and Bertrand Cardi and Forrest G Alogna are partners at Darrois Villey Maillot Brochier. The authors wish to thank Martin Lodéon, an associate of the firm, for his assistance in preparing this chapter.

financiers (AMF) no later than the close of market on the fourth trading day following the date on which the threshold was crossed.\textsuperscript{3} In addition, persons holding temporary interests in 0.5 per cent or more of the voting rights in a listed company incorporated in France must notify the issuer and the AMF no later than the second business day before a shareholders’ meeting.\textsuperscript{4} Net short positions in shares must be reported to the AMF upon crossing the threshold of 0.2 per cent of issued share capital (and every 0.1 per cent above that), and disclosed to the public when they reach 0.5 per cent of issued share capital (and every 0.1 per cent above that).\textsuperscript{5} More generally, AMF regulations require that persons preparing a financial transaction that may have a significant impact on the market price of public securities must disclose the transaction as soon as possible. Failure to adhere to these reporting obligations may result in significant sanctions.

Further, the disclosure obligations require any holder that comes to hold 10, 15, 20 or 25 per cent of the share capital or voting rights of an issuer to report to the AMF its intentions for the next six months with respect to the issuer and its shareholding, no later than the close of market on the fifth trading day following the crossing of the relevant threshold.\textsuperscript{6} In addition to the statutory thresholds, the company’s articles of incorporation may provide that shareholders must declare to the company the crossing of additional ownership thresholds below 5 per cent in increments of no less than 0.5 per cent.\textsuperscript{7} Finally, any agreement that provides preferential rights with respect to the sale or purchase of shares representing at least 0.5 per cent of the share capital or voting rights of a publicly listed company must be reported to the AMF within five trading days of its signature.\textsuperscript{8}

ii Shareholder rights
France has a strong legal tradition of vigorous shareholder rights, which continues to evolve.

Rights at shareholders’ meetings
Shareholders enjoy significant rights in shareholders’ meetings that can provide useful aids to an activist. For example, shareholders meeting the applicable minimum shareholding threshold in a French société anonyme (including a société européenne) or société en commandite par actions (the types of entities that may be listed in France), as well as qualifying minority shareholder associations, may add items for discussion to the agenda for any shareholders’ meeting or propose additional draft resolutions to be included in proxy materials distributed to shareholders.\textsuperscript{9} That said, the fundamental principle under French law of the proper

\textsuperscript{3} Commercial Code (C. com.) Articles L. 233-7 I-II and R. 233-1; AMF Règlement général, Article 223-14 I. ‘Share capital or voting rights’ include, among other things, cash-settled or physically settled derivative instruments providing an economic exposure equivalent to a long position in the underlying shares. C. com. Article L.233-9 I 4 bis; AMF Règlement général, Article 223-11 III.


\textsuperscript{5} EU Regulation No. 236/2012 on short selling and certain aspects of credit default swaps, Articles 5 and 6 (14 March 2012).

\textsuperscript{6} C. com. Article L. 233-7 VII.

\textsuperscript{7} C. com. Article L. 233-7 III.

\textsuperscript{8} C. com. Article L. 233-11 al. 1.

\textsuperscript{9} C. com. Article L. 225-105.
competence of the respective organs of corporate governance may permit the board to resist proposing an item that does not fall within the competence of the shareholders’ meeting (e.g., a change of strategic direction or approval of certain transactions).10

Further, any director may be removed (and replaced) at any shareholders’ meeting by a simple majority vote of the shareholders, upon the proposal of any single shareholder, even if the subject is not on the agenda for the relevant shareholders’ meeting and regardless of the term of office for which the director was originally appointed.11

In addition, shareholders holding 5 per cent, as well as certain minority shareholder associations, may request the president of the commercial court on an ex parte basis to convene a shareholders’ meeting if the company has failed to call the relevant meeting following a specific request.12 The same process can be used to appoint an independent expert to investigate one or more past or contemplated management decisions.13

Right to responses to written questions and right to participate in shareholders’ meetings
Any shareholder may timely present written questions to which the board of directors must respond during the shareholders’ meeting or on the company’s website.14 In addition, all shareholders have the right to participate in the discussion of issues raised at a shareholders’ meeting,15 in accordance with the topics set forth in the agenda for the meeting.16

Proxies and concerted action
Under French law, there is no prohibition on a shareholder soliciting proxies from other shareholders, and the requirements and restrictions on proxy solicitation (and the resulting expense) are relatively limited. All shareholders have a legal right to review the attendance sheets for shareholders’ meetings for the prior three years.17 In practice, large-scale proxy solicitation campaigns are rare in France, although the influence of proxy adviser firms is growing.

An activist may find itself acting in concert with other shareholders who come to share its views.18 This may trigger disclosure obligations with respect to the concert’s aggregate shareholding, as well as the obligation to make a mandatory tender offer for all the issuer’s shares if the concert exceeds 30 per cent.

‘Say-on-pay’ requirements
French law was modified in December 2016 and now imposes that shareholders annually approve the compensation of senior management in binding votes.19 This involves an ex ante vote regarding the principles and criteria for determining, allocating and paying fixed, variable

10 See, e.g., Safran, Addendum to the Meeting, Ordinary and Extraordinary Shareholders’ Meeting of Thursday, 15 June 2017, p. 9.
15 Civil Code 1844 alin. 1; C. com. L.242-9 alin. 1er (€9,000 fine for blocking a shareholder from participating in a shareholders’ meeting).
16 C. com. Article L. 225-105, al. 3.
17 C. com. Article L. 225-117.
and exceptional components of senior management’s total compensation, and any other benefits of any nature. If the *ex ante* vote is negative, the resolution fails and the previously approved principles and criteria remain applicable. The *ex ante* vote is then followed by an *ex post* vote at the next annual meeting relating to the compensation of the same executives. This *ex post* vote is individualised, with distinct resolutions relating to the compensation of each relevant executive. If the vote is negative, the variable and exceptional compensation is not payable. The first *ex post* shareholder votes under the new law occurred in 2018.

In 2018, the average approval rate for *ex ante* votes was 88.89 per cent and 88.53 per cent for *ex post* votes, but with significant variations in the level of approval. Only one negative vote was reported. Although the law does not sanction low approval rates, at least two proxy agencies have set 80 per cent as a threshold to consider that the shareholders’ vote may not be deemed satisfactory from a corporate governance standpoint. If issuers do not react in a meaningful manner, agencies recommend voting against the re-election of the chair of the remuneration committee or other committee members the following year. As expected, activists have not hesitated to use say-on-pay provisions as a basis to orchestrate a no confidence vote in management.

**Double voting rights and takeover defences**

French shareholders automatically benefit from double voting rights for shares that have been held for more than two years in registered form, unless the articles of the company expressly provide otherwise. The expressed goal of this change to the law was to free companies from ‘demands – often focused on the short term – of the financial markets and to “favour” [shareholders] who play the long term’. Some studies have suggested that this rule has favoured reference shareholders and decreased foreign institutional investment in companies that have not opted out.

France has also opted out of the passivity rule, so that a board of directors may now take measures aimed at frustrating a hostile bid. This provides companies with greater flexibility to negotiate with a potential bidder or an alternative acquirer, or to refuse an offer they do not deem to be in the company’s best interests. As expected, activists have increasingly sought to challenge directors’ exercise of discretion in that respect.

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20 Report of the High Committee for Corporate Governance, p. 22 (October 2018).
21 Since the implementation of the statutory say-on-pay framework, only one negative vote was reported with 34 per cent of the shareholders of CGG approving the package of the company’s CEO.
22 Proxinvest and Glass Lewis voting policies.
23 e.g., this was the strategy of CIAM in its challenge to Scor’s decision to reject Covea’s bid in 2018.
24 C. com. Article L. 225-123. Shares may be registered with the issuer itself or with a broker.
27 C. com. Article L. 233-32. The board’s exercise of its discretion is subject to the principles of the AMF takeover regime, the articles of incorporation and the limits of the powers granted by the shareholders’ general meeting, as well as of the corporate interest of the company.
28 This was the strategy of CIAM in its challenge to Scor’s decision to reject Covea’s bid in 2018.
France has adopted the ‘comply or explain’ framework with respect to corporate governance practices. French listed companies must either comply with the provisions of a corporate governance code prepared by a corporate association or provide an explanation in their annual report for any non-compliance.\textsuperscript{29} If the company does adhere to such a corporate governance code, the annual report must also provide an explanation of the reason for failing to follow any provisions of that code.\textsuperscript{30}

A significant percentage of French listed companies adhere to the AFEP-MEDEF governance code. Since 2013, the AFEP-MEDEF Code has included a High Committee on Corporate Governance to assist in evaluating governance issues and monitoring the implementation of the AFEP-MEDEF Code. The High Committee is also responsible for proposing amendments to the AFEP-MEDEF Code in light of changing practices, and recommendations made by the French market regulator or investors.

**Activist obligations**

Depending on the activist’s strategy, certain recurrent issues may expose it to potential liability. This includes insider trading, market manipulation\textsuperscript{31} and dissemination of false information,\textsuperscript{32} as well as potential violations relating to financial analysts and investment research.\textsuperscript{33} The year 2018 has seen the development in France of a new type of short activism with a heated debate on the distinction between market misconduct and activism.\textsuperscript{34}

**III  KEY TRENDS IN SHAREHOLDER ACTIVISM**

French native activists primarily comprise both financial and industrial perspectives, and include occasional as well as persistent activists. The former includes investment funds and individuals such as Amber Capital (UK-based but with founders with strong French ties), Charity Investment Asset Management (CIAM), SFAM, Wendel and Guy Wyser-Pratte (based in New York, but born in France). An example of the latter is LVMH in its acquisition of a significant position in Hermès. Certain commentators have on occasion characterised the French state as an activist, for example, under the Hollande administration, voting against management compensation in say-on-pay and golden parachute votes, or in the defence of

\textsuperscript{29} C. com. Article L. 225-37.
\textsuperscript{30} id.
\textsuperscript{31} European laws and regulations prohibit transactions or trading orders that (1) are likely to or actually give false or misleading signals as to the market for or price of public securities, (2) have the effect of setting or maintaining an artificial price for public securities, or (3) involve fictitious or deceptive devices or methods.
\textsuperscript{32} This includes disseminating information that gives or may give false, imprecise or misleading signals as to French securities, including spreading rumours, although the person knew, or should have known that the information was false or misleading.
\textsuperscript{33} This includes the following requirements: (1) that reasonable diligence be exercised to ensure that information is presented in an objective manner, (2) the obligation to expressly disclose possible conflicts of interest, as well as (3) the obligation to clearly distinguish between factual and non-factual matters (interpretations, estimates, opinions, etc.).
double voting rights at Renault. Finally, French associations of minority shareholders, such as the Defence Association of Minority Shareholders and SOS Small Holders, continue to play a role, including in litigation, sometimes in partnership with other activists.

Foreign activists primarily comprise long financial activists, notably including in recent years Cevian Capital (Sweden), Elliott Management (US), Pardus Capital Management (US), the Children’s Investment Fund (TCI) (UK), Third Point (US) and Trian (US). The US-based short seller Muddy Waters has also been active in France.

The number of campaigns in France held steady in 2018 with approximately 10 companies subject to public activist demands and seven new activist campaigns. Given the relatively small number of activist interventions in France (estimates are eight for 2017, and vary from seven to eight in 2016, and two to 10 in 2015), it is difficult to draw definitive conclusions about the profiles of French companies most likely to be targeted by activists. Consistent with worldwide trends, French listed targets have clearly grown larger in recent years (e.g., Accor, Airbus, Carrefour, Danone, Lagardère, Pernod Ricard, Safran, Scor, Suez Environnement, Vivendi). That being said, companies with a market capitalisation between €500 million and €5 billion continue to be prime targets (e.g., Euro Disney, Fnac Darty, Groupe Latécoère, Nexans, Rexel, SoLocal, Technicolor, XPO Logistics Europe), as well as companies with lower capitalisations.

Activists’ strategies and objectives in France are typically a function of the relevant situation and commonly include as follows:

a) seeking an exceptional dividend or spin-off (Airbus as regards its stake in Dassault; Nestlé as regards its stake in the French company L’Oréal; Vivendi as regards an exceptional dividend and the sale of Universal Music; Altamir Amboise as regards a significantly improved dividend; Technicolor as regards the break-up of the company);
b) mitigating for improved performance (Carrefour, Nexans, Pernod-Ricard, Rexel);
c) seeking to extract additional value or otherwise intervening in the context of an M&A transaction (Scor/Covéa, Safran/Zodiac, XPO/Norbert Dentressangle, Euro Disney, Etablissements Maurel & Prom/MPI); and

d) abandoning takeover protections (Lagardère).

Tactics can take a variety of forms, evidently determined in light of the strategy and situation, typically involving implementing certain tools referred to in the preceding sections, including as follows:

a) seeking to add items to the agenda of a shareholders’ meeting or propose new resolutions (CIAM regarding Scor; Wyser-Pratte regarding Lagardère; TCI in Safran/Zodiac);
b) seeking board seats (Amber regarding Lagardère; Cevian Capital in relation to Rexel; CIAM as regards Locindus and Alès Groupe; Pardus Capital Management regarding Valeo; Pardus Capital Management and Centaurus Capital in relation to Atos Origin; PhiTrust in relation to EssilorLuxottica; SFAM as regards FNAC Darty; Sterling Strategic Value and La Financière de l’Echiquier regarding Latécoère);
c) seeking a court-appointed independent expert (Elliott in its countersuit against XPO);
d) ‘no’ campaigns on executive compensation (CIAM regarding Scor; the French state in relation to Alstom, Renault and Safran (resulting in ‘no’ votes in 2016 against the compensation of Carlos Ghosn and Patrick Kron, the CEOs of Renault and Alstom respectively));
France

blocking a squeeze-out (Elliott regarding APRR and XPO Logistics Europe);
orchestrating a public relations campaign, including letter writing (including lobbying individual board members or relevant regulators), press interviews and, most crucially, the lobbying of proxy advisers; and
in relatively rare cases, initiating litigation (CIAM regarding Euro Disney; CIAM against Altice).

In the authors’ experience, a strong response to an activist by the board and management and their advisers often includes, among other things:
advance planning, to deliver strong teamwork in a crisis by and among the board, management and advisers as well as other key internal constituencies;
ongoing monitoring and rapid response to warning signs;
in the event of a public attack, implementing communication that is coherent on all fronts;
maintenance of dialogue with relevant regulators, proxy advisers and other key constituencies, including other significant shareholders;

Careful analysis of missteps by the activist or weaknesses in its approach;
in certain cases, the seeking of regulatory intervention and even initiation of litigation; and
avoidance of legal or other missteps that will be seized upon by the activist or others (including the AMF) at a time of heightened focus upon the company and its conduct.

Outcomes may vary significantly depending on the strategy and tactics of the activist, and the target’s response. Most shareholder resolutions are rejected and the vast majority of company resolutions are approved. But, victory is not counted in votes alone, and shareholders may also exert discipline in other ways. Key variables include the size of the activist position, whether the issue is ultimately submitted to a shareholder vote, the presence and preferences of any reference shareholders, the recommendations of proxy advisers and the substance of the critique and the company’s response, as well as the effectiveness of communication.

IV RECENT SHAREHOLDER ACTIVISM CAMPAIGNS

This section provides a few examples of recent activist campaigns that provide insight into current trends in French activism.


After having acquired 0.77 per cent of the capital of French reinsurer Scor SE in September 2018, CIAM wrote a letter to Scor’s chair and CEO, Denis Kessler, criticising the rejection by Scor of a takeover offer of €43 a share from Covéa, a French mutually owned insurance company. Arguing that Covéa’s offer was neither compatible with Scor’s strategy of independence nor adequately priced and reflecting the intrinsic value of Scor, Denis Kessler strongly rejected CIAM’s accusations. After further public exchanges, CIAM campaigned against Scor’s governance structure and sought to include the separation of the roles of chair and CEO in the agenda of the next shareholders’ meeting. Scor’s shareholders ultimately voted against CIAM’s governance proposal (74.37 per cent) and in favour of the CEO’s pay package and compensation policy by a small majority (54.46 per cent and 54.56 per cent).
ii Pernod Ricard/Elliott Management (2018–2019)
Elliott Management announced in December 2018 that it had acquired a 2.5 per cent stake in Pernod Ricard and issued a press release expressing dissatisfaction with the company's alleged material underperformance, disappointing M&A track record and inadequate governance. The company announced efforts to improve its corporate governance and created a new position of lead independent director. Following the disclosure of dialogue with Elliott Management, news reports also indicated that Pernod Ricard was considering selling its wine division. In April 2019, the company announced that it had agreed to buy premium gin brand Malfy and disclosed the adoption of a three-year plan to accelerate its growth and improve its profitability.

V REGULATORY DEVELOPMENTS
There have been a number of recent developments relevant to activism.

French law is becoming increasingly concerned with the promotion of a long-term approach to shareholder engagement and corporate conduct. As part of significant reforms implemented this year, directors and executives must comply with a statutory obligation to take into account the social and environmental aspects of corporate activities, and to abide by the corporation's purpose if one has been provided in the articles of association. Even though most of the legal implications of those statutory concepts are yet to be clarified by jurisprudence, the new law provides new grounds for corporate directors to defend against activist attacks and takeovers.36

As has been widely reported, the entry into force of MiFID II in January 2018 has resulted in a decrease in the extent and, in many cases, the quality of sell-side analyst coverage of equity securities in Europe. The decline of more neutral and objective coverage may increase the influence of activist analyses, whether long or short.

French law now requires asset management companies to develop and disclose a shareholder engagement policy in which they must describe how they account for their role as a shareholder of the companies they invest in.37

Proxy advisers are now subject to a comply or explain principle similar to the principle applicable to listed companies. Accordingly, proxy advisory firms have to elect for a professional code of conduct or explain why they do not do so.

To inform their clients about the exact extent and reliability of their activities, proxy advisers must publish annually the information on the preparation of their research, advice and voting recommendations. They must also inform their clients of their conflict of interest prevention policies and disclose any conflicts to their clients.

VI OUTLOOK

If current conditions and trends continue, activism appears poised to continue to play a vibrant role in France. Based on worldwide trends, a maturing of the international component of French activism may be expected, including as following:

a continuing major activist interventions in France;

b non-activist institutional investors becoming more ‘active’, ranging from supporting activists campaigns (Financière de l’Echiquier in its team-up with Sterling Strategic Value concerning Latécoère) to themselves opportunistically going activist (e.g., occasional activist P Schoenfeld Asset Management in its Vivendi campaign, and PhiTrust, Edmond de Rothschild, Fidelity International and Sycamore Partners regarding EssilorLuxottica);

c companies becoming the targets of distinct serial activist interventions (in addition to wolf packs), and

d more sophisticated and increasingly M&A-focused activist campaigns.

We may also see an increase in activism against targets that had previously been sheltered by the French state as it reduces its exposure in certain listed companies. In addition, as activism becomes commodified, an increase in local activism may occur, as a new generation of smaller European and French players join the fray. Elliott Management’s victory in Telecom Italia may be a harbinger of a more aggressive approach regarding companies with reference shareholders that lack outright control (a shareholder structure that is relatively common in Europe), as evidenced by Elliott Management’s more recent campaign at Pernod Ricard. 


39 ‘Vivendi locks horns with Elliott over equity derivatives’, available at https://www.ft.com/content/95e64656-344f-11e9-bb0c-42459962a812.


41 Renault, Air France, Engie, among others.

42 id., (discussing high activity of smaller first-time activists in the United States in 2017).


45 See details of the 2019 campaign in Section IV.ii. The Ricard family remains the largest shareholder of Pernod Ricard.
Chapter 4

GERMANY

Michael J Ulmer

I OVERVIEW

Shareholder activism has come to Germany and is here to stay. Only a few years ago, German managers perceived shareholder activism as a feature of the US and, to a certain extent, the UK market. Germany, they thought, was not interesting enough for activists they had heard of only in the international media, if at all. Further, the German market was understood to be sheltered from such inconvenience.

During the last decades of the twentieth century, corporate Germany was a close-knit community with a comparatively small number of listed companies. Debt, rather than equity financing, dominated corporate finance, and listing on a stock exchange was not necessarily the main goal of a thriving business. Cross-shareholdings were common among listed entities. These cross-shareholdings and the ubiquitous German banks led to supervisory boards being filled with representatives of a company’s business partners. Low attendance at shareholders’ meetings and depository banks exercising the voting rights of free-float shareholders created a friendly, albeit encrusted, environment. Strategy and business decisions of the executive board were only discussed with the supervisory board. Investor relations were not deeply embedded in the corporate culture.

This situation changed fundamentally, as the ‘Deutschland AG’ gradually broke up. Cross-shareholdings were largely abandoned, supervisory boards have become much more diverse and equity capital markets now play a significant role in company finance. Indeed, more, and much smaller, companies tap this resource. Listings now often take place earlier in a company’s history. These developments, together with the significant scope of minorities protection afforded under German corporate law, offer an enticing environment for shareholder activism that even a two-tier board system and co-determination cannot curb.

An invitation like this could not be ignored by activists, often US hedge funds, that are on the lookout for new opportunities. Low interest rates and past successes allow these funds to raise even more capital. In the United States, however, activist campaigns no longer lead to the same level of return as they once did. There, companies are now much better prepared, have turned into sophisticated communicators of their strategies and often preemptively take measures activists would usually press for. However, the less aggressive approach of active ownership recently followed by many activists resonates well with German corporate culture,

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traditionally fostering medium to long-term perspectives. Finally, not least because of large compliance cases and ‘Dieselgate’, shareholders proactively engaging with management are increasingly seen as playing a healthy role within the German market.

Against this backdrop, it is no surprise that shareholder activism has established itself as a mighty force in Germany. In recent years, the number of activist campaigns has increased significantly. Shareholder activism is currently seen as one of the key market trends, making its way onto the agenda of boards and advisers alike. These days, the mere possibility of activists looking at a specific situation may lead to unforeseen changes in corporate strategy or trigger huge transactions. Shareholder activism has taken to the German stage – and it will not go away.

II LEGAL AND REGULATORY FRAMEWORK

The German legal and regulatory framework relevant to activist campaigns is manifold. Whereas the corporate constitution of publicly traded companies exhibits features that could serve as protection against outside attacks, far-reaching minority rights offer activist shareholders starting points or even inroads; and be it only for creating a nuisance in support of their campaigns. Obligations of current or potential future shareholders towards the company, however, are limited. A tight regime of disclosure requirements leads to transparency with respect to stakebuilding, thereby creating a level playing field for both management and activist.

i Corporate constitution

The corporate constitution of German public companies is characterised by a two-tier board system, consisting of management and supervisory boards, as well as by a separation of powers within the company that is often described as a system of ‘checks and balances’.3

The management board runs the company independently and free from instructions by the supervisory board or the shareholders. The management board’s decisions must be guided exclusively by the best interests of the company, with the board being granted a certain level of discretion with respect to this assessment. In consequence, the management board in general cannot bindingly commit itself to take a specific measure in the future. The overall situation or the board’s assessment might change in the meantime, and the respective measure, therefore, may no longer be perceived as being in the company’s best interests.

The members of the management board are appointed and removed by the supervisory board, whose members are in turn elected by the shareholders’ meeting with a simple majority.4 Unless there is a vacancy within the supervisory board that needs to be filled by court appointment at short notice, it is the supervisory board that suggests to the shareholders’ meeting whom to vote onto the supervisory board. However, under certain

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3 The focus of this chapter is the German Aktiengesellschaft (AG), the archetypal entity under German law, whose shares can be listed on a stock exchange, and by far the most common form of publicly traded companies in Germany. The Kommanditgesellschaft auf Aktien (KGaA) and the Societas Europaea (SE), whose shares can also be listed, are not addressed. The KGaA is a special entity mainly used by ‘family enterprises’ to strictly limit external influence even in the event of listing. An SE can take several forms, and as a German listed entity often resembles an AG.

4 In the case of a company that is subject to co-determination, the employees’ representatives on the supervisory board are determined by means of special procedures.
circumstances, the supervisory board could agree with a shareholder to suggest a specific candidate to be voted for by the shareholders’ meeting. Depending on the number of the company’s employees, one-third or even half of the members of the supervisory board are determined by the company’s employees.5

The allocation of responsibilities between the management board, the supervisory board and shareholders of publicly traded companies is rather inflexible, and decisions to be taken by the management board cannot be made subject to prior shareholder approval. A limited number of significant acts of management, however, can be made subject to prior approval by the supervisory board.

The supervisory board is not entitled to share any confidential information with the shareholders of the company. The management board is also bound by confidentiality obligations but, within certain limitations, could share confidential information with shareholders or even with third parties. As a basic principle, all shareholders must be treated equally, and information provided to one shareholder must in general also be shared with the other shareholders. Each shareholder has a respective claim, to be brought at the shareholders’ meeting. Insider information can hardly ever be shared prior to public disclosure.

ii Minority rights

The protection of minorities is a guiding principle under German company law. Fundamental measures require an approving shareholders’ resolution cast with a qualified majority. Further, shareholders with small holdings, sometimes even holders of a single share, are granted a wide range of protective rights.

With a threshold of 95 per cent, squeeze-out resolutions require the highest qualified majority; this threshold is reduced to 90 per cent in the event of a merger-related squeeze-out. Other fundamental measures like mergers, spin-offs, other reorganisations or the sale of the company’s whole business require shareholders’ approval by a majority of 75 per cent at the shareholders’ meeting, as do capital increases, amendments of the company’s articles, conclusion of a domination and profit and loss transfer agreement, and the removal of a supervisory board member.

Even a single share entitles its holder to speak at the shareholders’ meeting. Each shareholder can also submit counter-proposals for shareholders’ resolutions, challenge shareholders’ resolutions or make a counter-proposal for an individual to be voted onto the supervisory board. The right to request a court decision on the appointment of a special auditor to independently audit specific acts of management requires a shareholding of 1 per cent of the company’s nominal capital or shares representing €100,000 thereof. Holding shares representing 5 per cent of the company’s share capital, or €500,000 thereof, grants the right to request amendments to the agenda of a shareholders’ meeting and a 5 per cent shareholding grants the right to request that a shareholders’ meeting be convened.

Shareholders can team up to pass the respective thresholds and proxies can be sought. Other than the management board of the company, a shareholder seeking proxies or general support by other shareholders must rely on publicly available information and tools to establish contact. Management can use the company’s information base when canvassing support among shareholders.

5 Having more than 500 employees leads to one-third of the supervisory board members being determined by the company’s employees, whereas more than 2,000 employees results in half of the board members being employees’ representatives.
Finally, minimum pricing rules under German takeover law also need to be understood in the context of the protection of minorities. In a takeover scenario for a publicly traded company, the bidder must offer all shareholders a price per share at least equal to the highest price the bidder paid for shares of the company in the six months prior to the offer. In the event of a squeeze-out, a merger, or conclusion of a domination and profit and loss transfer agreement, all shareholders are entitled to trade in their shares for what the law describes as ‘adequate’ compensation.

iii Disclosure requirements

When building a stake in a publicly traded company, activists face a tight regime of disclosure obligations. Acquiring shares and reaching the thresholds of 3, 5, 10, 15, 20, 25, 30, 50 and 75 per cent of the total voting rights within a company requires the shareholder to immediately notify the Federal Financial Supervisory Authority (BaFin) as well as the respective company, which in turn must inform the market about such transactions. In the context of a 10 per cent notification, the acquiring shareholder must inform the company about the underlying objectives behind the acquisition: classification of the investment as strategic or financial, intention to increase the stake within the next year or influence the composition of the company’s boards or to significantly change the company’s financing structure. Acquiring shares representing 30 per cent or more of voting rights is deemed to be taking over control of the company. A shareholder reaching this 30 per cent threshold is required to submit a public takeover offer for all shares in the company pursuant to the WpÜG (the Takeover Act).

When determining the percentage of voting rights a shareholder holds, certain voting rights are attributed that do not result from shares held by the shareholder. Among others, voting rights resulting from shares held by subsidiaries, and from shares that are held for the benefit of the shareholder or that could be acquired by the shareholder unilaterally, need to be added to the directly held voting rights. Further, voting rights held by shareholders acting in concert with respect to more than singular situations are attributed to all such shareholders.

Starting with the 5 per cent threshold, the aforementioned notification obligations also apply where an investor acquires financial instruments that either grant the investor an unconditional right to acquire shares with voting rights in the company, or that relate to the shares and have an economic effect comparable to financial instruments. Voting rights resulting from shares and related to these financial instruments are also added when determining the total percentage of voting rights held by a shareholder. In consequence, a combined stake of close to 3 per cent of voting shares and financial instruments related to shares granting up to 2 per cent of the voting rights in a company would fall just short of the notification requirements, and could be built and kept secretly. Failure to comply with disclosure obligations could lead to voting rights resulting from respective shares not being exercisable.

Besides voting rights, short positions in a company’s shares are also subject to disclosure obligations. Starting with 0.2 per cent of the issued share capital of a company, covered net-short positions must be notified to the BaFin. Thereafter, each 0.1 per cent increase triggers

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6 Should the weighted average stock exchange price of the shares during the three months prior to the notification about the upcoming offer be higher, the higher price would be the minimum price to be offered to all shareholders.

7 The BaFin and the company need to be informed without undue delay and no later than within four trading days. The company, in turn, must inform the market without undue delay and no later than within three trading days.
further notification requirements. As of 0.5 per cent of the issued share capital, notifications of covered net-short positions must also be made to the public.\(^8\) Taking uncovered short positions in shares of a publicly traded company is prohibited.

### iv Shareholder obligations

Although the rights of shareholders under the German legal and regulatory framework are far-reaching and even holders of single shares benefit from minorities protection, the obligations of current or potential future shareholders towards the company are limited.

As long as the disclosure obligations applicable to covered short positions are complied with, no inaccurate or misleading information is disseminated in the course of a campaign and existing conflicts of interests are made public by the activist in a correct and effective manner, even attacks by short sellers are considered legal.

Fiduciary duties also binding minority shareholders are discussed; however, for an activist to become liable, intentionally causing harm to the company would be required. In this context, it also needs to be taken into account that short sellers, when running their campaigns, usually do not hold shares in the companies they attack.

### III KEY TRENDS IN SHAREHOLDER ACTIVISM

Shareholder activism in Germany exhibits many features, and campaigns seen most often follow different approaches. With their attacks, short sellers aim to bring down the target’s share price to maximise individual short-term profit. Other activists take a medium to long-term perspective and try to create value for all shareholders by changing the way the company is managed. This might range from changing corporate governance structures to breaking up the company. Special situation activists make use of takeover scenarios or corporate measures that cannot be implemented without the votes resulting from their shareholdings and entail payment of adequate compensation to affected shareholders. Owing to the general principle of German corporate law that shareholders must be treated equally, raising the price to be paid for the company’s shares ultimately benefits all shareholders exposed to the respective situation.

### i Short sellers

Short sellers are increasingly active in Germany. Their campaigns start with the activist identifying a promising target. Complex business models and unclear strategies, opaque accounting and potential irregularities in financial reporting, and close financial or personal links between management and major shareholders often serve as a basis for their attacks.

The short seller then bets on a falling share price, using financial instruments. Often the activist, with the help of financial institutions, borrows shares in the target company and sells them immediately with the intention of repurchasing the shareholding at a lower price once the campaign has its effect. Following the sale of the lent shares, the activist publishes a report on the target company, sharing the analysis of the company’s potential weaknesses and making the case that the company is overvalued and its share price inflated. Usually, these reports are accompanied by managed media coverage. Short selling campaigns gain additional momentum once the falling share price triggers stop-loss orders. Further, if the

\(^8\) All notifications must be made by 15.30 on the trading day following the respective transaction.
target's share price rose quickly in the past, shareholders that bought cheap are generally willing to exit quickly once they observe the first signs of a downward trend. Sometimes, several activists proceed together right from the beginning of an attack. More often though, the short seller will already have repurchased the shareholding for a then lower price and transferred it back to the lender when other activists join the campaign, waiting for a second wave or just hoping to benefit from the momentum created by the attack.

Although the target of a short selling campaign needs to allocate significant resources to counter the attack, suffers from a falling share price and may take a long time to recover, short selling cannot be qualified as an outright negative. As long as applicable disclosure requirements are met, no inaccurate or misleading statements are disseminated and existing conflicts of interests are made public, campaigns can contribute to transparency and thereby increase overall market efficiency. This effect is mediated by the fact that negative consequences of an attack cannot be controlled so as to remain commensurate with the overall situation.

ii Value-driven activists

Value-driven activists’ aim is to achieve the opposite. They hope their campaigns will increase the target company’s value and the price of its shares. Companies with a low valuation, conglomerates perceived as sedate and enterprises that have not adapted to the fast-moving markets they operate in all qualify as potential target for their campaigns. Some activists have a special focus on executive compensation, compliance or good governance; others construe value more broadly, and also pursue ethical or ecological objectives.

The main aim of most value-driven activists is to push management to run the company’s business in a way they deem more efficient, thereby raising its valuation. Campaigns often challenge business models and corporate strategy. Changes within the boards are sought to gain direct influence on respective decision-making. Press campaigns and open letters to all shareholders accompany such efforts. Executive compensation is frequently identified as an inappropriate cost factor and good governance construed as the means to achieve the final goal. In this context, activist shareholders do not shy away from suggesting significant cost cuts, share buy-backs, changes to the company’s financing structure or the sale of less profitable businesses. Breaking up conglomerates to increase the valuation of its individual parts by creating more flexible and focused entities that are managed at a level closer to their business is in many cases the ultimate ambition.

While activist shareholders following this approach take minority stakes in the target company, they use several tools to increase their influence. Media campaigns that denounce inefficiencies and demand measures with an alleged direct impact on the share price help to win over other shareholders. More passive investors, such as asset managers, and pension and mutual funds are more and more often backing such campaigns, either in full or at least those elements that are within the focus of their investment guidelines, such as good governance or executive compensation. An increasing number of institutional investors announced their intention to more actively pursue such goals in the future, and have now begun to act accordingly. With most shareholders’ interest in increasing the value of their investment being aligned with this main objective of the activists, even a campaign based on a small shareholding can find majorities at shareholders’ meetings, especially given that proxy advisory services are now regularly seen in the German market.

iii Special situation activists

For years now, special situation activists have achieved a certain notoriety in Germany. They make use of scenarios where the votes resulting from their shareholding are required to either allow a takeover to succeed or to implement specific corporate measures. The qualified majorities required to take a company private by way of a squeeze-out (95 per cent or 90 per cent in the event of a merger-related squeeze-out), to merge or to reorganise a company (75 per cent), or to enter into a domination and profit and loss transfer agreement with the company (75 per cent), provide the platform for their campaigns. The latter threshold is of utmost significance, especially in takeover scenarios. Without a domination and profit and loss transfer agreement being in place with the target company after a takeover, the major shareholder cannot instruct the management of a publicly traded company on how to run its business. Measures required to realise synergies could not, therefore, be implemented. In addition, the company's cash flows could not be used to refinance the acquisition. This is one reason most public takeover offers are subject to the condition that 75 per cent of the company's shares are tendered.\footnote{Including the shares held by the bidder already that usually count against this 75 per cent condition.} Given that a significant number of shareholders usually ignore a takeover offer or deliberately keep all or parts of their shareholdings, even a stake well below 25 per cent could lead to a takeover offer failing. Special situation activists build such stakes when a takeover is announced or once corresponding rumours become more reliable. In the course of the takeover process, they agree a price with the bidder for which they would tender their shares, thereby significantly increasing the likelihood of the takeover offer being successful. Pursuant to the pricing rules under German takeover law, the price, on a per share basis, would also need to be offered to all other shareholders.

This approach is also used by special situation activists in the event of corporate measures that are not directly related to a takeover. The activists build and sell a stake that is required to implement upcoming corporate measures like a squeeze-out, a merger, other reorganisations or entering into a domination and profit and loss transfer agreement. These corporate measures imply that all shareholders are made an offer to trade in their shares for an adequate compensation. The valuation of the company performed to calculate the compensation aims at determining the intrinsic value of the company. Although the price the shares trade at on the stock exchange plays an important role in this respect, other than in a takeover scenario, the price paid for shares held by an activist does not generally have to be taken into account.

Each shareholder is entitled to challenge the adequacy of the compensation offered in these contexts. The compensation finally decided by the courts to be adequate is owed to all shareholders that traded their shares. In consequence, special situation activists successfully challenging and increasing the original compensation offered help all shareholders to realise the full value of their investment.

IV RECENT SHAREHOLDER ACTIVISM CAMPAIGNS

In recent years, the number of campaigns run by activist shareholders in Germany increased significantly and shareholder activism is now perceived as one of the key trends in the market. The following recent campaigns are of particular interest.
Advertising company Ströer, financial investor AURELIUS and media group ProSiebenSat.1 all recently came under attack from short sellers.

In the case of Ströer (2016), activist Muddy Waters, having built a short position, publicly made the case that the equity story of the company’s initial public offering had not been followed up on, and entering the digital media sector rather than fostering international expansion was not convincing. Further, the company’s accounting was challenged, and transactions between board members and the company were questioned, accompanied by hints at the lavish life styles of the CEO and members of the founder’s family. Muddy Waters liquidated its short position once the company’s share price had fallen significantly.

AURELIUS was attacked by Gotham City (2017). Building up a short position was followed by the publication of a research report that claimed shares were trading at a highly inflated price. The company’s business model was challenged and the way it accounted, in particular, for the profits of portfolio companies was described as inappropriate. Adding that the management had already sold their shares in the company below market increased the blow to the share price. Subsequently, Gotham City liquidated its short position.

Viceroy ran a short-selling attack against ProSiebenSat.1 (2018) briefly after it became known that the media group had to leave the leading German index DAX 30. The activist claimed the company’s shares were trading at four times their real value. The practice of investing in young enterprises, in connection with granting them free slots for television advertisements, was cited as a means to inflate profits. Further, the media group’s business strategy in a quickly changing and internet-dominated environment was heavily criticised. As to be expected, within minutes, the falling share price had destroyed a significant portion of investors’ wealth.

As previously with Bilfinger – where Cevian some years ago became the biggest shareholder, took two seats on the supervisory board and transformed the struggling building conglomerate into a more focused industrial service provider – the Swedish activist, now with Elliott, is pressing for radical change at industrial giant ThyssenKrupp (2017–2019).

Second only to Krupp Stiftung, Cevian holds a large stake in ThyssenKrupp. For some time, ThyssenKrupp’s management had been working on a new strategy for the group that is active in diverse business areas, including steel production, trading and plant construction, as well as ship and elevator building.

Against the background of financial results that persistently failed to meet Cevian’s expectations, the activist was demanding a break-up of the group, arguing that overall valuation could be increased significantly by creating more focused and efficient, independently managed enterprises. Management resisted these demands. This was when Elliott acquired a stake in ThyssenKrupp that, together with the shareholding of Cevian, equals that of Krupp Stiftung. Together, the activists initially pressed for adjustment of the terms of a steel joint venture that had been agreed with Tata Steel. Shortly thereafter, the CEO of ThyssenKrupp as well as the chair of the supervisory board resigned from their offices. The new CEO presented a plan to split the group, ultimately resulting in two listed entities. Krupp Stiftung, which had originally opposed a break-up, signalled it would back this plan. Cevian obtained a second seat on the company’s supervisory board, whose new chair is also well-known to the
activist from past cooperation. Due to adverse market conditions, the new CEO’s plan was finally renounced and now alternative structures, including a full break-up of the group, are being discussed.

iii  GEA, SAP, Uniper and Bayer/Elliott and others

Elliott is also pursuing several other interests in the German market.

At plant and mechanical engineering specialist GEA, Elliott successfully pushed for replacement of the long-time CEO, and for further changes within the company’s management and supervisory boards. The new management committed to overhaul the group to improve its financial performance (2018–2019). Groupe Bruxelles Lambert supported these efforts.

When SAP announced it would undertake a comprehensive review of its business – which will be overseen by a newly created management board committee – and further raised its financial targets, Elliott concurrently released a statement in support of such measures, and revealed it had acquired a significant shareholding in the software company (2019).

Upon pressure from Elliott, the shareholders’ meeting of Uniper was supposed to vote on the energy group being required to prepare the conclusion of a domination agreement with Finnish Fortum. Their takeover attempt had led to a deadlock situation at Uniper. Knight Vinke pushed for a vote on seeking a break-up of the company at the same shareholders’ meeting. Both activists withdrew their requests immediately before the meeting (2019).

Rumours that Elliott is pursuing a split of Bayer, making use of the challenges following Bayer’s acquisition of Monsanto, have not been confirmed (2018–2019).

iv  STADA/AOC and Elliott

Pharmaceutical company STADA is probably still the most prominent example of a German company being targeted by activist shareholders in recent years (2016–2017). With its two business segments, generic and over-the-counter products, a CEO holding office for over 20 years, with one of the more generous compensation packages on the market, a rather reclusive supervisory board chair and a less than optimal financial performance, STADA offered many features to pique activists’ interest.

Thus, AOC, together with others, built up a stake of approximately 5 per cent in the company and pressed for cost-cutting and improved performance. Further, they aimed to replace nearly all shareholders’ representatives on the supervisory board. Both the management and the activist applied sophisticated media strategies to win over the shareholder majority for their respective case. Finally, the company’s general counsel took over from the CEO and the chair as well as other members of the supervisory board were replaced.

Whether solicited by the activist or solely attracted by separable business units and unrealised upside potential, STADA drew strong and increasing interest from several private equity investors. This was when the new CEO decided to run a structured sales process for the company, ending in Bain and Cinven submitting a public takeover offer for all STADA shares. As usual, the offer was made subject to 75 per cent of the shares being tendered so a domination and profit and loss transfer agreement could be put in place, and the company’s cash flows used to partly refinance the acquisition.

Another activist entered the scene. Elliot acquired a stake in STADA big enough to hinder this condition being met, even with a finally lowered acceptance threshold. The takeover offer fell through. Based on an exemption granted by the BaFin, the private equity houses followed up with a second attempt in which the offered price was acceptable to Elliott. At this stage, AOC had already sold its shares with a high profit. To miss no opportunity,
Elliott then bought further STADA shares and made clear it would in any case challenge the adequacy of the compensation offered to shareholders in the context of the domination and profit and loss transfer agreement to be entered into following the takeover.

V REGULATORY DEVELOPMENTS

Among recent regulatory developments, the following should have an impact on campaigns run by activist shareholders.

At the end of 2018, the Federal Court of Justice (BGH) clarified that shareholders of a listed entity do not act in concert if, based on a one-time agreement, they vote to replace the members of the supervisory board with the aim of shifting the company’s strategy. A singular agreement would not qualify as acting in concert even if it had a long-term impact on the company. In consequence, the voting rights held by these shareholders are not attributed to the respective others, the 30 per cent threshold is not reached by way of attribution and no public takeover offer for all shares in the company is triggered by the agreement. This clarification will have a comforting effect on activist shareholders teaming up to change a target’s strategy.

One year earlier, the BGH held that the price paid by a bidder for bonds convertible into shares in the target in the context of a public takeover offer must be taken into account when determining the minimum offer price, at least if the bonds are convertible into shares in the target at short notice. McKesson, when taking over pharma wholesaler Celesio, bought bonds convertible into Celesio shares from Elliott, which had built that stake to finally be bought out by the bidder. The prices paid by the bidder for both shares and convertible bonds of the target were held to be relevant with regard to the minimum pricing rules. This judgment will thus influence the tactics of activist shareholders focusing on special situations when building a stake in the respective target.

When the newly appointed CEO of STADA announced that, in the light of informal offers by financial investors to take over the company, the management would start a structured sales process for STADA, he created the impression that the management board of a publicly traded company under these circumstances would or at least could be obliged to run a sales process. Unlike US law, German corporate law does not foresee this obligation. Even if a company has been put ‘in play’, the management board when taking its decisions must be guided exclusively by the company’s best interests and under German law in general there is no protected interest in the company’s shareholder structure. It can be expected though that this prominent precedent will lead to other management boards in comparable situations considering a potential obligation to follow this approach. Especially if activists threaten to bring damage claims against management, the boards might decide to run a sales process, if only as a defence against a liability allegedly resulting from not doing so. Adding the tool of putting the company in play by orchestrating offers, or at least serious communications of interest, provides activist shareholders interesting new perspectives.

12 BGH, judgment of 7 November 2017, II ZR 37/16 – Frankfurt am Main.
VI OUTLOOK

Not least because of the considerable success of recent campaigns, market participants agree that shareholder activism in Germany will play an even bigger role in the future. Its legal framework and corporate culture as well as factual circumstances led to Germany being identified as a new playground for activists. Many of their goals resonate well with other shareholders that, therefore, support their campaigns. Even formerly passive institutional investors announced their intention to become more actively engaged with the management of the companies they invest in and have now begun to act accordingly.

The increasing awareness of what an activist campaign would mean for a company that is hit unprepared leads many to expect changes within corporate culture in Germany. Good governance is already heading the agenda. Steps towards more open communication and discussions of a company’s strategy, as well as growing receptiveness regarding criticism by key shareholders, can be expected. The value of supportive anchor investors is increasing further.

Besides these general developments within corporate culture, many companies are seriously considering preemptively taking defensive measures that have proven effective in the US market. These measures include white paper exercises with the company’s management taking the position of an activist shareholder. Based on benchmark studies, risks for sustainable growth are identified and addressed. Further, early warning systems are being implemented. They focus on changes in the shareholder structure, trading volumes of the company’s shares and related financial instruments, changes in the investment and voting policies of major shareholders, as well as analysts’ reports or critical statements by stakeholders. Finally, defence manuals are being compiled that set out in detail which internal departments and which external advisers are to be involved in the event of an imminent attack, which steps need to be taken at a specific phase of a campaign and which approaches should be followed with respect to the activist, the key shareholders and the media.

Thus, in the long run, shareholder activism could arguably have a steering effect, also leading to more transparency and efficiency of the German market. From a macro perspective, creating value for shareholders and transparency for market participants can only be perceived as positive. When becoming the target of an activist campaign, however, this assessment differs. Awareness and preparation allow for an overall positive effect to materialise, while not individually paying too high a price for this to happen.
Chapter 5

INDIA

Nikhil Narayanan¹

I OVERVIEW

India’s corporate and regulatory environment has traditionally not been conducive to shareholder activism. First, there is little separation of ownership and management in India. Many Indian listed companies are controlled by ‘promoters’ (i.e., their original founders). The advent of listing often has little effect on their management and they often continue to be run as family businesses, with the interests of public (or non-promoter) shareholders being secondary to those of the promoters. Second, although India has a public mergers and acquisitions (M&A) market and a supporting regulatory framework, until recently, Indian market dynamics meant that most promoters historically did not fear the loss of control (even if their businesses did not perform). Third, the institutional investor base in India is not as organised as in the United States or the United Kingdom and has traditionally been passive. Finally, previous laws and the historic judicial approach has not been supportive of classical shareholder activism.

However, these historic dynamics are changing. The Companies Act 2013 (CA 2013), and certain regulations issued by India’s securities markets regulator, the Securities and Exchange Board of India (SEBI), has, apart from raising the bar on governance matters, improved minority shareholder rights, created new shareholder remedies and codified directors’ duties. Various proxy firms are now active in the Indian market and investors have become more adept at using the media.

Consequently, investors have been increasingly more willing to make their voices heard. Much of this dissent has been event-driven (opposing related party transactions, share repurchases and acquisitions) and limited to the larger listed companies. However, since the last quarter of 2016, there has been a broadening of shareholder engagement to cover other areas such as executive remuneration, strategy, succession planning and business underperformance. This period has seen Tata Group and Infosys, two of India’s better governed groups, undergo changes in management; the CEO of ICICI Bank face investigations; a director of Fortis Healthcare being removed by its shareholders; and the chair of one of India’s leading financial groups and one of the leading promoters in India have faced significant opposition to their reappointment as directors. There have been recent instances of investors seeking board positions and challenging transactions that are perceived to have enriched promoters. Also, though long-term institutional investors historically led shareholder engagement, certain

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recent activist campaigns have been led by other funds. In addition, there have been two recent high-profile contested and hostile public M&A transactions. Finally, international activist funds have started to invest in various Indian listed companies.

These dynamics have chipped away at the general position of strength of controlling shareholders in the Indian market, which does, nevertheless, remain. Therefore, although shareholder activism is nascent in comparison with the United States and the United Kingdom, it is clear that promoters can no longer take their shareholders for granted.

II LEGAL AND REGULATORY FRAMEWORK

i The ability of shareholders to appoint and remove directors

In India, directors are appointed by shareholders, just as they are in many other common law jurisdictions. However, there is no mandatory annual re-election requirement for directors of public companies (whether listed or otherwise). Independent directors are appointed for a term of up to five years, and, absent any special provisions in the articles (which are uncommon), one-third of all non-independent directors are subject to retirement and re-election by rotation every year. This contrasts with the position in England and Wales, where the requirement under the UK Corporate Governance Code on a ‘comply or explain’ basis for all FTSE 350-listed companies to annually reappoint directors serves as a powerful governance tool to keep directors in check. Historically, investors have not sought board access outside situations such as private equity investments but recently various funds have sought board appointments (see Section IV).

In addition to the traditional board appointment route discussed above, investors do have access to board representation in Indian listed companies in a manner that is not possible in England and Wales. An investor can seek board representation as a ‘small shareholder’ by acquiring a very small number of shares and then petitioning the company with the support of the lower of 1,000 other small shareholders or 10 per cent of the total number of small shareholders. There has been one recent attempt by activist investors to use this provision. In August 2017, Alembic (a pharmaceutical company) received a proposal from over 1,000 small shareholders, led by Unifi Capital, seeking the appointment of a small shareholder director. Although the board successfully resisted this (as the small shareholders were allegedly clients of Unifi Capital), this attempt illustrates that activists are thinking creatively about gaining access to board seats.

The removal of a director prior to expiry of his or her term normally requires an ordinary shareholders’ resolution (i.e., approval by a simple majority), and the director must

2 Section 149(10) of CA 2013.
3 Section 152(6)(c) of CA 2013. There is also a rarely used alternative in Section 163 of CA 2013, which allows for the concept of proportionate representation for at least two-thirds of the board.
4 Section 151 of CA 2013 and Rule 7 of the Companies (Appointment of Directors) Rules 2014. For these purposes, a ‘small shareholder’ is one who holds shares in a listed company, the nominal value of which is less than 20,000 rupees or any other government-prescribed sum.
5 Ingovern, India Proxy Season 2017.
first have been given an opportunity to be heard.\textsuperscript{6} In May 2018, institutional investors and certain funds removed a director of Fortis Healthcare in this manner (see Section IV). This is perhaps the first example of an activist campaign leading to changes on the board.

There is also currently no impediment to companies removing additional responsibilities or designations conferred upon directors. This issue attracted attention in the recent corporate leadership tussle in Tata Sons (see Sections III and IV), where the company’s articles did not require shareholder approval for the removal of the incumbent from his role as chair of the board (although the removal of his directorship did need shareholder approval).

\textbf{ii \quad Control over executive remuneration}\n
Control over executive compensation has recently emerged as a topical area. In September 2018, shareholders voted down the compensation of Neeraj Kanwar (managing director and promoter of the Apollo Group). A revised proposal resulting in a 30 per cent reduction in his compensation was subsequently approved. There have also been other instances in India of shareholders voting down executive remuneration packages, such as the rejection of executive remuneration resolutions in Tata Motors’ annual general meeting in 2014 and the withdrawal of executive remuneration resolutions by Seamac and ARSS Infrastructure in 2011.\textsuperscript{7} Also, in early 2017, Infosys, one of India’s leading IT companies, was criticised by its founders for the levels of severance payments made to exiting executives (see Section IV).\textsuperscript{8}

Also, due to the distress in the financial sector in India, the alignment of incentives and compensation in financial institutions has also become an area of regulatory focus. In February 2019, the Reserve Bank of India published a discussion paper (that would apply to private and foreign banks) recommending minimum levels of variable pay and caps on aggregate compensation, and recommendations that banks put in place clawback provisions. There has also been one instance of a private bank (ICICI Bank) seeking to claw back past compensation from a former CEO following allegations of wrongdoing.

\textbf{iii \quad The ability to requisition shareholders’ meetings and postal ballots}\n
In certain circumstances, shareholders have the ability to ‘go over the heads of the board’. Shareholders holding at least one-tenth of voting paid-up share capital can notify the board to requisition an extraordinary general meeting (EGM),\textsuperscript{9} and if the board does not call the EGM within 21 days of the requisition notice, the shareholders may themselves call the EGM (to be held within three months).\textsuperscript{10} If the directors fail to convene an EGM following a valid requisition notice, they become liable for any requisition-related expenses.\textsuperscript{11} Although this right provides shareholders with a useful tool, its successful use by activist shareholders in the Indian context may be challenging. Indeed, the requisitioning of an EGM was used in the recent Tata Sons affair to strengthen the promoter’s position.

\textsuperscript{6} Section 169(1) of CA 2013. The reference to ‘normally’ is because this does not apply to directors appointed by proportional representation (which is very uncommon).

\textsuperscript{7} Allirajan Muthsamy, ‘Shareholder Activism stalls promoter moves’, \textit{The Economic Times}, 5 July 2014.

\textsuperscript{8} With regard to shareholder controls, Section 197 of CA 2013 and Regulation 17(6)(c) of the Listing Regulations both require compensation to be approved by shareholders if they exceed certain thresholds.

\textsuperscript{9} Section 100(2)(a) of CA 2013.

\textsuperscript{10} Section 100(4) of CA 2013.

\textsuperscript{11} Section 100 (6) of CA 2013.
Indian company law does not expressly provide shareholders the ability to pass written resolutions, but there are provisions permitting postal ballots. In 2017, a public shareholder sought appointment as a non-executive director unsuccessfully through electronic voting (see Section IV.iv).

iv Shareholders’ influence over corporate strategy

Under Indian company law, directors are delegated the authority to manage company affairs, subject to the satisfaction of their duties. Public campaigns by third parties to encourage a change of strategic direction are uncommon, but shareholders do have certain powers to keep management and promoters in check.

Although there is no Indian equivalent as comprehensive as the ‘class tests’ under the UK Listing Authority’s Listing Rules, the SEBI (Listing Obligations and Disclosure Requirements) Regulations 2015 (the Listing Regulations) require shareholders’ special resolutions (i.e., a 75 per cent approval threshold) for any disposal of a controlling interest in a ‘material subsidiary’ or any transfer of a significant portion of the subsidiary’s assets.

Also, regardless of listing status, minority shareholders holding more than 25 per cent of a company’s voting power can influence a number of transactions that are subject to special resolution approval requirements. These include the issue of new shares by all companies, public or private, on a non-preemptive basis (which will affect non-cash consideration in M&A transactions), any transfer of an undertaking by a public company (which is the most direct statutory control over M&As) and any borrowing by a public company in excess of that company’s paid-up share capital, free reserves and securities premium (which will affect the financing of M&A transactions).

In addition, qualifying related party transactions require shareholder approval (simple majority) under both company law and the Listing Regulations. The regimes are overlapping and similar but although the company law rule applies to certain qualifying related party transactions (those satisfying certain threshold tests) the Listing Regulations apply to all related party transactions that are considered ‘material’ by a listed company (transactions whose value exceeds 10 per cent of annual turnover are deemed material).

Finally, the Listing Regulations do set out certain principles that have relevance in an activist context, including the rights of shareholders to ‘participate in, and to be sufficiently informed of, decisions concerning fundamental corporate changes’ and a principle requiring the ‘protection of minority shareholders from abusive actions by, or in the interest of, controlling shareholdings either directly or indirectly, and effective means of redress’. These principles have not been used by activist shareholders, but boards of listed companies do need to be wary of potential investor complaints to SEBI in the future.

12 Section 110 of CA 2013 and Rule 22 of the Companies (Management and Administration) Rules 2014.
13 Sections 62(1)(b) and 62(1)(c) of CA 2013. Private companies and the International Financial Services Centre public companies offering shares to employees under an employee benefits scheme need only pass an ordinary resolution (and not a special resolution).
14 ‘Undertaking’ is defined as any undertaking in which the company’s investment exceeds 20 per cent of the company’s net worth (as of the audited balance sheet of the preceding financial year) or that generated at least 20 per cent of the company’s total income during the preceding financial year.
15 Section 180(1)(c) of CA 2013.
16 Section 188 of CA 2013.
17 Regulation 23(4) of the Listing Regulations.
v The position of shareholders and boards in public M&A situations

In theory, Indian law confers considerable power on minority shareholders in public M&A situations. There are restrictions on the board taking frustrating action and so defences such as poison pills are difficult to implement. In addition, although there is no formal obligation under Indian takeover regulations to treat shareholders equally in a bid situation, equality of treatment is a guiding principle under the Listing Regulations, so it would be difficult for a target to provide selective information to certain bidders.

Also, just as in England and Wales, M&A transactions can be structured through court schemes, which need to be approved by 75 per cent in value of the shareholders. In contrast with England and Wales, there is no practice of obtaining irrevocable undertakings in the Indian public M&A market, so there is no further segregation of classes of shares (beyond the classes that already exist). Therefore, shareholders holding just over 25 per cent will be able to block a scheme.

Despite the availability of these rights, hostile takeovers have historically been extremely rare. However, 2018 saw a contested public M&A transaction involving Fortis Healthcare, in which shareholders succeeded in removing a director (see Section IV). More recently, in 2019, Larsen & Toubro completed a hostile offer for Mindtree. It is still too early to draw broad conclusions as to the broader openness of the Indian market to hostile public M&A transactions, but these are encouraging signs.

vi Legal remedies available to shareholders

The advent of CA 2013 is perceived as having significantly improved shareholders’ legal remedies in India. Although it is true that new remedies have been created, the lengthy nature of the litigation process in India and the judicial history of enforcing shareholder rights should temper expectations.

CA 2013 provides for slightly amended versions of remedies under the preceding Companies Act 1956 (CA 1956). For example, the ability of minority shareholders to claim relief against oppression and mismanagement by the majority on the ground that the company’s affairs are being conducted in a prejudicial manner, and the ability of shareholders with the support of at least 100 members, or shareholders holding 10 per cent voting power, to apply to the National Company Law Tribunal (NCLT) in certain circumstances to seek an investigation. However, the history of CA 1956 indicates that claimants found success difficult. There is limited experience under CA 2013, but the Tata Sons affair (see Sections III and IV) suggests that utilising these provisions may not be straightforward either.

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18 Regulation 26 of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations 2011.
19 In a board meeting of 27 June 2019, SEBI has recently permitted shares with superior voting rights in listed companies. This may open up an avenue for takeover defences, although there are a number of safeguards (such as a five-year sunset provision, limitation on the companies that can issue such shares and also restrictions on the use of superior voting rights in relation to related party contracts and other matters that SEBI may notify), which may limit their application in this context.
20 Section 230(6) of CA 2013.
21 Section 213 of CA 2013.
However, CA 2013 has introduced a significant change in that Indian company law now includes a ‘class action’ concept. Shareholders who hold a threshold level of shareholding can institute class action suits if they believe that the company’s management or affairs are being conducted in a manner that is prejudicial to the interests of the company or its shareholders. The NCLT has the power to issue a broad range of directions and can also order damages. This moves Indian company law away from the restraints of the exceptions to the rule in Foss v Harbottle. However, given the state of the litigation process in India, the effectiveness of this remedy in practice remains to be seen.

vii Other issues

Just as in other jurisdictions, shareholders need to be aware of insider dealing concerns when engaging with a listed company, under the SEBI (Prohibition of Insider Trading) Regulations 2015, as well as the SEBI regulations restricting manipulative, fraudulent and unfair dealings in shares.

With regard to ‘concert party’ issues, these have been less relevant in India in comparison to other jurisdictions. The test of ‘concertness’ under Indian takeover regulations is by reference to a common objective to acquire shares or voting rights in, or control over, a listed target and shareholders rarely come together for this purpose in India (they usually cooperate on corporate actions requiring shareholder approval).

Finally, although companies do not have a general obligation to provide investors with details of specific shareholders’ holdings, companies do need to maintain a register of members that is available for inspection. As far as listed public companies are concerned, certain significant acquisitions and disposals do need to be reported to the market and there are periodic disclosures of promoter positions. In addition, like other jurisdictions, Indian company law has recently introduced the concept of a register of significant beneficial owners, which shareholders are able to inspect.

III KEY TRENDS IN SHAREHOLDER ACTIVISM

These are still very early days for shareholder activism in India but some initial trends are summarised below.

i Most effective strategies

Historically, litigation strategies have proved to be less effective. For instance, the litigation strategy employed by the Children’s Investment Fund (TCI) against the directors of Coal India for breach of fiduciary duties between 2012 and 2014 did not meet with success. In 2014, TCI withdrew its court claims and sold its Indian holdings. Equally, recent attempts by

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23 Section 245 of CA 2013.
24 The threshold for shareholders to be able to trigger this protection (i.e., a shareholding percentage) is the lower of 100 shareholders or a percentage of shareholders to be prescribed. Draft rules had proposed a 10 per cent threshold for this latter threshold, but this proposal is, at the date of publication, not yet in force.
25 (1843) 2 Har 361. CA 1956 did not recognise derivative action, so claimants needed to establish a case on the basis of common law. Academic studies have shown that this had little success (see note 21).
26 Section 88 of CA 2013.
27 Section 90 of CA 2013.
Cyrus Mistry, the deposed chair of Tata Sons, to seek relief under Sections 241 and 244 of CA 2013 (for oppression and mismanagement) were dismissed by the NCLT,²⁸ and the Bombay High Court refused to entertain a separate representative suit against Ratan Tata (Cyrus Mistry’s predecessor) for damages.²⁹ Similarly, litigation by minority shareholders of Cadbury in relation to the valuation in a minority squeeze-out scheme failed as the court ruled against the minority shareholder group.³⁰ A more effective technique that certain shareholders have used is to register complaints with regulatory authorities.

Given that promoters still remain powerful, the more effective strategies are likely to be those that involve investors working with the promoters or seeking to curb obvious abuses, for which there is likely to be greater institutional investor and regulatory support (see Section IV).

ii Proxy firms

Several proxy advisory firms are now active in India. They regularly issue voting recommendations and maintain high visibility. Proxy advisory firms recommended that shareholders vote against the Tata Motors executive remuneration resolutions in 2014 and claimed credit for the outcome.³¹ They have also been vocal on governance matters, such as the leave of absence taken by the CEO of ICICI Bank (while allegations of impropriety are investigated). Although they do not have the same level of influence as in the United States, they are emerging as important market participants in India.

Although regulated by SEBI under the SEBI (Research Analysts) Regulation 2014,³² these firms have also faced criticism around perceptions of their own conflicts of interest. SEBI has recommended additional safeguards in this regard in a recent report (see Section V).

iii Role of the media

Although public campaigns by shareholders seeking strategic changes are uncommon,³³ the media has emerged as a key player, for instance, in the engagement that Narayana Murthy, a founder of Infosys, had with its board in 2016 and 2017 (see Section IV.i).

iv Greater investor participation

In the past, collective action issues held back shareholder activism, with investors preferring to simply exit their investments. However, mutual funds and other long-term investors in the Indian market now more actively engage with promoters (see Section IV). Part of this has

²⁹ Pramod Premchand Shah and others v. Ratan N Tata and others, 2018 (1) ALLMR 255.
³⁰ Khushboo Narayan, ‘Bombay HC asks Cadbury to pay Rs 2,014.50 per share for buyback’, Livemint, 18 July 2014.
³² Proxy firms are required to register with SEBI, although certain foreign proxy firms are not required to do so. However, SEBI has recently recommended that foreign firms also follow a common code of conduct with domestic proxy firms on a ‘comply or explain’ basis (see Section V).
³³ The only real example was in 2012 when CLSA wrote to the then CEO of Infosys, challenging its business model, but that did not result in any meaningful change or shareholder engagement.
been driven by regulation. Indian regulated mutual funds are now required by SEBI to vote on resolutions involving their portfolio companies and provide voting reports on a quarterly and annual basis.\textsuperscript{34} Efforts by India’s insurance regulator to encourage market engagement by insurance companies (as summarised in Section V) are likely to continue this trend.

In addition to these long-term investors, certain funds have sought to take activist positions in various listed companies, seeking board appointments (albeit unsuccessfully) and successfully removing a director (in the case of Fortis Healthcare).

IV RECENT SHAREHOLDER ACTIVISM CAMPAIGNS

i Fissures in corporate India

Ironically, in two high-profile cases, activism has been used by founders or key shareholders against management.

In late 2016 and 2017, Infosys, a US and Indian listed IT company, faced a period of sustained pressure from its original founder shareholders, which ultimately contributed to the resignation of its CEO. The founders criticised the level of severance payments paid to certain departing executives and the US$200 million Panaya acquisition, which led to an investigation by an international law firm (which reportedly exonerated the management team). Following this, in July 2017, the board of Infosys indicated its willingness to work with its founders. However, on 18 August 2017, Vishal Sikka, the incumbent CEO, resigned. Without naming the founders, he indicated that the criticism he faced made his role untenable.

The Tata conglomerate was also subject to a battle for control in late 2016 and early 2017. Following differences between Cyrus Mistry, then chair of Tata Sons, and Ratan Tata, the former chair, on 24 October 2016, Cyrus Mistry was removed from his position as chair through a board resolution. This was followed by allegations and counter-allegations between the two individuals. Cyrus Mistry was removed as director from the various Tata Group companies between November and December 2016 and, ultimately, removed as a director of Tata Sons pursuant to an EGM held on 6 February 2017. Various legal challenges by Cyrus Mistry did not succeed.

ii Blocking transactions

There have been a number of instances where shareholders have been able to block transactions adverse to the shareholders’ interests.

Since shareholders with an interest in related party transactions cannot vote to approve them, minority shareholders are sometimes very strongly placed. For instance, in 2018, shareholders of Tata Sponge Iron Limited, holding just 3.77 per cent of the votes, were able to defeat the related party approval resolutions for this reason. Also, in July 2017, the shareholders opposed a related party transaction between Raymond Limited and its promoters (involving the sale of an asset at a significant undervalue). More than 97 per cent of the votes cast were against the transaction.\textsuperscript{35}


\textsuperscript{35} Ingovern, India Proxy Season 2017.
Similarly, in November 2015, after pressure from its shareholders, Sun Pharma withdrew from a potential US$225 million investment in the United States.36

Finally, in 2016, HDFC Standard Life Insurance Company Limited and Max Life Insurance Company Limited announced a merger to create the largest private insurer in India. One of the deal terms was the payment of a 8.5 billion rupee non-compete fee to one of the promoters. Ultimately, the deal did not complete owing to regulatory concerns, but various proxy firms had recommended that investors oppose the payment of this fee.

iii Forcing renegotiation of terms
In certain cases, shareholders have been able to force a renegotiation of terms in large transactions.

In 2014, Maruti Suzuki’s proposed manufacturing contract with a shareholder, Suzuki, was criticised by public shareholders and proxy firms for failing to seek shareholder approval for the transaction. Some of the largest funds in India, HDFC Asset Management, Reliance Capital Asset Management, ICICI Prudential Asset Management, UTI Asset Management, DSP Blackrock Investment Managers, SBI Funds Management and Axis Asset Management all wrote a letter to Maruti Suzuki challenging the proposed transaction. Even Life Insurance Corporation of India, a state-owned insurer, known to be a passive investor, reportedly engaged with the company in this regard.37 Press reports suggest that the transaction terms were modified, and the company ultimately did obtain shareholder approval, as a related party transaction matter, in 2015.

Similarly, in August 2014, the shareholders of Siemens India voted down the proposed sale of its metal technologies business to Siemens AG for 8.57 billion rupees. Siemens India amended the terms of the transaction in November 2014, such that the sale price was increased to 10.23 billion rupees,38 and finally obtained shareholder approval in December 2014.

iv Changes to board composition
In the past, certain activist funds have sought board seats, but this has proved hard to achieve. For instance, the attempt of a 20 per cent investor to seek board representation in relation to MRO-TEK and the attempt by Florintree Advisors to seek a seat on the board of PTC India did not succeed. Some investors have persisted in unusual ways, such as the provisions for a ‘small shareholder’ director by Unifi Capital (see Section II).39

In certain cases, shareholders have opposed the reappointment of senior incumbent management as directors. For instance, in July 2018, 22.64 per cent40 of the shareholders of HDFC Limited voted against the reappointment of Deepak Parekh, the group chair, as a director. Similarly, in September 2018, a significant number of investors opposed the

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39 Ingovern, India Proxy Season 2017.
re-election of Kumar Mangalam Birla (head of Aditya Birla Group) to the board of UltraTech Cement.41 Although both reappointments were ultimately approved, this scale of opposition in relation to such senior figures in corporate India is noteworthy.

Litigation has also occasionally been attempted as a strategy to attempt to force a change in board composition, although these are harder to achieve. For instance, two investors (IDBI Trusteeship Services and Horizon Fund) litigated to prevent a proposal by Religare to invest 5 billion rupees in a loss-making subsidiary, but IDBI exited its investment and the promoters of Religare have raised counter-claims. Investors have had one notable success in removing a director of Fortis Healthcare in May 2018.42 This was in the context of investor concerns as to the board assessment of certain bids for the company, so this is a significant landmark in relation to shareholder activism in India.

V  REGULATORY DEVELOPMENTS

Four regulatory developments are likely to have a bearing on shareholder activism in India going forward.

First, in March 2017, the Insurance Regulatory and Development Authority of India published its Stewardship Code relating to investments by insurance companies in listed securities. These require insurers to have a clear engagement strategy (of their own choosing) with listed companies. There are also other principles requiring insurers to have a policy governing collaborations with other institutional investors and also to have a clear voting policy. These are likely to encourage insurers, who constitute a significant proportion of the institutional investor community in India, to be more engaged.

Second, SEBI is implementing a number of recommendations of the Kotak Committee (constituted in June 2017, which suggested various reforms to improve the governance of listed companies, among others). It is hoped that these changes will have a positive impact on the corporate governance landscape in India.

Third, the Indian Finance Minister in her budget speech in July 2019 suggested that SEBI consider a public float threshold of 35 per cent (rather than the current 25 per cent). This is just a recommendation and it is unknown whether SEBI will implement it, but if so, this will considerably increase the influence of independent and activist investors.

Fourth, on 29 July 2019, SEBI published recommendations on the further regulation of proxy firms. SEBI appears to be mindful of ensuring accountability without over-regulation. For instance, with regard to conflict situations, the emphasis is on disclosure and self-regulation through ‘Chinese Walls’. SEBI has also raised the prospect of a UK-style ‘stewardship code’ and has recommended a code of conduct for proxy firms, in both cases, on a ‘comply or explain’ basis. SEBI is also considering making the principles around the fiduciary duties of proxy firms more explicit. The proposed changes, if implemented, will improve transparency as the ‘light touch’ approach is measured and sophisticated. However, it remains to be seen whether this will be sufficiently robust to address conflicts in the Indian context.

VI OUTLOOK

Although nascent, shareholder activism in India is evolving quickly. The changing shareholder registers of listed companies, with greater participation by financial investors, and the financial distress among a number of promoter groups are driving change. In addition, there is some evidence that international activist investors are starting to engage with some listed companies in India.

That said, this has, so far, been limited to the bigger names in corporate India and activism is less developed than in the United States. Therefore, since these are still early days for activists, it is likely that some adaptation of activist strategies may be necessary in the Indian context. In response to the growth of activism, shareholder engagement by corporate India will also need to evolve. Boards of Indian companies should start considering more meaningful shareholder engagement by setting up investor relations teams, improving their governance systems and providing information to the market to support board strategy, particularly as far as large transactions are concerned. In the years ahead, corporate India will need to adapt accordingly.
Chapter 6

JAPAN

Akira Matsushita1

I OVERVIEW

In recent years, the corporate governance of listed companies in Japan has gradually changed for various reasons. Japan’s Corporate Governance Code (the Governance Code), issued in June 2015, and Japan’s Stewardship Code (the Stewardship Code), issued in February 2014, have worked as ‘the two wheels of a cart’ to promote and achieve effective corporate governance. The management of listed companies in Japan may also be experiencing changes because the ownership of shares in listed companies in Japan by foreign entities has increased (29.1 per cent of the shares in all listed companies in Japan were owned by foreign entities as at 31 March 2019)2 in comparison with the ownership of such shares by individual shareholders, which has decreased. Under such circumstances, shareholder activism in Japan has grown in recent years. As a result, the management of listed companies in Japan need to consider the possibilities and effects of shareholder activism when managing these companies.

This chapter discusses details of shareholder rights and shareholder activism with respect to a stock company that has shares listed on a financial instruments exchange.

II LEGAL AND REGULATORY FRAMEWORK

i Shareholder rights

In Japan, rights of shareholders are provided under the Companies Act (Act No. 86 of 26 July 2005). Outlines of the shareholder rights that may typically be exercised by shareholders in the context of shareholder activism, among others, are set out below.3

Inspection rights

Shareholders have the right to request a company to provide relevant access for them to inspect or copy the shareholder registry, with certain exceptions.4 This request right enables activist shareholders to access the information on other shareholders in the company when waging a proxy fight.

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1 Akira Matsushita is a partner at Mori Hamada & Matsumoto.
3 The numerical requirements under the Companies Act that are described below may be changed by a company by setting out the changed numerical requirements in the company’s articles of incorporation.
4 Article 125(2–3) of the Companies Act.
Shareholders also have the right to request a company to provide relevant access for them to inspect or copy minutes of board of directors’ meetings by obtaining the permission of the court if access is necessary to exercise the rights of a shareholder.\(^5\) Shareholders having 3 per cent or more of the votes of all shareholders or shareholders having 3 per cent or more of outstanding shares have the right to request the company to provide relevant access for them to inspect or copy accounting books, with certain exceptions.\(^6\) Activist shareholders may gather information by utilising these inspection rights for use in gaining leverage against or exerting pressure on the management of the company.

**Shareholder proposals**

The Companies Act provides shareholder proposal rights that are quite favourable to shareholders. A shareholder of a listed company who owns, consecutively for the preceding six months or more, at least 1 per cent of the voting rights of all shareholders in the company or at least 300 votes of the voting rights of all shareholders in the company may demand directors of the company to present proposals submitted by the shareholder as an agenda at the shareholders’ meeting and demand the directors to describe the summary of the proposals in convocation notices of the shareholders’ meeting by submitting the demand to the directors no later than eight weeks prior to the day of the shareholders’ meeting.\(^7\) Additionally, a shareholder attending the shareholders’ meeting may submit proposals at the meeting with respect to the matters that are within the purpose of the shareholders’ meeting.\(^8\)

In this way, a shareholder who submits proposals to the company can deliver the proposals to the other shareholders at the company’s expense, and cause the other shareholders to vote on the shareholder proposals using the voting card mailed by the company without conducting a proxy solicitation by itself at its expense.

In response to recent cases of abusive exercises by shareholders of such shareholder proposal rights, in January 2019, the subcommittee of the Legislative Council of the Ministry of Justice issued an outline of amendments to the Companies Act to limit to 10 the number of proposals that each shareholder can demand the directors to describe, in the summaries thereof, in the convocation notice of the shareholders’ meeting (whereas under the current Companies Act, the number of proposals that an eligible shareholder can submit is unlimited), and to enable a company to refuse, among other matters, shareholder proposals that may significantly hinder appropriate operation of the shareholders’ meeting such that it would impair the common interests of the shareholders.

**Calling of a shareholders’ meeting**

A shareholder of a listed company who owns, consecutively for the preceding six months or more, at least 3 per cent of the voting rights of all shareholders in the company may demand the directors of the company to call a shareholders’ meeting regarding any matter that the shareholder calling the meeting is entitled to vote on. If the calling procedure is not effected without delay after the demand, or the notice calling the shareholders’ meeting designating

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5. Article 371(2) of the Companies Act.
7. Articles 303 and 305 of the Companies Act.
the date of the shareholders’ meeting to fall within the eight weeks of the date of the demand is not dispatched, the shareholder who made the demand may call the shareholders’ meeting by itself with the permission of the court.  

**Enjoinment of acts of directors**

If a director of a company engages, or is likely to engage, in any act in violation of laws and regulations or the articles of incorporation, and if the act is likely to cause irreparable damage to the company, a shareholder who owns the shares consecutively for the preceding six months or more may enjoin the director’s act, usually by obtaining an order of provisional disposition from the court. Violations of a director’s duties of care and loyalty may constitute a violation of such laws and regulations.

**Derivative actions**

A shareholder who owns shares consecutively for the preceding six months or more may demand that the company file an action to recover for damages and liabilities caused by its directors due to their violation of their duty of care and loyalty, and if the company does not file the action within 60 days of the date of the demand, the shareholder may file a derivative action on behalf of the company.

**Dissenting shareholders’ appraisal rights**

Shareholders who object to certain agenda items at the shareholders’ meeting, such as a merger, certain consolidation of shares or certain amendments to the articles of incorporation that may be related to a transaction to squeeze out minority shareholders from the company, may demand that the company purchase their shares in the company at a fair price. If dissenting shareholders and the company cannot reach agreement on the price of the shares within a certain period, the dissenting shareholders or the company may file a petition to the court for a determination of the price.

**ii Regulations on shareholder activism**

**Large-scale shareholding report**

A shareholder is generally required to file a large-scale shareholding report with the relevant local finance bureau within five business days of the shareholder’s shareholding ratio in a listed company exceeding 5 per cent under Article 27-23 of the Financial Instruments and Exchange Act (Act No. 25 of 13 April 1948) (FIEA). The shareholding ratio is calculated by aggregating shares held by the shareholder with any other shareholders with whom the shareholder has agreed to jointly acquire or transfer shares in the company, or to jointly exercise the voting rights or other rights as shareholders of the company (a joint holder). After filing the report, if the shareholding ratio increases or decreases by 1 per cent or more, an amendment to the report must be filed within five business days of the date of the increase or decrease. Certain financial institutions that do not intend to take actions to materially influence the business activities of the company are required to file the report only twice a month.

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9 Article 297 of the Companies Act.
10 Article 360 of the Companies Act.
11 Article 847 of the Companies Act.
The Financial Services Agency (FSA) expressed its position that if different shareholders communicate to each other their plans to exercise their voting rights in a certain manner and their plans happen to be the same, this does not cause the shareholders to be deemed as joint holders because an ‘agreement’ means an undertaking to act (whether in writing or orally, and explicitly or implicitly) rather than the mere exchange of opinions. Therefore, activist shareholders may not be required to file a large-scale shareholding report as joint holders even if they communicate with each other privately and act in the same manner without explicit agreement.

Under the FIEA, rights to request delivery of shares under a sales and purchase contract, as well as options to purchase shares and borrow shares, are subject to the large-scale shareholding reporting obligations. However, the holding of equity derivatives that are cash-settled and that do not involve the transfer of the right to acquire shares would likely not trigger the reporting obligations. The FSA released guidelines that provide that derivatives that transfer only economic profit and loss in relation to target shares, such as total return swaps, are generally not subject to the disclosure obligations, provided that holding such cash-settled equity derivatives may trigger such obligations if a holder purchases long positions on the assumption that a dealer will acquire and hold matched shares to hedge its exposure.

**Proxy regulations**

Any person who intends to solicit a proxy with respect to shares in a listed company shall deliver a proxy form and reference documents containing the information specified in the Cabinet Office Ordinance to the person solicited. However, a solicitation of a proxy with respect to shares in a listed company that is made by persons other than the company or the officers, including the directors and the executive officers, thereof and in which the solicited persons are fewer than 10 is exempt from the proxy regulations.

When a solicitor has delivered the proxy form and reference documents to the solicited persons, the solicitor shall immediately submit a copy of the documents to the relevant local finance bureau, provided that if the reference documents and form of voting card are delivered by the company to all of the shareholders of the company who are entitled to vote with respect to the relevant shareholders’ meeting pursuant to the Companies Act, the solicitor does not have to submit those documents to the relevant local finance bureau. No solicitor may make a solicitation of a proxy by using a proxy form, reference documents or any other documents, or an electromagnetic record, in each case that contains false statements or records on important matters, or that lacks a statement or record on important matters that should be stated, or a material fact that is necessary to avoid a misunderstanding.

### iii The Governance Code and the Stewardship Code

The Governance Code has had a major effect on the corporate governance of listed companies in Japan since its release in June 2015. The Governance Code does not adopt a rule-based approach.

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13 FSA, Q&A Regarding Large Scale Shareholding Report of Share Certificates, etc., 31 March 2010, at 10.
approach, rather, it adopts a principle-based approach that is not legally binding on companies with a ‘comply or explain’ approach (i.e., either comply with a principle or, if not, explain the reasons why the company is not complying with the principle).

The Governance Code provides that companies should, positively and to the extent reasonable, respond to requests from shareholders to engage in dialogue, and the board of directors should establish, approve and disclose policies relating to measures and organisational structures that aim to promote constructive dialogue with shareholders. Specifically, the senior management or directors, including outside directors, are expected to be more directly involved in dialogue with shareholders. Furthermore, although listed companies cannot accurately know their substantive shareholder ownership structure without conducting shareholder identification searches owing to indirect shareholding – such as shareholding through trusts or custodians – the Governance Code provides that companies should endeavour to identify their shareholder ownership structure as necessary to promote constructive dialogue with their shareholders.

The Governance Code was amended on 1 June 2018. The amended Governance Code expressly provides that companies should disclose their policies regarding the reduction of cross-shareholdings. It also provides that the board should annually assess whether to hold each individual cross-shareholding, specifically examining whether the purpose is appropriate and whether the benefits and risks from each holding cover the company’s cost of capital.

The Stewardship Code was amended on 29 May 2017 and the amendment provides that institutional investors should disclose their voting records for each of its investee companies on an individual agenda item basis to enhance visibility of the consistency of the voting activities of institutional investors with their stewardship policies. This amendment may affect the voting behaviour of institutional investors and, consequently, supportive votes for listed companies may decrease.

The amended Stewardship Code also provides that in addition to institutional investors engaging with investee companies independently, it would be beneficial for the institutional investors to engage with investee companies in collaboration with other institutional investors (collective engagement) as necessary.

iv Rules for directors

Directors facing shareholder activism must abide by their duties of care and loyalty, and treat all shareholders equally under the Companies Act.

Settlement agreements

Settlement agreements with activist shareholders, which may include agreements regarding agenda items of shareholders’ meetings, the exercise of voting rights and restraint in acquiring additional shares in the company, have not often been entered into between activist shareholders and listed companies in Japan. There are several precedents of such settlement agreements though, such as the case of Aderans Holdings Ltd entering into an agreement with Steel Partners, a US-based hedge fund, regarding a slate of directors to be submitted to the extraordinary shareholders’ meeting in 2008.

Since the Companies Act prohibits a company from giving any property benefits to any person in connection with the exercise of shareholder rights, including voting rights,\(^\text{15}\)

\(^{15}\) Articles 120 and 970 of the Companies Act.
the company generally cannot agree to reimburse any costs incurred by activist shareholders from their shareholder activism campaigns in connection with their entering into any voting agreement.

**Takeover defence measures**

The board of directors of a company may adopt takeover defence measures to deter the building of a large stake in the company by activist shareholders. Most common takeover defence measures adopted by Japanese listed companies are the ‘advance warning’ type of defence measures. Under such defence measures, a company establishes rules that must be followed by any potential acquirer who intends to acquire more than a certain level of shares (typically, 20 per cent) in the company, and the company publicly announces the rules before an acquirer actually emerges. No rights or stock options are issued upon the adoption of such rules. If an acquirer violates the rules, or an acquisition is considered to be harmful to the corporate value of the company or the common interest of the shareholders of the company, the company would allot stock options to all shareholders without contribution that are only exercisable by, or callable for new shares by the company from, those shareholders other than the acquirer.

The number of takeover defence measures adopted by listed companies has decreased in recent years (whereas 567 listed companies had adopted the measures as at 2009, 386 listed companies had adopted the measures as at 2018, due to opposition by institutional investors).

### III KEY TRENDS IN SHAREHOLDER ACTIVISM

#### i Profile of activist shareholders

Activist shareholders who engage in shareholder activism are mainly domestic and global hedge funds, and individual investors. In particular, in recent years, more foreign activist funds have invested in the Japanese market. Additionally, institutional investors that have not been recognised as activist shareholders have tended in the past few years to become more aggressive in making demands on the management of companies that are similar to those typically made by activist shareholders to management.

#### ii Types of companies targeted by activist shareholders

Activist shareholders have targeted companies of different sizes and in all types of industries. In particular, activist shareholders are more likely to target companies that own a large amount of surplus cash or other assets, have a low return on equity (ROE) or have share prices that are undervalued by the market. Until the end of 2007, activist shareholders often focused on building large stakes in small-cap or medium-cap companies to apply pressure on the managements of those companies. In recent years, activist shareholders have also been targeting large prominent companies, including companies with market capitalisation of over US$20 billion. Another source of targets for activist shareholders is listed companies that have a parent company or a controlling shareholder, and in which there is a structural conflict of interest between the controlling shareholder and minority shareholders.

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iii Objectives of shareholder activism

The most common objective of shareholder activism in Japan is to improve capital efficiency of Japanese companies. ROEs of many Japanese companies are low compared to the average ROEs of US companies. Activist shareholders usually demand that Japanese companies conduct a buy-back of their shares or increase the amount of dividends to improve their ROEs. Moreover, activist shareholders urge companies to carve out their non-profitable businesses and sell their assets that are not utilised or not related to their primary business, including cross-holding shares. A lot of activist shareholders tend to take these actions to gain returns on their investments in the short term.

In recent years, proposals for companies by activist shareholders to conduct potential mergers and acquisitions (M&A) transactions with another company or to undertake changes in business strategies are becoming common in Japan. Some activist shareholders usually conduct detailed due diligence on the company’s business prior to engaging in this kind of shareholder activism. Some activist hedge funds, if they consider that a company is not adequately responsive to their demands, may push the company to elect a person recommended by the hedge funds to serve as a director on the company’s board of directors. This person would often be a manager or partner of the hedge funds, a person who has experience in the management of other companies in the industry to which the company belongs, or a person who has expertise in capital allocation or restructuring.

Improving corporate governance is also a common objective of shareholder activism. Although the corporate governance of many listed companies has changed as a result of the application of the Governance Code – which, for example, recommends that listed companies appoint at least two independent directors – activist shareholders have continued to advocate for changes in the corporate governance of companies such as with respect to increasing the number of independent directors and adopting stock price-linked remuneration of directors.

Furthermore, activist shareholders often bring attention in their campaigns to incidents and actions in which directors are not abiding by their duties of care and loyalty. For instance, as activist shareholders often acquire large amounts of shares in companies that have a controlling shareholder, the activist shareholders speak against transactions that may involve conflicts of interest between the controlling shareholder and minority shareholders.

Activist shareholders are also engaging in shareholder activism with respect to M&A transactions, including mergers, share exchanges or tender offers, in which the support of a certain number of shareholders is necessary to successfully complete such transactions. Activist shareholders may speak against the disclosed transactions, and demand that the company amend certain terms that are, in their view, inappropriate, such as purchase price. These cases often occur in transactions involving conflicts of interests between a controlling shareholder and minority shareholders. This M&A activism may result in a change in the acquisition structure or increase of acquisition costs for the transaction. Some activist shareholders also exercise, after completion of the transaction, their appraisal rights as dissenting shareholders, and file a petition to the court for a determination of the fair price for the relevant shares.

Some Japanese companies have been targeted by short selling activist funds. These funds short the shares of a target company by borrowing shares of the target company and then issuing reports to the public stating that shares in the target company are overvalued.

17 As a result of the tax reform in 2017, the deferral of taxation arising from certain spin-off transactions in which a part of the company’s business is carved out and shares in the business are distributed to its shareholders through dividends in kind, is permitted.
After the price of the target company’s shares drop, the funds purchase the shares to make a profit through the difference between the price of these purchased shares and the price of the borrowed shares.

There are also activist shareholders who take actions mainly in consideration of social issues, which is different from the more common type of shareholder activism that focuses on the increasing shareholder value of the company. For example, shareholder proposals concerning nuclear power generation have been submitted to electric power companies.

### iv Tactics used by activist shareholders

#### Closed engagements

An activist shareholder typically initiates contact with the company in which it has acquired shares by sending a letter to the company describing its demands, after which the shareholder and company engage in private communications. An activist shareholder usually requests quarterly or biannual meetings with the management of the company. Some activist shareholders try to resolve issues of the company by proposing alternatives or solutions, or providing advice in a friendly manner, and are reluctant to make their engagement with the company public.

#### Public campaigns

If activist shareholders decide that they cannot achieve their objectives through non-public engagements with the company, they may wage public campaigns with the aim of attracting the support of other shareholders for their objectives. Elements of public campaigns include the following:

- **a** issuing press releases;
- **b** posting white papers or relevant information on websites prepared by the activist shareholders for the campaigns;
- **c** placing web advertisements;
- **d** disseminating letters to shareholders;
- **e** providing information through the media; and
- **f** holding information sessions for other shareholders.

Given that the support of public opinion is important in the public campaigns, the tools used by activist shareholders to conduct public campaigns are becoming more sophisticated as ways to deliver information to the public have become more diverse. If the company and the activist shareholder reach agreement prior to the submission of a shareholder proposal and commencement of a proxy fight, the activist shareholder can avoid bearing the expenses relating to the proxy fight.

#### Shareholder proposals and proxy fights

To effect changes in companies, activist shareholders can use the right of shareholder proposals under the Companies Act. Moreover, activist shareholders may conduct proxy solicitation in accordance with the FIEA to obtain votes for the shareholder proposals or votes against agendas proposed by companies that are opposed by the activist shareholders. As explained above, activist shareholders who intend to obtain approval for certain agenda items at the shareholders’ meeting do not necessarily have to make a proxy solicitation because they can communicate their proposals and the reasons for these proposals to other shareholders by
having the company dispatch the convocation notice and reference documents describing the summary of the proposals at the company’s expense. However, there are practical advantages for an activist shareholder to engage in proxy solicitation, including (1) the submission by shareholders of a voting card to the company that is left blank is generally treated as a vote in favour of the company’s proposal and against the shareholders’ proposal, (2) the reason for the shareholder proposal set forth in the company’s reference documents is subject to a character count limit set by the company, but there is no such limit in the case of a proxy solicitation, and (3) a proxy can authorise a procedural motion at a shareholders’ meeting.

If an activist shareholder conducts the proxy solicitation to garner support for its cause, it often approaches and tries to persuade proxy advisers, such as Institutional Shareholder Services, Inc (ISS), which is considered influential, especially on US-based institutional investors, and Glass, Lewis & Co, which is considered less influential than ISS. The proxy advisers often recommend that investors vote against proposals made by the board of directors and that they vote for shareholder proposals. In such cases, companies should promptly issue press releases stating their objections against recommendations by the proxy advisers.

**Empty voting and morphable ownership**

Empty voting (i.e., votes by shareholders who have more voting rights of shares than economic ownership in the shares because the shareholders own voting rights of shares that are decoupled from the economic ownership of the shares) may be used by activist shareholders. Empty voting may be implemented by, among other means, equity swaps or record date capture by borrowing shares. Empty voting deviates from the principle of one-share-one-vote in stock companies, and may result in resolutions of shareholders’ meetings that are not properly aligned with the interests of the company or its shareholders as a whole because empty voters’ voting rights in the company are not in proportion to their economic interests in the company. Thus far, there has been no reported case in Japan in which a grossly improper resolution was made or a proper agenda item was voted down at a shareholders’ meeting as a result of empty voting.

As a related issue, an activist shareholder may substantively own shares in the company without disclosure by using equity derivatives. Given that dealers that sell equity derivatives usually purchase matched shares in practice to hedge their risks involved in the equity derivatives, activist shareholders, when necessary, may have the ability to terminate the equity derivatives and purchase the matched shares held by the dealers (morphable ownership). Activist shareholders may suddenly emerge in this way as shareholders owning a large amount of the shares without giving the company adequate time to prepare for the shareholder activism.

**Litigation**

Activist shareholders sometimes engage in litigation as a tactic of shareholder activism, such as seeking an order of provisional disposition for enjoinment of directors’ actions and bringing a derivative action against directors of the company to recover for damages and liabilities caused by such directors. Activist shareholders often place pressure on the directors by expressing their willingness to bring actions to the courts to achieve their goals.

**Hostile takeovers**

The most aggressive approach of shareholder activism is a hostile takeover, which is an acquisition of shares in a company by an activist shareholder without the consent of the management of the company through on-market transactions or tender offers. However,
a limited number of hostile takeovers have been successfully consummated in Japan partly because there have been stable shareholders in the companies subjected to such takeovers and public opinion in Japan has been generally against hostile takeovers thus far.

IV RECENT SHAREHOLDER ACTIVISM CAMPAIGNS

i Campaigns by foreign large activist funds
Activist shareholders have recently targeted large-cap companies in Japan as in the case with the United States and other countries. One of the most well-known activist hedge funds in the United States, Third Point, has held shares of several Japanese large-cap companies. For example, Third Point proposed to the electronics company Sony Corporation (market capitalisation as at August 2013: approximately US$20 billion) that it should carve out its entertainment business and make an offering of shares in the entertainment business to the public, although Sony Corporation ultimately announced that it refused to undertake the proposal in August 2013. According to public information, Third Point also urged the machinery manufacturing company Fanuc Corporation (market capitalisation as at April 2015: approximately US$43 billion) to repurchase a large amount of its shares and to increase the amount of dividends to improve its capital efficiency. Third Point’s conduct may have prompted Fanuc Corporation to take actions to increase its shareholder returns during 2015 when Fanuc Corporation made a buy-back of its shares and paid a large amount of dividends.

ii Nomination of directors
In the past few years, there have been a number of cases of companies accepting the elections of directors recommended by activist shareholders. For example, in 2019, Olympus Corporation nominated a partner of ValueAct, the US-based activist fund, as a director, and Kawasaki Kisen Kaisha, Ltd nominated a director of Effissimo Capital Management, a Singapore-based activist fund, as a director. Toshiba Corporation disclosed in 2019 that it engaged in discussions with its major shareholders, including activist shareholders, in the course of its determination of the company’s director candidates. Reno, Inc – which is considered to have some connection with the well-known Japanese activist fund Murakami Fund and owned approximately 35 per cent of the shares in Kuroda Electric Co, Ltd with Reno, Inc’s joint holders – submitted a shareholder proposal to elect an outside director designated by Reno, Inc for the annual shareholders’ meeting of Kuroda Electric Co, Ltd in June 2017, which was approved at the shareholders’ meeting. This example suggests that shareholders in Japan are becoming comfortable with, and supportive of, shareholder activism.

iii Litigation
Effissimo Capital Management has acquired shares in a number of listed companies that have a parent company. Effissimo Capital Management, which owned approximately 30 per cent of the shares in car manufacturer Nissan Shatai Co, Ltd, brought a derivative action to recover damages caused by directors of the car manufacturer and sought an injunction in court against certain acts of the directors on the grounds that the directors were violating their duties of care and loyalty. The fund claimed that the directors were violating their duties because Nissan Shatai Co, Ltd deposited a large amount of cash with a low interest rate in a subsidiary of Nissan Motor Co, Ltd, which is a parent company of Nissan Shatai Co, Ltd, by participating in the cash management system of the Nissan Motor group without reasonable reasons,
Japan

and the directors of Nissan Shatai Co, Ltd did not manage its cash efficiently. Yokohama District Court dismissed the case in favour of the directors in February 2012.\(^{18}\) According to news reports, a Hong Kong-based activist fund, Oasis Management Company Ltd, filed a provisional injunction against the directors of Toshiba Plant Systems & Services Corporation with the Yokohama District Court in March 2017 to prevent it from depositing funds with the parent company, Toshiba Corporation. As a result, Toshiba Plant Systems & Services Corporation withdrew the deposit amount, which was, as at 31 March 2016, approximately US$760 million, from Toshiba Corporation. These cases indicate that activist shareholders are willing to engage in court and litigation procedures to accomplish their goals.

iv  M&A activism

Oasis Management waged a public campaign in 2016–2017 against the acquisition by Panasonic Corporation of its listed subsidiary, PanaHome Corporation, by asserting that the consideration to be paid was lower than the fair value of the shares in PanaHome Corporation. Panasonic Corporation changed the structure of the acquisition from a share consideration transaction through a share exchange to a cash consideration transaction through a tender offer after Oasis Management commenced the public campaign. Oasis Management also waged a public campaign in 2017–2018 against the integration of a business through a share exchange in which Alps Electric Co, Ltd would acquire all the shares in its listed subsidiary, Alpine Electronics Inc. In this case, Elliott Management, the US-based activist fund, also purchased approximately 9.8 per cent of the shares in Alpine Electronics Inc as well as approximately 11.2 percent of the shares in Alps Electric Co, Ltd, after the public announcement of the share exchange. Oasis Management filed a suit in court after the completion of the transaction asserting that the share exchange was invalid; the suit is still pending in court.

Elliott Management purchased shares in Hitachi Kokusai Electric Inc, which represented approximately 8.6 per cent of the issued shares of the company, after the public announcement by KKR of a tender offer for the shares in Hitachi Kokusai Electric Inc. KKR eventually increased the tender offer price by approximately 25 per cent to facilitate the success of the tender offer transaction.

V  REGULATORY DEVELOPMENTS

The Companies Act was amended on 1 May 2015. One of the purposes of the amendment was to enhance the corporate governance of companies; for example, to prompt companies to have outside directors. The amended Companies Act allows a company to adopt a new governance structure in which the company has an audit and supervisory committee. An audit and supervisory committee audits the activities of directors of the company, and a majority of the members of the committee must be outside directors. In January 2019, the subcommittee of the Legislative Council of the Ministry of Justice issued the outline of amendments to the Companies Act, which includes changes in the shareholder proposal rights.

In addition, the Governance Code was issued in June 2015 and the Stewardship Code was issued in February 2014. Consequently, 2015 is often referred to as the first year of corporate governance for listed companies in Japan.

\(^{18}\) Yokohama District Court, judgment, 28 February 2012, not cited in digests.
The FSA also issued the Guidelines for Investor and Company Engagement, which is intended to be a supplemental document to the Governance Code and the Stewardship Code. (Details of the Governance Code and the Stewardship Code are discussed in Section II.iii).

The FIEA was amended on 1 April 2018. This amendment provides a fair disclosure rule pursuant to which if a listed company transfers certain of its unpublicised material information to certain persons, including investors, the company must disclose the information to the public at the same time. Listed companies need to take into account this fair disclosure rule as well as the insider trading rules under the FIEA when they communicate with activist shareholders and other institutional investors.

As the reduction of cross-shareholdings moves forward as encouraged in the amended Governance Code, the Cabinet Office Ordinance on Disclosure of Corporate Affairs (Ordinance of the Ministry of Finance No. 5 of 30 January 1973) was amended in January 2019 to require companies to disclose in their annual securities report more detailed information concerning cross-shareholdings, including the number of increased or decreased shares, the purchase prices thereof and the reasons for the increase.

VI OUTLOOK

The Governance Code has prompted, and will continue to prompt, listed companies to place greater importance on establishing and maintaining dialogue and relationships with their shareholders. The concerns and actions of institutional investors have become, and will likely become more, similar to those of activist shareholders, such that the demands and voting behaviour of institutional investors with respect to companies in which they own shares will become more strict or demanding. If more cross-shareholdings are dissolved in the future, the number of shareholders who support the management of companies may decrease, and the number of shareholders who are supportive of activist shareholders may increase. As a result, the influence of shareholder activism on the management and direction of companies may increase further. Therefore, the management of listed companies should operate the companies, including conducting proactive engagement and communications with the companies’ shareholders, and make appropriate preparations to take into account increasing shareholder activism if they are actually targeted by activist shareholders.
Chapter 7

KOREA

Hyeon Deog Cho, Joon B Kim, Byoung Kwon Park and Eun-Young Lee

I OVERVIEW

It is generally understood that shareholder activism in Korea started in late 1990s with the deregulation of foreign investments in Korean companies. Early shareholder activism in Korea was led by activist funds, mostly foreign hedge funds, and targeted large listed companies. Corporate governance and accounting transparency of these targets was questioned at the time, but there are few such precedents.

Since 2015, two major changes marked shareholder activism in Korea. First, activist funds started to acquire equity interests and actively exert their opinions and shareholders’ rights in the course of mergers, spin-offs and split-mergers to reform corporate governance and investment structures of major conglomerates. Second, local activist funds, in addition to foreign hedge funds, became more active in Korea. Detailed examples will follow in Section III.

Shareholder activism is generally subject to the Korean Commercial Code (KCC), the Financial Investment Services and Capital Markets Act (FSCMA) and the Korean stock exchange regulations. Recently, the government has been reinforcing laws and regulations to improve transparency in large business groups’ investments structures as well as their corporate management, and to strengthen shareholders’ rights in individual companies. Shareholder activism has been on the rise, creating greater demand for improved corporate governance, business structures, financial structures, business environment, corporate social responsibilities and shareholder returns. In this changing landscape of the regulatory environment and the capital market, maintaining effective communication and positive relationships with domestic and foreign shareholders, including sovereign wealth funds, pension funds, other institutional investors and private investors in the capital market space, to reasonably reflect their management input (which in turn will improve the reputation of Korean corporate managers and increase shareholders value), is becoming an important goal in corporate management.

In the following sections, the legal and regulatory framework, key trends and recent campaigns of shareholder activism in Korea are examined.

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1 Hyeon Deog Cho, and Byoung Kwon Park are senior attorneys, Joon B Kim is a senior foreign attorney and Eun-Young Lee is an attorney at Kim & Chang.
II LEGAL AND REGULATORY FRAMEWORK

The legal and regulatory framework for shareholder activism primarily comprises the KCC, the FSCMA and the Korean stock exchange regulations. Additional guidelines are provided in the policy guidelines of proxy advisory firms and the Korean Stewardship Code.

i Laws and regulations

Shareholders' rights

The activities of shareholder activists are mostly based on specific rights afforded to minority shareholders under the KCC, including the rights to request inspection of a company’s documents and accounting books, to request convocation of a general meeting of shareholders, to propose agendas, to file a shareholder derivative suit and to request an injunction against a director’s misconduct.

Inspection rights

A shareholder holding at least 0.1 per cent² of the total number of issued and outstanding shares of a listed company (0.05 per cent if the company’s paid-in capital is no less than 100 billion won) for at least six months may request the inspection or copying of the accounting books and documents of the company, which the company may not reject unless it proves the request is unreasonable.

Right to convene shareholders’ meetings

A minority shareholder holding at least 1.5 per cent³ of the total number of issued and outstanding shares of a listed company for at least six months may exercise its right to request convocation of a general meeting of shareholders by submitting a written statement or electronic document specifying the agenda and the reason for convening the meeting.

Right to propose agendas

A shareholder holding at least 1 per cent⁴ of the total number of issued and outstanding voting shares of a listed company (0.5 per cent if the company’s paid-in capital is no less than 100 billion won) for at least six months may propose agendas for a general meeting of shareholders by submitting a written statement or electronic document at least six weeks prior to the meeting.

When a shareholder proposes an agenda, the board of directors cannot refuse and must present it at the general meeting of shareholders, unless presenting the proposed agenda would violate any applicable laws (including certain cases described in the presidential decrees of the KCC) or the articles of incorporation of the company.

Where an agenda proposed by a shareholder is presented at a general meeting of shareholders, the shareholder must be given an opportunity to explain the agenda during the meeting, if so requested by the shareholder.

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² For an unlisted company, at least 3 per cent of the total number of issued and outstanding shares.
³ For an unlisted company, a shareholder holding at least 3 per cent of the total number of issued and outstanding shares.
⁴ For an unlisted company, a shareholder holding at least 3 per cent of the total number of issued and outstanding voting shares.
Right to file a derivative suit

If a director violates any applicable laws or the articles of incorporation, or neglects his or her duties by wilful misconduct or negligence, the shareholders have the right to file a derivative suit against the director to compensate for damage suffered by the company. A shareholder holding at least 0.01 per cent of the total number of issued and outstanding shares of a listed company for at least six months may request the company to file a lawsuit against the violating director in writing. If the company does not file the lawsuit, the shareholder may directly file the derivative suit against the director on behalf of the company.

Right to request an injunction against a director’s unlawful conduct

If a director is in breach of any applicable laws or the articles of incorporation, which may cause irreparable damage to the company, the KCC allows shareholders to demand the immediate cessation of the unlawful conduct. A shareholder holding at least 0.05 per cent of the total number of issued and outstanding voting shares of a listed company (0.025 per cent if the company’s paid-in capital is no less than 100 billion won) for at least six months may make such demand directly against the director on behalf of the company.

KCC special provisions on listed companies

The KCC has a number of ‘special provisions’ applicable to listed companies that relax the shareholding ratio requirement for minority shareholders to exercise their rights. To prevent abuse of these provisions, they typically add a minimum holding period requirement (e.g., six months). Ambiguity exists as to whether a minority shareholder of a listed company may exercise its right when it satisfies the requirement under KCC’s general provision (e.g., shareholding ratio) but not the special provisions (e.g., holding period) applicable to listed companies.

On this issue, a district court has previously held that the holding period requirement should in principle be complied with for listed companies as their shares can be easily traded, which may result in abuse (e.g., in the judgment concerning Elliott Management’s request for an injunction against misconduct by directors of Samsung C&T). The Seoul High Court took a similar stance in the case concerning KCGI’s request for a preliminary injunction for presentation of agendas against Hanjin KAL. However, the trial court of the Hanjin KAL case held that minority shareholders satisfying the shareholding ratio may exercise their rights even if they do not meet the six-month holding period requirement, because the special provisions on listed companies should not preclude the application of KCC’s general provisions. The Supreme Court is yet to render a judgment on this issue.

5 For an unlisted company, a shareholder holding least 1 per cent of the total number of issued and outstanding shares.
6 For an unlisted company, a shareholder holding at least 1 per cent of the total number of issued and outstanding voting shares.
7 Seoul Central District Court Decision No. 2015Kahap80582, rendered on 1 July 2015.
8 Korea Corporate Governance Improvement Fund (KCGI) is a domestic private fund established in July 2018.
9 Seoul High Court Decision No. 2019Ra20280, rendered on 21 March 2019.
10 Seoul Central District Court Decision No. 2019Kahap20313, rendered on 28 February 2019.
Disclosure regulations

Significant shareholding disclosure

Under the FSCMA, if a shareholder comes to own at least 5 per cent of a listed company, changes its shareholding ratio thereafter by at least 1 per cent, or if there are changes in its purpose of shareholding or any other material matters, the shareholder must report its shareholding status and a detailed account of any changes to the Financial Services Commission (FSC) and the Korea Exchange (KRX) within five business days of such event.

For any person intending to purchase shares of a listed company, if the aggregate number of shares acquired from 10 or more persons in the preceding six-month period (including the number of shares it intends to purchase) amounts to at least 5 per cent of the total number of shares of a company, the share purchase must take the form of a tender offer.

In calculating the threshold shareholding ratios that trigger the above obligations, a shareholder may be deemed to have 'possession equivalent to ownership' over shares that it does not directly own, if the shareholder has voting rights or a right to claim the shares in law or by contract (and the shares will count toward calculating the threshold). Furthermore, shares held by related parties or their joint holders are counted together in calculating this threshold. These rules should be considered in determining whether a shareholder has any disclosure obligations.

Use of material non-public information and obligation of fair disclosure

The FSCMA prohibits insiders from obtaining material non-public information (i.e., information that may materially influence an investor's judgement in making an investment) of a listed company and using, or enabling others to use, this information in a transfer of securities. The regulations further require listed companies to make its disclosures impartially. Listed companies should use caution in communicating with activist shareholders so as not to violate these requirements.

Proxy regulations

Under the FSCMA, to solicit proxy of a listed company (i.e., to exercise multiple votes in the general meeting of shareholders), the proxy solicitor must deliver to a proxy the relevant form and related documents before or simultaneously with its solicitation to the shareholders (and submit the same to the FSC and the KRX two business days prior to the solicitation).

Though a number of types of conduct (direct solicitation, requesting shareholders to vote in a certain manner, sending proxy forms to shareholders, etc.) may be deemed an act of proxy solicitation, which triggers the above prior delivery and submission obligations, the following cases are not deemed proxy solicitation:

a soliciting proxy to fewer than 10 persons, provided that the solicitor (including related persons) is not the issuer or its officers (including related persons);

b soliciting proxy to a trustee by a trustee (or other similar legal relationship); and

c soliciting proxy to the public through an advertisement (e.g., newspapers, broadcasts, magazines) that contains only the name of the share issuer, the purpose of the advertisements, the subject matter of the general meeting of shareholders and the place where the proxy form and related materials will be distributed.
Other sources of practice guidelines

Korea Stewardship Code

On 16 December 2016, the Korea Corporate Governance Service (KCGS)\(^1\) formulated the Principles on the Stewardship Responsibilities of Institutional Investors (the Korea Stewardship Code), which set out key principles and guidelines for institutional investors to comply with their fiduciary duties. Among other things, these principles call institutional investors to (1) formulate and disclose a clear policy to implement their stewardship responsibility; (2) formulate and disclose a voting policy; and (3) regularly report their voting and stewardship responsibilities.

The Korean Stewardship Code is not legally binding as it is comprises principles promulgated by a non-profit organisation (NGO). However, it may become binding on institutional investors who have agreed to the principles and have elected to adopt and implement them.

Guidelines of proxy advisory firms

In many cases, shareholder activism takes the form of a proxy contest to take control of the agenda items submitted to the general meeting of shareholders. In Korea, domestic proxy advisers such as KCGS, Sustinvest and Daishin Economic Research Institute, are offering those services. Institutional Shareholder Services (ISS) and Glass Lewis, major global proxy advisers, are also offering similar services by analysing agendas for general meetings of shareholders of Korean companies with foreign shareholders. Korean institutional investors take the recommendations made by proxy advisory firms as important reference in exercising their voting rights.

Defences available to companies

Korean law does not recognise poison pills, or stocks with unequal voting rights (other than non-voting shares that are issued as different class shares), and thus, they are unavailable as defences in corporate raids.

In practice, when activist shareholders propose agendas, a company may consider issuing new shares to a third party (who can serve as a white knight) or disposing of its treasury stock. However, if such judgements do not serve any business purpose and are used merely as defence against activist shareholders, they may be deemed to breach the director’s fiduciary duties and be nullified by the court.

In sum, corporations may defend themselves against activist shareholders by securing sufficient voting rights through proxy solicitation, adopting shareholder-friendly policies and effectively communicating with institutional investors.

\(^1\) The Korea Corporate Governance Service is a non-profit organisation set up pursuant to the KCC. It formulates and revises major codes for capital market development, conducts environmental, social and governance evaluation, offers agenda analysis services and performs policy research in furtherance of public interest. The KRX, the Korea Securities Depository, the Korea Securities Finance Corporation, the Korea Financial Investment Association, the Korea Listed Companies Association, the Korean Institute of Certified Public Accountants, and KOSDAQ Listed Companies Association are its member organisations.
III  KEY TRENDS IN SHAREHOLDER ACTIVISM

i  Activist shareholders

Shareholder activists are mainly divided into civic groups and activist funds. Until the mid-1990s, shareholder activism was almost non-existent in Korea. After the mid-1990s, however, shareholder activism was initiated by civic groups (NGOs) amid a growing social movement and drive for corporate social responsibility (e.g., a lawsuit filed by the People’s Solidarity for Participatory Democracy to revoke a resolution by Korea First Bank in 1997 and a shareholder derivative suit instituted against Samsung Electronics in 1998).

Shareholder activism by activist funds has been emerging in Korea since the late 1990s, when it opened up its stock market to foreign investors in earnest, beginning with the Tiger Fund. Foreign hedge funds, such as Sovereign Asset Management and Hermes Investment Management, were active in Korea in the 2000s. Elliott Management, a foreign hedge fund, has made headlines with its activities since 2015. Lately, Korean activist funds such as KCGI, Platform Partners Asset Management and KB Shareholder Value Focus Fund have become increasingly active.

In the past, institutional investors were less interested in improving business performance or governance than in realising capital gains. In the traditional investment climate of Korea, participation in corporate management was perceived as an intrusion into corporate control, and as a result, there were very few cases where an institutional investor actively requested for management information and exercised other minority shareholders’ rights. However, since the National Pension Service (NPS), which manages public pension funds directly operated by the Korean government, adopted the Korean Stewardship Code in July 2018, it has aggressively exercised its rights as a shareholder in domestic conglomerates in 2019 (see table in Section V for major NPS activities in general meetings of shareholders of companies in 2019). As such, shareholder activism from institutional investors is likely to increase.

ii  Target companies

Shareholder activism in Korea targets businesses in various industries with no concentration in any specific industry.

The following six types of companies are generally vulnerable to and mostly targeted by activist shareholders:

a  companies with a weak or no major shareholder;
b  companies with a high foreign shareholding ratio (that actively participate in the general meeting of shareholders);
c  companies with low shareholder returns (e.g., low share prices or low dividends);
d  companies with uncertainty of distributable cash or free cash flow according to their balance sheets;
e  companies with a controversial agenda pending, such as a restructuring; and
f  companies under public criticism due to events such as ongoing criminal or administrative investigations.

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iii Shareholders’ campaigns

Key objectives of activist campaigns

The objectives of the activist campaigns in Korea do not differ significantly from those of other jurisdictions. They encompass (1) improvement of corporate governance, including recommendation of candidates and appointment of directors, replacement of the management, and limitations on remuneration for directors in terms of corporate governance; (2) dividend increase, treasury stock acquisition and optimisation of capital structure; and (3) disposal of non-core assets and pursuing mergers and acquisitions as business strategies.

A key notable objective witnessed recently has been campaigns against business and governance restructuring plans proposed by the board in the form of split-offs and mergers, alleging adverse impact on shareholder value. As a case in point, in 2015, Elliott Management vigorously opposed and contested the merger of Samsung C&T and Cheil Industries for reasons of, among others, unfairness in the merger ratio; little or no business benefits or synergies arising from the merger; and increased circular shareholding issue.

Another notable objective has been higher dividends (or acquisition of treasury stocks) by using idle cash and achieving greater efficiency in capital structure. For instance, in 2019, Elliott Management proposed that Hyundai Motor Company pay out a cash dividend of 21,967 won per ordinary share, which was about seven times higher than the per share dividend payment planned by Hyundai Motor Company (i.e., 3,000 won).14

Activist shareholders also seek to appoint their preferred candidates to serve on the board. For instance, in 2019, Elliott Management proposed an agenda in an attempt to put its outside directors on the board of Hyundai Motor Company, and KCGI proposed an agenda to place its preferred outside director on Hanjin KAL’s board.15

Tactics used by activists

Tactics used by activist shareholders are also similar to those used by activist shareholders in other jurisdictions and they vary depending on their goals or their target companies’ circumstances.

Sending a letter requesting private dialogue to the board of directors

As individual shareholders are free to send letters to the board of directors, activist shareholders commonly demand private conversation in their letters to the board of directors as the first step in engaging target companies.

Proposing shareholder meeting agendas and soliciting delegation of voting rights

The shareholders’ right to propose agendas is the most frequently exercised right by activist shareholders. By exercising this right, activists submit their agenda items (e.g., dividend distribution or director appointment) for the general meeting of shareholders and engage in


15 This attempt was frustrated when KCGI lost a lawsuit on the ground that it failed to meet a requirement for exercise of a shareholder’s right to propose agendas (i.e., minimum period of stock retention (six months), according to special provisions on listed companies under the KCO).
proxy contests by soliciting delegation of voting rights. Activist shareholders have frequently filed requests for a preliminary injunction with the court when target companies refuse to honour their request for submitting agendas proposed for the general meeting of shareholders.

**Other minority shareholders’ rights and publicity campaigns**

Activist shareholders have also exercised other minority shareholders’ rights provided in the KCC, such as the right to request an injunction against a director’s misconduct, and the right to request inspection of documents and accounting books of a company, directly as legal rights or as rights secured by a preliminary injunction.

Publicity campaigns or investor communication through the media or the activists’ websites, is also among the key strategies used by activist shareholders.

**iv Outcome**

There are not enough instances of shareholder activism in Korea to derive statistically meaningful inferences on the results of the contests between activist shareholders and their target companies. There are both cases where companies conceded to or rejected the demands made by activist shareholders.

When Tiger Fund demanded restitution of undue gains and replacement of the management to SK Telecom, and objected to its paid-in capital increase in 1999, SK Telecom accepted most of those demands, except for the request concerning its paid-in capital increase, and thereafter purchased the stake of Tiger Fund. During Hyundai Motor Group’s restructuring in 2018, the company voluntarily relinquished its corporate governance restructuring plan in accordance with the opinions and assessments of shareholders, investors and market players, including the objections raised by Elliott Management, ISS and KCGS.

When Elliott Management objected to the merger between Samsung C&T and Cheil Industries in 2015, the major shareholder of Samsung C&T obtained approval of the proposed merger in the general meeting of shareholders by obtaining support of shareholders.

**IV RECENT SHAREHOLDER ACTIVISM CAMPAIGNS**

**i Elliott Management’s objection to Samsung C&T and Cheil Industries’ merger**

On 26 May 2015, Samsung C&T and Cheil Industries announced that their respective board of directors approved the proposed merger between the two companies. The following day, Elliott Management, in its capacity as a shareholder, notified Samsung C&T of its objection to the merger citing unfairness with the calculated merger ratio between Cheil Industries and Samsung C&T (about 1:0.35), which resulted in a low valuation of Samsung C&T, and demanded that the merger ratio be recalculated. On 9 June 2015, Elliott Management filed a request for a preliminary injunction against Samsung C&T to prevent the company from issuing a convocation notification for the general meeting of shareholders at which the
approval of the merger was anticipated. On 11 June 2015, Elliott Management additionally filed a request for a preliminary injunction to the court against Samsung C&T’s sale of its treasury stock, which had taken place on the preceding day.

On 24 June 2015, Elliott Management obtained Samsung C&T’s shareholders register by demanding the company to allow inspection and reproduction of it. On the same day, Elliott Management sought proxies from the shareholders of Samsung C&T. On 25 June 2015, a proxy contest was initiated with Samsung C&T also seeking proxies from its shareholders.

On 3 July 2015, the preliminary injunction requested by Elliott Management was dismissed in its entirety by the Korean courts in spite of recommendation by ISS against the merger between Samsung C&T and Cheil Industries. The NPS, which held an 11.61 per cent stake in Samsung C&T, decided to vote in favour of the merger in its internal meeting. Consequently, on 17 July 2015, the proposed merger was approved at Samsung C&T’s general meeting of shareholders with 69.5 per cent of the shareholders present voting in favour (58.8 per cent of the total number of issued and outstanding shares).18

In 2018, Elliott Management filed for an investor–state dispute (ISD) settlement against the Korean government under the US–Korea Free Trade Agreement, claiming that it suffered damage of at least US$770 million19 due to the Korean government’s unlawful involvement through the NPS during the process of approving the merger of Samsung C&T and Cheil Industries. The ISD proceeding is currently pending.

ii Elliott Management’s objection to Hyundai Motor Group’s restructuring

In 2018, Hyundai Motor Group pursued its corporate restructuring plan to spin off certain divisions of Hyundai Mobis to merge them with Hyundai Glovis. However, Elliott Management objected to the plan, calling for a merger between Hyundai Motor Company and Hyundai Mobis instead, and a subsequent conversion of the merged entity into a holding company. Moreover, virtually all global proxy advisory firms, including ISS, recommended against Hyundai Motor Group’s restructuring plan (KCGS also opposed the plan). Under the circumstances, it would have been very difficult for Hyundai Motor Group to persuade its shareholders in its favour. On 21 May 2018, about a week before the general meeting of shareholders, Hyundai Motor Group voluntarily withdrew its restructuring plan, noting that it would fully reflect the opinions expressed by the shareholders, investors and market players.

In February 2019, Elliott Management proposed the expansion of dividends, the appointment of outside directors, and the establishment of compensation and management transparency committees as agenda items for the general meeting of shareholders of Hyundai Motor Company and Hyundai Mobis. However, on 29 March 2019, all of these agenda items were voted down at the shareholders meeting of the two companies.

iii KCGI’s request for improvement of Hanjin KAL’s corporate governance

KCGI was established with the objective of enhancing the value of investee companies through improving corporate governance. In November 2018, KCGI became the second-largest

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18 Under Korean law, a merger requires the consent of at least two-thirds of voting rights of the shareholders present and at least one-third of the total number of issued and outstanding shares. For the referenced voting results, see ChosunBiz, ‘Merger between Samsung C&T and Cheil Industries is approved’ (18 July 2015).

shareholder of Hanjin KAL by acquiring a 9 per cent stake in the company.\textsuperscript{20} KCGI cited ‘severe undervaluation owing to idle assets and delay in investment, and great potential for increasing enterprise value through corporate governance improvement’ as a reason behind its investment.

In January 2019, KCGI suggested that Hanjin KAL, the holding company of Hanjin Group, which includes Korean Airlines, improve its credit rating by lowering its debt-to-equity ratio, sell undervalued assets as part of improving its business structure and dispose of unprofitable businesses. In addition, KCGI proposed the establishment of corporate governance, compensation and officer recommendation committees. KCGI also suggested that any officer perpetrating a crime against the company or harming its reputation be banned from assuming office. KCGI subsequently proposed the appointment of one auditor and two outside directors as agenda items for the shareholders’ meeting.

In February 2019, when Hanjin KAL refused to accept KCGI’s proposed agenda, KCGI filed a request for a preliminary injunction to allow presentation of its agenda to the general meeting of shareholders, but this request was ultimately dismissed by the court. In March 2019, KCGI raised objection to the three outside directors nominated by Hanjin KAL in a general meeting of shareholders, but all of them were appointed. KCGI increased its stake in Hanjin KAL to 14.98 per cent in April 2019 and 15.98 per cent in May 2019.\textsuperscript{21} It has consistently been calling for improvement of Hanjin KAL’s corporate governance.

V REGULATORY DEVELOPMENTS

There are a number of bills currently pending in the National Assembly designed to amend the KCC for stronger minority shareholders’ rights (e.g., separating the election for audit committee member directors from that of non-audit committee member directors; a cumulative voting system; a multi-tiered shareholder derivative suit; a mandatory electronic voting system). The passage of an amendment bill will likely have some degree of impact on shareholder activism in Korea.

The NPS’ adoption of the Korean Stewardship Code in July 2018 will likely induce many other institutional investors to adopt the code in 2019. As at May 2019, 96 institutional investors have adopted the Korean Stewardship Code.\textsuperscript{22} According to a roadmap announced by the NPS (which lays out stages in which the NPS will exercise its shareholders rights) the NPS is expected to actively exercise its shareholders’ rights in 2019 (see the table below for major activities of the NPS in connection with general meetings of shareholders in 2019). In addition, the NPS announced that it would transparently reveal its activities related to its fiduciary duties by publishing an annual report on responsible investment on the basis of real cases of responsible investment and exercise of shareholders’ rights.


\textsuperscript{22} Participants List, Korea Corporate Governance Service, http://sc.cgs.or.kr/participation/investors.jsp (accessed on 11 July 2019).
Major activities of the NPS concerning general meetings of shareholders in 2019

<table>
<thead>
<tr>
<th>Type</th>
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<tr>
<td>Prior disclosure of voting direction</td>
<td>The NPS made advanced disclosure of how it intends to exercise its voting rights regarding 96 companies, such as Korean Air, Hyundai Motor Company and Hyosung. The NPS cast negative votes concerning the agendas of 46 of these companies.</td>
</tr>
<tr>
<td>Participation in management</td>
<td>The NPS changed its objective of shareholding in Hanjin KAL to participation in management.</td>
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<tr>
<td>Proposal of agendas for shareholders’ meetings</td>
<td>The NPS proposed the revision of Hanjin KAL’s articles of incorporation on directors’ qualifications as an agenda item for the shareholders’ meeting.</td>
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<tr>
<td>Announcement of NPS guidelines for the Korean Stewardship Code</td>
<td>The NPS announced its guidelines regarding the Korean Stewardship Code, under which it intends to exercise its shareholders’ rights when (1) a company’s dividend policy is overly unfavourable to the shareholders; (2) a company is managed in an undisciplined manner (e.g., paying excessive remuneration to its officers regardless of business performance); (3) a company is involved in unlawful acts such as embezzlement, breach of fiduciary duty, and unfair assistance; (4) a company’s situation does not improve despite the NPS having voted twice or more against the appointment of a director or auditor; or (5) a company’s enterprise value is impacted by ‘unforeseen concerns’.</td>
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VI OUTLOOK

It is expected that shareholder activism in Korea will continue to become more active given that major Korean companies continue to have surplus cash, corporate governance issues and many stakeholders increasingly demanding more transparency in corporate governance. These factors are further bolstered by the impending amendment to the KCC and a proactive adoption of the Korean Stewardship Code. As for mergers and spin-offs to reform major conglomerates’ corporate governance, more sophisticated shareholder activism campaigns will likely be launched based on past experience.

It is also expected that shareholder activism targeting medium-sized corporations will increase given the rising number of Korean activist shareholders. Deregulation of investment in Korean private funds will also diversify the investment structures of these indigenous activist funds.

To defend against such increased activities of activist funds, it is anticipated that potential target companies will seek business alliances with other companies and proactively adopt shareholder friendly policies, as well as seek improved transparency with the market and better corporate governance.
Chapter 8

LUXEMBOURG

Margaretha Wilkenhuysen and Anke Geppert-Luciani

I  OVERVIEW

Unlike certain neighbouring countries, in Luxembourg listed companies are often controlled by one or more major shareholders, rendering it difficult to provide examples of shareholders or investors having taken public and adversarial approaches. Probably the most memorable example of shareholder activism in Luxembourg is in relation to the ArcelorMittal merger in 2007. Furthermore, a significant number of Luxembourg companies are listed abroad and these entities often need to apply Luxembourg law as well as the rules of the foreign exchange (e.g., the New York Stock Exchange (NYSE) or Nasdaq). Luxembourg is about to adopt a bill of law (the Bill) supposed to transpose Directive 2017/828, which amends Directive 2007/36/EC on the encouragement long-term shareholder engagement, into national law. Luxembourg will do so by amending the Shareholder Act, which marked in 2011 an important step in Luxembourg corporate social responsibility legislation and provided shareholders with more statutory rights aiming to increase their active participation in their companies.

II  LEGAL AND REGULATORY FRAMEWORK

i  The corporate governance regime

Luxembourg’s main statutes on corporate governance include the 10 August 1915 Act on commercial companies (the Companies Act), the Market Abuse Regulation and the Shareholder Act.

1 Margaretha Wilkenhuysen is a partner and Anke Geppert-Luciani is a professional support lawyer at NautaDutilh.
2 Bill No. 7402 lodged on 4 February at the Chamber of Deputies by the Minister of Justice.
6 The Act of 10 August 1915 on commercial companies.
The current version of the Shareholder Act came into force on 1 July 2011. It implemented Directive 2007/36/EC on the exercise of certain rights of shareholders in listed companies, aiming to increase shareholders’ activism and setting out a number of shareholders’ rights. The Shareholder Act even goes beyond Directive 2007/36/EC’s requirements, by enabling shareholders to exercise their voting rights, ensuring their right to place items on shareholders’ meetings’ agendas and to ask questions. Currently, the Shareholder Act applies to companies that have their registered office in Luxembourg and whose shares are admitted to trading on a regulated market in a Member State of the European Union, and to Luxembourg companies whose shares are traded on a regulated market outside the European Union if the companies have elected to opt into the rules of the Shareholder Act. Pursuant to the requirements of Directive 2017/828, this scope will be extended to institutional investors and asset managers.8

Shareholder rights and governance in Luxembourg are statute-based, consisting primarily of the Civil Code, the Companies Act and, for listed companies, the rules and regulations of the Luxembourg Stock Exchange (LuxSE). However, the statutory law provisions only give very general governance rules or principles.

As a supplement to the general statutory law, the LuxSE’s 10 Principles of Corporate Governance (the LuxSE Principles), as modified in October 2009 and revised in March 2013 and December 2017 (fourth edition),9 provide guidelines on best practice on corporate governance for all companies listed on the LuxSE and all Luxembourg companies whose shares are admitted to trading on a regulated market operated by the LuxSE.10 Luxembourg companies listed abroad often find inspiration in these principles of good governance. The LuxSE Principles refer to general corporate governance issues, such as duties of the management board, the management structure, conflicts of interest provisions, remuneration and reporting issues. They also aim to enable the shareholders of listed companies to be actively involved in the companies’ activities. The LuxSE Principles are highly flexible and adaptable to the activity, size and culture of individual companies. They consist of general principles that must be complied with (i.e., compliance) and recommendations that, although obligatory in principle, may be deviated from when justified in specific circumstances, provided that adequate explanation is provided (i.e., comply or explain). The recommendations are supplemented by guidelines on how a company should implement or interpret them. The obligation to comply or explain does not apply to the guidelines, which are indicative but not binding.

ii The market for publicly traded companies and Luxembourg-based companies traded abroad

Many companies’ shares are traded on the LuxSE, but there are also a number of entities whose shares are listed on a regulated market within the European Union, other than the LuxSE, such as Euronext or the Warsaw Stock Exchange, and also on the NYSE or Nasdaq. In the case of Luxembourg entities listed abroad, their boards needs to reconcile and combine the Luxembourg rules with the rules of the exchange, which in some cases may be challenging.

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8 Article 1(1) of the Bill.
9 Available at www.bourse.lu/corporate-governance.
10 As an exception, the LuxSE Principles do not apply to regulated investment companies with variable capital and funds, to which specific regulations apply.
Corporate bodies

The Companies Act and the Shareholder Act provide in general the rules and the framework for shareholders to become active. The Companies Act contains the provisions on the governance of commercial companies, including the powers and responsibilities of the board of directors and the shareholders.

The board of directors

Structure

Although the Act of 25 August 2006 introduced the possibility for public limited liability companies to choose a two-tier board structure, the one-tier board structure remains by far the preferred option in Luxembourg, with the company being managed exclusively by a board of directors invested with the broadest powers to act in the name and on behalf of the company.

In the two-tier system, a company is managed by two bodies: the management board, charged with the day-to-day management of the company, and a supervisory board. The supervisory board’s responsibilities include the appointment and the permanent supervision of the management board members, as well as the right to inspect all company transactions. No person may at the same time be a member of both the management board and the supervisory board. Members of the supervisory board are liable towards the company and any third party in accordance with general law. However, there is no specific guidance relating to the exercise by members of the supervisory board of their duties.

Composition of the board

The board is composed of appointed members (the company’s directors). The Companies Act requires a minimum of three directors; the maximum number of directors is undefined (the LuxSE Principles advise 16 directors as a reasonable limit). Although the directors are appointed by the shareholders of the company, the directors choose a chair among their members.

Even if director nomination is typically made via the company’s nomination committee, one or several shareholders holding together at least 5 per cent of the votes for listed entities falling within the scope of the Shareholder Act or 10 per cent for the other entities, as the case may be, have the right to amend a notice to the shareholders’ meeting and add the nomination of directors for election.

Although no general legal obligations are in place, the LuxSE Principles require that listed companies’ boards have a sufficient number of independent directors (the number

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11 Article 442-1 of the Companies Act.
12 Articles 441-1 to 441-13 of the Companies Act.
13 Article 442-1 et seq. of the Companies Act, in particular, Articles 442-2(3), 442-3(1), 442-7(1), and 442-11 to 442-16.
14 Article 442-17(1) of the Companies Act.
15 Article 442-16 of the Companies Act.
16 Article 441-2(1) of the Companies Act.
17 LuxSE Principle 3, guideline to Recommendation 3.3.
18 Article 441-2(3) of the Companies Act.
19 Article 444-3(2) of the Companies Act.
20 Article 4 of the Shareholder Act.
depends on the nature of the company’s activities and share ownership structure), defining independent directors as not having ‘any significant business relationship with the company, close family relationship with any executive, or any other relationship with the company, its controlling shareholders or executive managers which is liable to impair the independence of the director’s judgement’.21 Although there are no specific legal provisions regarding independent directors, it is generally understood that all directors, including independent directors, should be provided with information in good time for the proper performance of their duties.

Separation of CEO and chair roles – the chair’s role and responsibilities

Although the roles of CEO and chair tend to be separated in practice, there are no legal provisions or guidelines pertaining to a separation of roles or responsibilities. For listed companies, a Recommendation of the LuxSE Principles requires that the chair prepares the board meeting agendas after consulting the CEO and ensures that the procedures for preparing meetings, deliberations, decision-making and the implementation of decisions are correctly applied.22 Under this non-compulsory guideline, the chair should ensure the proper application of the rules of governance and provide advice to the board.

Luxembourg law does not currently provide for a specific procedure for direct communication between the CEO or the chair and the shareholders.

For listed companies, according to the LuxSE Principles, companies should ‘establish a policy of active communication with the shareholders’ and allow shareholder dialogue with the board and the executive management.23

Responsibilities of the board of directors

Directors must act in the best corporate interests of the company, and are obliged to comply with the Companies Act and with the company’s articles of association. This includes the obligation to act as reasonably prudent business persons. They must manage the company’s business in good faith, with reasonable care, in a competent, prudent and active manner, at all times in the company’s best interests, and must refrain from doing anything that does not fall within the scope of the company’s corporate objectives. The Companies Act also imposes certain general duties on directors, including the general management of the company, representation of the company towards third parties and upholding their duty to avoid any conflict of interests.24

The Luxembourg legislature has remained silent on what should be considered a company’s best corporate interest. In its judgment delivered in 2015,25 the Luxembourg District Court made some observations on this notion. It explained that it is an adaptable concept of which the exact interpretation depends on the company concerned and the nature of its activities. For some companies, the corporate interest is aligned with the interests of a company’s shareholders. For other companies, it includes the interest of the legal entity as a whole, including the interests of shareholders but also those of employees and creditors. The

21 LuxSE Principle 3, guideline to Recommendation 3.5.
22 LuxSE Principle 2, guideline to Recommendation 2.4.
23 LuxSE Principle 10.
24 Articles 441-7 and 441-12 of the Companies Act.
25 Luxembourg District Court, 23 December 2015, Nos. 145 724 and 145 725.
court remarked that for financing companies and pure holding companies, the interest of the company’s shareholders will be of overriding importance as the focus of the company’s activities is on the rate of return of its investments.

However, directors of LuxSE-listed companies are held to a number of more specific duties under the Transparency Act\textsuperscript{26} and the Market Abuse EU Regulation,\textsuperscript{27} in addition to the LuxSE regulations and principles. In terms of the LuxSE Principles, the board of a listed company is bound by a fiduciary duty to its company and shareholders, and ‘shall act in the corporate interests and shall serve all the shareholders by ensuring the long-term success of the company’.\textsuperscript{28}

Directors are jointly and severally liable in accordance with the general provisions on civil liability and the provisions of the Companies Act,\textsuperscript{29} towards both the company and all third parties for any damage resulting from a violation of the Companies Act or of the articles of association of the company. The company as well as third parties (including any shareholder or creditor with a legitimate interest) may bring an action against a director for violation of the articles or the Companies Act. To elude collective liability, a director must prove that he or she has not taken part in the breach of the Companies Act or of the articles of association of the company; that no misconduct is attributable to him or her; and that he or she reported the breach at the first shareholders’ meeting following his or her discovery or knowledge of the breach. With regard to mismanagement, every director is individually liable.\textsuperscript{30}

In the event of misconduct, according to prevailing doctrine and case law, the shareholders’ meeting must decide whether to make any claim against a director in connection with faults committed by the director in the performance of his or her functions. Creditors of a company may, under certain circumstances, institute action on behalf of the company if the latter fails to do so and if that failure harms the company’s creditors.\textsuperscript{31} Besides, each director is individually liable in accordance with the general provisions on tort liability.\textsuperscript{32}

If the shareholders have suffered collective damage, it is up to the shareholders’ meeting to demand compensation, in which case an action must be brought by the shareholders’ meeting on behalf of the company (an action initiated by a single shareholder will be dismissed). The legal basis for the action differs depending on whether the proceedings are invoked by the company or by third parties. Shareholders may only seek compensation for a prejudice that is distinct from the company’s collective damage, and that can be defined as an individual or personal damage. The possibility for a (minority) shareholder to sue a director has recently been given an explicit legal basis in Luxembourg law.\textsuperscript{33}

\begin{flushleft}
\textsuperscript{26} Act of 11 January 2008 on transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market, as last amended by the Act of 23 December 2016.
\textsuperscript{28} LuxSE Principle 2.
\textsuperscript{29} Article 441-9(2) of the Companies Act.
\textsuperscript{30} Article 441-9(1) of the Companies Act.
\textsuperscript{31} Article 1166 of the Civil Code.
\textsuperscript{32} Articles 1382 and 1383 of the Civil Code.
\textsuperscript{33} Article 444-2 of the Companies Act.
\end{flushleft}
Any action by the company has a contractual basis, whereas an action by third parties will be brought on the grounds of tort liability. Under contractual liability, only reasonably foreseeable damage is to be repaired (except in cases of fraud), whereas under tort liability, all damage caused by the misconduct must be repaired.

Directors are discharged from their liability towards the company if approved by the annual shareholders’ meeting approving the annual accounts. This discharge is only valid for the period covered by the accounts presented to and approved by the general meeting of shareholders, provided that they do not contain any omission or false statement of a material fact. Although a discharge given by the general meeting of shareholders extinguishes the board members’ liability towards the company, proceedings initiated by third parties are not affected by this discharge.

For listed companies, the LuxSE rules and regulations provide a series of sanctions in the event its rules are breached, including fines or compensation for damage caused to the stock market.

### III KEY TRENDS IN SHAREHOLDER ACTIVISM

In line with the developments in EU law, there is a trend in Luxembourg law for more transparency, accountability and increased shareholder rights, especially in listed companies. Minority shareholders have additional rights further to the changes to the Companies Act in 2016. By transposing Directive 2017/828, shareholders rights are further strengthened, in particular with regard to the possibility of expressing their view on directors’ remuneration and needing to approve important transactions with related parties to a shareholders’ vote. Besides, in the future, institutional investors, asset managers and proxy advisers must also meet transparency requirements. It is hard to predict whether these changes will lead in practice to more public campaigns led by activist shareholders. It is certain that boards will, however, after transposition of Directive 2017/828 into Luxembourg law, more than ever have to take into account the potential involvement and action from their shareholders, including minority shareholders.

### IV RECENT SHAREHOLDER ACTIVISM CAMPAIGNS

There are very few publicly available examples of shareholder activism in Luxembourg listed companies. The most prominent example was the takeover of Arcelor by Mittal Steel, which was only finally made possible following the pressure of the shareholders. This concrete example, however, is already more than 10 years old, since the takeover took place in 2006.34

A more recent example is Deer Park Road’s investment in a Luxembourg-based company in 2017.35

Luxembourg

On a side note, Luxembourg hosts a number of funds that invest in companies worldwide and are active as shareholders in these entities. As an example, Active Ownership is a fund, based in Luxembourg, that managed to replace certain members in the supervisory board of STADA and became recently the most important shareholder of Agfa.

V REGULATORY DEVELOPMENTS

i Shareholder rights and powers

Transparency of directors' remuneration and approval of material transactions with related parties

Although the Companies Act does not set out any specific areas in which board decisions must be approved by the shareholders, the articles of association of the company may provide that all or certain board decisions must be ratified by the shareholders. It is, however, quite uncommon in listed entities for the board to need approval or seek ratification of its decisions that do not fall in the scope of statutory shareholder rights. However, according to the Bill, shareholders must be informed in detail about directors’ remuneration and the company's remuneration policy. A shareholders’ vote on the remuneration policy is advisory, except if otherwise provided for by the company’s articles of association.

Besides, shareholders must approve material transactions with related parties. With regard to the definition of ‘material transaction’, according to the Bill, Luxembourg will take into account the nature of the transaction as well as the position of the related party.

Equality of voting rights

The Shareholder Act came into force on 1 July 2011 aiming, inter alia, to strengthen the exercise of minority shareholders’ voting rights in listed companies to improve the corporate governance of the companies. The Shareholder Act explicitly refers to a principle of equal treatment of shareholders. This principle is limited to the participation of shareholders at the general meeting of shareholders and the exercise of their voting rights at that meeting. In 2016, the Companies Act amended the previous rule that one vote is in principle attached to one share, henceforth allowing the company to provide for different voting rights for different shares.

In addition, the LuxSE Principles provide that ‘the company shall respect the rights of its shareholders and shall ensure that they receive equal treatment. The company shall define a policy of active communication with its shareholders and shall establish a related structured set of practices.’

36 See www.reuters.com/article/us-stada-shareholders-aoc-idUSKCN1111AD.
37 See www.agfa.com/corporate/investor-relations/shareholder-structure.
38 Article 7(a) of the Bill.
39 Article 7(d) of the Bill.
40 Article 2 of the Shareholder Act.
41 Article 2 of the Shareholder Act.
42 LuxSE Principle 10.
The powers of shareholders to influence the board

The Companies Act reserves the management of the company, in principle, to its board.\(^{43}\) Should a shareholder be directly involved in the management of the company, he or she may be deemed a de facto director and face civil or criminal liability, or both, and generally be liable under the same circumstances as the appointed directors.

Shareholders do, however, control the appointment of the board (and, therefore, its composition) via a majority decision of over 50 per cent of the capital to appoint or revoke directors.\(^{44}\) In addition, shareholders representing 10 per cent of a company’s share capital may force the board to postpone a general meeting of shareholders for up to four weeks.\(^{45}\)

Furthermore, during the annual general meeting, the shareholders can question the board on all aspects of the company’s management, accounting and so forth throughout the year, and may withhold granting discharge. The Shareholder Act and the Companies Act expressly lay down that shareholder right in relation to the items on the agenda of the meeting.\(^{46}\)

Under the Shareholder Act, in addition to the right to ask questions orally during a meeting, shareholders may have the right to pose written questions about the items on the agenda before the meeting is held. If provided for in a company’s articles of association, questions may be asked as soon as the convening notice for the general meeting is published. The company’s articles of association will furthermore provide the cut-off time by which the company should have received the written questions.\(^{47}\)

Apart from several specific circumstances (e.g., in the case of confidential information), the company must answer any questions addressed to it. Should several questions relate to the same topic, the company may publish a detailed question and answer document on its website, in which case the chair should draw the shareholders’ attention to the publication.

The Companies Act also allows shareholders to submit questions to management outside of a meeting.\(^{48}\) Any shareholder representing at least 10 per cent of the company’s share capital or voting rights can ask the board of directors or management body questions about the management and operations of the company or one of its affiliates, without the need for extraordinary circumstances. If the company’s board or management body fails to answer these questions within one month, the shareholder may petition, as in summary proceedings, the president of the district court responsible for commercial matters to appoint one or more independent experts to draw up a report on the issues to which the questions relate.\(^{49}\)

Certain matters must also be reported to the shareholders, such as any director’s conflict of interest relating to voting on a resolution (see Section II).\(^{50}\)

Furthermore, if a minority shareholder finds that directors and members of its management and supervisory boards of a public limited liability company are negligent or

\(^{43}\) Article 441-5 of the Companies Act.
\(^{44}\) Article 441-2(3) of the Companies Act.
\(^{45}\) Article 450-1(6) of the Companies Act.
\(^{46}\) Article 7 of the Shareholder Act.
\(^{47}\) Article 3(2) of the Shareholder Act.
\(^{48}\) Article 1400-3 of the Companies Act. This new management evaluation procedure, inspired by French law, was introduced to the Companies Act by the Act of 10 August 2016.
\(^{49}\) Luxembourg District Court, 18 November 2016, No. 1809/2016. This judgment clarified the scope of application of this provisions, and, in particular, the questions that can be asked by the shareholders and the answers provided by the management that are to be considered satisfactory.
\(^{50}\) Article 441-7(2) of the Companies Act.
simply not diligent in the performance of their duties, it may sue them. Such an action may be brought by one or more shareholders or the holders of founders’ shares representing 10 per cent or more of the company’s voting rights.51

**Decisions reserved to shareholders**

The Companies Act provides that a company’s management board has the most extensive powers to perform all actions necessary or appropriate to fulfil the company’s corporate objective,52 with the exception of the actions specifically reserved by law to the shareholders’ meeting. These actions include, inter alia, any amendments to the company’s articles of association, the approval of annual accounts and the allocation of the company’s results, which are reserved to the company’s shareholders.

**Rights of dissenting shareholders**

The Companies Act currently recognises only a few rights of action on behalf of the company in favour of individual shareholders.

Seeking invalidation of a shareholder decision by dissenting shareholders is only possible on the basis of five grounds specified in the Companies Act:

a. procedural irregularity that influenced or could have influenced the outcome of the decision;

b. violation with fraudulent intent of the rules governing general meetings;

c. an ultra vires act or abuse of power affecting the decision;

d. exercise at a general meeting of voting rights that have been suspended by legislation other than the Companies Act, provided the quorum or majority required to adopt the decision would not have been met but for the unlawful exercise of these voting rights; and

e. any other cause provided for by the Companies Act.53

In addition, minority shareholders enjoy a sell-out right under certain conditions. According to the Act of 21 July on the squeeze-out and sell-out of securities (the Squeeze-out Act),54 in the event of an individual or legal entity acquiring at least 95 per cent of the share capital of the company and subject to certain conditions, the remaining minority shareholders are entitled to exercise a sell-out right within three months of the required notification and publication of the acquisition.55

However, the extension of the protection of minority shareholders by stipulating provisions in the company’s articles of association (e.g., the right of a minority coalition to propose directors, provisions for a more stringent majority for certain decisions, approval clauses or share transfer restrictions) is well recognised insofar as the arrangement does not conflict with Luxembourg’s public policy rules. Providing such additional protection

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51 Article 444-2 of the Companies Act.
52 Article 441-5 of the Companies Act.
53 Article 100-22 of the Companies Act.
54 Act of 21 July to squeeze-out and sell-out in respect of companies whose securities are or have been admitted to trading on a regulated market or have been the subject of a public offer.
55 Article 5 of the Squeeze-out Act.
in favour of minority shareholders, whether in the articles of association or otherwise, is common in Luxembourg, particularly among international joint ventures and groupings that use a Luxembourg company structure to promote mutual business activities.56

In this respect, the use of shareholders’ agreements of a purely contractual nature is far more common than providing for relevant provisions in the articles of association. Since the amendment of the Companies Act in 2016, the use of shareholders’ agreements is now explicitly recognised in Luxembourg law. The Companies Act does not state that these types of arrangements need to be limited in time. However, it does set out three types of voting arrangements that are null and void: (1) a shareholders’ agreement that violates the provisions of the Companies Act or that is contrary to a company’s corporate interest; (2) an undertaking by a shareholder to vote in accordance with instructions given by the company itself, a subsidiary or any corporate organ of such entities; and (3) an undertaking by a shareholder to those same companies or corporate organs to approve proposals made by the company’s corporate bodies.57 If votes are cast at a general meeting of shareholders pursuant to an invalid voting arrangement, the votes shall be considered null and void along with any resolutions taken, unless the votes did not affect the final outcome.58 Although the use of shareholders’ agreements does allow for discretion and flexibility, any compulsory implementation of this type of arrangement remains at risk.

Benefits for long-term shareholders

The Companies Act does not provide for any specific benefits (e.g., extra votes or dividends) for long-term shareholders, although such facilities may be agreed upon in a shareholders’ agreement or incorporated into the articles of association, or both.

ii Shareholders’ duties and responsibilities

Controlling shareholders’ duties and liability

All shareholders have certain obligations by law, including the payment of shares, a proportional contribution to any losses suffered by the company and an obligation of loyalty.

In addition, the controlling shareholders are notably prevented from dictating or imposing an increase of the other shareholders’ obligations without their prior consent, although this principle has been considerably attenuated by the Squeeze-out Act, which granted the right to force the acquisition of shares held by minority shareholders to shareholders controlling at least 95 per cent of the share capital.59

Institutional investors’ duties and best practice

In the future, institutional investors as well as asset managers shall develop and publicly disclose an engagement policy that describes how they integrate shareholder engagement in their investment strategy. They shall also, on an annual basis, publicly disclose how this policy has been implemented.60 After the amendment to the Shareholder Act, institutional investors

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57 Article 450-2(1) of the Companies Act.
58 Article 450-2(2) of the Companies Act.
59 Article 5 of the Squeeze-out Act.
60 Article 1(f) of the Bill.
as well as asset managers and proxy advisers will be bound by accrued transparency obligations. Besides, a number of Luxembourg-based investors have signed the United Nations-supported Principles for Responsible Investment.\textsuperscript{61} The first of these six principles is to incorporate environmental, social and corporate governance considerations into investment analysis and decision-making processes. Furthermore, a growing number of investors – though not being signatories to the Principles for Responsible Investment – are taking the private initiative to take such risks into account.

\textbf{Code of best practice for shareholders}
Luxembourg has no official code of best practice for shareholders, although companies may draw up internal codes of best practice for their shareholders.

\textbf{iii Contact with, and identification of, shareholders}

One of the main objectives of Directive 2017/828 is to give listed companies the right to identify their shareholders and, in the end, to improve the communication between the companies and their shareholders. Intermediaries, even those in third countries, are required to provide the company with information on shareholders identity.\textsuperscript{62} They must also provide the shareholders with information to facilitate the exercise of shareholder rights.\textsuperscript{63} According to Directive 2017/828, Member States may provide for companies having a registered office in their territory to be only allowed to request the identification of shareholders holding more than a certain percentage of shares or voting rights. This percentage shall not exceed 0.5 per cent. According to the current Bill, Luxembourg will not use this option, meaning that all shareholders can be identified.\textsuperscript{64}

Pursuant to the Shareholder Act, listed companies must give at least 30 calendar days’ notice before holding a meeting\textsuperscript{65} (notwithstanding particular requirements under the Takeover Bid Act).\textsuperscript{66} By doing so, Luxembourg’s parliament has imposed a longer notice period than the minimum 21-day notice period required under Directive 2007/36/EC. Should the quorum not be met at the first meeting, a second meeting must be convened at least 17 calendar days before the meeting is held.\textsuperscript{67} The convening notice must be published in the electronic compendium of companies and associations, a Luxembourg newspaper and other media in a manner that ensures the effective distribution of the information to the public throughout the European Economic Area.\textsuperscript{68} If all the shares are registered, convening notices may be sent by registered letter to the shareholders, members of the board (or the

\textsuperscript{61} Further information available at www.unpri.org. The principles are an investor initiative in partnership with the United Nations Environmental Programme Finance Initiative and the United Nations Global Compact.

\textsuperscript{62} Article 1(a) of the Bill.

\textsuperscript{63} Article 1(d) of the Bill.

\textsuperscript{64} Article 1(a) of the Bill.

\textsuperscript{65} Article 3(1) of the Shareholder Act.


\textsuperscript{67} Article 3(1)(2) of the Shareholder Act.

\textsuperscript{68} ibid.
management board and the supervisory board) and the statutory auditors. The Shareholder Act requires that, in addition to the agenda, date and place of the general meeting to be held, convening notices must also include the following:

a a clear description of the shareholders’ rights to put items on the agenda and to bring forward draft resolutions, the procedure for voting by proxy and a form to be used for such purpose and, if provided for in the company’s articles of association, the procedure to vote by electronic means;

b the postal and email addresses that can be used to obtain documents in relation to the meeting;

c where applicable, a copy of the ‘record date’ as defined by the Shareholder Act (i.e., the date by which shareholders must register their shares to participate and vote at the general meeting). The date for listed companies is set at midnight CET on the 14th calendar day before the meeting. The shareholder must notify the company at the latest by such date of its intention to participate in the meeting; and

d the company’s website address, which must contain all of the above information, as well as a full copy of the draft resolutions.69

The Shareholder Act and the Companies Act allow distance voting by shareholders in advance of the meeting, provided that the company expressly recognised this possibility and has outlined the related requirements in its articles of association. The Shareholder Act details the content of the ballot paper, which must include, inter alia, the full identity of the shareholder, the content of the vote cast in advance, the agenda of the meeting and the deadline before which the ballot paper must be received.70 In the future, according to Directive 2017/828, when votes are cast electronically a confirmation of receipt of the vote must be sent within two months of the vote.71 The Shareholder Act imposes that proxy voting be offered to shareholders, under certain conditions, with the proxy holder having the same rights as the shareholder. The company has no obligation to verify that the proxy holder votes in accordance with the shareholder’s instructions.72

iv Shareholder activism
Shareholder activism is not a defined notion under Luxembourg law, and neither derivative actions nor proxy battles are common practice in Luxembourg.

v Takeover defences
Takeover bids are covered by the Takeover Bid Act. The scope of this act is limited to companies whose shares are traded on a regulated market in one or more Member States of the European Union. Although Luxembourg law admits the principle of defensive measures, there has been no case law specifically covering the question as yet. In implementing any defensive measures, the board has an obligation to act in good faith with respect to the shareholders’ interest.

In the absence of a specific provision in a company’s articles of association requiring shareholder approval, the board may adopt defensive measures (e.g., issuing new shares within

69 Article 3(3) of the Shareholder Act.
70 Article 6 of the Shareholder Act.
71 Article 1(d) of the Bill.
72 Article 8 of the Shareholder Act.
the limits of authorised capital or selling key assets) without the approval of the shareholders, provided that these measures are taken in the best interests of the company. The board may not prohibit the shareholders from accepting an offer.

However, measures aimed at frustrating bids in the long term are not generally deemed to be admissible under Luxembourg legislation. It would not be possible, therefore, to repeat defensive measures whenever the bid is repeated or to take defensive measures that have a long-term effect.

**Shareholder and voting rights plans, and similar measures**

As a general rule, any increase of a Luxembourg company’s share capital is decided upon by the general meeting of shareholders. However, the articles of association of a Luxembourg public limited liability company may authorise the board of directors to increase the share capital up to a designated amount in one or more instalments. As a result of the entry into force of the Luxembourg Act of 10 August 2016, the articles of association of Luxembourg private limited liability companies may now also include an authorisation to the board of managers to issue shares, provided that the shares so issued are either issued to existing shareholders or to a third party that has been approved in accordance with the law.

The authorisation to do so is only valid for five years, but may be renewed by the general meeting of shareholders. As an inducement for an existing shareholder to purchase more shares, it may be decided to abandon any payment of share premium. Beyond that, there is no possibility for a company to offer a discount on the par value of shares to be issued.

**White knight defence**

In Luxembourg practice, the board of any company that is the subject of a takeover bid may seek out a third party with the purpose of such party making a counter-offer that is more favourable to the company. It can do so without the need for approval by the company’s shareholders.

**Staggered boards**

Directors of a Luxembourg public limited liability company shall be appointed for a term of office that may not exceed six years. However, directors may be removed from office by the general meeting of shareholders at any time and without stating reasons. As a result, a staggered board does not constitute a major obstacle for a hostile acquirer holding sufficient shares to make changes to the composition of the board.

**VI OUTLOOK**

Although there are not many publicly known campaigns of activist shareholders in Luxembourg, in line with the developments in EU law, there is a trend in Luxembourg law for more transparency, accountability and increased shareholder rights, especially in listed companies. Time will tell whether the changes in Luxembourg law will lead to more public campaigns led by activist shareholders. It is certain that boards will, however, have to be aware of potential involvement and action from their shareholders.

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73 As a result of the entry into force of the Luxembourg Act of 10 August 2016, the articles of association of Luxembourg private limited liability companies may now also include an authorisation to the board of managers to issue shares, provided that the shares so issued are either issued to existing shareholders or to a third party that has been approved in accordance with the law.

74 Article 420-22 of the Companies Act.

75 Article 441-2(4) of the Companies Act.
I OVERVIEW

Shareholder activism is a hot topic in many Dutch boardrooms. In 2017 and 2018, several activist campaigns aimed at Dutch multinationals made headlines in the Netherlands, as well as abroad, including in particular the Boskalis versus Fugro battle and later the campaign of Elliott Advisors against AkzoNobel. Following these campaigns – both characterised by the activist shareholder being unsuccessful in litigation proceedings against the company – the level of public shareholder activism seems to have decreased, but it remains to be seen whether this is a continuing trend. Discussions between boards and shareholders on matters such as strategy, executive compensation and environmental, social and governance (ESG), will continue to dominate the agendas within Dutch listed companies. Aside from shareholder activism, we have also seen numerous (unsuccessful) hostile approaches in recent years, including for PostNL, Unilever and AkzoNobel. Partly fuelled by these takeover attempts, the global wave of increased protectionism has also reached the Netherlands with both public sentiment and the government calling for increased protection of (certain) Dutch companies.

This chapter gives an overview of the Dutch regulatory and legal framework in which listed companies and their shareholders operate, points out the key trends concerning shareholder activism in the Dutch market, and zooms in on a few topical battles between companies and activist shareholders.

II LEGAL AND REGULATORY FRAMEWORK

i Primary sources of law, regulation and practice

Dutch Civil Code

Book 2 of the Dutch Civil Code (DCC) is the primary source of law with regard to Dutch corporate law. As such, the DCC also covers the rights and duties of, and the division of powers between, the boards and the general meeting of shareholders.

Dutch Corporate Governance Code

The Dutch Corporate Governance Code complements the DCC, as it lays down principles and best practice provisions that regulate the relationship between the boards and the general meeting. The Corporate Governance Code focuses on long-term value creation for the company and its business, as well as culture. This fits into the Dutch stakeholder model of

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corporate governance and can be an important element for companies in encounters with activist shareholders. The Corporate Governance Code applies, in principle, to all Dutch listed companies on a comply-or-explain basis.2

**Dutch Financial Markets Supervision Act and the Market Abuse Directive**

The Dutch Financial Markets Supervision Act (FMSA) contains, among other things, disclosure obligations for listed companies, major shareholders and board members, and rules on takeovers of listed companies. The FMSA has implemented numerous EU directives, such as the Transparency and the Takeover Directives. In 2016, several market abuse provisions were removed from the FMSA, and are now dealt with in the Market Abuse Regulation, which has a direct effect in all EU Member States.

**EU Shareholder Rights Directive**

In 2017, the European Council adopted a revised version of the EU Shareholder Rights Directive.3 The Dutch bill implementing the revised EU Shareholder Rights Directive is currently subject to review by the upper house of the Dutch parliament and is expected to be adopted in the course of 2019. Following the implementation, the remuneration policy of the management and supervisory boards will be subject to the approval of the general meeting. In addition, material related party transactions will require the approval of the supervisory board and will be subject to increased transparency requirements. Investors will be required to be transparent how they invest and how they engage with companies they invest in.

In line with the amended directive, Dutch pension funds, insurers and asset managers published the first Dutch Stewardship Code in July 2018.4 The Stewardship Code sets forth certain principles on institutional shareholder engagement, which, among other things, are aimed at stimulating institutional investors to cast informed votes at shareholder meetings, engaging with listed companies on strategy, performance and ESG topics, and being transparent on its voting policy and history. From financial year 2019 onwards, asset owners and asset managers are expected to apply the Code’s principles and to report on its implementation.

**EU Alternative Investment Fund Managers Directive**

For hedge funds and private equity funds specifically, the Alternative Investment Fund Managers Directive is also relevant as it sets out rules and requirements for the authorisation, ongoing operation and transparency of alternative investment fund managers.

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2 For detailed commentary on the Dutch Corporate Governance Code, see: RH Kleipool, M van Olffen and BW Roelvink, Corporate Governance in the Netherlands – A practical guide to the new Corporate Governance Code (2017).


Division of powers – roles of the executive and supervisory boards, and the general meeting

Most Dutch public limited liability companies with a listing on the Amsterdam Stock Exchange have a two-tier board, consisting of an executive and a supervisory board. In a two-tier board governance model, the roles of the main corporate bodies can be summarised as follows.

The executive board manages the company and is in charge of the company’s aims, strategy, risk profile, results and corporate social responsibility issues. It is accountable to the supervisory board and the general meeting of shareholders.

The supervisory board is charged with supervising and advising the executive board. It has certain rights regarding the appointment, suspension and dismissal of executive board members, and the approval of the supervisory board is required for certain important resolutions. It is accountable to the general meeting.

The general meeting monitors the performance of the executive and supervisory boards, and can exercise the rights vested upon it by the DCC and the company’s articles of association. For example, a decision of the general meeting is needed for resolutions concerning an issuance of shares, dissolution of the company, adoption of the annual accounts, board compensation or amendment of the company’s articles of association. Transactions regarding an important change in the company’s identity or character (e.g., sale of a large division) require prior approval of the general meeting. The general meeting also has the power to appoint or dismiss board members. The company’s articles of association, however, may limit this power by providing that the appointment or dismissal occurs only upon a (binding) proposal from the executive or supervisory board, or can only be taken with an increased majority requirement.

Stakeholder model as the guiding principle for a company’s boards

The executive and supervisory boards must always act in the best interests of a company and all its stakeholders, with a focus on long-term value creation. In practice, this means that Dutch boards have a fiduciary duty towards a wide range of stakeholders, including shareholders, employees, customers and suppliers, as well as the communities in which the company operates. This is in contrast with the shareholder model of corporate governance, in which a company’s main interest is to promote shareholder value, which is the predominant model in jurisdictions with an Anglo-Saxon legal tradition.

The Dutch stakeholder model also applies in takeover situations. As a logical consequence, the target company’s boards can reasonably reject an unsolicited takeover proposal even if this proposal is supported by (a majority of) shareholders. This guiding principle was confirmed in the case of Elliott Advisors v. AkzoNobel (see Section IV.iv).

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5 Dutch law gives companies the option to structure their boards based on a one-tier model (single board with both executive and non-executive board members) or a two-tier model (separate executive and supervisory boards). One-tier board structures are often seen with Dutch public limited liability companies with a listing on the New York Stock Exchange or Nasdaq; for example, Mylan NV, NXP Semiconductors NV and Unilever NV.
The activist shareholder’s toolbox

The following are tools that activist shareholders commonly use in pursuing their agenda. See Table 1 for the various levels of aggression of these tools.

**Table 1**

<table>
<thead>
<tr>
<th>Level of aggression</th>
<th>Tools</th>
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<tbody>
<tr>
<td>Least aggressive</td>
<td>Private discussions and engagement with the company</td>
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<td></td>
<td>Public engagement with the company</td>
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<tr>
<td></td>
<td>Stakebuilding</td>
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<td></td>
<td>Right to participate in and vote at the general meeting</td>
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<td></td>
<td>Right to place an item on the agenda</td>
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<tr>
<td>Most aggressive</td>
<td>Right to convene a meeting</td>
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<tr>
<td></td>
<td>Initiate litigation</td>
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</table>

**Private discussions and engagement with the company**

The vast majority of shareholder activism starts with the activist engaging with the boards of the company in a private setting. This could take the form of informal one-on-one discussions or conference calls with the company’s CEO to discuss strategy and measures to maximise shareholder value, or more formal communication by sending private ‘Dear Board’ letters.

**Public engagement with the company**

Where a shareholder activist is dissatisfied with the company’s response to issues raised in private discussions, starting a public campaign may be an alternative strategy to realise its agenda. Typically, this includes the use of traditional and social media, teaming up with other shareholders and institutional investors, and gaining support from the investor community at large by publishing investor presentations or setting up websites dedicated to the activist campaign.

In the Netherlands, there have been numerous public campaigns by activist shareholders. The most notorious examples in this respect are the 2007 campaign of UK-based hedge fund, the Children’s Investment Fund against ABN AMRO and, more recently, the campaign of Elliott Advisors, the British arm of Paul Singer’s US hedge fund, against AkzoNobel in the context of an unsolicited approach from US paint producer PPG Industries.

**Stakebuilding**

For an activist shareholder to ramp up the pressure on the company’s boards, building a significant stake may be a critical element in its strategy. Stakebuilding may enable an activist shareholder to add weight to its opinions and to be taken as a serious threat by the company, especially when the activist shareholder reaches the threshold for placing items on the agenda of the general meeting or for convening a general meeting (see below). Even with a small stake (e.g., 1–3 per cent), an activist shareholder may have significant influence. In some events, the mere fact that a typical activist shareholder has acquired a stake may push the targeted company to critically review its performance and strategic options to avoid a (public) activist campaign.

When buying shares, the activist shareholder must observe the rules on disclosure of substantial shareholdings. Pursuant to the FMSA, a shareholder must immediately notify the Netherlands Authority for the Financial Markets (AFM) if its percentage of capital interest or
voting rights exceeds (or falls below) a number of specific thresholds. Currently, the thresholds are 3, 5, 10, 15, 20, 25, 30, 40, 50, 60, 75 and 95 per cent.\(^6\) A possible new development in this context is the intention of the Cabinet to introduce a new threshold of 2 per cent. The Cabinet is of the opinion that the introduction of such threshold could contribute to long-term value creation by listed companies and preserve a stable shareholder base. An activist shareholder building up its stake should also be aware of the mandatory offer rules. Under the FMSA, a mandatory offer is triggered by a person, or by a group of persons acting in concert, acquiring ‘predominant control’ (at least 30 per cent of voting rights).\(^7\)

**Right to participate in and exercise right to vote at the general meeting**

Every shareholder has the right to participate in and exercise its voting right at the company’s general meeting. Generally, a holder of one share is entitled to one vote. The articles of association may stipulate a voting record date 28 days prior to the general meeting. The record date determines which shareholders are entitled to vote at the general meeting. Shareholders may vote in person or by proxy (which may be granted electronically).

In the Netherlands, a ‘vote no’ campaign has been seen on numerous occasions. In 2016, hedge fund Highfields Capital Management opposed the plans of insurer Delta Lloyd to pursue a rights offering. Another example is the 2016 ‘vote no’ campaign of Dutch shareholders’ association VEB against the pay package for Shell board members. Shareholders sometimes also express their dissatisfaction by voting against the discharge of the board – which is normally granted by the general meeting with an overwhelming majority. A recent example concerns Dutch bank ING where the general meeting did not discharge the (former) members of the executive or supervisory boards from their potential liability against the company for their duties performed in the 2018 financial year. This was seen by many as a reprimand for the €775 million fine\(^8\) ING incurred for failing to prevent money laundering. In late 2018, Unilever was confronted with a ‘vote no’ campaign when some of its shareholders, which collectively owned around 12 per cent of the company’s stock, publicly opposed Unilever’s plans to move the company headquarters from London to Rotterdam and simplify the company’s corporate structure.

**Right to place an item on the agenda**

Shareholders individually or jointly holding 3 per cent of the company’s stock have a right to submit items for the agenda of the general meeting. The company’s articles of association can prescribe a lower percentage of 1 per cent, which relates to the former statutory threshold for submitting agenda items. The company can refuse to put an item on the agenda of the general meeting if this contravenes the standards of reasonableness and fairness. The

\(^6\) For non-EU entities with a listing on the Amsterdam Stock Exchange that choose the Netherlands as their EU home Member State, the thresholds are 5, 10, 15, 20, 25, 30, 50 and 75 per cent.

\(^7\) A mandatory offer will not be required if, within 30 days following the acquisition of control, the controlling party reduces its stake below the 30 per cent voting rights threshold, provided that the voting rights held by that controlling party have not been exercised during this period and the shares are not sold to another controlling shareholder of the company. The Enterprise Chamber may extend this period by an additional 60 days.

\(^8\) Press release, ‘ING reaches settlement agreement with Dutch authorities on regulatory issues in the ING Netherlands business’, 4 September 2018.
Corporate Governance Code stipulates that a shareholder may exercise this right only after it has consulted the executive board. See in this respect the company’s right to invoke a 180-day response time (see subsection v).

A notable example in this respect is the case concerning ASMI, a Dutch multinational active in the semiconductor industry. Two hedge funds Fursa and Hermes put a proposal – to replace the CEO and most of the supervisory board members – on the agenda of the 2008 general meeting. Further, in both 2017 and 2018, social activist Follow This put a ‘green’ resolution on the agenda of the general meeting of oil giant Shell in which it requested that Shell set and publish targets that are aligned with the Paris Climate Agreement’s goal to limit global warming to well below 2°C. Although the resolution was voted down each time, it gained more support from institutional investors in 2018 than in the year before, in line with institutional investors’ higher prioritisation of ESG issues. In 2019, Follow This withdrew its green resolution following intensive discussions with fellow proponents Aegon, NN Investment Partners, MN, Achmea, Van Lanschot Kempen, Actiam and Blue Sky Group. It was decided to give Shell more time to achieve its climate ambitions. This move could be seen as a reaction to Shell’s plans set out in December 2018 to introduce industry-leading targets to reduce greenhouse gas emissions and link them to executive pay (see Section III.v).

Shareholders can submit items for the agenda as either a voting or a discussion item. However, shareholders cannot force the board to put an item on the agenda as a voting item if the general meeting does not have the power to resolve the topic; in other words, shareholders cannot use this right to organise referendums or ‘motions’ on topics belonging to the primacy of the boards. See the 2016 case of Boskalis v. Fugro, discussed in Section IV.iii.

**Right to convene a shareholders’ meeting**

Shareholders individually or jointly holding 10 per cent of the company’s stock (the company’s articles of association can prescribe a lower percentage) may request the company’s boards to call a general meeting and put such items on the agenda as requested by these shareholders. If the board refuses to do so, the shareholders could request authorisation from the district court to call a general meeting. The court will decide whether the shareholder has a legitimate interest in convening a shareholders’ meeting. The board can refuse to call a general meeting if it is of the opinion that the request contravenes the standards of reasonableness and fairness, or that it does not meet the ‘legitimate interest’ test. A prominent example of activists exercising this right is Centaurus and Paulson & Co, who called shareholders’ meetings at Dutch industrial conglomerate Stork to vote on alternative strategies, including a public-to-private transaction and the dismissal of the entire executive board. In 2017, Elliott Advisors also invoked the right to call a general meeting in its crusade against AkzoNobel, which was rejected by the boards of AkzoNobel. In subsequent court proceedings, the Enterprise Chamber and the Amsterdam District Court rejected Elliott Advisors’ request to convene a general meeting (see Section IV.iv).
Initiate litigation

Shareholder litigation typically takes place in inquiry (mismanagement) proceedings before the Enterprise Chamber. Any shareholder that alone or acting jointly holds sufficient shares may initiate inquiry proceedings and request the Enterprise Chamber to order an inquiry by independent, court-appointed investigators into the policy of the company.

The Enterprise Chamber may order an inquiry into the policy of a company if it is demonstrated that there are reasonable grounds to believe that there is mismanagement. This may consist of, for instance, abuse of minority shareholders, insufficient disclosure to shareholders, conflicts of interest of board members or the unjustified use of takeover defences.

The Enterprise Chamber may at any time during the proceedings order interim measures. These may play an important role in takeover situations and activist campaigns. Interim measures may include suspending executive or supervisory board members, appointing interim executive or supervisory board members, and suspending shareholders’ voting rights. These interim decisions tend to carry great weight and, despite being provisional, are often decisive in the matter’s outcome. It is not uncommon that the Enterprise Chamber postpones a decision to order an inquiry into the policy of a company, and only rules on the requested interim measures.

The Enterprise Chamber has repeatedly demonstrated its willingness to act promptly and take rigorous action in takeover and activist situations. In the context of takeovers of public companies, shareholder interest groups and other activist shareholders often use (the threat of) inquiry proceedings to protect the interests of minority shareholders; for example, against the boards of the target company (some or all members of which may no longer be regarded as independent) or a majority shareholder.

The company’s toolbox

Corporate law provides for several structural mechanisms that enable a company to prevent or deter hostile approaches. Many Dutch listed companies have adopted such mechanisms in their articles of association. Examples include the use of listed depositary receipts without voting rights, priority shares with certain control rights, shares with double or multiple voting rights, voting caps, the use of change of control clauses in financing arrangements, golden parachutes and structures that limit the shareholders’ control of the board. However, no

9 A shareholder can also initiate summary proceedings before the competent district court. However, summary proceedings are much less common, since the Enterprise Chamber is regarded as the specialised court regarding corporate litigation.

10 If the company’s issued share capital does not exceed €22.5 million of aggregate nominal value, persons who alone or acting jointly hold shares representing at least 10 per cent of the issued share capital or representing an aggregate nominal value of at least €225,000; or the company’s issued share capital exceeds €22.5 million of aggregate nominal value, persons who alone or acting jointly hold shares representing at least 1 per cent of the issued share capital or, if the shares are listed, representing an aggregate value of at least €20 million based on the closing price of the last trading day.

The threshold for an activist shareholder to have standing in the Enterprise Chamber can be extremely high as a result of the capital structure of the company. This was the case at Mylan (which was the subject of an unsolicited approach by Teva Pharmaceutical Industries) where the nominal value of each share was set at €0.01 and the aggregate nominal value of the issued share capital did not exceed €22.5 million. As a result, a shareholder wanting to initiate inquiry proceedings would at the time need to hold shares with a market value of more than US$1 billion to reach the threshold of €225,000 in aggregate nominal value.
company is immune to shareholder activism even with such structural mechanisms in place. In the following we describe some typical response measures that a targeted company could use.\textsuperscript{11} See Table 2 for the various levels of aggression regarding these tools.

\textbf{Table 2}

<table>
<thead>
<tr>
<th>Level of aggression</th>
<th>Tools</th>
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<tbody>
<tr>
<td>Least aggressive</td>
<td>Enter into a dialogue with the activist shareholder</td>
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<tr>
<td></td>
<td>Get the company’s message out to shareholders</td>
</tr>
<tr>
<td></td>
<td>Relationship, standstill or settlement agreements</td>
</tr>
<tr>
<td></td>
<td>‘Just say no’ strategy</td>
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<tr>
<td></td>
<td>Invoke response time</td>
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<tr>
<td></td>
<td>‘Put up or shut up’ rule</td>
</tr>
<tr>
<td></td>
<td>Issue ordinary shares</td>
</tr>
<tr>
<td></td>
<td>Sell treasury shares</td>
</tr>
<tr>
<td>Most aggressive</td>
<td>Trigger a call option on anti-takeover preferred shares</td>
</tr>
<tr>
<td></td>
<td>Initiate litigation</td>
</tr>
</tbody>
</table>

\textit{Enter into a dialogue with the activist shareholder}

The most informal response measure for a company is to enter into a dialogue with the activist shareholder. This provides the opportunity for the company’s boards to assess the activist’s views on the company’s strategy, and shows their willingness to listen to the activist shareholder’s concerns and suggestions. Building a relationship of trust and creating consensus with the activist shareholder can be a strong tool from which the company can benefit in the long run. Entering into discussions with the activist shareholder may give the boards new (industry) insights, ‘breathing space’ and time to determine its strategy if private discussions do not result in a long-term solution.

\textit{Get the company’s message out to shareholders}

A company dealing with shareholder activism could reiterate and emphasise its current or revised strategy (in combination with a ‘just say no’ strategy). The executive board can give presentations to (key) shareholders and potential investors in which it explains that its current or revised strategy is in the best interest of the company and its stakeholders, and, next to that, is the preferred path to maximise value for its shareholders. Gaining the support of (other) shareholders might prove pivotal in fending off an activist shareholder.

\textit{Relationship, standstill or settlement agreements}

A growing trend in the Dutch market is that listed companies conclude relationship agreements with one or more large, vocal shareholders. In a relationship agreement, the company and the shareholder generally agree on topics such as strategy, governance, financing and exchange of information. The company could give one or more supervisory board seats to the shareholder in exchange for support for its strategy. Relationship agreements are typically concluded with

\textsuperscript{11} According to the Supreme Court, defensive measures can be justified if they are necessary with a view to the long-term continuity of the company and its various stakeholders, provided that the measures are taken to maintain the status quo, and provided that they constitute an adequate and proportional response. Implementing defensive measures for an indefinite amount of time, generally, will not be justified.
activist shareholders with a significant shareholding (typically more than 10 per cent), but also with non-hostile cornerstone investors in the context of an initial public offering. Examples include the relationship agreements between telecom company KPN and its Mexican suitor América Móvil (see Section IV), and between critical materials company AMG and hedge fund RWC.

Although concluding a relationship agreement may reduce or channel the pressure exercised by a shareholder, the board must be aware that representation of an activist shareholder on the board inevitably has an impact on the boardroom dynamics.

In an activist situation, a company may also seek to enter into a pure standstill or settlement agreement to reach a (temporary) ceasefire with an activist shareholder. An example is AkzoNobel agreeing to a standstill with Elliott Advisors, in August 2017, to end pending litigation and gain support for the proposed change in its board composition, which included new supervisory board members that were nominated by AkzoNobel following consultation with its biggest shareholders.

**Invoke response time**

Pursuant to the Corporate Governance Code, the executive board may invoke a 180-day response time when shareholders request certain agenda items that could lead to a change in the company’s strategy, such as the request to appoint a new CEO, or dismiss an executive or supervisory board member. The executive board must use the response time for further deliberation and constructive consultation with the shareholder involved, and to explore alternatives. Case law has further defined that, in principle, shareholders must respect the response time as invoked by the executive board; the response time may only be set aside if there are sufficiently important reasons for this. The response time provides the executive board with some breathing space and the opportunity to enter into a dialogue with the activist shareholders, or to seek alternative measures.

The government has published a draft bill to implement a 250-day statutory time-out period for companies confronted with either a proposal from shareholders concerning the appointment, suspension or dismissal of members of the management or supervisory boards, or a non-supported public offer for their shares, which, in the opinion of the management board, conflict with the interests of the company and its stakeholders. The decision of the management board to invoke the time-out period is subject to approval of the supervisory board and needs to be motivated by the management board. During the time-out period, the general meeting cannot appoint, suspend or dismiss members of the management or supervisory boards, or amend the articles of association of the company on these topics. The management board is required to consult shareholders holding more than 3 per cent during the time-out period to gather their views. Shareholders that have the authority to initiate inquiry proceedings (see footnote 10) may challenge the management board invoking the statutory time-out period in proceedings with the Enterprise Chamber.

**‘Put up or shut up’ rule**

The objective of the ‘put up or shut up’ rule is to prevent a listed company from being the object of rumour and speculation regarding a potential public offer for its securities. At the request of the potential target company, the AFM can impose disclosure obligations on an entity or person that has published information that could create the impression that it is considering the preparation of a public offer. Following the AFM’s instructions, the potential bidder must ‘put up’ or ‘shut up’ by either announcing a public offer for the target company.
or indicating that it does not intend to launch a public offer for the target company. In the latter case, it will be prohibited from announcing or launching an offer for the target company for six months.

**Issue ordinary shares**

As noted above, the general meeting has the power to issue ordinary shares. However, pursuant to the DCC, the general meeting may delegate this power to another corporate body for up to five years. The same applies for the limitation and exclusion of pre-emptive rights of existing shareholders. Typically, as is the case for the vast majority of Dutch listed companies, the general meeting authorises the executive board to issue ordinary shares. In general, the authorisation stipulates that the executive board can issue a certain percentage of shares without pre-emptive rights for ‘general corporate purposes’ (often 10 per cent) and a certain percentage for the purpose of mergers and acquisitions (M&A) (often 10 per cent). To defend itself from activist shareholders or hostile bidders, the executive board could decide to issue shares (without pre-emptive rights) to a ‘friendly’ third party; for example, a long-time strategic party. Although perceived as aggressive, such an issuance dilutes the activist shareholder’s stake in the company and accordingly reduces its influence. An interesting development is that, since 2018, the Institutional Shareholder Services recommends in its voting guidelines to vote against authorisation for the executive board to issue more than 10 per cent of shares without pre-emptive rights. We have observed that many listed companies have since confined themselves to request an authorisation to issue shares only up to 10 per cent.

**Sell treasury shares**

When a company holds a certain number of its own shares (e.g., as a result of a share buy-back), and these shares have not yet been cancelled (treasury shares), a company may sell these to a friendly third party. As a result, similar to issuing ordinary shares, the third party acquires a stake in the company and dilutes the shareholding of the activist shareholder. Alternatively, a company could use treasury shares as consideration when purchasing certain assets from a third party. Depending on the specific situation, the company’s boards must be aware that this defensive measure, similar to issuing ordinary shares, is likely to be perceived as aggressive not only by existing shareholders but also by the investor community and regulators.

**Defence foundation – issuing anti-takeover preferred shares**

The most common defensive measure consists of the possibility for a company to issue preferred shares to an independent, yet friendly, foundation. The company grants the foundation a call option, pursuant to which the foundation can effectively obtain up to 50 per cent of the votes.

The company’s boards may invite the involvement of the defence foundation. It will then be up to the foundation to decide whether to exercise its call option and choose its course of action, including whether it wants to engage with an activist or bidder to signal

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12 In general, a prospectus is required for both the offering and the listing of shares. Under Dutch law, companies can make use of an exemption to publish a listing prospectus if it issues less than 10 per cent of the company’s stock to qualified investors during a 12-month period, or publish an offering prospectus if it issues shares to fewer than 150 retail investors.
what the foundation would not find acceptable, or to give an opportunity to an activist or bidder to clarify their intentions. The foundation must make its own decision in accordance with its objectives as stated in its articles of association. In general, the foundation’s articles of association state that the foundation serves the interest of the company and its stakeholders by safeguarding, among other things, the continuity, independence and identity of the company and its business.

Foundations rarely exercise their call option, which may be partly explained by the fact that the presence of a defence foundation alone may have a deterrent effect on a hostile bidder. One of the few, and most recent, examples – in which a defence foundation exercised its call option – concerns the defence foundation of KPN, which exercised its call option as a reaction to América Móvil’s announcement to launch a hostile bid. Another example is the defence foundation of global pharmaceutical company Mylan NV (having its registered office in the Netherlands), which made use of its call option to deter Teva Pharmaceutical Industries.

Initiate litigation

Although uncommon, a targeted company can also initiate summary proceedings before the district court or inquiry proceedings before the Enterprise Chamber. In such proceedings, the company can request interim or provisional measures to neutralise the attack or campaign of an activist shareholder.

III KEY TRENDS IN SHAREHOLDER ACTIVISM

i General overview

Shareholder activism reached its first peak between 2000 and 2007, when various US and UK-based hedge funds targeted listed companies in the Netherlands. Examples included the financial conglomerate ABN AMRO, Dutch industrial giants ASMI and Stork, and other well-known multinationals such as Ahold and Philips.

The Netherlands has also seen a surge in shareholder activism in the past decade as a result of market and economic conditions, a boost in M&A activity and increased attention from US and UK-based hedge funds for European targets. This follows the global trend of a growing number of activist campaigns: JPMorgan reported 651 campaigns globally in 2018, as opposed to 394 campaigns globally in 2012. In recent years, shareholders have also become more vocal on matters relating to executive compensation and ESG topics.

Since 2010, the Netherlands has seen numerous publicly known activist shareholder campaigns. The total level of shareholder activism is most likely significantly higher, however, since shareholder activism in the Netherlands often takes place behind closed doors.

Given the relatively low number of activist shareholder campaigns in the Netherlands compared with the United States and the United Kingdom, trends described in this section are not only based on statistics, but are also based on more subjective observations and anecdotal evidence.

Activist shareholders – the usual suspects

Activist shareholders in the Netherlands are predominantly US or UK-based hedge funds with a European or global investment focus. Activism comes from both pure-play activist hedge funds, which acquire a stake in a company and subsequently put pressure on the management to adopt their views to maximise shareholder value, and multi-strategy hedge funds, for which shareholder activism is only one of their strategies. Pure-play activist hedge funds typically have an event-driven investment strategy, in which M&A plays a crucial role (see below). These activist hedge funds often seek to initiate M&A activities by ‘suggesting’ that a company spin off or sell a division, and also become active in pending M&A transactions to push for a better price. Over the past decade, some of the largest global activist hedge funds have been active in the Netherlands; the most prominent examples are listed below.

Table 3

<table>
<thead>
<tr>
<th>Activist shareholder</th>
<th>Target</th>
<th>Objective</th>
</tr>
</thead>
<tbody>
<tr>
<td>The Children’s Investment Fund</td>
<td>ABN AMRO</td>
<td>Pushing for a sale of ABN AMRO</td>
</tr>
<tr>
<td>Centaurus</td>
<td>Stork, Ahold (together with Paulson &amp; Co) and SBM Offshore</td>
<td>Pushing for a split-up (Stork); selling US activities (Ahold); requesting a different financing structure (SBM Offshore)</td>
</tr>
<tr>
<td>Hermes</td>
<td>ASMI, and Océ (together with Orbis)</td>
<td>Pushing for a split-up and changes in board composition (ASMI); litigation against recommended takeover (Océ)</td>
</tr>
<tr>
<td>Third Point</td>
<td>DSM and Philips</td>
<td>Suggesting a split-up (DSM); stakebuilding (Philips)</td>
</tr>
<tr>
<td>RWC</td>
<td>Corbion and AMG</td>
<td>Stakebuilding (Corbion); discussions about strategy, board composition and board compensation (AMG)</td>
</tr>
<tr>
<td>Paulson &amp; Co</td>
<td>Stork (together with Centaurus), KPN and Ahold (together with Centaurus)</td>
<td>Pushing for a split-up (Stork); stakebuilding (KPN); selling US activities (Ahold)</td>
</tr>
<tr>
<td>JANA Capital</td>
<td>Philips and TNT Express</td>
<td>Talks on performance and capital structure (Philips); pushing for a sale and changes in board composition (TNT Express)</td>
</tr>
<tr>
<td>Highfields Capital Management</td>
<td>Delta Lloyd</td>
<td>‘Vote no’ campaign against Delta Lloyd’s proposed rights offering</td>
</tr>
<tr>
<td>TT International</td>
<td>TomTom</td>
<td>Suggesting a split-up of TomTom into parts</td>
</tr>
<tr>
<td>Eminence Capital</td>
<td>ASMI</td>
<td>Pushing for sale of ASMI’s 34 per cent stake in Asian subsidiary ASM PT</td>
</tr>
<tr>
<td>Elliott Advisors</td>
<td>AkzoNobel, NXP and Intertrust</td>
<td>Pressing for a takeover by PPG (AkzoNobel); contesting the agreed offer price in the takeover by Qualcomm (NXP); stakebuilding at Intertrust</td>
</tr>
<tr>
<td>PGGM, CalSTRS and the City of New York and the State of New York Pension Funds</td>
<td>Mylan</td>
<td>‘Vote no’ campaign regarding board nominees and executive compensation package</td>
</tr>
<tr>
<td>ValueAct Capital</td>
<td>Royal Vopak</td>
<td>Stakebuilding</td>
</tr>
</tbody>
</table>

Besides these, we have seen increased attention to shareholder activism from institutional investors. Activism from institutional investors in the Netherlands typically cannot be characterised as ‘aggressive’. Institutional investors tend to focus on corporate governance issues, such as remuneration policy and corporate social responsibility. Most activism from institutional investors takes place behind closed doors. An example of institutional investors publicly expressing their position in a takeover situation is the 2014 public campaign that Dutch pension fund manager APG, together with Dutch insurer NN Group, waged against animal and fish feed company Nutreco. APG and NN Group disagreed with the board’s decision to sell the company to SHV, claiming that the offer significantly undervalued
Nutreco’s business – while, at the same time, Cargill and private equity firm Permira had expressed their interest in Nutreco (although they did not make an offer). In a public letter, APG and NN Group questioned the Nutreco boards’ decision to sell the company to SHV. Eventually, SHV raised its offer, and APG and NN Group sold their shares.

Although we see that institutional investors are not unwilling to play a more active role as shareholders, institutional investors typically refrain from exercising public pressure on the companies they invest in and do not tend to carry out aggressive campaigns in the same way as pure-play activist hedge funds do. Globally, increased activism is seen among institutional investors, with several examples of traditional long-only funds embracing activist tactics and other institutional investors publicly supporting activist campaigns.14

In line with a recent global trend, Dutch institutional investors show an increasing focus on ESG issues and some have actively challenged the companies they invest in to take more responsibility for their contribution to society. For example, Aegon pushed Dutch oil giant Shell to commit to the targets of the Paris Climate Agreement.

### iii Targets for activist shareholders – size is no deterrence

One of the recent global trends also observed in the Netherlands is activist shareholders expanding their focus to some of the largest companies. This is largely driven by the increased financial capacity of the large activist hedge funds. Globally, the total level of capital deployed for activist campaigns in 2018 amounted to US$65 billion. The top 10 global activists contribute the majority thereof, each holding activist positions of more than US$3 billion. TCI’s position in US tech company Altaba was by far the largest, with their position representing a market cap of US$7.2 billion.15

In the Netherlands, this trend was first observed with hedge funds targeting Ahold in 2006 (market cap at that point over €10 billion), ABN AMRO in 2007 (market cap at that point over €50 billion) and Philips in 2007 (market cap at that point over €30 billion). In recent years, Shell (market cap over €230 billion) was targeted by activist shareholders, who were pushing for more focus on sustainable energy and a business model that is more climate change-proof. In 2017, Elliott Advisors targeted AkzoNobel (market cap around €20 billion) and NXP (market cap around €30 billion). A company’s large size thus does not deter activist shareholders.

### iv Objectives of activist shareholders – five common themes

**Conglomerate discount**

Several Dutch companies were pressured by shareholders to unlock shareholder value by divesting or spinning off non-core divisions, or breaking up the company. The best-known examples include **Ahold**, where Paulson & Co and Centaurus demanded the sale of Ahold’s US activities; **Stork**, where Paulson & Co and Centaurus pushed to break up the company; **DSM**, where Third Point pushed for a split-up; and **ASMI**, where Hermes campaigned for a split-up of the company’s front and back-end activities.

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14 ibid.
M&A situations

M&A continues to be a fertile hunting ground for activist shareholders; pushing for sales processes, intervening in announced transactions (i.e., bumpitrage), and forcing break-ups and divestitures are illustrious objectives from an activist’s playbook. TCI’s public ‘Dear Board’ letter to ABN AMRO is notorious in this respect as it brought the bank into play, resulting in the largest ever takeover battle in the Netherlands. Other notable examples include AkzoNobel, where hedge fund Elliott Advisors pressured the company to engage with PPG after PPG’s unsolicited proposals to takeover AkzoNobel; and ASMI, where Eminence Capital urged management to sell the company’s 34 per cent stake in Asian subsidiary ASM PT. Elliott Advisors was found on the other side of the gamble at NXP, where it opposed the recommended offer made by Qualcomm for NXP, arguing that it had undervalued NXP.

Strategic

Activist investors have pushed companies to make strategic changes and improve their performance. This is often part of campaigns aimed at breaking up or selling the company, as discussed directly above. A prominent example is ASMI, where the two activist hedge funds Hermes and Fursa criticised the front and back-end strategies of ASMI.

Inefficient balance sheet

In several cases, activist investors demanded a return of capital to the shareholders in the form of a share buy-back or dividend payment. Well-known examples include Philips, where shareholders demanded that the capital raised by spinning off Philips’ semiconductors unit NXP be returned to the shareholders, and SBM Offshore, where Centaurus pressured the board to adopt a different financing structure for its fleet.

Governance or board composition

Activist shareholders often target the governance structure and composition of the company’s boards. Demands made by activist shareholders may include representation on the supervisory board, dismissal of certain board members, amendments to executive compensation or a challenge to the company’s defence measures. Examples include TNT Express, where hedge fund JANA Capital requested the appointment of three new supervisory board members; AMG, where RWC questioned AMG’s governance and remuneration practices; and Boskalis, which requested Fugro to dismantle (one of) its defence mechanisms.

Higher prioritisation of ESG issues

Another global trend, which arrived in the Netherlands, is that shareholders, both financial and institutional investors, increasingly demand companies to address ESG issues. ESG issues have become a major corporate governance topic in recent years, reflecting sentiments from a broad group of stakeholders, including customers, employees, suppliers and society as a whole. Activist shareholders and institutional investors alike have taken note of these sentiments, and they are keen to include ESG matters in their campaigns and investment policies. In 2018, for example, Dutch pension fund ABP took the next step in its sustainable and responsible investment policy with its announcement to exclude tobacco and nuclear weapons products from its investments. ABP stated that it reached its decision ‘after extensive consultation at board level, based on the insights shared by participants, employers, and
various special interest organizations. Dutch (institutional) investors are particular involved in environmental matters. For example, ABP, Aegon Asset Management, APG, NN Investment Partners and Robeco are part of Climate Action 100+, a five-year initiative to engage important greenhouse gas emitters and other companies that have significant opportunities to drive the clean energy transition and help achieve the goals of the Paris Climate Agreement. In 2019, Climate Action 100+ filed a climate resolution with British oil and gas company BP, demanding (1) a strategy consistent with the Paris Climate Agreement, (2) a formulation of climate ambitions and goals for the short, medium and long-term, and (3) an annual report on the foregoing. The resolution gained support by several senior executives of BP.

vi Tactics used by activist shareholders

**Tactics used until ABN AMRO (2007) and ASMI (2010) – proposals at general meetings to change the company’s strategy**

Between 2005 and 2010, several large activist hedge funds initiated aggressive US-style campaigns in the Netherlands. These hedge funds typically started their campaigns with ‘Dear Board’ letters in which they presented their ideas to the company. As a next step in their campaign, these hedge funds generally submitted shareholder proposals – to split up or sell the company, or to change the company’s strategy – at the general meeting.

In several cases, the activist shareholders and the company ended up in court to determine who had the final say on the matter. In landmark cases – ABN AMRO and ASMI – the Supreme Court ruled that the company’s strategy is within the remit of the executive board, subject to the approval of the supervisory board. As a result, shareholders cannot impose a strategy on the executive board that must be followed. If shareholders disagree with the execution of the strategy by the executive board, or otherwise disagree with how the executive board is running the company, they may attempt to exercise the specific powers vested in them in the DCC and the company’s articles of association, such as the power to appoint and dismiss board members. These landmark cases most likely led to a change in how activist shareholders approach Dutch listed companies.

**Tactics used in recent years – private and public engagement with the boards to force a change in the company’s strategy**

After ABN AMRO and ASMI, activist shareholders rarely put forward shareholder resolutions directly aimed at forcing a change in strategy or a breakup of the company. Instead, activist shareholders now tend to build up pressure on the company by acquiring a stake, sometimes demanding seats on the board, or trying to influence the company’s strategy through private or public engagement with the boards.

Typically, activists that aim to change the company’s strategy put pressure on the boards by challenging them on a broad spectrum of matters, such as the appointment and dismissal of board members, operational performance and board compensation. In an aggressive campaign, activist shareholders may demand that their own candidates replace current board members.

As an example, this strategy was followed by US-based activist hedge fund JANA Capital against TNT Express. JANA put pressure on the board of TNT for a long period, both publicly and privately, in an effort to improve TNT’s operational performance, with

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the aim of proving its potential to possible buyers. JANA demanded seats on the supervisory board, including one for a former M&A executive of UPS, which may have been seen by some as an attempt by JANA to arrange a deal between TNT and UPS (TNT was eventually acquired in a friendly deal by FedEx in 2016). More recently, the tactic of trying to influence the strategy of the company, by putting pressure on the boards, was adopted by Elliott Advisors against AkzoNobel.

Direct confrontations between boards and activist shareholders at general meetings are now generally restricted to topics on which the general meeting has the power to resolve, such as board composition, annual accounts, compensation policy and board members’ compensation. This trend seems to be largely influenced by landmark cases concerning ABN AMRO and ASMI – case law that was recently confirmed by the Enterprise Chamber in the AkzoNobel case. In addition, in the Fugro case, Dutch courts barred shareholders from putting pressure on the executive board, by demanding a referendum vote on a topic on which the general meeting cannot resolve.

IV RECENT SHAREHOLDER ACTIVISM CAMPAIGNS

i América Móvil v. KPN (2014)

An example of a strategic party acting as an activist shareholder is found in América Móvil v. KPN. Over the course of two years, América Móvil built up a stake of 29.9 per cent (through a partial public offer) and eventually announced a hostile offer for all KPN shares to gain full control. The takeover was countered by KPN’s defence foundation based on, among other things, purported national security interests. In its battle, KPN deployed numerous defensive mechanisms, including divesting its crown jewel E-Plus to Telefónica, and eventually KPN concluded a relationship agreement with América Móvil in an effort to (at least temporarily) bury the hatchet. América Móvil did not pursue KPN’s offer, and it eventually sold its stake and moved on to acquire full control of Telekom Austria to gain a foothold in the European telecoms market.

ii Boskalis v. Fugro (2016)

Dutch dredging contractor Boskalis built up an unsolicited stake of more than 20 per cent in Dutch geoscience service provider Fugro and subsequently submitted an agenda item – urging the boards to take down one of Fugro’s defence measures – for the general meeting. Fugro agreed to put Boskalis’ proposal on the annual general meeting’s agenda for discussion – but not as a voting item – since decisions regarding defensive measures are the exclusive domain of the boards. Boskalis challenged this decision in court, but without success in both first instance and on appeal. In April 2018, the Supreme Court confirmed that shareholders do not have a right to table voting items on the agenda of a public company’s general meeting in respect of matters that are for the board to decide upon, including the policy and strategy of the company.

iii Elliott Advisors v. AkzoNobel (2017)

In 2017, Dutch paint producer AkzoNobel received three unsolicited takeover proposals from its US competitor PPG Industries. Elliott Advisors demanded that AkzoNobel enter into discussions with PPG. After AkzoNobel rejected the first two proposals from PPG, Elliott Advisors – together with certain other shareholders – requested that AkzoNobel convene a shareholders’ meeting with the sole agenda item being the dismissal of the chair of
AkzoNobel’s supervisory board. This request was rejected by AkzoNobel. After AkzoNobel subsequently rejected PPG’s third proposal in May, Elliott Advisors filed a petition with the Enterprise Chamber requesting an inquiry into AkzoNobel’s conduct and policies, as well as the introduction of certain interim measures, including an extraordinary general meeting to vote on the dismissal of the chair of AkzoNobel’s supervisory board, whom Elliott believed was standing in the way of a discussion with PPG. The Enterprise Chamber dismissed Elliott Advisors’ requests and set out important viewpoints for corporate governance in takeover situations. First, the Enterprise Chamber ruled that a company’s response to an unsolicited takeover proposal falls under the authority of the executive board to determine the company’s strategy, under the supervision of the supervisory board. The company’s boards do not have to consult shareholders prior to their response to an unsolicited takeover proposal (although they remain accountable to their shareholders for their corporate actions). Second, the ruling made clear that there is no general obligation for a target company to enter into substantive discussions or negotiations with a bidder that has made an unsolicited takeover proposal, even in the case of a serious bidder making a serious bid. Whether substantive discussions or negotiations with a bidder are required depends on the actual circumstances; for example, to what extent the company can assess the proposal without substantive discussions, the bidder’s strategic intentions and whether the target company has decided to abandon its standalone strategy. After this landmark ruling by the Enterprise Chamber, on 1 June 2017, PPG announced the withdrawal of its takeover proposal for AkzoNobel.

In July 2017, Elliott Advisors initiated proceedings before the Amsterdam District Court requesting an extraordinary general meeting with the dismissal of AkzoNobel’s chair as sole agenda item. AkzoNobel subsequently convened an EGM on its own motion, to be held in September 2018, where AkzoNobel would give further explanation regarding its response to the proposals made by PPG. The dismissal of AkzoNobel’s chair was not tabled on the agenda of that EGM. In early August 2017, the Amsterdam District Court rejected the request from Elliott Advisors to convene an EGM regarding the dismissal of the chair and ruled that Elliott Advisors should, before requesting the dismissal of the chair of AkzoNobel, await the explanation AkzoNobel were to give regarding its response to PPG’s proposals during the EGM in September 2018. On 16 August 2017, AkzoNobel announced that it reached a standstill agreement with Elliott Advisors.17


Four pension funds from the Netherlands and the United States initiated a public ‘vote no’ campaign against the pharmaceuticals company Mylan (which is incorporated in the Netherlands). The pension funds campaigned against the nomination of six long-standing directors (with an average of 11.8 years’ tenure) and the executive compensation package proposed by Mylan’s board, arguing that these directors should be held accountable for its costly record of compensation, risk and compliance failures. The ‘vote no’ campaign was initiated against the backdrop of a public and regulatory debate triggered by the price-hiking controversy involving Mylan’s EpiPen. The campaign had limited success. The appointment

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of the six contested directors was approved at the annual general meeting but a significant majority of the general meeting voted against the executive compensation package; however, the latter vote was non-binding and only of an advisory nature.

**Elliott Advisors v. NXP and Qualcomm (2018)**

On 27 October 2016, Dutch chipmaker NXP Semiconductors and US technology company Qualcomm announced that they had reached agreement on Qualcomm’s acquisition of NXP at a price of US$110 per share; this valued NXP at US$47 billion, making it Europe’s largest ever tech deal. The announcement of the transaction attracted attention, from both the investor community and from regulators around the globe, and showed the growing importance of antitrust and state intervention in M&A deals.

In August 2017, Elliott Advisors joined the party by acquiring approximately 6 per cent of NXP’s stock. During its campaign, which showed levels of aggression reminiscent of its AkzoNoel campaign, Elliott argued that NXP’s board did not achieve the best deal for NXP’s shareholders; in Elliott’s words, the consideration offered by Qualcomm ‘dramatically undervalued’ NXP. Elliott’s tactics included launching a website with analyses of its claim in an effort to persuade NXP shareholders not to tender their shares ‘for less than fair value’. Later that year, on 6 November 2017, Singapore-based Broadcom raised the number of players to four, announcing an US$130 billion bid for Qualcomm. Broadcom’s unsolicited bid for its rival would create the largest tech company in the world. Broadcom’s offer was indifferent on Qualcomm completing its bid for NXP, turning the scene into a classic capitalist multiplayer chess game.

The battle of NXP and Qualcomm versus Elliott – a textbook example of bumpitrage – eventually ended with Qualcomm improving the terms of the transaction. Qualcomm increased the cash consideration payable to the NXP shareholders to US$127.50 per share – an increase of 16 per cent, or approximately US$5.9 billion in aggregate equity value, on the prior offer price. In exchange, Elliott – together with eight other NXP shareholders collectively owning approximately 28 per cent of NXP’s stock (including New York-based hedge fund Soroban Capital Partners) – supported the new deal. In response, Broadcom cut its offer consideration for Qualcomm – which, by then, had been increased – to US$117 billion, and was eventually forced to withdraw its bid after President Trump issued an executive order blocking the proposed transaction. President Trump acted on a recommendation by the Committee on Foreign Investment in the United States (CFIUS), which, after reviewing the combination, had concluded that Broadcom ‘might take action that threatens to impair the national security of the United States’. Later, in 2018, Broadcom completed its redomiciliation to the United States.

Qualcomm’s pursuit of NXP also attracted regulatory scrutiny, particularly from the State Administration for Market Regulation (SAMR) of China. In June 2018, after Qualcomm had extended the offer period multiple times, SAMR refused to grant clearance for the proposed deal. Subsequently, Qualcomm chose not to close the transaction, incurring an US$2 billion break-up fee payable to NXP.

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Dutch state v. Air France-KLM (2019)

On 26 February 2019, the Dutch state acquired a 12.68 per cent stake (worth €680 million) in airline Air France-KLM SA. One day later, the state announced that it had increased its shareholding to 14 per cent (worth €744 million). The state explained that, through its shareholding, it wanted to be able to exercise direct influence over future developments at the Air France-KLM holding company ‘to ensure that Dutch public interests are optimally assured’. One of the reasons for the state to acquire the shares was that it had become apparent that significant decisions about KLM’s strategy were increasingly taken at the level of the Air France-KLM holding company, where the French state had significant influence through its 14.3 per cent stake. Furthermore, discussions about the reinforcement of existing agreements about public interest (state guarantees) and the management structure were difficult. Given that the position of Schiphol airport and its most important user KLM are of great importance to the Dutch economy and employment – thousands of jobs are directly and indirectly involved with the airport and the intercontinental network of KLM – the state felt the urge to intervene. With the acquisition of the strategic stake, which added to the 5.9 per cent stake the state already held in the company following the merger between KLM and Air France in 2004, the state obtained formal influence at the highest level and secured a seat at the table for future decision-making. The state’s move was seen by many as surprising and by some even as incomprehensible and aggressive, reminiscent of actions of an activist shareholder rather than a state shareholder.

V REGULATORY DEVELOPMENTS

The relatively high number of takeover attempts involving Dutch multinationals in recent years has fuelled a political debate on whether those companies should be more protected against foreign takeover threats. After the takeover battle for KPN in 2014 and the acquisition of Dutch cybersecurity company Fox-IT by UK-based information assurance firm NCC in 2015, a draft bill of the Telecommunications Act was published, enabling the Dutch government to prevent takeovers of ‘telephony, data centres, hosting services and internet’ companies that are ‘of vital importance to national security and public order’. After unsolicited takeover attempts involving Dutch giants PostNL (2016), Unilever (2017) and AkzoNobel (2017), the focal point of the political debate has expanded to protection of Dutch companies in general. The intentions of the Dutch Cabinet to implement a 250-day statutory time out period and the interventionist move of the state regarding Air-France KLM should be seen in this light.

The rise of protectionist political sentiments in the Netherlands is consistent with the global trend. Not only in the United States, where the CFIUS has intervened in several high-profile transactions (e.g., Qualcomm, Lumileds, Aixtron and Lattice), but also across Europe, various initiatives are being deployed that should protect countries’ ‘national champions’ against undesirable control by third parties. On an EU level, a new EU framework for the screening of foreign direct investments officially entered into force on 10 April 2019.

and will apply as from 11 October 2020. Although the framework neither introduces a screening mechanism on an EU level nor introduces a regulatory body that can issue binding decisions, it does create a cooperation mechanism where Member States and the Commission are encouraged to exchange information and raise concerns related to specific investments. It is expected that the framework will have a significant impact on foreign investment control into the European Union, in particular focused on the growing Chinese investments into the European Union.

VI OUTLOOK

Over the past decade, there have been a number of high-profile cases where activist shareholders have pushed companies to break up, sell divisions and change their corporate governance structures. Following decisions of the Supreme Court in ABN AMRO and ASMI, activist shareholders (while still pursuing the same objectives) seem to have shifted their approach to some extent – from confrontations over a company’s strategy in general meetings, to private and public engagement with the boards – to change the target company’s direction.

The tools that activists can employ against boards to achieve their objectives seem to have lost some power in recent landmark cases in the Netherlands. In the AkzoNobel and Fugro cases, the court rejected the attempts from activist shareholders to ramp-up the pressure on the boards through agenda items proposed for general meetings. Following the AkzoNobel and Fugro cases, we have not seen attempts from shareholders to put pressure on the boards by proposing agenda items, but too little time has lapsed since these cases to tell whether that is an actual trend.

We expect that shareholder activism through private and public engagement with the boards will remain at least at current levels, with an increased focus on M&A, corporate governance and, in particular, ESG matters. Shareholder activism in recent years has increased the contrast between short and long-term value creation, and stakeholder interests and (immediate) shareholder value. We expect a continued emphasis by Dutch companies on stakeholders’ interests and long-term value creation as well as (institutional) investors to push more on ESG topics. A continued rise of shareholder activist campaigns and unsolicited takeover attempts, mixed with the geopolitical trend of protecting national economies, could result in additional protection of Dutch listed companies against hostile approaches, from both bidders and activist shareholders.
I  OVERVIEW
Shareholder activism in the Western sense had relevance in Russia between 2000 and 2008. In the 1990s, some isolated issues, such as improving financial reporting, had been focused on by institutional investors. Since around 2008, shareholder activism has been dying down. In the first half of the 2010s, seemingly politically dominated disclosure of events linked to state companies occurred and, in the last years of that decade, some corporate conflicts gained very substantial attention. Though regulators occasionally voice concern about the lack of liquidity in capital markets, there are no legislative plans with practical context aiming at satisfying private shareholder interest. Also, there is a tendency – for special purposes typically linked to the political tensions between Russia and the West – to permit information to be kept confidential.

II  LEGAL AND REGULATORY FRAMEWORK
Companies with their main business in Russia frequently use foreign stock exchanges to attract investors. Sometimes, that is linked to foreign corporate vehicles being used for the listing. More frequently, however, the corporate forms used are Russian. Sometimes, there is a conflict between the rules in Russia and the listing rules. In the event of a conflict, the manner in which Russian law and practice treat questions and issues is likely to prevail as it will be difficult to implement any decision that would be made under non-Russian law. Accordingly, the following discusses Russian law, because it is Russian law that is relevant for companies with their main business in Russia. In addition to Russian corporate law, sometimes Russian rules on listing would be likely to be relevant to questions related to shareholder conflicts.

Under Russian joint stock law (only joint stock companies are entitled to list), each shareholder has the right to participate in the shareholders’ meeting. The shareholders’

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1 Max Gutbrod is a partner at Baker & McKenzie – CIS, Limited.
3 In the public domain, a conflict between Kazakh and international listing and corporate rules has played some part, see: https://informburo.kz/novosti/protivostoyanie-kazmunaygaza-s-rd-kmg-mozhet-nanesti-udar-po-reputacii-kazahstana-inostrannyе-smi.html (accessed on 5 September 2016). Most of the information here and in the following footnotes is general information that is in the public domain as there does not seem to be a consistent overview of shareholder activism in Russia.
A shareholders’ meeting is to be held in person and deal with the main issues relating to the life of the company, such as annual reports, the approval of the activity of management, capital increases and transactions that exceed a certain value. Generally, decisions are to be made with a simple majority of votes, with some, such as an increase in charter capital, requiring a 75 per cent majority. Accordingly, activist shareholders could in general potentially influence decision-making. Anecdotal evidence, however, suggests that Russian listed companies are typically owned by a single or a few shareholders who are present at shareholders’ meetings. As a consequence, it is unlikely that activist shareholders will obtain a majority at voting. Also, decisions will be invalidated only if they would not have been made had it not been for the violation. Accordingly, the reversal of decisions of a shareholders’ meeting is the exception rather than the rule. As a consequence, not many substantive discussions take place at shareholders’ meetings.4

For the election of the board of directors, shareholders have as many votes as directors are elected (see Article 66(4)(2) of the Joint Stock Law). In other words, minority shareholders, by putting all their votes on the few candidates they have preselected, can have their candidates elected even if the shareholders with controlling votes do not agree. In general terms, the German dual system of division of responsibilities applies to the governance of Russian joint stock companies and the board of directors has extensive supervisory power. As a consequence, and given the comparatively high importance that boards typically have in Russian companies, it would be possible to exert substantial influence by being a member of a board. Indeed, some hope has been put in independent directorship.5 In particular, from 2000 to 2004, some practices seemed to have changed through the activity of independent directors.6 Also, independent directorship had prominent and outspoken supporters, like Mr Boris Fyodorov.7 None of the independent board members, however, currently seem to have a focus on active shareholder representation. Significantly, where independent members of boards are mentioned, it seems that mostly they do not specialise in active representation of shareholders’ interests.8

Shareholders have a right to dividends. Sometimes, this right has been violated and a few shareholder activists have focused on the implementation of this right.9

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8 Characteristic in this regard is board representation at Sberbank, including the independent board members having impressive careers as politicians, scientists and managers, but not having any track record as investors, and in some cases only having a relatively short term of office, www.sberbank.com/investor-relations/corporate-governance/supervisory-board (accessed on 20 June 2018).

Furthermore, when purchasing 30 per cent or more of the stock of shares, the shareholder taking over must make an obligatory tender offer. Accordingly, shareholders could try, by being aggressive, to prompt such an offer. However, the number of related offers has been decreasing in recent years.

Also, information rights for shareholders, which in the early days of joint stock law had been very broad, have been gradually reduced. Namely, in 2001, the law clarified that only shareholders with more than 25 per cent of shares are entitled to receive the accounting documents and minutes of the meetings of the collective executive body. Political tensions have been given as a reason for the proposal to declare further information as being confidential.

Additional limitations on information rights have been introduced by court practice. For instance, a company was recognised as being entitled to limit the right of shareholders with less than 25 per cent of shares to get information on issues of extended competence, that is, the exclusive competence of the board of directors, as opposed to the competence of the executive bodies of the company. Additionally, court practice has allowed companies to refuse shareholders information in cases of lack of ‘legitimate interest’ to receive the requested information. Moreover, companies can refuse to provide information to their shareholders referring to commercial confidentiality, and sometimes companies use this right extensively.

III KEY TRENDS IN SHAREHOLDER ACTIVISM

When market reforms began in the early 1990s, minority shareholders’ rights, in a certain sense, were a key issue attracting the attention of the population at large. Since the main aim of market reforms was to distribute what was seen as being the people’s wealth to the people, shares were distributed to the population at large through voucher auctions and, therefore, protection of the many recipients of these vouchers should have been a major concern. However, attention to the detail of implementation of these rights was low and no stable funds or associations to represent minority shareholders emerged.

10 Federal Law of 26 December 1995, No. 208-FZ on joint stock companies, Article 84.2.
11 Statistics regarding voluntary tender offers, mandatory tender offers and squeeze-out requests are available at www.e-disclosure.ru/poisk-po-soobshheniyam (accessed on June 2019) with the filter in the ‘Выбрать тип сообщения’ dropdown list to be set on ‘Сведения о поступившем эмитенту (ОАО) добровольном или обязательном предложении’ plus ‘Сведения о поступившем эмитенту (ОАО) уведомлении о праве требовать выкупа или требовании о выкупе’. The accuracy of the numbers seems to be better for later years; 13 mandatory offers being mentioned from 16 June 2018 to 3 June 2019, but the system suggests that between 21 October 2013 and 20 June 2018 there was only one offer.
12 See the Decision of the Constitutional Court of RF of 16 June 2004, No. 263-O, which considered this rule as being constitutional.
15 See e.g., Decision of the Arbitrazh Court of the Central District of 30 June 2015, No. F10-1836/2015.
In the early years of stabilisation (2000–2005), there were some signs that shareholder activism would play a major role going forward. In particular, some of the major corporates implemented major internal reforms, and some of those reforms were encouraged by pressure from shareholder activists. Also, part of some government programmes, such as electricity and pension reforms, was raising or investing in capital through stock exchanges.

Publicly, shareholder activism has for some time been associated with Mr Bill Browder. Since the beginning of 2019, shareholder activism has also be associated with Mr Calvey. Mr Browder, after having maintained a high public profile for some time, came under attack from sources that must have been close to government, which culminated in accusations of brutality against the people involved on the side of Mr Browder, and in particular the United States imposing countersanctions against individuals allegedly involved. Though Mr Browder’s shareholder rights-related activity may have substantially contributed to the aggressiveness of the reaction towards him and his allies, the evidence presented for the shareholder activism having been the only reason for the pressure against Mr Browder and his allies does not appear plausible. Rather, the actions against Mr Browder are likely to have had different sources. Mr Calvey was arrested on charges of embezzlement from a joint venture company, and it was reported that the other joint venture partner was influential.

In sum, it appears that the cases around Mr Browder and Mr Calvey have showcased some of the risks of action, and accordingly interest in shareholder activism has only been renewed where a political motive for the activism was at least likely, and such shareholder activism has been used for political or private interests. Also, regulators tend to dislike controversy and misunderstand the value of controversy for corporate governance. In any instance, this difference of assessment does not make any difference to the result; namely that investors’ rights are limited to an extent that does not seem to allow activist investment.


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In addition, in parallel with the above, regulators appeared to be particularly concerned with inappropriate action of aggressive shareholders leading to a loss of assets. As a consequence, options for shareholders to act have substantially decreased over time. Furthermore, and as mentioned before, majority ownership in listed companies has mostly been consolidated.

IV RECENT SHAREHOLDER ACTIVISM CAMPAIGNS

Technically, and for the reasons described, shareholder activism is limited to random phenomena like simple access to information or to a shareholders’ meeting. Also, there has been some argument that shareholders have a right to correction of the accounts of companies. However, in the light of existing legislation there is little basis for such an argument and related lawsuits have been dismissed as would have been expected. Some funds continue to be involved in asset tracing.

V REGULATORY DEVELOPMENTS

There have been many changes in corporate law recently and, similarly to what was concluded in another context, it is not always easy to determine what purpose the many changes in

25 An examination of the practices that lead to such concern can be found in Philip Hanson. ‘Reiderstvo: Asset-Grabbing in Russia, Russia and Eurasia PP 2014/03’, www.chathamhouse.org/sites/files/chathamhouse/home/charham/public_html/sites/default/files/20140300AssetGrabbingRussiaHanson1.pdf (accessed on 5 September 2016).

26 Peter B Maggs, Olga Schwartz, William Burnham. Law and Legal System of the Russian Federation. Juris Publishing, Sixth Edition, https://books.google.ru/books?id=J0jwCQAAQBAJ&pg=PA428&dq=transneft+access+to+shareholders+meeting&source=bl&ots=uNVp7Km9J&sig=6H5g32kHi6dEDz2aXAl8UgZxvl&hl=ru&sa=X&ved=0ahUKEwj-x5bYevOAhVLKcAKHaeDBxEQ6AEILTAC#v=onepage&q=transneft%20access%20to%20shareholders%20meeting&f=false (accessed on 5 September 2016), in the cases reported, the interest appears mainly to be politically (as opposed to economically) caused.

27 Information about important act can be found at www.transneft.ru/u/importan_fact_file/5902/15-08-2016.pdf (accessed on 5 September 2016).


30 See ‘Report on the Observance of Standards and Codes on IOSCO Objectives and Principles of Securities Regulation for the Russian Federation’, July 2016, www.imf.org/external/pubs/ft/scr/2016/cr16233.pdf (accessed on 5 September 2016): ‘While some have argued that the absence of overarching provisions is an inevitable consequence of the principles of Russian law, others have correctly pointed out that there are some overarching obligations already in the legal framework and steps are being taken to develop the approach to legislation on these lines.’
relevant laws have had. The author’s impression is that even where it seems that options for minority shareholders are to be strengthened, the control of the management and majority shareholders over the procedure is increased.

However, though earlier privatisation attempts have not led to the expected results, in 2016 there was some hope that the difficulty with planned sales of Russian state assets and the concern with increasing the investor base would lead to more attention on, and openness to, shareholder activism, but this does not seem to have materialised in 2018.

VI OUTLOOK

There has not been much shareholder activism recently and it remains to be seen whether there will be any over time.


I \hspace{1cm} \textbf{OVERVIEW}

Shareholders play an important role in preserving balance in the corporate governance of a company. Though shareholding is intended to enable passive investment participation in a company, shareholders have a legitimate interest in the governance of a company and a right to hold the board accountable. Management has historically been able to push through its agenda without much shareholder resistance in Singapore, but the trend is changing, and we are seeing, like elsewhere in the world, growing shareholder activism.

Years 2018 and 2019 have seen a rise in shareholder activism in Singapore; noteworthy cases include Noble Group (Noble), YuuZoo Corporation (YuuZoo) and Hyflux Ltd, described in Section IV.

II \hspace{1cm} \textbf{LEGAL AND REGULATORY FRAMEWORK}

Shareholder rights and engagement are regulated by a combination of statutory and non-statutory instruments as well as under common law. The Companies Act (CA) and the Securities and Futures Act (SFA) make up the relevant core statutory framework, which is supplemented by non-statutory instruments such as the Listing Manual of the Singapore Exchange (the Listing Manual), the Singapore Code of Corporate Governance 2018 (the Governance Code) and the Singapore Code on Takeovers and Mergers (the Takeover Code).

The Listing Manual sets out the obligations (including disclosure obligations) that companies have to comply with to be listed on the Singapore Exchange (SGX). It empowers RegCo, the SGX’s regulatory unit, to issue enforcement and administrative orders to ensure that the market is fair, orderly and transparent, including: (1) requiring a company to make specified disclosures; (2) objecting to the appointment of individual directors or executive officers for a period not exceeding three years; (3) requiring an issuer to appoint special auditors, compliance advisers, legal advisers or other independent professionals for specified purposes; and (4) halting or suspending trading of listed securities of a company.

i \hspace{1cm} \textbf{Requisitioning or calling a general meeting}

The CA empowers shareholders to either requisition for a general meeting or directly call a general meeting, if they collectively have no less than 10 per cent of the total number of issued shares of the company. The key difference between requisitioning for and calling a general meeting is that requisitioning shareholders will need to give the company’s directors up to

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1 Lee Suet-Fern is the senior director at Morgan Lewis Stamford LLC.
21 days to proceed to convene a general meeting at a date no later than two months after the receipt by the company of the requisition, and only if the directors fail to act within the specified 21 days may the requisitionists (or any of them representing more than 50 per cent of the total voting rights of all of them) convene a general meeting at a date no later than three months from the requisition date. In contrast, shareholders wishing to directly call for a general meeting may do so under a more expedited procedure without having to exhaust any timeline given to the directors to act. However, although the company must pay the requisitionists all reasonable expenses incurred to call a general meeting (in the event of a failure by the directors to do so), no equivalent provision exists in relation to the direct calling of a general meeting by shareholders. A meeting will require 14 days’ notice or a longer period as is provided in the constitution of the company or the CA, unless it is convened for the passing of a special resolution, which for public companies requires at least 21 days’ notice.

ii Shareholder transparency
An activist shareholder of a listed company will be able to identify all key shareholders having an interest in no less than 5 per cent of the total voting shares of the company, as well as the shareholding interest that any of the company’s director or chief executive officer may have in the company – information that is required to be publicly disclosed under the SFA.

iii Removal of a director
Unlike a private company where it is possible for the directorship of a person to be entrenched in the constitution, a director of a public company can always be removed by an ordinary resolution of its shareholders, regardless of anything to the contrary in the company’s constitution or in any agreement between the company and the director. The person proposing the resolution must give a special notice to the company at least 28 days before the meeting to be convened to approve the resolution, and a copy of the resolution must be sent to the director concerned, who will be entitled to be heard on the resolution at the meeting.

iv Concert party obligations
Where shareholders act in concert to obtain or consolidate effective control of a public company, implications arising under the Takeover Code should be borne in mind, including the obligation to make a general offer for the shares in the company upon crossing sensitive shareholding thresholds. Shareholders voting together on resolutions at a general meeting would not normally be regarded as an action that would lead to an offer obligation, but coordinated voting patterns in more than one general meeting may be taken into account as an indication that the shareholders are acting in concert. Shareholders who requisition or threaten to requisition the consideration of a ‘board control-seeking’ proposal at a general meeting, however, will generally be presumed to be acting in concert with one another and with the proposed directors, such that subsequent acquisitions of shares of the company by any member of the concert party group could give rise to an obligation to make a general offer for the company under the Takeover Code.

v Derivative action
Directors who have committed wrongdoings or have otherwise breached their fiduciary duties to the company would naturally have little incentive to procure the company to bring an action against themselves. To ensure accountability, the CA provides for a statutory
derivative action that gives shareholders an ability to bring an action on behalf of the company against errant directors or third parties in respect of the directors’ conduct, which is subject to obtaining leave of court and is dependent on the company itself having a claim, given that the action is brought in the company’s name. The complainant is required to give 14 days’ notice to the board of his or her intention to apply for the action if it is not pursued by the board, and is required to demonstrate that he or she is acting in good faith and that the action is prima facie in the interests of the company. The statutory derivative action is available to all companies incorporated in Singapore, whether private or public (including listed) companies. Though foreign-incorporated companies do not currently fall within the scope of the statutory derivative action regime, they may avail themselves of the common law derivative action, the requirements of which entail the complainant to establish that the errant directors committed fraud on the minority.

vi Oppression or unfair prejudice
Shareholders may also apply to court for what is commonly known as the ‘oppression remedy’ under the CA if they can establish essentially that they have been treated in a manner that is ‘commercially unfair’, which is an exception to the principle of ‘majority rule’ in companies. As contrasted with a statutory derivative action, the oppression remedy is not brought in the name of the company but is personal to the complainant. The oppression remedy is very rarely seen in the context of listed companies.

vii Market manipulation and insider dealing
When pursuing any activist strategy, shareholders should be careful not to fall afoul of regulations against market manipulation, making false or misleading statements, or fraudulently inducing persons to deal in capital markets products, among other offences relating to dishonesty, all of which attract civil and criminal penalties under the SFA. Where an activist shareholder engages with the board on matters not otherwise made available by the board to the public as well as to the rest of the shareholders, it is possible that insider information may have been divulged, in which case the shareholder must not deal or encourage another to deal in the company’s securities until the price-sensitive information has been disseminated to the public.

viii Defamation
An activist shareholder wishing to launch a media campaign and level criticisms against a company or other individuals in the public domain should be aware of the risk of defamation. Though defences such as justification and fair comment are available, the law in this area in Singapore is very developed and an activist shareholder should ideally seek expert advice on what is legally permissible to not to end up at the wrong end of a defamation action.

III KEY TRENDS IN SHAREHOLDER ACTIVISM
i Hedge fund activism
The corporate landscape in Singapore is changing as new hedge funds are now being set up with the exclusive focus on influencing the way local listed companies are run. Smaller construction and engineering companies that often have a lot of cash or reserves because of the recent building boom may be targeted by activists, who may push for payment of
special dividends or share buy-backs by way of open confrontation, or with much less fanfare through the exercise of voting power. Though such activist pressure on companies is, when exerted responsibly, generally welcome by minority shareholders, these demands may not always be successful given that it is not uncommon for founder shareholders in many smaller to medium-cap issuers to hold a significant block of shares in such companies.

ii Influential investor lobby groups
The Securities Investors Association (Singapore) (SIAS) seeks to empower retail shareholders by guiding them to ask relevant questions at annual general meetings (AGMs). SIAS analysts, based on the annual reports of the companies, compile relevant questions to be asked, which will primarily focus on strategy, financials and corporate governance. Companies are encouraged to address SIAS’s questions at their AGMs and publish their answers on SGXNet. SIAS also conducts workshops on how to analyse annual reports for retail and novice investors to help them ask relevant questions at AGMs.

SIAS actively advocates progressive industry practices and organises investor education programmes through collaborative arrangements with financial institutions and listed companies interested in investor education as part of its corporate social responsibility agenda. On an annual basis, SIAS tracks and grades listed companies for their corporate governance practices and rewards those who have excelled with the Singapore Corporate Governance Award.

SIAS is one of the biggest investor lobby groups in Asia and has mediated many high-profile shareholder issues involving companies listed on the SGX. SIAS has often stated that it prefers a conciliatory approach to resolving investors’ rights issues. However, in the wake of recent market and corporate governance lapses in listed companies, SIAS warned that it will not hesitate to take errant companies to court on behalf of their minority shareholders if the situation warrants it. Representative actions are available to enable one or more persons to sue, for themselves and on behalf of others, a wrongdoer for a common harm inflicted upon all of them provided that there is a common interest among the claimants. SIAS has commented that SIAS members and retail investors have the option of joining SIAS in a representative action, and that it may set up a litigation fund to which minorities can contribute, although SIAS itself, as a registered charity, may not contribute to the fund. Nonetheless, SIAS emphasised that representative actions should be a last resort to avoid unnecessary adverse publicity for the board and the company, which has serious consequences for share value.

iii The media’s catalytic role
The media has played a catalytic role in the ascendancy of shareholder activism in Singapore, with corporate governance analysts and commentators often being the first to highlight shortfalls in corporate governance best practices, define issues and set the agenda for change. Shareholders are thus galvanised to hold the relevant boards and management to account, with companies caught in the crosshairs of the media often feeling compelled to respond publicly to concerns raised. Unrelenting media storms have sometimes created enough damage to public perceptions of the targeted companies and their boards that the relevant directors announce their retirement from their positions even before shareholders vote on whether to keep the incumbents in office at the next re-election cycle.
Companies whose board composition does not meet best practice expectations, such as where it lacks diversity or where existing directors have served for very long periods, continue to come under the spotlight. Indeed, the Governance Code was revised in 2018 to fortify expectations in relation to director independence and board diversity.

Beyond traditional forms of media, shareholders have also taken to banding online through various social media and messaging platforms to air their grievances and to seek support for their positions. For example, a group of minority investors in Sabana Shariah-Compliant Real Estate Investment Trust (REIT), a Singapore-based real estate investment trust, organised themselves on a Facebook page, ‘Vote out Sabana Manager’, to keep minority investors abreast of latest developments, post their analyses of the REIT’s performance and galvanise support from other investors to call for a meeting to change the REIT manager.

IV RECENT SHAREHOLDER ACTIVISM CAMPAIGNS

i Noble

Noble announced a debt restructuring plan in January 2018, which would dilute existing shareholders to a 10 per cent stake in the restructured entity. However, Noble’s management stood to receive a 20 per cent stake in the restructured entity without providing any capital injections. Noble’s proposed debt restructuring aroused widespread concern among shareholders, including substantial shareholder Goldilocks Investment Company Limited (Goldilocks), and perpetual bondholders. To compound matters, Noble’s debt restructuring plan came off a record US$4.938 billion loss for the 2017 financial year and a payout of over US$35 million to the directors. RegCo eventually issued a notice of compliance requiring Noble to appoint an independent financial adviser to provide an opinion on whether the debt restructuring plan was fair and reasonable and not prejudicial to shareholders. Goldilocks also commenced a derivative action against Noble’s previous and incumbent directors and management for breaches of fiduciary duties, and sought to requisition for the nomination of five non-executive directors at Noble’s AGM on 30 April 2018. However, Noble refused to acknowledge Goldilocks’ requisition on the basis that the Central Depository (and not Goldilocks) was reflected on Noble’s member register. This culminated in Goldilocks applying for and obtaining an injunction against Noble’s holding of the AGM. In June 2018, a revised restructuring deal was tabled giving shareholders a higher shareholding in the restructuring entity of 20 per cent, and giving Goldilocks a board seat in the restructured entity. On the back of this improved deal, a settlement was reached between Goldilocks and Noble, and the restructuring of Noble was eventually completed in December 2018.

ii YuuZoo

YuuZoo faced public scrutiny over potential lapses in its unaudited financial results for the 2017 financial year, which were announced in early 2018. This eventually led to RegCo issuing a notice of compliance requiring YuuZoo to appoint a statutory auditor to provide an opinion on the veracity and reasonableness of its unaudited financial results for the 2017 financial year. Although YuuZoo sought to engage shareholders through a dialogue session moderated by SIAS, YuuZoo was unable to comply with the notice of compliance resulting

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in RegCo suspending YuuZoo’s shares from trading on the SGX. Subsequently, YuuZoo’s office was raided by the Commercial Affairs Department (CAD) on suspicions of possible breaches of the SFA.

Shareholders of YuuZoo have formed an association to urge the SGX to lift the trading suspension, but the SGX responded that the suspension will be lifted when it is satisfied the company’s affairs can be ascertained and shares in YuuZoo can be traded on a fair, orderly and transparent basis. The SGX added that as the CAD investigation is ongoing, trading will continue to be suspended. In March 2019, YuuZoo announced that it was closing its Singapore operations.

iii Asiatic Group (Holdings) Ltd and Stamford Land Corporation Ltd

In early 2018, Jerry Low, a minority investor in Asiatic Group (Holdings) Ltd, wrote an open letter to the company criticising the poor performance of the company’s power plants and the high remuneration of its senior management team. Asiatic responded with allegations of defamation in a cease-and-desist letter issued by its lawyers. Jerry Low subsequently removed his statements from the public domain and the company dropped the matter. In a separate case, Manohar Sabnani, a minority investor in Stamford Land Corporation Ltd, criticised the high executive pay and low dividends to shareholders via statements made at its AGM in July 2018, and also published on Facebook and in a letter to the newspapers. The company responded by commencing defamation proceedings against him. A settlement was subsequently reached, with Sabnani apologising and retracting his comments. Commentators have pointed to these as worrying illustrations of the use of defamation lawsuits to chill minority shareholder speech.

iv Hyflux Ltd

In March 2019, more than 100 retail investors of embattled water treatment firm Hyflux Ltd’s perpetual securities and preference shares organised a public demonstration – rare in Singapore – to, among others, rally support for the rejection of the company’s restructuring plan, which would have imposed a steep haircut on such investors. At the heart of the problems is Tuaspring, Hyflux Ltd’s desalination and power plant, which accumulated losses due to a drop in power prices resulting from a glut in electricity caused by market liberalisation. Investors also protested the Public Utilities Board’s decision to take over the desalination plant for zero cost. In recent developments to the saga, in April 2019, Hyflux Ltd cancelled its restructuring agreement with the investor consortium Salim-Medco, saying it has ‘no confidence’ the investor will complete the deal, and in May 2019, announced that it was in discussions with a new white knight, UAE utilities provider Utico FZC, among other potential white knights that had separately expressed interest in Hyflux Ltd.

v Various shareholder-initiated general meetings

Another indicator of growing shareholder activism in Singapore is the increasing number of shareholder-initiated meetings. All of such shareholder-initiated meetings involved, among others, proposals to remove one or more existing directors and to appoint new directors on

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3 Hyflux announcement of 4 April 2019.
the board of the relevant companies. In some cases, requisition notices were later withdrawn or the meetings not held as originally planned, but in many instances resolutions proposed by the shareholders were eventually passed.

V REGULATORY DEVELOPMENTS

i Multiple proxies
A multiple proxies regime has been introduced in the CA. Previously, nominee shareholders were limited to appointing only two proxies, as a result of which not all the views of their indirect investors could be represented. Under the new regime, specified intermediaries, such as banks whose business includes the provision of nominee services and that hold shares in that capacity, and capital markets services licence holders providing custodial services and that hold shares in that capacity, are allowed to appoint more than two proxies to attend and vote at general meetings. The legislative change enfranchises indirect investors by enabling them to participate in shareholders’ meetings with the same voting rights as direct shareholders and also raise any queries they may have to the board of the company. This may potentially enhance attendance at shareholders’ meetings and increase the number of shares that are voted.

ii Dual-class share structure
Public companies in Singapore may offer shares with different voting rights to investors, subject to the rights granted by such shares being clearly specified in the company’s constitution and certain other safeguards, including requiring the approval of shareholders by way of a special resolution for the issuance of those shares, and requiring holders of non-voting shares to have equal voting rights for resolutions on winding up or on the variation of rights of non-voting shares. The dual-class share structure provides greater flexibility in capital management and gives investors a wider range of investment opportunities. At the same time, the SGX implemented a new framework allowing issuers with a dual-class structure to be listed, subject to certain safeguards, on its mainboard. Proponents of dual-class share structures argue that weighted voting would allow founding shareholders more protection to pursue their long-term vision for the company against shareholder demands for short-term returns. Detractors point out that such structures remove a significant channel of accountability by the management, who are typically the ones holding shares with superior voting rights, and who could potentially exercise untrammelled control over the company despite owning much less equity than the rest of the investors. This is a recognition that, in Singapore, such listings are increasingly being considered in industries such as information technology and life sciences.

iii Increase in transparency of ownership and control
Unless exempted, all Singaporean companies, foreign companies and limited liability partnerships are now required to maintain and keep up-to-date a register of controllers that will have to be made available to the Accounting and Corporate Regulatory Authority (ACRA) and public agencies (to administer or enforce any written law) upon request. A foreign company is required to keep a register of its members at its registered office in Singapore or the registered office of its registered filing agent. A director of a company who is a nominee, unless exempted, is also required to disclose his or her nominee status and nominator to the company. The company must keep a register of nominee directors and make it available to ACRA and public agencies (to administer or enforce any written law) upon request.
iv  Enhanced audit disclosure

Two key changes have recently been made in respect of audit reports to help investors and other users in their decision-making by giving them more pertinent information on companies. First, auditors of listed companies will be required to communicate ‘key audit matters’ (KAMs) in their financial statement report beyond the current ‘pass or fail’ opinion. KAMs are matters that, in the auditor’s judgement, are of the most significance in the audit of the financial statements, and are typically areas that involve difficult or complex auditor judgements. Auditors are required to describe each KAM, include a reference to related financial statement disclosures, if any, and address why the matter is considered to be one of significance in the audit and how it is addressed in the audit. Auditors are also expected to take into account areas of higher risk of material misstatement, and the effect on the audit of significant events or transactions that occurred during that year. Second, auditors are required to ensure that a company has made adequate disclosures regarding management’s judgement and assessment on going concern even if the circumstances do not lead to any material uncertainty over the company’s going concern. This is more stringent than the previous standard, which only requires auditors to highlight issues that result in a material uncertainty over a company’s going concern, such as the loss of a major customer. These two changes have been deemed by market observers as ‘a big step forward’ to encourage company directors and management to become more transparent in their engagements with shareholders. Previously, KAMs were communicated by auditors to the audit committees of companies but were otherwise kept largely out of the public domain. The move to compel the disclosure of KAMs to the public will enable investors to gain insights on the significant audit risks identified and to have more focused and meaningful discussions with the board. To ensure that KAM reporting is relevant and useful, ACRA has assured investors that it will be focusing its audit inspection on auditors’ compliance with the enhanced standards and has also issued an audit practice bulletin to guide auditors on ACRA’s expectations on these standards.

v  Revised Code of Corporate Governance

The Monetary Authority of Singapore (MAS) revised the Governance Code in August 2018, replacing the previous Governance Code issued in May 2012. The Governance Code has been streamlined to be more concise and less prescriptive, to encourage thoughtful application and to move away from a box-ticking mindset. Important requirements and baseline corporate governance practices have been shifted to the Listing Manual, making compliance with them mandatory. It will also be mandatory to comply with the core broad principles of corporate governance set out in the Governance Code. The changes put a heavy emphasis on strengthening director independence and enhancing board composition and diversity. For example, the shareholding threshold in determining a director’s independence has been reduced from 10 to 5 per cent, independent directors are expected to make up a majority (increased from ‘at least half’) of the board where the chair is not independent, and with effect from 1 January 2022, independent directors must comprise at least one-third of the board and a director who has been on the board for more than nine years will not be considered as an independent director unless approved by a two-tier shareholder vote. The changes also seek to promote transparent remuneration practices and stakeholder engagement.

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vi Corporate Governance Advisory Committee

A Corporate Governance Advisory Committee (CGAC) was established in February 2019 to advocate good corporate governance practices among listed companies in Singapore. The CGAC is a standing industry-led body, and its role is advisory in nature and does not have any regulatory or enforcement powers. It will identify risks to corporate governance and take a lead in advocating good practices, and will monitor international trends and recommend updates to the Governance Code. The members of the CGAC may include practitioners who have served as directors on the boards of listed entities, corporate governance experts and representatives from various stakeholder groups. The chair and members are appointed by the MAS.

vii Changes to the voluntary delisting regime

In November and December 2018, RegCo sought feedback on its proposed amendments to the voluntary delisting regime to protect the interests of minority shareholders in privatisations. The first key proposal is that, in respect of a voluntary delisting resolution, the offeror and its concert parties must abstain from voting on the resolution (currently, they are not required to abstain) to strengthen the protections for minority shareholders. Given the proposed abstention requirement, to strike an appropriate balance and ensure that the power accorded to minority shareholders is not unduly disproportionate, RegCo proposes that the approval threshold be reduced to a simple majority of 50 per cent from the current threshold of 75 per cent, and the current blocking threshold (whereby 10 per cent of the total number of issued shares held by shareholders present and voting can block the resolution) be removed. The second key proposal is that the exit offer made in connection with a voluntary delisting must be both fair and reasonable. Currently, it is required to be reasonable but not required to be fair. The appointed independent financial adviser must give the opinion that the exit offer is reasonable and fair. In addition, RegCo proposes to codify the existing practice that the exit offer must include a cash alternative as the default alternative. Subject to the feedback received, RegCo expects to implement the new rules in 2019. The proposed changes come off the back of the delisting of Vard Holdings, a shipbuilder that was previously listed on the SGX, whereby its controlling shareholder, Fincantieri Oil & Gas, pushed through the delisting of the shipbuilder as it could vote on the offer despite an outcry from minority investors and opposition over what they considered was a low ball offer.

VI OUTLOOK

Shareholder activism has risen and is expected to continue to increase in Singapore as a result of a confluence of factors, including the flood of facilitative regulatory changes, increasing investor sophistication, louder voices by investor lobby groups and Singapore's growing role as one of Asia's leading economic and financial hubs. In the wake of such an unmistakable trend, companies and their boards need to prepare themselves for a changing corporate landscape by proactively developing a shareholder engagement plan so that mutual understanding and different expertise can converge through conciliatory dialogues. It is crucial for any company to understand its shareholder base, appreciate that their interests are not monolithic and critically assess its own performance, practices and risk factors from time to time in preparation for the contingency of any activist campaign.
Chapter 12

SOUTH AFRICA

Ezra Davids and Ryan Kitcat

I OVERVIEW

Historically, shareholder activism has not been an important force in South Africa. More recently, however, shareholder activism has been on the rise, in line with global trends. This increase in shareholder activism, which has been gradual rather than a surge, can be attributed to a number of factors, including:

a the influence of shareholder activism in other jurisdictions, mainly the United States and Europe;
b a widely held market with an internationalised shareholder base: as at March 2019, 52 per cent of South African equities were held by international investors;
c a greater tendency towards active engagement by institutional and other investors; and
d a regulatory and corporate governance framework that creates an enabling environment for shareholder activism or activist-like interventions.

Shareholder activism in South Africa manifests itself through campaigns or proposals by one or more shareholders seeking to effect some change or reform within a company, in relation to its business, governance, management or strategy, or in respect of a particular corporate action or fundamental transaction. Examples of activist proposals seen in South Africa include the following:

a reconstituting the board or replacing a CEO;
b changing executive remuneration;
c revising corporate strategies;
d addressing operational performance issues;
e pursuing environmental, social and governance (ESG) agendas;
f making balance sheet proposals, such as returns of capital to shareholders through buy-backs or distributions;
g changing the capital structure or capital allocation strategy;
h monetising assets (e.g., by forcing divestitures or spin-offs); and
i facilitating or frustrating mergers and acquisitions (M&A).

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1 Ezra Davids is a partner and Ryan Kitcat is a senior associate at Bowmans. The authors would like to thank Lauren Midgley (associate) and Richard Griffin (candidate attorney) for helpful research assistance.

II LEGAL AND REGULATORY FRAMEWORK

The primary sources of laws and regulations that are relevant to shareholder rights and activism are the Companies Act 71 of 2008 (the Companies Act), Chapter 5 of the Companies Regulations 2011 promulgated thereunder (the Takeover Regulations), the Financial Markets Act 19 of 2012 (the Financial Markets Act) and common law.

Takeovers and other ‘affected transactions’ (e.g., statutory mergers, schemes and disposals of all or a greater part of a company’s assets or undertaking) are regulated under Chapter 5 of the Companies Act and the Takeover Regulations. In the context of such transactions, the Takeover Regulation Panel (TRP) is mandated to ensure the integrity of the marketplace and fairness to securities holders, and to prevent actions by offeree companies designed to impede, frustrate, or defeat an offer or the making of fair and informed decisions by securities holders. The TRP has the power to initiate or receive complaints, conduct investigations and issue compliance notices.

The Financial Markets Act provides for the regulation of financial markets and prohibits insider trading and market abuse. The Financial Sector Conduct Authority (FSCA) is responsible for enforcing the Financial Markets Act. Earlier this year, the FSCA reported that it and its predecessors had investigated 421 cases, taken enforcement action in 91 and imposed approximately 138 million rand in penalties since 1999.3

The Listings Requirements (the Listings Requirements) of the Johannesburg Stock Exchange (JSE), enforced by the JSE, apply to JSE-listed companies. The Listings Requirements regulate, among other things, the fair and equal treatment of shareholders, access to information, certain voting thresholds, and pre-emptive rights and related party transactions.

The King IV Report on Corporate Governance for South Africa 2016 (the King Code), issued by the Institute of Directors in Southern Africa, contains various principles and recommendations intended to promote good corporate governance, many of which are relevant to shareholder rights and engagement. Certain principles in the King Code are incorporated into the Listings Requirements, making it mandatory for JSE-listed companies to comply with them, with the balance of the King Code’s principles and recommendations to be implemented on an ‘apply and explain’ basis.

Additionally, certain other regulatory avenues, although not intended as a means for shareholder activism, indirectly create opportunities for shareholder intervention and engagement. For example, shareholders, acting alone or with other stakeholders, may use the ‘public interest’ considerations assessed by the competition (antitrust) authorities as part of the merger approval or clearance process as a means to delay or thwart a transaction.

Some of the legal and regulatory avenues for shareholder activism are set out below.

i Ability to influence shareholders’ meetings and approvals

Shareholders are entitled to attend, speak at and vote at a meeting, either themselves or via proxy. This allows shareholders to ask difficult questions of directors, express their views or lobby support from other shareholders for a particular agenda (e.g., a ‘vote no’ campaign).

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Shareholders have the ability to requisition a shareholders’ meeting by delivering signed demands to the company, specifying the purpose for which the meeting is proposed. If the company receives, in aggregate, demands from holders of at least 10 per cent of the voting rights entitled to be exercised in relation to the matter proposed, it must call a meeting unless the company or another shareholder successfully applies to court to set aside the demand on the grounds that it seeks only to reconsider a matter that has already been decided by shareholders, or is frivolous or vexatious.

Any two shareholders of a company may propose that a resolution concerning any matter in respect of which they are each entitled to exercise voting rights (e.g., the removal of a director) be submitted to shareholders for consideration at the next shareholders’ meeting, at a meeting demanded by shareholders or by written vote.4

Corporate actions that require shareholder approval present opportunities for shareholder intervention. Generally, ordinary resolutions may be passed by a majority of 50 per cent plus one share, and special resolutions with a majority of at least 75 per cent, of the voting rights exercised on the resolution. Blocs of shareholders may therefore cooperate to block or pass resolutions. In particular, a minority shareholder holding 25 per cent of the voting rights may block special resolutions (e.g., to approve a buy-back, an issue of securities or a fundamental transaction).

In certain instances, the Companies Act and the Listings Requirements impose special approval requirements. For example, resolutions proposing fundamental transactions (statutory mergers, schemes, certain business or asset disposals) require approval at a quorate meeting of 75 per cent of disinterested shareholders present and voting (i.e., excluding voting rights of the acquirer and related or concert parties). Similarly, in respect of JSE-listed companies undertaking related party transactions, the votes of related parties and their associates will not be taken into account in the approval of any resolution in connection with the related party transaction.

ii Access to company records and information

A shareholder can access certain company records to assist with activist proposals and seek the cooperation of other shareholders. A holder of a beneficial interest in a company’s securities has the right to inspect and copy the company’s MOI,5 securities register, register of directors, reports and minutes of annual meetings, and annual financial statements. If additional information is required for the exercise or protection of a right, a shareholder may be able to rely on the Promotion of Access to Information Act 2 of 2000, enacted to give effect to the constitutional right of access to information.

iii Dissenting shareholders

Dissenting shareholders may frustrate or even prevent the implementation of a proposed scheme, merger or sale of all or a greater part of the assets or undertaking. Despite shareholders having approved a special resolution in respect of such a transaction, a company may not implement it without the approval of a court if (1) the resolution was opposed by at least 15 per cent of the voting rights exercised thereon, and any of the dissenting shareholders,

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4 Shareholders entitled to exercise at least 10 per cent of the voting rights may propose an amendment to a company’s memorandum of incorporation (MOI).

5 This is the constitutional document of a company, which is binding among the company, its board and shareholders.

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within five business days of the vote, requires the company to obtain court approval; or
(2) any dissenting shareholder who voted against the resolution, within 10 business days
of the vote, successfully applies to a court for a review of the resolution. A court may set
aside the resolution only if it is satisfied that the resolution is manifestly unfair to a class of
shareholders or the vote was materially tainted by a conflict of interest, inadequate disclosure,
a failure to comply with the Companies Act or the company’s MOI, or some material
procedural irregularity.

iv Appraisal rights
In certain prescribed circumstances – including schemes, mergers or sales of all or a greater
part of a company’s assets or undertaking – a dissenting shareholder may force the company
to purchase its shares in cash at a price reflecting the fair value of the shares.6 This is a ‘no
fault’ appraisal right that enables a shareholder to sell all of its shares and exit the company.
It applies if (1) the shareholder notified the company of its objection to the resolution to
approve the action or transaction; and (2) the shareholder voted against the resolution (which
was nonetheless approved) and complied with procedural requirements to demand that the
company buy its shares for fair value.

v Actions and remedies
In extreme cases, a holder of issued securities may apply to court for an order necessary to
protect any right of the securities holder, or rectify any harm done to the securities holder by
(1) the company due to an act or omission that contravened the Companies Act, the MOI or
the securities holder’s rights; or (2) any director of the company, to the extent that he or she
is or may be liable for a breach of fiduciary duties.7

Similarly, a shareholder may apply to court for appropriate relief if (1) any act or
omission of the company has had a result; (2) the business of the company is being carried
on in a manner; or (3) the powers of a director, prescribed officer or related person are being
exercised in a manner that is oppressive or unfairly prejudicial, or unfairly disregards the
interests of that shareholder.8 Having considered the application, the court may make any
interim or final order it considers fit, including an order restraining the conduct complained
of, ordering a compensation payment, or varying or setting aside an agreement or transaction.

The Companies Act also introduced a statutory derivative action that enables a
shareholder (among other stakeholders) to demand that the company bring or continue
proceedings, or take related steps to protect the legal interests of the company.9 A company
may apply to court to set aside the demand only on the grounds that it is frivolous, vexatious
or without merit.

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6 Section 164 of the Companies Act.
7 Section 161 of the Companies Act.
8 Section 163 of the Companies Act.
9 Section 164 of the Companies Act. Section 159 also provides whistle-blower protections for shareholders
to make good faith disclosures of information to a relevant regulator where the shareholder reasonably
believed at the time of disclosure that the company, director or prescribed officer had: (1) contravened
the Companies Act; (2) failed to comply with a statutory obligation; (3) engaged in conduct that
endangered or harmed an individual or the environment; (4) unfairly discriminated against a person; or
(5) contravened other legislation that could place the company at risk. These shareholders are immune
vi Stakebuilding
Activists should carefully structure any on-market or off-market stakebuilding, taking into account the legal and regulatory obligations applicable to their particular circumstances.

Disclosure obligations require persons who acquire or dispose of a beneficial interest in securities, such that they hold or no longer hold 5 per cent or any further multiple of 5 per cent of the voting rights attaching to a particular class of securities, to notify the issuer within three business days of the acquisition.\(^\text{10}\) This applies irrespective of whether the acquisition or disposal was made directly, indirectly, individually or in concert with any other person, and options and other interests in securities must be taken into account.

If an acquisition takes the acquirer’s beneficial interest in voting rights to 35 per cent or more (whether acting alone or in concert), the acquisition will trigger a mandatory offer to the remaining shareholders, unless a whitewash resolution waiving the mandatory offer is approved by a majority of independent shareholders.

Where a stakebuilding involves two or more persons cooperating for the purposes of proposing an ‘affected transaction’ or offer, concert party rules in the Companies Act and the Takeover Regulations will apply. The latter also impose strict requirements in relation to dealings in securities before, during and after an offer period.

Activists should be mindful of the insider trading offences and the broader framework regulating market abuse under the Financial Markets Act.\(^\text{11}\)

vii Defences available to companies and directors’ duties
There are various strategies available to companies when faced with shareholder activism. Companies that have anticipated and prepared for activism will be better placed to respond quickly, and to defend against proposals that are not, or may not be, in the best interests of the company. Strategic private engagements with various stakeholders, tactics such as ‘bear hugs’ and accounting for potential activist activity in the course of creating transaction timelines will also play an important role in preventing or resolving activist issues in a transactional context.

The legal and regulatory framework described above includes various rules that boards may use to defend against activism, particularly if the activism is frivolous, vexatious or without merit.

As a general principle, it is the board that has primary legal responsibility for managing the business and affairs of the company. In doing so, the directors are subject to various fiduciary duties, all of which flow from the overarching duty to act in the best interests of the company at all times. There is no list of factors that a director must consider when assessing what is in the best interests of the company. The Companies Act includes a statutory business judgement rule, which affords directors some latitude and a degree of protection in responding to shareholder activism.

Directors need to take care not to engage in any conduct that is directed at, or could have the effect of, frustrating an offer made in good faith.

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\(^\text{10}\) The issuer then has 48 hours to disclose the acquisition to the market and shareholders.

\(^\text{11}\) See Chapter X of the Financial Markets Act.
III KEY TRENDS IN SHAREHOLDER ACTIVISM

i Profile of activist investors

In broad terms, it is possible to distinguish between economic activists and governance activists. Economic activists in South Africa primarily comprise institutional investors (such as asset managers, collective investment schemes, hedge funds, insurers, retirement and pension funds) whose activism is often event-driven and is generally directed at extracting greater shareholder value. Governance activists typically seek to influence board composition and company policy, and to improve corporate governance.

Recently, non-profits and NGOs, such as Just Share, the Raith Foundation and the Centre for Environmental Rights, have actively pursued ESG agendas. A number of prominent individual activists also regularly query companies on corporate governance, ESG and related issues.

Of course, many investors regard shareholder activism as integral to their investment strategies and will pursue both economic and governance activism. Examples of investors who have pursued both economic and governance activism include Allan Gray, Sygnia Asset Management, Value Capital Partners and Foord Asset Management. The Public Investment Corporation (PIC) – an investment management company owned by the South African government, which manages the Government Employees Pension Fund – holds significant stakes in a number of JSE-listed companies and exercises considerable influence as a shareholder, particularly in M&A contexts. As at 31 March 2018, the PIC reported having assets under management worth 2.08 trillion rand.12

ii Companies targeted by activist investors

Activism in South Africa has not been restricted to any particular industries, or by company size or performance. These factors are only a few among many, endogenous and exogenous, that might render a company a more vulnerable target of an activist campaign.

iii Activist campaigns

Historically, most campaigns in South Africa have focused on executive compensation and board composition.

On remuneration, following the introduction of ‘say-on-pay’ rules, certain JSE-listed companies (including Datatec, Tongaat Hulett, Naspers and Old Mutual) have had to reconsider their remuneration policies following significant shareholder opposition to such policies or implementation reports.13


13 In particular, the King Code contains recommendations relating to executive remuneration, including a recommendation that companies should produce and disclose, in respect of a reporting period, a remuneration policy and a report on the implementation of that policy. This remuneration policy and implementation report must be tabled annually for a separate non-binding advisory vote by shareholders at the company’s annual general meeting (AGM). If 25 per cent or more voting rights are exercised against
On board composition, campaigns have forced companies to take steps to change the make-up of their boards or pushed for the resignation of the CEO. The most notable example of this was in 2014, involving PPC, a cement manufacturer, where activists sought to remove the entire board.\textsuperscript{14}

In the M&A context, the influence of shareholder activism is gradually increasing. Shareholders have intervened to block or force certain M&A activity. Recent examples of the former include shareholder opposition to a proposed takeover of PPC,\textsuperscript{15} and Prudential’s opposition to an attempted takeover of poultry producer Sovereign Foods by Country Bird Holdings.\textsuperscript{16} An example of the latter is Grand Parade Investment’s (GPI) disposal of its interests in certain franchises (described in Section IV).

Recent campaigns involving African Phoenix Investments (API) and La Concorde (described in Section IV) demonstrate the potential for shareholders, in certain statutorily prescribed circumstances, to delay potential M&A transactions by requiring a company to obtain court approval before implementation or to exit their investments for fair value by exercising their appraisal rights.

The objectives of activists, and the strategies and tactics employed by them in pursuit of their objectives, vary. Shareholders typically give their views on such matters by voting against resolutions at general meetings. However, some shareholders follow the strategy of proactively engaging with the board and executives of companies with the aim of shaping the relevant companies into better ones with more sustainable long-term financial prospects to unlock shareholder value. Other shareholders, particularly certain prominent individual shareholder activists, have leveraged public criticism to pressure companies into justifying, and subsequently revising, their compensation packages.

\textbf{Outcomes and the path to resolution}

Recent examples of shareholder activism indicate that shareholder activists have had an impact on the manner in which South African companies engage with their shareholders. As shareholders become increasingly concerned with executive remuneration policies, transparency and other corporate governance issues, companies will need to pay closer attention to their adherence to principles of good governance and engagement in M&A. This is especially prevalent in the context of changes introduced by the King Code.

\textsuperscript{14} During 2014, a group of shareholders requisitioned a special shareholders’ meeting to consider the removal of the entire board of PPC and to replace it with the nominees of the requisitioning shareholders. These measures successfully forced the board to engage with the requisitioning shareholders’ concerns.

\textsuperscript{15} In 2018, PPC was the subject of a merger attempt by a consortium comprising its smaller rival AfriSam and a Canadian investment house, Fairfax Financial Holdings. This failed as a result of shareholder resistance to a perceived undervaluation of PPC. Following failure of the proposed transaction, activist shareholders pressed for the removal of the chairperson and reconstitution of the PPC board.

South Africa

IV RECENT SHAREHOLDER ACTIVISM CAMPAIGNS

i GPI

In November 2018, GPI, a franchisee of Burger King, Dunkin’ Donuts and Baskin-Robbins, was the subject of activism by a consortium of disgruntled minority shareholders.\(^{17}\) The consortium requisitioned an extraordinary general meeting (EGM) to overhaul the board and appoint four of its own non-executive directors. It sent a letter to GPI detailing its grievances: doubts about the competency, skills and independence of the board; large bonuses paid to executive directors despite a collapsing share price and dwindling dividend; poor capital allocation decisions; and an exodus of key executives. After GPI failed to abide by a JSE directive ordering it to notify investors of the letter, the JSE issued the letter to shareholders directly.

An investor presentation preceded the EGM, during which GPI’s interim CEO threatened ‘war’ against the activists, branding them ‘short-termists’ and ‘usurpers’. At the EGM, the consortium gained sufficient shareholder support to appoint two of its preferred nominees to the board as non-executive directors. Days later, the CEO resigned, shortly before a vote on her appointment at the company’s AGM, and shortly after Value Capital Partners, a turnaround specialist, acquired an influential stake in GPI.

In February 2019, GPI announced that it was exiting its interests in the Dunkin’ Donuts and Baskin-Robbins franchises. The consortium had long pushed for GPI to exit the chains, given their track record of underperformance – since their launch in 2016, the South African outlets struggled to gain traction, incurring cumulative losses of over 96 million rand.\(^{18}\)

ii Datatec

JSE-listed ICT group, Datatec, experienced considerable activism following the publication of its financial results in May 2018, which showed that significant cash had been generated from sales of certain group assets. Shortly after publishing its results, Datatec received feedback from several shareholders indicating support for a return of capital to shareholders. Datatec responded by convening for a general meeting in July 2018, well in advance of its AGM in September, to seek shareholder authority for a buy-back.

At Datatec’s AGM, shareholders voiced concerns about various issues, including the tenure of the company’s non-executive directors and external auditors, and the company’s executive compensation. Datatec’s remuneration policy was narrowly approved (50.2 per cent) by shareholders, but 62.8 per cent voted against its remuneration implementation report. Board and committee changes and a shareholder engagement process followed.

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\(^{17}\) The consortium comprised Kagiso Asset Management, Denker Capital, Excelsia Capital, Westbrooke Alternative Asset Management and Rozendal Partners.

Datatec carried out four buy-backs between August 2018 and February 2019, repurchasing approximately 615 million rand worth of shares. At another general meeting at the end of June, Datatec shareholders approved a general authority for it to carry out further buy-backs.

iii Standard Bank

Recently, prominent individual activist Theo Botha and the Raith Foundation, a non-profit, requisitioned two climate change-related resolutions to be considered at Standard Bank’s 2019 AGM. The resolutions sought to require Standard Bank to (1) report to shareholders by November 2019 on the company’s assessment of greenhouse gas emissions resulting from its financing portfolio; and (2) adopt and publicly disclose a policy on lending to coal-fired power projects and coal mining operations. Standard Bank provided a detailed response to the proposed resolutions, explaining why the board recommended that the shareholders vote against the resolutions. The board did not consider the proposed resolutions as providing shareholders with any more meaningful understanding of the company’s climate change risk exposure and risk management. Moreover, given the uncertainty as to how the group would practically comply with the proposed resolutions, it did not believe them to be in the best interests of the group at the time. The first resolution did not achieve the majority vote required for approval, but nonetheless received significant shareholder support (38.18 per cent for, 61.82 per cent against, with 6.29 per cent abstaining). The second was approved (55.09 per cent for, 44.91 per cent against, with 3.95 per cent abstaining).19

iv API

In March 2019, dissenting shareholders intervened in a proposed transaction of API, an investment holding company, forcing it to obtain court approval before implementing the transaction. The shareholders relied on a previously untested provision of the Companies Act that allows a dissenting shareholder to require a company to obtain court approval before

implementing a resolution approving a fundamental transaction, if at least 15 per cent of voting rights were exercised against the resolution to approve the proposed transaction (discussed above). At its AGM, API sought shareholder approval for a preference share buy-back scheme under which API would repurchase and cancel 13.5 million preference shares at a significant discount to face value. The resolution to approve the scheme received 76.5 per cent approval, but more than 15 per cent of votes exercised were against the resolution. That entitled dissenting shareholders to send a notice to API, in terms of Section 115(3)(a) of the Companies Act, requiring API to seek court approval for the resolution and, by extension, the share buy-back scheme. On 5 June 2019, API published an announcement notifying shareholders that it had successfully applied (unopposed) to court for approval of the contested transaction.

La Concorde

In June 2018, the High Court considered the issue of whether a dissenting shareholder in a holding company is entitled to exercise appraisal rights (mentioned above) in respect of a subsidiary’s disposal of all or the greater part of its assets or undertaking. Individual activist Albie Cilliers exercised his appraisal rights in respect of a sale of assets by a wholly owned subsidiary of La Concorde. After rejecting La Concorde’s initial offer of 13.47 rand per share, Cilliers applied to court for a declaration that the valuation did not represent fair value. La Concorde countered by challenging Cillier’s entitlement to appraisal rights at all, arguing that Section 164 of the Companies Act granted such rights to shareholders of the disposing company only (i.e., the subsidiary, not the holding company). Notwithstanding that Cilliers did not hold shares in the subsidiary that was disposing of the assets, the High Court found in his favour, adopting a purposive approach to the appraisal right. The Court held that the appraisal right was introduced to protect minority shareholders, particularly where they are unable to effectively influence company direction or pursue private actions. To treat dissenting shareholders in a holding company any differently from those in a subsidiary, the Court reasoned, would undermine the objective of protecting minority shareholders. Correctly interpreted, the relevant provisions of the Companies Act gave appraisal rights to both sets of shareholders. Therefore, Cilliers, as a minority shareholder in the La Concorde holding company, was capable of exercising a shareholder appraisal right in relation to the subsidiary’s disposal of assets.

V REGULATORY DEVELOPMENTS

The fourth iteration of the King Code (effective for financial years commencing on or after 1 April 2017) adopts a qualitative, outcomes-based ‘apply and explain’ application
and disclosure regime, in contrast with earlier iterations that imposed an ‘apply or explain’ regime. The King Code promotes a stakeholder-inclusive approach to corporate governance (as opposed to a shareholder-centric approach), which regards shareholders as an important subset of stakeholders who, by virtue of their rights as shareholders, are able to hold companies and their boards to account. The King Code, therefore, encourages shareholder activism, while further developing principles such as shareholder engagement through a number of its recommendations. As such, it creates an opportunity for a framework for the responsibilities of shareholders, particularly institutional investors, to be incorporated in the corporate governance system of checks and balances.

In November last year, following recent campaigns and disruption in the market by certain short-sellers, the FSCA published a ‘Discussion Paper on the Implementation of a Short Sale Reporting and Disclosure Framework’.

VI OUTLOOK

Recent events, including some high-profile corporate scandals and governance failures, have resulted in (calls for) shareholder bases that are less apathetic in their approach to management accountability and the pursuit of shareholder value. Shareholder demands for greater levels of accountability, transparency and return on investment are on the rise. A failure to engage with sophisticated activist shareholders or provide them with the levels of transparency demanded, may leave the board exposed to shareholder disapproval sparked by shareholder activists who are armed with an increased amount of information and a variety of regulatory rights and protections.

As discussed above, shareholder activists who hold even nominal stakes in companies are afforded relatively strong rights and protections: as such, companies will need to ensure that they practise good corporate governance and proactively participate in appropriate levels of shareholder engagement, with particular focus on unlocking shareholder value. This includes abiding by the disclosure and engagement recommendations of the King Code, particularly in the context of listed companies.

In the course of preparing for increased shareholder activism in South Africa, companies should monitor their shareholder portfolios carefully and seek to anticipate the kinds of activists likely to emerge, as well as the types of demands they are likely to make, on a case-by-case basis.

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25 Among other things, the King Code recommends that the board encourage shareholders to attend general meetings and engage with shareholders through various means such as websites, advertising and press releases. Certain parts of the King Code have been incorporated into legislation by reference. The King Code has recently been updated to introduce greater disclosure recommendations, including in respect of board committees (e.g., remuneration committees) and CEOs (e.g., in respect of notice periods, contractual conditions relating to termination and succession planning).


I OVERVIEW

The number of campaigns by activist shareholders in Switzerland is still relatively low compared with other jurisdictions, in particular the United States. In the past few years, however, the Swiss market has seen a growth of shareholder activism, including high-profile campaigns against large multinational companies. Furthermore, since the annual shareholders’ meeting season in 2018, there has been an increasing willingness of shareholders to express their dissatisfaction with the board of directors (the board) or the management by rejecting board proposals regarding directors or executive management compensation in ‘say-on-pay’ votes. We expect this change of mindset and the consequential potential increased the support base for activist shareholders to further foster shareholder activism in Switzerland.

The key factors that have contributed to Swiss companies appearing on the radar of activist shareholders are not materially different from the drivers in other parts of the world:

a. The company has underperformed its peers, in particular based on its shareholder return.

b. The company has a low market value relative to its book value, but is profitable.

c. The company’s cash reserves are relatively high historically and relative to its peers, but the company is not prepared to make material adjustments to its distribution policy or has not committed to a significant share buy-back.

d. A particular business segment has underperformed.

e. Corporate governance issues, in particular if the company does not meet ‘best practices’ recommended by proxy advisory firms.

II LEGAL AND REGULATORY FRAMEWORK

i The Swiss Code of Obligations

The most important tools available to an activist shareholder in Switzerland are included in the Swiss Code of Obligations (CO). The corporate law contained in the CO governs shareholders’ rights, the duties of the board, and the division of power between the board and the shareholders’ meeting.

ii The Swiss Ordinance against Excessive Compensation

The Swiss Ordinance against Excessive Compensation (the Ordinance), which entered into effect on 1 January 2014, introduced additional shareholders’ rights that may be used by

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activist shareholders of listed companies. The most prominent elements of the Ordinance are the binding say-on-pay votes on directors and executive management compensation. Further, the Ordinance limits the term of office of board members of listed companies to one year, thus abolishing the staggered board structure many companies used as a defence mechanism. The Ordinance gives shareholders the right to elect the members of the board’s compensation committee directly and obliges certain pension funds to exercise their voting rights with respect to certain agenda items; in particular, the election of the members of the board and the chair of the board, and the compensation of the directors and the executive management. The Ordinance further provides that any institutional representation of shareholders can be done only through an independent proxy elected annually at the shareholders’ meeting, and no longer through a company representative.

iii  The Swiss Financial Market Infrastructure Act, the Swiss Financial Market Infrastructure Ordinance, the Financial Market Infrastructure Ordinance of FINMA and the Takeover Ordinance

An activist shareholder building its stake will have to comply with the disclosure rules included in the Swiss Financial Market Infrastructure Act and the Financial Market Infrastructure Ordinance of the Swiss Financial Market Supervisory Authority (FINMA), which apply to companies incorporated in Switzerland with a primary or secondary listing on a Swiss stock exchange (or foreign companies with a primary listing on a Swiss stock exchange). Pursuant to these rules, persons who directly, indirectly or in concert with other parties acquire or dispose of shares of a company listed on a Swiss stock exchange, or purchase or sell rights or obligations relating to such shares (including call options, put options, derivative instruments and cash-settled financial instruments), and, thereby, directly, indirectly or in concert with other parties reach, exceed or fall below a certain threshold relative to the company’s voting rights (whether exercisable or not) must notify the issuer and the stock exchange of the acquisition or disposal. Unlike in most other jurisdictions, the initial threshold that triggers a disclosure obligation is not set at 5 per cent, but at 3 per cent (calculated by reference to the relevant company’s share capital registered in the commercial register). The additional disclosure thresholds are set at 5, 10, 15, 20, 25, 33.3, 50 and 66.6 per cent.

If an activist shareholder, directly, indirectly or acting in concert with third parties, acquires equity securities that, when added to the equity securities already owned, exceed the threshold of 33.3 per cent of the voting rights of a target company, whether exercisable or not, the activist shareholder must submit a mandatory public tender offer to all shareholders of the company to acquire all listed equity securities of the target company. Target companies may raise this threshold to 49 per cent of the voting rights in their articles of association or exclude the obligation of submitting a mandatory offer entirely. Only a few Swiss companies have done so.

iv  The Listing Rules of the SIX Swiss Exchange

The obligation of companies listed on the SIX Swiss Exchange (SIX) – Switzerland’s pre-eminent stock exchange – to disclose price-sensitive, non-public facts as set out in the SIX Listing Rules and the SIX’s Directive on Ad hoc Publicity may have an impact on the extent to which the discussions between the company and the activist shareholders, or the campaign of an activist shareholder, can be held confidential.
v  The activist shareholder’s toolbox

The following section provides an overview of the variety of tools available to an activist shareholder in Switzerland.

Private discussion and engagement with the company

Typically, the first tools that activist shareholders utilise are discussions with the management and the board in an effort to seek consensus with respect to specific changes that activist shareholders believe the company should adopt. Swiss companies targeted by activist shareholders have traditionally engaged in this form of communication with activists. Subject to limited exceptions (e.g., equal treatment of shareholders and non-disclosure of insider information), Swiss law generally permits this kind of interaction between the management or the board and shareholders. Shareholders do not have any possibility, however, to force management or the board to engage in discussions if they refuse to do so.

Public campaigns and contact with shareholders

Following or in parallel with the discussions with the board or the management, activist shareholders usually launch public campaigns, through print and online media specifically dedicated to such shareholders’ campaigns, in particular the ‘vote no’ campaigns where an investor (or coalition of investors) urges shareholders to withhold their votes from one or more of the board nominees, rejects board proposals regarding directors and executive management compensation, or engages in an actual proxy contest; for example, by nominating own board candidates or proposing corporate governance changes (e.g., changes to capped voting rights provisions, the rules regarding board composition or the size of the board, or a change to the proposed distribution to shareholders).

As shareholders of a Swiss company have no right to request direct access to the company’s shareholder register, direct contact by the activist shareholder with other shareholders is limited to those shareholders whose interest in the issuer is publicly known; for example, owing to public filings such as those disclosed on the SIX ‘significant shareholder’ platform, or through searches of other publicly available sources (Bloomberg, FactSet). Hence, contact with most of the shareholders must occur through media campaigns, special websites or proxy advisers.

Even if the other shareholders are known, depending on an activist shareholder’s interest in a company and its willingness to disclose its shareholdings or to submit a public tender offer, an activist shareholder is well-advised to carefully consider the form of discussions it engages in with other shareholders prior to a shareholders’ meeting. Discussions among shareholders may qualify as ‘acting in concert’, with the consequence that disclosure obligations and mandatory offer obligations could be triggered if the thresholds for the disclosure obligations or mandatory offers are reached or crossed.

Right to participate in, and exercise of voting rights at, the general meeting

Every shareholder registered in the share register at the relevant record date has the right to participate in, and exercise its voting rights at, the company’s general meeting. In addition, each shareholder, including shareholders having requested the inclusion of an item on the agenda, is entitled to explain its position regarding a certain agenda item or submit proposals with respect to duly notified agenda items (Article 700(4) CO). The board may restrict the length of speeches, but must treat all shareholders equally.
Although this right to speak gives activist shareholders a platform to communicate with other shareholders and promote their campaign, its benefit is limited because of the decision-making process shifting from the general meeting to the run-up to the general meeting. The independent proxy, who is obliged to vote in accordance with the shareholder’s instructions, typically represents the majority of the votes at the general meeting. Hence, any activist shareholder’s speech, no matter how persuasive, is unlikely to change the outcome of the shareholders’ vote at the general meeting. This holds true all the more for proposals submitted at the general meeting itself, as proxy forms typically provide, as part of the general voting instructions, that absent specific voting instructions, the independent proxy would vote on the shares for which proxy is granted in accordance with the recommendations of the board.

**Right to request the inclusion of an item on the agenda of a general meeting and right to call an extraordinary general meeting**

For a shareholder to be able to request the inclusion of an item on the agenda of a general meeting or to call an extraordinary general meeting, the shareholder must hold, as an owner of record, the number of shares required pursuant to the company’s articles of association. Absent specification in the articles of association, the default rule – companies are not permitted to introduce stricter provisions – is that shareholders holding shares with a par value worth in the aggregate 1 million Swiss francs or more have a right to request the board to put a specific item on the agenda of a general meeting. According to a significant view in Swiss legal writing – a persuasive authority under Swiss law – shareholders who hold 10 per cent of the company’s share capital – a reference to the issued share capital, rather than outstanding shares – may also request the inclusion of an item on the agenda of a general meeting.

Unless the articles of association provide for a lower threshold, shareholders who hold 10 per cent of the share capital have the right to request the board to call an extraordinary general meeting. Also, a significant part of legal writing has adopted the view that, alternatively, shareholders holding shares with a par value worth at least 1 million Swiss francs would have the right to call an extraordinary general meeting.

Upon receipt of a request to call an extraordinary general meeting, the board must comply with the request within a reasonable period. According to precedents, this generally means between four and eight weeks, depending on the circumstances. If the board does not comply with the request, the shareholder would have to seek a court order to enforce its request. The court would either require the board to call a meeting within a certain time or, in exceptional circumstances, call the meeting itself.

If a valid and complete request for inclusion of an item on the agenda has been submitted to the board, the board is in principle obliged to include the agenda item and the proposal in the proxy card.

Shareholders do not, however, have the right to request the inclusion of explanatory notes in the company’s proxy card. In practice, many companies would, however, include a short explanatory statement of the activist shareholder.

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2 This obligation could, however, be introduced with the revision of Swiss corporate law; see Article 700(2)(4) of the Swiss Corporate Law Reform Bill published on 23 November 2016.
Share register, information and inspection rights, special audit

Under the CO, a shareholder has the right to inspect the share register with regard to its own shares (but not with regard to the shares of other holders) and otherwise to the extent necessary to exercise its shareholder rights. No other person has a right to inspect the share register.

The books and correspondence of a Swiss company may be inspected with the express authorisation of the general meeting or by resolution of the board, and subject to the safeguarding of business secrets. At a general meeting, any shareholder is entitled to request information concerning the affairs of the company. Shareholders may also ask the auditor questions regarding its audit of the company. The board and the auditor must answer shareholders’ questions to the extent necessary for the exercise of shareholders’ rights, and subject to prevailing business secrets or other material interests of the company.

In addition, if the shareholders’ inspection and information rights as outlined above prove to be insufficient, any shareholder may propose to the general meeting that specific facts be examined by a special commissioner in a special investigation. If the general meeting approves the proposal, the company or any shareholder may, within 30 calendar days of the general meeting, request the court at the company’s registered office to appoint a special commissioner. If the general meeting rejects the request, one or more shareholders representing at least 10 per cent of the share capital or shares in an aggregate par value of at least 2 million Swiss francs may ask the court to appoint a special commissioner. The court will issue such an order if the petitioners can demonstrate that the board, any member of the board or an officer of the company infringed the law or the company’s articles of association, and thereby damaged the company or the shareholders. The costs of the investigation would generally be allocated to the company and only in exceptional cases to the petitioners. Although rarely used, Article 731a of the CO provides for the right of a shareholder to also request the general meeting to appoint an expert to examine the management or parts thereof. Unlike the special commissioner pursuant to Article 697a of the CO, the expert may assess and appraise facts, and is not limited to fact-finding.

Litigation

Within two months of a general meeting, any shareholder may challenge shareholders’ resolutions adopted in violation of applicable laws or the company’s articles of association. Resolutions of the board, however, are not challengeable, except if the resolutions were to be considered void.

An effective tool available to activist shareholders, at least temporarily, is the blockage of commercial register entries. Under Swiss law, many corporate actions, such as capital increases in connection with the issuance of new shares, statutory mergers or more generally amendments to the articles of association, require registration with the commercial register to be effective. Such a blockage can be obtained through the submission of a written objection to the commercial register. The initial blockage would then need to be prosecuted through an application for provisional measures in court and the subsequent court challenge of the shareholders’ resolution that is underlying the commercial register entry. Even if ultimately unsuccessful, blockage actions have the potential to significantly delay the process, thus adding significant nuisance value to the tool box of an activist shareholder.

Shareholders may also file liability law suits against members of the board and the management for breaches of their fiduciary duties. Directors and the persons engaged in the management of the company are liable to the company, the shareholders and, in bankruptcy, the creditors for any losses arising from any intentional or negligent breach of their duties.
A rule similar to the business judgement rule applies. There are almost no reported cases of directors’ and officers’ liability outside insolvency matters. In addition, Switzerland is a non-litigious environment partly due to the fact that class actions are not permitted and a plaintiff must bear court costs in a shareholder lawsuit and reimburse the defendant for attorney’s fees if the shareholder loses the case. Liability claims against directors and executives are typically derivative in nature, and therefore the remedy would be to seek damages payable to the company. Only in extraordinary circumstances could direct damages (payable to the shareholder submitting the liability claim) be requested.

Structural defences and director duties
Many companies have included structural defences in their articles of associations designed to make activist campaigns more difficult. The key elements available to Swiss companies are capped voting rights, and qualified presence quorums and supermajority.

Capped voting rights
A company may limit the voting rights of shareholders to a certain percentage (usually between 2 and 5 per cent), above which the registration with voting rights in the company’s share register may be refused. Through this feature, a company may also be able to limit coalitions between shareholders. As a consequence, the shareholders’ voting rights are capped at the relevant percentage limit.

Qualified presence quorums and supermajority
Swiss law does not stipulate any presence quorum requirements; however, the company’s articles of association may do so, for example, for matters such as increase in the board size or the removal of board members. Once qualified presence quorum provisions have been introduced, the board does not have the authority to waive quorum requirements stipulated in the articles of association. Under the CO’s default rules and subject to certain supermajority requirements, the shareholders generally pass resolutions and make elections by the affirmative vote of an absolute majority of the shares represented and voting at the general meeting. The articles of association may, however, include increased majority requirements (e.g., two-thirds of the shares entitled to vote) for matters such as dismissal of board members or the increase in the size of the board to prevent the election of additional board members. There are a number of corporate actions that under Swiss law by default require a qualified majority of two-thirds of the votes and an absolute majority of the par value, each as represented at the general meeting. Among other things, share capital increases without pre-emptive rights, the introduction of authorised share capital and merger transactions fall into this category.

Defences against public tender offers
There are relatively strict limitations to the board’s ability to take defensive measures on its own, without authorisation of the general meeting, at least once a public tender offer has been submitted. However, a board may seek authorisation in the authorised share capital included in the articles of association to issue shares under withdrawal of the shareholders’ preferential subscription rights. Although there have been a number of companies that have included such provisions in their articles, there have not been any instances where these types of provisions have been used to issue shares to white knights.
III KEY TRENDS IN SHAREHOLDER ACTIVISM

In line with the global increase of shareholder activism in recent years, Switzerland has seen a significant increase in campaigns of activist shareholders up to 2016 and a stabilisation in 2017 and 2018. Both international hedge funds, mainly from the United States, and Swiss hedge funds have acted as activists. Though it is difficult to make a general statement about the long-term or short-term orientation of activists in Switzerland, most of the activist investors appear to be invested in the target companies for more than one year. Shareholder intervention historically focused on board representation, share repurchases, distributions and more generally on the company’s strategy. With the introduction of the binding say-on-pay votes, board and executive remuneration has also become a target of activist shareholders’ campaigns. Apart from these classical topics, Switzerland has also seen activist campaigns focusing on the board reaction to public tender offers (Syngenta and Monsanto).

i Influence of proxy advisers

In recent years, Switzerland has seen a significant increase in the influence of institutional proxy advisers. One of the reasons for this trend is the introduction of the obligation of certain pension funds to exercise their voting rights on specific agenda items. Given that the votes must be exercised in the interest of the insured persons and that pension funds do often not have sufficient resources to thoroughly analyse the relevant agenda items, many of the pension funds pay institutional proxy advisers for advice regarding the exercise of voting rights.

The most influential proxy advisers in Switzerland are Institutional Shareholder Services Inc and Glass Lewis & Co LLC. Owing to their increasing influence, discussions with proxy advisers have become one of the main elements of shareholder activism campaigns. With the support of institutional proxy advisers, winning a shareholders’ vote will become possible even with only taking a limited stake in the company. Though a general trend is not yet apparent, it is possible that this will bring funds with fewer assets under management into play as activist shareholders.

ii Use of dedicated websites

Recent shareholder activism campaigns have shown that not all activists and target companies are able to attract the same media attention. As an alternative or as supplement to media campaigns, activist shareholders have started to use dedicated websites to promote their messages more broadly. Although possible, websites have not yet been used to solicit proxies directly, but rather to publish voting recommendations or disclosing voting recommendations of proxy advisers.

IV RECENT SHAREHOLDER ACTIVISM CAMPAIGNS

i Transocean

Transocean Ltd (Transocean) is special among Swiss companies, as it qualifies as a US issuer that is subject to US proxy rules. Accordingly, Carl Icahn and his group (Icahn) were able to use activist shareholder tools that would otherwise not be available to shareholders of a

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Switzerland

Swiss company, when Transocean came onto his radar in 2013. Also, Transocean made public filings with the Securities and Exchange Commission, thereby disclosing its interaction and communication with Icahn and its own campaign strategy.

Icahn requested a significantly higher dividend payout, board declassification and the election of three director candidates. In pursuit of his requests, Icahn was able to reach an agreement with Transocean to send out a separate ‘gold’ proxy card to its shareholders – the alternative, giving Icahn access to the share register directly, is not permissible under Swiss law. The gold proxy card only included the agenda items and proposals requested by Icahn, whereas the Transocean proxy card, in line with Swiss law requirements, included all agenda items and proposals, including the Icahn proposals. At the annual general meeting at which the Icahn proposals were subject to a shareholder vote, Icahn did not succeed with its increase in dividend request; however, Icahn did achieve the election of one board member, and in the course of the campaign run by Icahn in the run-up to the annual general meeting, Transocean’s chair of the board had resigned. Subsequent to the annual general meeting, Transocean and Icahn entered into a settlement agreement, in which Transocean’s board agreed to propose and support at the next annual general meeting that the company’s shareholders approve an increased dividend, two Icahn representatives be elected as directors and the board size be decreased. Icahn in return agreed to certain standstill restrictions and committed to vote in favour of the board director nominees and certain other board proposals.

ii Holcim

In connection with Holcim and Lafarge’s merger of equals in 2014–2015, a coalition of investors started challenging the merger of equals after the deal was announced. The demands came after a divergence in the performances of the two companies. Holcim’s operating performance and share price had outperformed those of Lafarge’s since the deal was struck. The board of Holcim ultimately renegotiated some of the deal terms, in particular the exchange ratio, thus giving Holcim shareholders a greater share of the combined entity.

iii Nestlé

A shareholder activist campaign was initiated in 2017 by hedge fund Third Point, a company led by activist shareholder Daniel Loeb, against Nestlé AG (Nestlé). On 25 June 2017, Third Point announced in a public letter to shareholders that it had invested over US$3.5 billion in Nestlé. Third Point tried to influence Nestlé’s strategy by requesting, inter alia, the sale of Nestlé’s 23 per cent stake in L’Oréal, the repurchase of shares and the sale of non-strategic activities. Only two days after Third Point’s letter, Nestlé announced a share buy-back programme of up to 20 billion Swiss francs. Pursuant to Nestlé’s press release, this was a consequence of a comprehensive review of the company’s capital structure initiated already in early 2017. Although Third Point admitted in its letter published on 22 January 2018 that CEO Dr Mark Schneider had begun to take the needed steps to move Nestlé forward – in particular, the plans to add three outsiders to Nestlé’s board were well received – with its letter published on 1 July 2018, Third Point continued to put pressure on Nestlé. Third Point requested the internal split of Nestlé into three units: beverages, nutrition and grocery.

iv Clariant

Another activist shareholder campaign initiated in 2017 is the campaign of activist Keith Meister, controlling the general partner of Corvex Master Fund LP and Corvex Select Equity Master Fund LP (Corvex), and David Winter and David Millstone, both controlling
persons of the investment manager of 40 North Latitude Master Fund Ltd (40 North) against Clariant AG (Clariant). In July 2017, Corvex and 40 North increased their stake through White Tale Holdings LP (White Tale) to at least 10.06 per cent of the voting rights of Clariant, corresponding to an investment of around 800 million Swiss francs. Corvex and 40 North pressured Clariant to seek alternatives to the Huntsman Corporation (Huntsman) deal announced on 22 May 2017. The activists argued that the planned merger of equals aiming to create a global speciality chemicals company with a combined enterprise value of approximately US$20 billion lacked strategic rationale and undervalued the shares of Clariant. As a consequence of the continued accumulation of Clariant shares by White Tale, and the resulting uncertainty as to whether Clariant would be able to secure the two-thirds majority required under Swiss law for shareholder approval of the transaction, Clariant announced on 27 October 2017 that Huntsman and Clariant jointly decided to abandon the merger of equals. After Clariant abandoned the merger of equals, White Tale continued to put pressure on Clariant requesting the engagement of another investment bank to conduct a strategic review process as well as three board seats. In January 2018, Clariant confirmed that White Tale had sold its stake in Clariant, which in the meantime had increased to 24.99 per cent, to SABIC.

v Credit Suisse

After its activist shareholder campaigns against asset manager GAM and airline caterer Gategroup, RBR Capital Advisors AG (RBR) announced in October 2017 that it had acquired a 0.2 per cent stake in Credit Suisse Group AG (Credit Suisse). RBR requested the split up of Credit Suisse into three independent and focused companies, namely a private and business bank, an independent investment bank and an independent asset manager, as well as the creation of a new IT platform. Although the annual shareholders’ meeting of Credit Suisse would have been an ideal platform for RBR to present its arguments, according to a Credit Suisse representative, RBR did not hold any shares entered in the share register in April 2018.4

V REGULATORY DEVELOPMENTS

We do not currently expect a significant overhaul of the rules and regulations governing activist shareholders’ campaigns. There is, however, a corporate law bill pending in Parliament, which, among other things, intends to strengthen the rights of minority shareholders. The thresholds for requesting a shareholders’ meeting and the inclusion of an item on the agenda would be lowered to 5 and 0.5 per cent, respectively, of the capital or voting rights (from 10 per cent currently) of private and listed companies, respectively. In private companies, shareholders with 5 per cent or more would have the right to ask the board questions not only at shareholders’ meetings (as currently), but also between meetings. The delisting of a company’s shares, which today is in the board’s authority, would require shareholder approval with two-thirds of votes and half of the capital, each as represented at the general meeting. It is currently unclear in what form the bill will ultimately be adopted. We would expect the bill to come into effect in 2020 at the earliest.

VI OUTLOOK

Based on the high-profile campaigns launched by US activist shareholders and the trend for shareholders of Swiss companies in general to become more engaged with the company they are invested in, we expect campaigns of shareholder activists to increase and become more of a mainstay of Swiss corporate law. We also believe that the growing importance of online services and social media will continue to facilitate shareholder activists’ campaigns in Switzerland, in particular as a way to overcome the limitations shareholder activists currently have because of the lack of a direct access to the company’s share register.
Chapter 14

UNITED KINGDOM

Gavin Davies, Greg Mulley and Mark Bardell

I OVERVIEW

Shareholder activism continues to grow in prevalence and significance in the United Kingdom, in common with global trends. Although shareholder activism is not a new concept in the UK market, the types of investors undertaking activism, the companies that they are targeting and the outcomes that they are seeking to achieve have continued to evolve over recent years, influenced in large part by the development of such activity in the United States.

‘Shareholder activism’ is a generic term that is usually used to describe an approach by a shareholder or shareholder group to a company’s board, and if necessary to its fellow shareholders, seeking to effect change within a company. Although shareholder activism in the United Kingdom has historically been focused on obtaining board representation, activist investors have begun to utilise the legal and regulatory tools available to them to achieve a more diverse range of outcomes, short of a full control transaction.

Shareholder activism campaigns in the United Kingdom can be categorised in many different ways. One simple approach is to distinguish between: (1) event-driven activism, where an activist shareholder will seek to assert its influence on a company’s current corporate activity, particularly in relation to a takeover or other M&A situation; and (2) strategic or operational activism, where outside a company’s current corporate activity, a shareholder activist seeks to address operational performance, the balance sheet or other strategic issues, or some other longer-term concern at a company, such as governance or remuneration. Although strategic or operational activism is often associated with management or leadership changes, achieving control in the strict company law sense is not usually an objective and paying a control premium is something activists will seek to avoid.

Just as the type of shareholder activism can vary broadly, there is no one type of shareholder activist in the United Kingdom, and the term can cover a wide range of investors. Some activists are specific investment funds with activism as their business model, and it is these investors that are generally classed as ‘activist’ shareholders. Equally, existing shareholders may become ‘active’ shareholders; for example, where they consider that the company is underperforming or they disagree with the decisions being made by the company’s board. Traditionally, institutional investors in the United Kingdom have refrained from voicing their concerns or criticisms of management in the public domain, and the vocal activist community has historically been composed of hedge funds, specific investment funds and other alternative investors. Increasingly, however, institutional investors and other shareholders are becoming more prepared to air their concerns in the open, or to lend
their support (publicly or privately) to those who are more willing or able to do so, when they feel that their concerns are not being registered by management. Activist shareholders are sometimes described as performing a ‘lightning rod’ role for such dissent in the public market; they can sometimes provide a useful channel for the dissatisfaction felt by a wider group of shareholders and potentially gain their support.

The established shareholder activist funds operating in the United Kingdom are generally well researched, tactically astute and determined, and come armed with the access to funds needed to support their campaigns. These activists will be prepared for a hostile response (and will not shy away from public disagreement) but may prefer to reach a consensual agreement with a board if they can. They are persistent (some with multi-year time horizons on their investment) and relatively resistant in the face of an initial knock-back (with a number of examples of activists willingly reiterating arguments and returning to shareholders for a second shareholder vote).

II LEGAL AND REGULATORY FRAMEWORK

The global focal point of shareholder activism over the past decade has been and remains the US market, where activist investors have been ready and willing to employ the legal means available to them to achieve their objectives. In the United Kingdom, corporate law has always provided a strong basis of shareholder rights from which to challenge directors. This, together with concerted efforts over many years by UK regulators and policymakers to encourage more active shareholder engagement (particularly following the failures identified in the global financial crisis), has resulted in a legal and regulatory framework in the United Kingdom that is arguably the most benign framework for possible activist activities in Europe. This position is likely to increase in a post-Brexit environment.

The most important legal tools available to an activist shareholder are enshrined in English company law (the Companies Act 2006), which provides an activist shareholder with the means of amplifying its influence beyond the size of its shareholding (which in some cases may be quite small) and becoming the lightning rod for the shareholder voice of change referred to in Section I. The most powerful tool in an activist shareholder’s toolkit is the ability to call for a general meeting of a company. Provided that a shareholder holds at least 5 per cent of a company’s issued share capital, it may requisition a general meeting of its fellow shareholders and propose one or more resolutions to be considered at that meeting (Section 303). Alternatively, shareholders holding at least 5 per cent, or a group numbering at least 100 shareholders, may requisition specific resolutions to be considered at a company’s annual general meeting (AGM) (Section 338). It is this ability to introduce a resolution, taken with the ability of a simple majority of those voting at the relevant meeting to remove or appoint a new director, that gives the shareholder its most potent threat. Accordingly, in strategic and operational as well as governance and pay situations, the requisition will be to remove existing directors from the board or appoint new directors nominated by the activist investor, to ensure new voices on the board to help achieve the desired outcome. However, provided that it relates to a matter that is not defamatory or vexatious and, if passed, would be effective, there is no limit to the type of wording of a resolution that an activist may propose. ‘Directive’ resolutions by shareholders to the board, which are not very prevalent and are most frequently used by action groups, and issue-focused activists, are not generally regarded as being effective, unless the resolution is passed by a special resolution.
Ordinary resolutions of a company may be passed by a simple majority (50 per cent plus one share), whereas special resolutions require a majority of 75 per cent. This means that a group of shareholders holding 50 per cent of the shares voted at a meeting have the power to pass ordinary resolutions or, conversely, a minority bloc of 25 per cent may block special resolutions. These thresholds refer to percentages of shareholders present and voting at the meeting, so a much smaller overall bloc of shareholders may be able to pass or block resolutions, depending on turnout. It is generally thought that FTSE 350 shareholder turnout is around the 70 per cent mark. For a UK-listed company, in particular, one with a premium listing, certain significant corporate transactions will require shareholder approval (e.g., a class 1 major transaction under the UK Listing Rules or where non-preemptive issuances of consideration shares are required). Therefore, significant corporate activity will often present a voting opportunity for a shareholder to intervene (and likewise on a takeover, by exercising votes on a scheme of arrangement, or accepting or not a contractual takeover offer).

The Companies Act 2006 contains a number of other ancillary rights that may also assist a shareholder in conducting its activist campaign. Under Sections 116, 809 and 811, shareholders have the right to inspect and copy a company’s register of members and any register of beneficial interests, which can allow other shareholders to be identified and subsequently communicated with, or (if the directors of a company have failed to comply with a shareholder’s requisition) allow the activist shareholder to call the general meeting itself at the company’s expense (Section 305).

In addition, any shareholder has the right to attend and speak at a general meeting of a company (whether that meeting has been requisitioned or is being held in the ordinary course of business), giving that shareholder the opportunity to state a view or ask difficult questions to the directors. This right may be exercised by a representative of the shareholder or via a proxy.

Listed companies in the United Kingdom are required to hold an AGM each year, which will include re-election of directors by rotation and, in the case of FTSE 350 companies, will typically propose resolutions to reappoint each of their directors to comply with the UK Corporate Governance Code. This can provide shareholders with an annual opportunity to effect change. Another common means of activist shareholders voicing their discontent has been to vote against the annual directors’ remuneration report, the subject of an annual advisory vote at each AGM (high-profile examples include AstraZeneca, Drax Group, London Stock Exchange and BT in 2018). In the United Kingdom, across the FTSE 100, the number of remuneration reports to have faced at least 10 per cent shareholder opposition in 2018 has increased by 39 per cent, and the number of contested (20 per cent or greater opposition) remuneration report resolutions has increased by 63 per cent relative to the 2017 AGM season. The introduction in 2013 of a binding AGM vote every three years on the directors’ remuneration policy provides another more significant opportunity for shareholder ‘say-on-pay’ intervention.

In extreme cases, an activist shareholder may decide to exercise its right under the Companies Act 2006 to take legal action in the form of a derivative claim against a company’s directors (which is a claim on behalf of the company) (Section 260) or an unfair prejudice petition (Section 994). Such shareholder litigation is very rare in the United Kingdom in relation to listed companies.

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Although the legal and regulatory framework in the United Kingdom is generally favourable to activist shareholders, the United Kingdom has tended to see a higher level of cooperation between activists and boards of directors when compared with the United States. In a substantial majority of cases, a disgruntled investor in a UK company will begin by contacting the board of that company and attempting to persuade the directors of its view, or to take certain actions, through informal engagement in the first instance. A host of other soft or ‘non-legal’ options are open to activists, including private discussions with other shareholders and public press, or social media campaigns. The shareholder activist will gauge support for certain resolutions that a group of investors may come together to require the board to propose at a general meeting (as discussed above), or cooperate in opposing certain resolutions proposed by the board.

Although shareholders are generally free and indeed encouraged by policy (such as the Stewardship Code) to talk to one another, it is important to take account of the regulatory context for any such discussions. As discussed below, investors will need to be careful that they do not unlawfully disclose any inside information (as defined in the EU Market Abuse Regulation (EU 596/2014) (MAR)) in relation to their intentions, or (if they have such information) the company, which could amount to market abuse under MAR.

A strategy often employed by activist funds, acting individually, is to build up a stake in a company to increase its leverage to call for change. Such stake-building exercises require particular care. Under the City Code on Takeovers and Mergers (the Code), a person will be required to make an offer for all of the remaining shares of a company subject to the Code for a price not less than the price paid for any shares by the potential controller during the previous 12 months if he or she (together with any persons ‘acting in concert’ with him or her) becomes interested in shares carrying 30 per cent or more of voting rights. Although shareholders will not generally be deemed to be acting in concert as a result of agreeing to vote on resolutions in a certain way, the Code states that where a group of shareholders requisition a ‘board control-seeking’ resolution (or threaten to do so), and subsequently acquire shares taking the aggregate interest of the group above 30 per cent, a mandatory offer will be required (Note 2 on Rule 9.1; see also Practice Statement No. 26 for further guidance). The ruling of the Takeover Panel in respect of Petropavlovsk Plc in June 2017 confirms that if the resolutions requisitioned by activists propose the appointment of directors who are truly independent of the activists, the resolutions will not be board control-seeking for the purposes of Note 2 on Rule 9.1 and so the acting in concert provisions of the Code will not apply.

Activist investors building a stake will, in the usual way, need to consider their disclosure obligations under the Financial Conduct Authority’s (FCA) Transparency Rules. Where a shareholder’s interests in shares in a listed UK issuer reach or fall below 3 per cent, and every 1 per cent increment thereafter, he or she must notify the issuer, who is then required to announce to the market. For these purposes, indirect and derivative interests will both be counted as well as direct holdings. This prevents an activist from building up a significant stake in secret. Limited exemptions may apply (e.g., investment firms will only be required to disclose from 5 per cent). Disclosure thresholds are slightly less onerous for companies that are listed in the United Kingdom but incorporated in another country.

The activist wishing to deal in shares will also need to be well advised on the restriction contained in MAR on dealing on the basis of inside information, and the criminal offence of insider dealing under the Criminal Justice Act 1993. If the only inside information in a
stakebuilder’s possession is its own intentions, a safe harbour is available under MAR (and the FCA’s Market Watch 20 publication has also generally been regarded as clear that this will not amount to market abuse). However, care needs to be taken where information is obtained from the target or from other shareholders.

Institutional investors in UK-listed companies should have regard to the Stewardship Code, which sets out good practice for their duties to engage as shareholders, and is applied on a ‘comply or explain’ basis. It recommends that institutional investors establish clear guidelines on when and how they will escalate stewardship activities. It says engagement is likely to begin with confidential discussions but may be escalated where a company does not respond constructively. The Stewardship Code recognises the role that activism may play in improving corporate governance.

The board of a company facing an approach from activist shareholders is unlikely to sit idly by, but may select from various strategies to defend its position. Some of these are ‘legal’ defences. For example, a company may refuse to allow a resolution to be requisitioned on the grounds that it is ‘frivolous or vexatious’ or defamatory, or it may challenge a requisitioned resolution on technical grounds. Careful consideration needs to be given before adopting such an approach since it may well give the impression that the board is unwilling to openly engage with shareholder concerns. An engagement on the substantive issues of concern and a demonstration that directors are open to measured and thoughtful challenge is generally regarded as an approach more likely to dissipate activist pressure.

III KEY TRENDS IN SHAREHOLDER ACTIVISM

Globally, shareholder activism has seen a substantial increase over recent years, with particularly strong growth in 2018 in terms of both numbers of activists engaged in activism and companies that were publicly targeted by activist shareholders. Globally, a record 131 activists engaged in activism against companies with market capitalisations greater than US$500 million at the time of the campaign. In 2018, the number of companies targeted by activists worldwide was 922, compared with 856 in 2017. Shareholder activism has been a long-term feature of US markets; however, it is increasingly being exported overseas as funds look for new markets that have not yet been fully explored. In 2018, 433 companies outside the United States were publicly subjected to activist campaigns, compared with 344 in 2017. Of these 433 companies, 78 were in Australia and 57 were in Canada. The European and UK markets are also at the forefront of this global trend: between 2010 and 2015, the number of shareholder activist campaigns in Europe (including the United Kingdom) was thought to have increased by 126 per cent, while in 2018, only 53 per cent of campaigns against UK companies were led by UK activists. This is evidenced in the increased activities of US funds such as Elliott Management, Third Point and ValueAct in continental Europe. It seems that this US–Europe activism has increased in recent times: see, for example, Elliott Management’s campaign against the AkzoNobel board in respect of the latter’s stance on the proposed takeover by rival PPG; and Third Point’s campaign against the board of Nestlé, which resulted in the board announcing a US$21 billion share buy-back.

Both historically, and reinforced by the introduction of ‘say-on-pay’ legislation, shareholder intervention in the United Kingdom has been focused on board-related matters

such as executive remuneration and requests for board representation. In January 2017, BlackRock issued its chair and CEO Larry Fink’s annual letter to the CEOs of more than 300 UK companies stating that pay rises for executives should not go beyond the level of such rises in respect of other employees without a strong rationale. Given that BlackRock owns a stake in every company in the FTSE 100, this represented a potential catalyst for further shareholder intervention in remuneration issues.

Shareholder intervention has also recently focused on environmental, social and governance (ESG) matters. In January 2018, BlackRock issued Larry Fink’s annual letter to CEOs stating that a company’s management of ESG matters demonstrates leadership and good governance that is essential to sustainable growth and is therefore increasingly being integrated into BlackRock’s investment process.

The number of activist matters relating to company M&A and other corporate activities is, however, also increasing (as outlined in Section III.i).

i Event-driven activism

As outlined above, shareholder activism in the UK market has been traditionally focused on the performance and remuneration of executive directors and requests for board representation by activists. Over the past decade, however, the types and objectives of shareholder activists have evolved and an increasing number of activist campaigns have been event-driven, involving company M&A (both private and public) or other corporate activity (including the return of value to shareholders by means of dividends or share buy-backs). In 2018, 216 activist campaigns launched worldwide related to company M&A. Event-driven activism has been marked in the United Kingdom this year, particularly around high-profile M&A, such as the takeover bids made by Comcast and 21st Century Fox for Sky.6

Whenever a company is required to obtain prior shareholder approval to acquire or dispose of a company or business (e.g., if the transaction is a class 1 or related party transaction for the purposes of the UK Listing Rules), shareholders are given the ability to reject a deal after it has been conditionally agreed by the company’s board. In M&A situations that are dependent on shareholder approval, activists may seek to influence a particular outcome through public criticism, proxy solicitation, lobbying of institutional investors or proposing alternative transactions.

Activists may also seek to instigate or put pressure on a company to undertake an acquisition or disposal, or otherwise return value to its shareholders, particularly if a company is perceived to be sitting on too much cash or shareholders would prefer a return of cash to an M&A transaction that has been proposed by the board.

In public takeover situations, where the ultimate decision as to whether to proceed with the transaction rests with the shareholders of the target company (by shareholder vote on a takeover by scheme, or acceptance of the offer on a takeover by contractual offer), activist investors can have a significant influence. This is the case even at the early stages of a potential bid, by encouraging a target board to negotiate with the bidder or indicating that they, as shareholders, will not accept an offer below a certain minimum level to attempt to encourage an increase in the bidder’s offer price.

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6 ibid, pp. 10–11.
ii Activism as a more acceptable activity and name-calling

Shareholder activism has historically had pejorative connotations in the United Kingdom, with activists being stereotypically cast as opportunistic and aggressive ‘corporate raiders’ concerned with realising short-term returns at the expense of long-term shareholder interests and value creation.

The rise of an activism advisory community and the terminology being used suggest that, as in the United States, in the United Kingdom, there is increasing acceptance of activism as a valid and indeed desirable public market business model, as evidenced by the more neutral language used.

In the United Kingdom, in addition to the traditional broker role for the company, financial advisers have been establishing specialist teams to advise listed companies on activist situations. Specialist proxy solicitation agents have moved across from the United States to support the hunt for shareholder votes on behalf of both boards and activists. The Big Four accountancy firms have built up teams to support their listed clients and, like financial advisers, PR consultancies are increasingly seeing activism as a specialist area of advice. Interestingly, the terminology has changed; a few years ago, terms such as ‘corporate defence’ were prevalent among this type of advisory work. Now ‘corporate preparedness’, ‘shareholder engagement’ and ‘valuation solutions’ are terms in widespread use.

Similarly, in the United States, a new nomenclature shows a change in attitudes. ‘White hat’ has been introduced in recent years to identify a less contentious form of ‘constructive activism’ with a focus on medium to long-term value creation. White hat activists are characterised as typically favouring more collaborative measures conducted in private (usually on a consensual basis) and as only instigating a public activist campaign as a last resort.

More generally, the term ‘activist shareholder’ is increasingly being moderated to terms such as ‘active’ or ‘engaged’ shareholder, to disassociate from historic negative connotations associated with the term ‘activist’.

iii US-style tactics and developments – the adoption of the settlement agreement

The global focal point of shareholder activism over the past decade has been and remains the US market, with activist investors such as Carl Icahn, Pershing Square, ValueAct and Elliott Management playing prominent and well-publicised roles in the US activist community.

Although some of the tactics and approaches developed by US activist investors have been adopted in the UK market, regulatory and legal limitations on the type of influence activists can have on UK boardrooms has meant that many of the bolder forms of US activism have not translated across the Atlantic. However, one US trend that is beginning to be implemented in the United Kingdom is the use of settlement agreements or ‘activist relationship agreements’. These are an evolution of UK-style relationship agreements that have, for many years, been used to regulate relationships between listed companies and their controlling or significant shareholders.

Settlement agreements have been in use in the United States over the past decade and provide a means of settling a potential contest between an activist investor and a company, while avoiding the significant drain on resources that a protracted proxy battle may entail. US-style settlement agreements typically include the following basic components:

a an agreed set of actions to be taken by the company, which may include the appointment of board representatives for the activist investor;

b a standstill agreement in relation to the activist’s share ownership in the company;
a standstill agreement in relation to certain corporate governance matters (e.g., a restriction on the activist from taking certain actions designed to gain additional board representation); and

d other material provisions, which may include non-disparagement clauses, remedy provisions and the term of the agreement.

An example of a US-style settlement agreement with an activist investor being adopted by a UK company was announced by Rolls-Royce in March 2016, considered further below, even though the company labelled it a ‘relationship agreement’, which is more familiar and more neutral sounding to a UK audience familiar with such agreements. These agreements are required under the UK Listing Rules for shareholders with interests of 30 per cent or more of voting rights, a level of shareholding ValueAct had not reached.

In February 2019, Hammerson disclosed that in 2018 it had entered into a similar relationship agreement with Elliott Management, which will remain in force for a maximum of 12 months, subject to certain conditions.

iv Use of dedicated websites and microsites

A practice that has become more common among activist shareholders in the United Kingdom is the use of dedicated websites or microsites as a platform to promote their message more widely. These sites provide activists with the means of collating their arguments (generally from Regulatory News Service press releases, shareholder circulars, etc.) with other supporting data and third-party resources in a public forum that is easily accessible for other shareholders, journalists and the public in general.

Well-advised activist shareholders will carefully evaluate the legal and regulatory basis on which this information is made available. They will consider financial services and market abuse law and regulations, as well as defamation issues, just as they would with any public release or circular. They will also consider the full range of legal challenges as they would for contents of any website or microsite before it is launched to avoid breaching any copyright, third-party confidentiality or data protection laws.

v Board diversity

A topic that is not yet widely raised specifically in relation to activist campaigns, but may become more important and is becoming increasingly challenged by institutional investors, is the role of gender diversity on the boards of listed companies.

According to a study conducted by Bloomberg, between 2011 and 2016, the five biggest US activist funds only nominated women for a board seat in seven out of 174 occasions. In the United Kingdom, the charge of ‘male, pale and stale’ has been levelled in the context of a proposed board slate, and the Equality and Human Rights Commission has published a good practice guide on ‘how to improve board diversity’.

Furthermore, according to the Investment Association, 42 per cent of UK asset managers made a voting decision based on a company’s gender diversity in 2018, while 56 per cent had engaged with companies on the subject. Legal & General Investment Management, for example, resolved to vote against the re-election of any chair whose board consists of fewer

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than 25 per cent women and cast over 100 votes against the election of UK chairs in 2018, up from 31 in 2017 and 13 in 2016. The United Kingdom’s largest private pension scheme (the Universities Superannuation Scheme) and the Church Investors Group have declared similar voting policies. This is illustrative of a growing trend of investors’ expectations of companies to disclose policies, procedures and targets in response to the Hampton-Alexander review (2018) and the Parker review (2017) focusing on gender and ethnicity respectively on FTSE 350 boards.

With increasing focus being given to the diversity of company boards by regulators, policymakers and investors, the question of diversity, of both existing boards and whether nominees of activist shareholders improve or worsen that position, may be raised more often.

vi  Focus on the consumer sector
Activists seek out value in listed companies, whether by balance sheet restructuring, encouraging corporate events or through business turn-around, wherever they see the most valuable opportunity. But, there can be phases of the economic cycle where certain sectors become a particular focus for funds (e.g., historically, opco/propco separation or conglomerate break-ups). Activism in the consumer sector is not new: in 2007, Cadbury Schweppes announced a demerger of its confectionery and soft drinks business at a stage when Trian was holding 3 per cent of the company’s shares and leading calls for such a change. Large international consumer companies currently face challenges around focuses and efficiencies, against a background of slowing sales growth and thinning margins. Activists are currently looking at opportunities for value to be created in such consumer companies, through cost-cutting, the use of leverage and other tools. This has seen campaigns led by Trian (in relation to Procter & Gamble) and, in Europe, by Third Point (in relation to Nestlé) and by Elliott Management (in relation to Whitbread’s divestment of Costa Coffee). Consumer companies in the United Kingdom will be watching this trend carefully.

vii  Focus on larger cap companies
Activists are increasingly targeting larger cap companies with the view increasingly appearing to be that ‘no one is too big’ if they present a valuable opportunity, and even household names and ‘national champions’ are the subject of activist intervention. Reasons that shareholder activism at larger cap companies appears to be becoming more common include: (1) larger cap companies are thought to be more prone to inefficiency and poor corporate governance than smaller companies and there may be inefficiencies created by the ‘conglomerate effect’; and (2) activist funds are of an increasingly large size and are able to take advantage of the increasing support for activism from fellow shareholders and their ideas and input becoming more widely accepted. Some of the more notable activist situations involving large-cap companies in recent years include Elliott at AkzoNobel and Telecom Italia, Hudson Executive Capital at Deutsche Bank, Trian in relation to Procter & Gamble and Third Point in relation to Nestlé. In the United Kingdom, large-cap companies in focus recently include Unilever, Barclays and Whitbread.

Focus on ‘proxy plumbing’

Though UK shareholder votes are generally passed on comfortable margins, there have been some close votes recently on high-profile matters (e.g., bids by Melrose for GKN, and CVC and Blackstone for Paysafe), increased focus on ‘proxy plumbing’ and the role of proxy solicitation agents in helping to get votes through the back office to ensure that they are taken into account. Where the result of the vote will be or is likely to be close, there is also the right that exists under the Companies Act for a shareholder who holds at least 5 per cent of a company’s issued share capital to require the directors of a company to obtain an independent report on any poll taken or to be taken at a general meeting of the company (Section 342).

IV RECENT SHAREHOLDER ACTIVISM CAMPAIGNS

i Rolls-Royce

ValueAct Capital Partner’s investment into Rolls-Royce Holdings Plc provides an example of white hat activism and the adoption of a US-style settlement agreement.

Following several months of stakebuilding, in July 2015, ValueAct became Rolls-Royce’s largest shareholder with a shareholding of 5 per cent. ValueAct positioned itself as an engaged investor, not an activist, and began to exert pressure on Rolls-Royce privately. Following an initial rejection of board representation in November 2015, on 2 March 2016, Rolls-Royce announced that it had entered into a ‘bespoke relationship agreement’ with ValueAct, which contained the following key terms:

a ValueAct was to be granted one representative on the Rolls-Royce board, subject to certain conditions relating to ValueAct’s shareholding;

b a standstill in relation to ValueAct’s share ownership (ValueAct cannot acquire more than a 12.5 per cent shareholding);

c a standstill on certain corporate governance matters, including restrictions on ValueAct requisitioning general meetings, soliciting proxies, proposing mergers or other change of control transactions, proposing changes to Rolls-Royce’s strategy or publicly criticising or disparaging Rolls-Royce; and

d a commitment from ValueAct to vote in accordance with the board’s recommendation on ‘customary resolutions’ at general meetings.

The relationship agreement expired on 3 May 2018, and it was replaced with an agreement relating to confidentiality, the board representative’s compliance with applicable law, Rolls-Royce’s codes, policies and guidelines, and the right of the representative to attend committee meetings.

ValueAct now holds an approximate 9.5 per cent shareholding and has one seat on the board.

ii Electra Private Equity

Sherborne Investors’ activist campaign in relation to Electra Private Equity Plc is a high-profile example of a contentious proxy battle for board representation, in furtherance of a call for an operational turnaround.

Following a period of stakebuilding and a public rebuttal of its request for board representation, in October 2014 Sherborne requisitioned a general meeting for shareholders to vote for the appointment of two Sherborne nominee directors to the board of Electra and the removal of one existing director. Sherborne’s campaign was centred on the belief
that it had identified significant value in the Electra portfolio that the existing board had failed to realise and that could be unlocked by certain changes to the company’s strategy. The proposals were defeated at the general meeting, and Electra’s board subsequently announced its own strategic review.

Following the release by the company of its strategic review and a further period of stakebuilding in Electra, Sherborne requisitioned a second general meeting in November 2015. At that meeting, Electra shareholders voted in favour of the appointment of two Sherborne nominee directors to the board of the company.

iii Premier Foods

The campaign by Hong Kong-based activist Oasis Management in relation to Premier Foods is an example of how M&A events can create opportunities for operational-focused activists.

In May 2016, Premier Food’s board rejected a takeover approach from McCormick at 65p per share; however, in the following months, its shares generally traded at between 40p and 45p per share (bar a rise in the summer of 2016), with a profit warning subsequently issued in January 2017. Following the rejection of the McCormick approach, and in an atmosphere of shareholder discontent, Oasis Management began to build its stake and the pressure on the board: it reached a 5 per cent holding in October 2016 and increased this to 8 per cent by March 2017. Subsequently, Premier Foods agreed to appoint an Oasis Management representative as a non-executive director on its board, pursuant to a relationship agreement whereby Oasis Management agreed to further raise its shareholding in Premier Foods to 10 per cent by 30 June 2018 (but no higher than 15 per cent).

The relationship agreement between Oasis Management and Premier Foods was terminated in April 2018 with the Oasis Management representative stepping down from the board. Oasis Management voted against the re-election of Premier Foods’ then CEO at its AGM held in July 2018. Despite shareholders voting in favour of re-electing Premier Food’s CEO, he later stepped down in November 2018. More recently, Oasis Management’s representative joined the Premier Foods board as a representative and Oasis continues to hold a 12 per cent stake.

iv Bowleven

The Monaco-based fund Crown Ocean Capital’s successful campaign against African oil explorer Bowleven, is an example of activists focusing on operational and strategic changes within a company.

In early 2017, Crown Ocean Capital made repeated calls for Bowleven to be restructured from an exploration company to a holding company, to return just under £100 million in cash to shareholders. Crown Ocean Capital also raised concerns over the independence of the Bowleven board. Throughout its campaign, Crown Ocean Capital grew its shareholding, from 13 per cent in November 2016 to 22 per cent in March 2017. Crown Ocean Capital subsequently requisitioned a general meeting resulting in five directors and the CEO of Bowleven being removed. The narrow majority in favour of each of their respective removals ranged from approximately 51 per cent to 54 per cent. At the same time, two Crown Ocean Capital representatives were appointed to the Bowleven board, having captured approximately 55 per cent and 52 per cent of the vote.
v  AB InBev/SABMiller

Elliott Management’s involvement in the AB InBev/SABMiller takeover is an example of a ‘hold-out’ approach through which activists seek to profit during live takeover situations. It is particularly noteworthy given the size of the transaction.

In November 2015, AB InBev made a formal £71 billion offer for SABMiller. However, after a sharp fall in the value of sterling following the result of the referendum in the United Kingdom on whether to leave the European Union in June 2016, the value of the cash offer fell below the value of the alternative offer consisting primarily of shares in AB InBev’s new holding company, which appeared to have been designed for the benefit of SABMiller’s two largest shareholders. Elliott Management, in July 2016, acquired (through derivative contracts) an interest in SABMiller and argued for AB InBev to make an offer on improved terms. As a result of Elliott Management’s campaign, AB InBev increased its cash offer by 100p per share to 4,500p per share valuing SABMiller at £79 billion.

vi  Johnston Press

Two activist shareholders in Johnston Press, Crystal Amber and Custos Group, engaged the board in 2017 with various demands, including removal of its chair and CEO, reform of executive pay and moving its headquarters from London to Scotland. Custos Group proceeded to serve a requisition in November 2017 proposing removal of the chair and one other director, and the appointment of two non-executive directors of the company. The requisition was subsequently determined by the company to be invalid. In May 2018, the CEO resigned and was replaced by the CFO.

vii  Whitbread

Whitbread is an example of activists attempting to unlock value at a company by pushing for a break-up or demerger.

After disclosing an interest in Whitbread in December 2017, Sachem Head publicly urged Whitbread in January 2018 to spin off its Costa Coffee chain from its hotels and restaurants business. On 16 April 2018, Elliott Management disclosed an approximate 5 per cent holding in Whitbread. On 25 April 2018, Whitbread announced that it was committed to a demerger of its hotel and coffee chain businesses and that the demerger of Costa Coffee would be pursued as quickly as practical and appropriate to optimise value for shareholders. On 31 August 2018, Whitbread announced that it had agreed to sell Costa Coffee to Coca-Cola for an enterprise value of £3.9 billion, the net proceeds of which were to be used to repay debts, return value to shareholders and pursue its international expansion into Germany.

viii  London Stock Exchange

The London Stock Exchange is an example of an activist using a directive resolution to attempt to force the board to take certain actions.

In October 2017, the London Stock Exchange announced that its CEO would leave the group by the end of December 2018 and that the board had initiated a process to find a successor. In November 2017, TCI Management Limited sent the London Stock Exchange a letter questioning the announcement regarding the CEO’s departure and subsequently requisitioned a general meeting of the London Stock Exchange to consider: (1) an ordinary resolution to remove the chair; and (2) a special resolution to direct the board to terminate
the search for a new CEO and permit the current CEO to remain in office as a director and
CEO until 2021 on no less favourable terms than his existing arrangements. Subsequently,
in November 2017, the London Stock Exchange announced that the CEO would step
down with immediate effect (having been asked to do so at the board’s request) and that he
would not be returning under any circumstances and also that the chair would not stand for
re-election at the 2019 AGM. In light of those events, TCI withdrew the requisition relating
to the CEO at the London Stock Exchange’s request, but not the resolution to remove the
chair. Some 79 per cent of shareholders present and voting at the general meeting voted
against the resolution to remove the chair that had been requisitioned by TCI.

ix  Sky

Comcast and 21st Century Fox’s competing bids to acquire Sky plc prompted an example
of event-driven activism and how activists can attempt to engage with regulators on a live
takeover situation.

In December 2016, Fox made a firm offer for the 61 per cent stake in Sky that it did
not already own at a price of £10.75 per share. Comcast then made a competing bid in
April 2018 by offering £12.50 per share in Sky, which resulted in an increased competing
bid by Fox at a price of £14 in July 2018. In December 2017, Walt Disney Company had
announced the terms of a definitive agreement to acquire Fox.

The UK Takeover Panel confirmed that, pursuant to its ‘chain principle’, The Walt
Disney Company would be compelled to make a mandatory offer of £14 per share to
Sky shareholders if the company was not acquired by another bidder. However, Elliott
Management, which had built a 2.8 per cent stake in Sky, as well as other investors, including
Davidson Kempner, contested that the Panel’s approach to the application of the chain
principle had produced an inadequate price. Elliott Management argued that Walt Disney
should make a mandatory offer of at least £15.01 per share and other activist investors made
similar arguments.

Although the Panel did not rule in favour of Elliott Management or other shareholders’
representations for a higher offer price, the transaction ultimately culminated in an
auction process resulting in Comcast’s acquisition of Sky for £17.28 per share (totalling
US$38.8 billion), a 71 per cent increase in Sky’s share price.

x  Unilever

Aviva Investors’ activist campaign in relation to Unilever Plc is a high-profile example of an
activist influencing a company’s business decisions, in particular its restructuring plans.

On 15 March 2018, Unilever announced plans to unify its dual parent company
structure (dual-incorporated and dual-listed in the United Kingdom and the Netherlands)
under a new holding company, incorporated and tax domiciled in the Netherlands. The new
parent company would have had a premium listing in London, with shares traded on the
Main Market of the London Stock Exchange as well as on Euronext in Amsterdam. It would
not, however, have been eligible for admission to the FTSE UK index series.

A range of institutional shareholders, including Aviva Investors and Lindsell Train who
each respectively held 1.4 per cent and 2.5 per cent, announced their intention to oppose the
move because some would have been forced to sell their shares when Unilever dropped out
of the FTSE UK index, leading shareholders to perceive the move as having no discernible
benefit for UK public shareholders.
The shareholder response led to the company announcing on 5 October 2018 that they ‘recognise that the proposal has not received support from a significant group of shareholders and therefore consider it appropriate to withdraw’. 10

**The Investor Forum**

The Investor Forum was launched in 2014 as an investment industry body of institutional investors to facilitate shareholder engagement. Since then, it has steadily increased its activity: in 2018, it was asked to review 12 UK companies, with five reviews resulting in comprehensive collective engagement.11 Recent examples include Unilever, Imperial Brands and Victrex. Given that the Investor Forum’s 43 members represent approximately 30 per cent of the FTSE All-Share market capitalisation, the next 12 months will likely see it continue its efforts to foster collective engagement.

**V REGULATORY DEVELOPMENTS**

Perhaps the most significant recent change in the regulatory landscape as far as shareholder activism is concerned was the coming into force of MAR on 3 July 2016. MAR, as an EU Regulation, has direct effect in each Member State without the need for any implementing measures by national legislatures. It aims to impose a more uniform market abuse regime across the European Union than that possible under its predecessor, the Market Abuse Directive, and is also broader in scope. It governs, among other things, market abuse and the obligation on issuers to disclose inside information regarding themselves or their financial instruments to the market. There are some detailed changes with potential relevance to shareholder activism, in particular, the introduction of formal provisions regarding market sounding, which sit alongside pre-existing provisions relating to wall crossing and selective disclosure.

Market sounding is defined for the purposes of MAR as the communication of information (whether or not inside information) prior to the announcement of a transaction to gauge the interest of one or more potential investors in the transaction or by a bidder to sound out target shareholders on a takeover. Detailed requirements apply to all persons who disclose information in a market sounding. These include requirements for an assessment of whether the information is inside information, the use of scripts, recorded telephone lines (if available), sounding lists, cleansing and recorded keeping. Although the market sounding regime will be most relevant to a company being targeted by an activist, it will be important for all parties to an activist campaign to ensure continued compliance with MAR.

The aspects of the regime that are most important to shareholder activism (i.e., market abuse and disclosure of inside information by issuers) have not been altered materially by MAR from the previous regime applicable in the United Kingdom (and indeed much of the case law is likely to remain informative for interpretation). However, there are areas that active shareholders, and companies targeted by them, will focus on. These include questions of inside information (including inside information of the shareholder itself), and the applicability of the new investment recommendation regime to shareholder activist situations.

Another development is the formal adoption of certain amendments to the Shareholder Rights Directive (2007/36/EC). The Shareholder Rights Directive is the source of many of

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10 Unilever, RNS announcement, ‘Statement from the Board of Unilever’, 5 October 2018.
the shareholder rights discussed above that have been given effect in English company law through amendments to the Companies Act (including shareholders’ rights to requisition meetings and resolutions). The amendments adopted in April 2017 pursuant to the Shareholder Rights Directive (EU/2017/828) were implemented on 10 June 2019 through a patchwork of legislation and regulation, including the Proxy Advisors (Shareholders’ Rights) Regulations 2019 (SI 2019/926) which introduced new rules for proxy advisers who will now be subject to transparency requirements and a code of conduct.

A further more recent development is the introduction of the Investment Association’s Public Register, which is an aggregate list of publicly available information regarding meetings of companies in the FTSE All-Share that have received significant shareholder opposition to proposed resolutions (votes of 20 per cent or more against any resolution) or withdrew a resolution prior to their AGM. The Investment Association introduced the Public Register in response to the UK government’s green paper on corporate governance reform with the aim of highlighting those companies that receive a high vote against, or withdraw, a resolution, and to understand the process used by those companies to identify and address the concerns of their shareholders. The Investment Association announced\(^\text{12}\) that the analysis of the data from the AGMs and general meetings held in 2018 revealed that 120 companies (over 20 per cent) were added to the Public Register compared with 110 companies over the same period in 2017.

### VI OUTLOOK

The legal and regulatory framework in the United Kingdom relating to shareholder rights and engagement has continued to evolve to encourage active shareholder engagement, and will continue to provide a benign framework for shareholder activists. The market will continue to develop, as activists increasingly seek to distinguish themselves, and as institutional shareholders, listed companies, advisers, commentators and the investment community become more widely accepting of this activity, seek to understand the nuances between its various protagonists and, in the case of some institutional investors, become active themselves.

For a number of market structural reasons, shareholder activism in the UK market is unlikely to reach the prevalence currently seen in the United States. But, the United Kingdom remains a fertile ground for activists to continue to seek targets for strategic campaigns, as well as companies with a range of corporate events in which they will choose to intervene, and sectors that come into focus. As more players become involved, the possibilities of situations involving more than one shareholder leading on engagement, or multi-year or multi-approach campaigns, and the possibility of shareholders speaking out in defence of a company, will increase. Although the extent of the change to the United Kingdom’s legal and regulatory framework resulting from Brexit is impossible to judge at this stage, it will certainly provide activists with new opportunities, as some listed company boards seek to address their own business strategies in an economically turbulent post-Brexit environment.

It does seem clear that any company that is party to an M&A proposal, whether on the buy-side or sell-side, or as a public bidder or a target itself, can expect its shareholders to focus not only on that M&A proposal but also on any fallout from that M&A, particularly if it is unsuccessful.

\(^{12}\) Investment Association, 15 February 2019, ‘FTSE 100 pay and director re-election spark renewed shareholder rebellion at 2018 AGM season’.
Concerns over high-profile corporate issues mean that there is now an increasing focus in the United Kingdom on corporate governance and the ESG standards of companies, and anticipation that shareholders will become more involved in these issues going forwards. The new UK Corporate Governance Code was published in July 2018 and applies to all premium listed companies for financial years beginning on or after 1 January 2019. The FRC has also published a detailed consultation on a new UK Stewardship Code and intends to publish the final-form Stewardship Code in October 2019. The direction of travel of institutional shareholders is to an ever-increasing and more meaningful focus by their investee companies on ESG issues, and the effect of this is expected to be seen in engagement by active shareholders with their investee companies.
I OVERVIEW

Shareholder activism is and will continue to be a prominent feature of the corporate landscape in the United States. Following a wave of corporate scandals in the early 2000s (most memorably Enron Corporation), there was a sea change in US corporate governance. Subsequently enacted federal regulations that focus on corporate governance have dramatically changed the face of US corporate boards of directors; shareholder engagement has become an expectation for companies; and a number of other legal and cultural changes have increased the power of shareholders of US public companies.

Shareholder activism historically referred to an asset class of hedge funds that raided and agitated US publicly traded companies. In present times, however, there is broader recognition that shareholders more generally have a desire to engage with management and boards of directors regarding governance reforms and other aspects of a company's business. This trend has caused the lines between the traditional shareholder activists and other shareholders of public companies to blur, thereby diluting the brand of shareholder activism. There is now an increased expectation that shareholders will seek to have more influence over governance and strategic decisions made by public companies, although it is still the case that certain activist campaigns become a public display of the differences of strategic vision between the shareholder activist and its subject company.

Although the term ‘activist’ may have become diluted by more types of shareholders entering the mix, the increased acceptance of activism in the corporate landscape has by no means decreased its frequency. The number of large US public companies that have been subject to a public activist demand is more pronounced than ever, with an approximate 5 per cent increase in publicly announced campaigns against US companies in 2018 as compared with 2017. Those numbers do not tell the entire story: for every public activist demand, there may be another activist campaign that never becomes public knowledge. Success by activist hedge funds in raising capital and increased support from prominent institutional investors, combined with activists achieving their objectives and gaining board seats at public companies (through both settlements with companies and proxy contests), has

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1 Francis J Aquila is a partner at Sullivan & Cromwell LLP. The author thanks Lauren S Boehmke for her assistance in drafting this chapter and overall assistance with this project.

fuelled increased activity. As a result, US public company boards of directors and management teams have continued their focus on understanding shareholder activism as well as working to prevent, and preparing to respond to, activist campaigns.

II LEGAL AND REGULATORY FRAMEWORK

The legal and regulatory framework relating to shareholder rights, activism and engagement in respect of US publicly traded companies is primarily comprised of federal laws and regulations, and state corporations laws. US public companies also must comply with the listing rules of their stock exchange (either the New York Stock Exchange or the Nasdaq Stock Market), which include corporate governance requirements. Additional sources of practice with respect to shareholder activism and engagement include proxy advisory firms and guidelines set forth by other investment community members. Taken together, the applicable laws and regulations, as well as other influential sources of practice, govern the means by which a shareholder activist pursues an activist campaign and the structural defences against shareholder activists available to US public companies.

i Federal laws

Federal securities laws relating to shareholder activism and engagement include the Securities Act of 1933, the Securities Exchange Act of 1934 (the Exchange Act), the Sarbanes-Oxley Act of 2002 and the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the Dodd-Frank Act). The federal securities laws, and the rules and regulations promulgated thereunder, are administered by the Securities and Exchange Commission (SEC). A key focus of the federal securities regulations is on disclosure and ensuring that shareholders and the market have the information required to make fully informed investment decisions.

The Exchange Act provides the SEC with broad authority to regulate the securities industry. Pursuant to Section 13(a) of the Exchange Act, the SEC requires periodic and current reporting of information by public companies, and companies must consider these disclosure requirements in reporting on corporate governance matters. Section 13(d) of the Exchange Act requires reporting by persons who have directly or indirectly acquired beneficial ownership of more than 5 per cent of an outstanding class of a company's equity securities. An activist investor that crosses the 5 per cent threshold must file a report with the SEC within 10 calendar days disclosing its ownership and certain additional information, including its activist intentions. Section 13(d) also governs whether investors are considered a 'group' for purposes of acquiring, holding or disposing of a company's securities, a very relevant consideration for shareholder activists who may form a 'wolf pack' to work together on an activist campaign.

Section 14(a) of the Exchange Act imposes disclosure and communications requirements on proxy solicitations, or the materials used to solicit shareholders' votes in annual or special meetings held for the election of directors and the approval of other corporate actions. Shareholder activists that wage a proxy contest to nominate directors for election in opposition to a company's slate of director nominees must comply with these proxy solicitation rules. These rules apply to, and require the timely filing of, all written communications made as part of the solicitation, including investor presentations, transcripts of speeches and certain interviews, and social media postings. Further, the Exchange Act governs disclosure by anyone seeking to acquire more than 5 per cent of a company's securities by means of a tender offer.
Regulation Fair Disclosure (Regulation FD), which aims to promote full and fair disclosure by ensuring that companies do not engage in selective disclosure, requires a public company to make public disclosure of any material non-public information disclosed to certain individuals, including shareholders, who may trade on the basis of that information. Regulation FD applies to discussions between a company and a shareholder activist; therefore, companies must be mindful of this regulation when holding discussions with an activist.

The Sarbanes-Oxley Act, enacted in response to the corporate scandals in the early 2000s, mandated numerous reforms to enhance corporate responsibility and financial disclosures. The Dodd-Frank Act implemented further reforms, including with respect to trading restrictions, corporate governance, disclosure and transparency. Both statutes have had a significant influence on corporate governance, and shareholder activism and engagement.

In addition to the federal securities laws, the Hart-Scott-Rodino Antitrust Improvements Act (the HSR Act) may apply to an investment by a shareholder activist in a public company if the investment exceeds a certain size threshold, currently set at US$90 million for 2019.3 If an activist will cross the size threshold with respect to the amount of voting securities of a company it intends to acquire, the activist is required to make a filing with US antitrust authorities and observe a waiting period prior to completing the transaction. The HSR Act provides an exemption from reporting requirements for acquisitions that result in the acquirer holding 10 per cent or less of a company’s outstanding voting securities if made ‘solely for the purpose of investment’.4 This investment-only exception has been construed narrowly; it does not apply if an investor intends to participate in and influence business decisions, which is often the case with shareholder activists.5 In July 2016, activist hedge fund ValueAct Capital agreed to pay a record US$11 million fine to settle a lawsuit filed by the US government alleging that ValueAct violated the HSR Act by improperly relying on the investment-only exception in connection with its US$2.5 billion investment in Halliburton Company and Baker Hughes Inc.6

ii State laws

State corporations law governs actions by companies in the state’s jurisdiction and establishes the fiduciary duty regime that applies to a company’s directors and officers. This chapter focuses on corporate law in the state of Delaware because it is the most popular state of formation for legal entities and its laws significantly influence corporate law in other states. Many provisions of the Delaware General Corporation Law (DGCL) govern the relationship between a corporation and its shareholders, impacting the processes by which a shareholder activist may pursue, and a company may defend against, an activist campaign.

The DGCL includes laws governing, among other things, the composition of the corporation’s board of directors, annual and special meetings of shareholders, actions by written consent, voting thresholds for approving corporate actions, requests by shareholders

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3 The current threshold, which is adjusted annually for inflation by the Federal Trade Commission, is available at www.ftc.gov/enforcement/premerger-notification-program/current-thresholds.
4 See 15 U.S.C. Section 18a(c)(9) and 16 C.F.R. Section 802.9.
for books and records, and appraisal rights. As described further in subsection iv, a corporation may use its organisational documents (certificate of incorporation and by-laws) to customise certain elements of its corporate governance to the extent not inconsistent with the DGCL.

All directors and officers of Delaware corporations owe the company and its shareholders fundamental fiduciary duties of care, loyalty and good faith. Subject to certain exceptions, when reviewing a company’s decision the Delaware courts apply the ‘business judgement rule’, which presumes directors satisfied these fiduciary duties, and will not second-guess the directors’ decision if it has a rational business purpose. However, enhanced judicial review applies in certain circumstances, including when a board of directors takes defensive measures in response to a perceived threat to corporate control. Under the Unocal test, a board that has implemented a defensive measure has the burden of demonstrating that (1) it had reasonable grounds to believe a threat to corporate policy and effectiveness existed and (2) its defensive response was reasonable in relation to the threat posed. The Unocal test is particularly relevant to shareholder activism because it applies to defensive measures such as shareholder protection rights plans (poison pills). Shareholder activists may, as part of their campaign strategy, file lawsuits against a corporation and its directors and officers alleging fiduciary duty violations.

iii Additional sources of practice

Shareholder activism and engagement are influenced by other sources of practice and various members of the investment community. Although their impact has waned somewhat in recent years, proxy advisory firms such as Institutional Shareholder Services (ISS) and, to a lesser extent, Glass Lewis have an impact on a company’s corporate governance policies and may affect the outcome of a proxy contest with a shareholder activist. These advisory firms set forth policy guidelines as well as make recommendations with respect to proposals to be voted upon at a shareholders’ meeting, such as director elections, fundamental transactions and other governance matters. As an adviser to many institutional shareholders, ISS is keen on shareholder engagement and is often inclined to take a ‘what’s the harm’ approach and recommend in favour of at least one activist director candidate in a proxy contest for minority representation on the board of directors if the shareholder activist has demonstrated that some change is warranted at the company. ISS recommendations match the ultimate outcome of the vote in a majority of proxy contests. Although the gap between the voting practices of ISS and institutional shareholders has narrowed, large traditional institutional investors such as BlackRock, Fidelity and Vanguard have generally stopped relying on the analysis of proxy advisory firms and have instead developed internal proxy advisory functions to make decisions in proxy contests and put forth corporate governance initiatives. Given that the stock ownership of many US public companies is increasingly concentrated at a relatively small number of these large institutions, it is critical for both the company and the shareholder activist to garner the support of these investors. Other members of the investment community, such as the Teachers Insurance and Annuity Association of America-College Retirement Equities Fund (TIAA-CREF), the California State Teachers’ Retirement System (CalSTRS), and the Council of Institutional Investors, also set forth policy guidelines and express opinions on governance and activism.

Company defences

A company’s best defence against shareholder activism is strong financial performance, a solid record of shareholder engagement and adoption of corporate governance best practices. A company must also adopt a proactive strategy to anticipate and prepare for the potential for an activist campaign, including actively monitoring the company’s shareholder base and conducting regular and thorough reviews of the company’s business plan, strategic alternatives and intrinsic value. In the current environment, in which there is now an expectation that shareholders will be more involved in governance and strategic decisions made by public companies, it is crucial for companies to maintain a positive dialogue, relationship and credibility with its shareholders, particularly key institutional investors and other large holders. Practising consistent shareholder engagement, including articulating the company’s current and long-term vision for creating shareholder value and practising good governance, will pay dividends for the company in terms of both understanding investor concerns and securing support in the face of future shareholder activism campaigns. A shareholder activist may face an uphill battle if the company already has a strong relationship with, and the support of, its large institutional shareholders.

The prevalence of shareholder activism in the United States has created an entire cottage industry of firms, such as proxy solicitors, dedicated to helping companies monitor their shareholders and set up meetings with institutional investors. Investment banks and law firms also have groups of professionals dedicated to activist preparation and defence. A company facing an activist investor requires a core response team of outside advisers, including a law firm, proxy solicitor, investment bank and public relations firm. The most prepared companies create these teams in advance and establish procedures that are ready to be implemented on a moment’s notice should an activist appear. In addition to monitoring a company’s shareholders and facilitating shareholder engagement, a company’s adviser team can assist the company with ‘thinking like an activist’ by routinely assessing the company’s strengths and vulnerabilities to activism, reviewing its structural defences, and keeping current on the evolving corporate governance practices and preferences of its shareholders and the broader market.

Companies have structural governance defences that may protect them against shareholder activists. The value of any particular structural defence will depend on the specific activist situation and no defence will fully protect a company against activism. As mentioned above, a company may customise certain governance elements in its organisational documents. For example, most public companies have by-laws that require a shareholder to provide advance notice and certain information to the company before it is permitted to nominate a director for election to the company’s board of directors or propose business before a shareholders’ meeting, and these by-laws eliminate the possibility of surprise from last-minute proposals. Companies also specify in their by-laws that the board of directors has the sole right to determine its own size and fill vacancies, both of which prevent activist shareholders from filling the board of directors with their preferred candidates. Companies may also restrict its shareholders’ ability to call special meetings or take actions by written consent, either entirely or below certain ownership thresholds.

Some companies have adopted even more stringent structural defences, such as having two classes of stock (one of which has additional voting rights and is not publicly traded, limiting an activist’s ability to obtain voting power) or creating a classified board of directors (directors are divided into three classes with staggered, multi-year terms, making it more difficult for an activist to replace board members). Companies may also adopt a
poison pill, which can be triggered by the company to dilute the equity and voting stake of a shareholder activist that has purchased over a certain percentage of the company’s stock by allowing all other shareholders to purchase additional shares at a steep discount. Most large US companies have abandoned these harsher defences in recent years in light of scrutiny from the institutional investor community and proxy advisory firms. It is recommended that companies keep a poison pill ‘on the shelf’ and ready to be implemented in response to a threat from a particular activist (see the Unocal defensive measures discussion in subsection ii), although the company must weigh the possibility that it will lose some credibility in the market even if it successfully blocks an activist campaign.8

The DGCL Section 203 includes an anti-takeover provision that prevents a corporation from entering into certain business combination transactions with an interested shareholder (generally one that owns more than 15 per cent of the company’s stock) for three years after becoming an interested stockholder unless the business combination is approved in the manner prescribed by the statute.

The HSR Act requires an investor to provide written notice to a company before acquiring shares that are subject to the HSR Act’s filing requirements, which may serve as the first warning to the company that an activist intends to take a significant stake in the company and advocate for change, or alternatively that an existing shareholder has altered its intentions with respect to the company from passive to active and plans to increase its stake.

III KEY TRENDS IN SHAREHOLDER ACTIVISM

i Shareholder activists

Shareholder activists primarily fall into two categories: hedge fund activists and Rule 14a-8 activists. Hedge fund activists are investors whose investment strategy is to identify what they consider to be vulnerabilities at certain companies and purchase a sizeable minority stake in those target companies with the view that changes they recommend and agitate for, if successful, will increase shareholder value and result in a financial gain for their investment portfolio. Rule 14a-8 activists are shareholders that submit proposals to companies under Rule 14a-8 promulgated under the Exchange Act, a rule that requires a public company to include a shareholder proposal in its proxy materials for a shareholders’ meeting if certain requirements are met by the shareholder. A company’s preparation for and response to activism will differ depending on the type of shareholder activist it faces.

Hedge fund activists are the main focus of this chapter. Hedge funds pursuing activist strategies have had tremendous success in raising capital in recent years, with aggregate assets under management of hedge funds engaged in activism exceeding US$100 billion since 2014.9 Each hedge fund activist has its own strategy, objectives, personality and frequency of engaging in activism. Some activists, such as Carl Icahn and Third Point, are long established, while others are second generation. The investment horizon of an activist hedge fund can range from very short-term to somewhat longer-term. Certain hedge fund activists invest

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9 S&C 2018 Shareholder Activism Review, at page 15.
their own funds, whereas others invest third-party funds. Additionally, an activist hedge fund’s redemption policy (e.g., whether investors have the right to redeem their funds quarterly or have longer-term ‘lock up’ commitments) may impact its behaviour and investment strategy.

Rule 14a-8 activism is often socially driven, with the activists including retail shareholders, advocates of social issues (e.g., environmentalists), religious organisations, pension funds and a variety of other groups. During the 2018 proxy season, corporate governance-related proposals continued to represent approximately half of the Rule 14a-8 proposals voted on, and approximately 14 per cent of these proposals received sufficient shareholder support to pass. Other 2018 Rule 14a-8 proposals included environmental, social and political (ESP) proposals as well as compensation proposals, which have a very low pass rate, although ESP proposals are gaining traction terms of both in the average percentage of votes cast in favour of those proposals and companies’ receptivity to addressing ESP issues.

Traditional institutional investors such as BlackRock, Fidelity, State Street and Vanguard may be considered shareholder activists as well. The concentration of ownership among these large institutional investors has continued to grow. As at December 2018, one of BlackRock, Vanguard or State Street was the largest single shareholder in 438 companies out of the S&P 500 and collectively the three firms owned 18.7 per cent of all shares in the S&P 500. These institutions have developed internal proxy advisory functions and are displaying an increased willingness to directly express their views on governance matters in recent years. These investors are long-term shareholders by nature, and their inability to exit investments nimbly increases their incentive to advocate for changes that will increase enterprise value and protect their investment. Traditional institutional investors also increasingly support activism, although in certain cases there may be a tension between the institutional investor’s long-term outlook and a shareholder activist’s short-term focus.

ESP parameters are increasingly playing a prominent role in the public discourse of both Rule 14a-8 activists and institutional investors. Recently, several of the largest institutional investors reaffirmed this trend with clear statements that they continue to be focused on issuers’ ‘purpose,’ how corporations treat their employees, communities and other stakeholders (not just shareholders), and similar concepts. In his annual letter to CEOs, BlackRock’s Larry Fink described ‘purpose’ as ‘a company’s fundamental reason for being – what it does every day to create value for its stakeholders’.

ii Target companies

Hedge fund activists target companies in which they think there is potential to increase shareholder value, and often look for traditional red flags such as stock price underperformance, operational challenges relative to peers, significant unused cash on the balance sheet, perceived management weakness, multiple business lines, undervalued assets or perceived excessive executive compensation. However, more recently, shareholder activists

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11 id.
12 id.
have also been targeting companies that have performed in line with or better than their peers. A company’s liquidity and size of its market cap can play a role in its susceptibility to activism; it is inherently more difficult for a shareholder activist to amass a large enough stake to influence a company with illiquid stock or a large market cap. Nevertheless, activists have been successful with small stakes (under 1 per cent) and have targeted even the largest and most well-run companies, proving that no company is immune to activism. In 2018, activists targeted companies with market capitalisations greater than US$10 billion (which represent 15 per cent of companies in the Russell 3000) in 11 per cent of total campaigns. However, given the capital required to acquire a significant stake in large-cap companies, only a small number of prominent activist investors consistently target Fortune 100 companies. All industries are susceptible to activism, with investment vehicles, pharmaceutical companies, software companies and other commercial service providers being the most targeted industries from 2014 to 2018.

iii Activist campaigns

Although there was a modest uptick in the number of publicly announced activism campaigns against US companies in 2018 as compared with 2017, the general consistency of 2018 data with 2017 data across multiple metrics suggests that US activism practices are stabilising. Shareholder activists pursue a variety of objectives, including pursuing a company’s sale to a third party (or conversely seeking to block a planned merger), pushing for another type of fundamental transaction such as a spin-off, balance sheet demands such as dividends or share repurchases, operational and capital structure demands, and governance demands. Shareholder activists frequently pursue multiple objectives in the same campaign, with governance demands – particularly board representation or seeking changes in management – often used as a means of achieving economic objectives. In 2018, activist campaigns focused mostly on balance sheet issues and merger and acquisition actions.

Shareholder activists utilise a number of different strategies to achieve their objectives, depending on factors such as the activist itself (many have a consistent modus operandi) and the subject company’s defensive posture. The standard activist ‘playbook’, though not applicable to every campaign, follows a series of escalating tactics with the key objective of creating an impression of inevitability. A shareholder activist often begins a campaign by engaging in a private dialogue with the company’s management before its stake in the company becomes public. If successful, these discussions can avoid further agitation by leading to either an informal or formal settlement between the company and the shareholder activist. If private discussions fail, the shareholder activist may initiate a public campaign to apply pressure on the company through press releases, open letters to management, the board of directors and shareholders, issuing white papers presenting its investment thesis and analysis, and using other means of communication to rally the company’s other shareholders to support its cause. Shareholder activists have also become increasingly adept at using media, including social and alternative electronic media, to their advantage.

16 id., at page 19.
17 id., at page 22.
18 id., at page 3.
19 id., at pages 3, 13 and 27.
20 id., at page 12.
The shareholder activist may then threaten and eventually initiate a proxy contest for representation on the company’s board of directors. Shareholder activists seek to gain representation by either replacing only a minority of the company’s directors or, in more extreme scenarios, trying to replace at least a majority of the board of directors (a control slate contest). The percentage of proxy contests involving a control slate has ranged from 51 per cent to 74 per cent from 2014 to 2018. This suggests that, once activists invest in formally commencing a proxy contest, many are not content to merely gain a couple of seats at the table. If a shareholder activist is well funded, it may also commence a lawsuit (sometimes in conjunction with other tactics) to obtain information from the company, reverse board decisions or redeem the company's poison pill, among other claims. With some notable exceptions, shareholder activists do not usually make an offer for the entire company, although hostile offers have been made by hedge fund activists in past campaigns and prominent activist hedge fund Elliott Management (Elliott) has established a private equity arm.

iv Paths to resolution

Activist campaigns continued to achieve high levels of success in 2018. Shareholder activists place a high value on the public perception of a successful campaign, including a partial victory or settlement, even without achieving an outright win for all of its demands. Partial success can entail the shareholder activist receiving at least one board seat (either through a settlement or proxy contest that goes to a vote) or the company agreeing to pursue one of the activist’s economic objectives.

As shareholder activism and campaigns by activist hedge funds have become more mainstream, it has also become common for a company and shareholder activist to settle and enter into a cooperation agreement. A typical cooperation agreement provides the shareholder activist with minority board representation and includes customary standstill restrictions for the benefit of the company, such as prohibiting the activist from soliciting proxies in opposition to management prior to the company’s next annual meeting. In many cases, companies conclude that settling with a reputable activist is preferable to expending significant time and resources on a protracted and distracting proxy contest. A company’s board of directors has an interest in appearing firm but open-minded about an activist’s credible suggestions to its other shareholders and the investment community at large. Most shareholder activists also have an interest in creating working relationships with the company’s board of directors and building a public reputation for playing fair, which can facilitate future negotiations with the company and the future subject companies.

Companies must recognise that providing a shareholder activist with board representation is simply the beginning and not the end of the company’s discussions with the activist. Once the shareholder activist is represented on the board of directors, it will most likely seek changes that it believes are in the best interests of the company and its shareholders. In addition, the presence of the activist’s director designees may alter boardroom dynamics. Activist designees that receive board seats also stay on the boards for long periods.

21 id., at page 33.
22 id., at page 19.
Since 2010, prominent activist fund insiders who became directors following a settlement agreement stayed on the relevant board for an average of approximately two years longer than the minimum provided for in the settlement agreement, and many insiders in this subset are still on the relevant board.

**IV RECENT SHAREHOLDER ACTIVISM CAMPAIGNS**

Although there are many recent US shareholder activism campaigns worthy of discussion in this chapter, this section highlights two campaigns by US activist hedge funds against US public companies that helpfully demonstrate the varying nature and objectives of shareholder activists.24

**i Campbell Soup Company/Third Point**

In May 2018, Campbell Soup Company (Campbell), approximately 41 per cent of which is owned by heirs to the founder of Campbell, announced that its CEO had retired and the company planned to conduct a strategic review of its portfolio. On 9 August 2018, Third Point filed a Schedule 13D disclosing a 5.65 per cent stake in Campbell and its belief that the company’s strategic review should result in a sale of the company. Third Point also stated that it might seek board representation. Third Point entered into an agreement to partner with George Strawbridge, a Campbell heir who owns approximately 2.8 per cent of the company. On 30 August 2018, Campbell announced the results of its strategic review, and its decision to focus on two distinct businesses and pursue divestitures of non-core businesses. In September 2018, Third Point nominated a full slate of 12 directors to replace Campbell’s entire board, citing poor company performance and criticising the results of the strategic review. Third Point’s proxy contest campaign involved a bold media strategy that gained widespread public attention. In October 2018, the other heirs to the Campbell founder pledged to vote their shares in support of the incumbent Campbell board. Also in October 2018, Third Point filed a lawsuit against Campbell and its directors claiming breaches of fiduciary duties related to Campell’s proxy disclosure. In early November 2018, Third Point reduced its slate from 12 to five director candidates and ISS recommended that shareholders vote for all Third Point candidates. On 27 November 2018, Campbell agreed to place two Third Point nominees on the board and allow Third Point to consult on the appointment of a third independent director in exchange for certain standstill restrictions. In December 2018, Campbell announced the appointment of a new CEO.

**ii athenahealth, Inc/Elliott**

In May 2017, Elliott filed a Schedule 13D disclosing a 9.2 per cent stake in athenahealth, Inc (athenahealth) and its belief that the company had a ‘disruptive value proposition’ that was not reflected in the company’s market value. Elliott also noted operational and strategic opportunities to unlock shareholder value that it would seek to discuss with the board. In early May 2018, two weeks after athenahealth announced disappointing earnings, Elliott filed an amended Schedule 13D reporting an 8.9 per cent stake and disclosing that it had made an offer an to acquire the remaining shares of the company. Valued at US$6.9 billion,

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24 The campaign detail included in this section was sourced from SharkRepellent, FactSet Research Systems Inc and other public filings.
this bid marked Elliott’s largest takeover offer. Elliott’s filing also disclosed that it had initially approached athenahealth regarding a take-private transaction in November 2017 but its bid was rejected. In late May 2018, athenahealth’s largest shareholder stated publicly that athenahealth should initiate a strategic review process. In June 2018, athenahealth’s CEO resigned and the company initiated a review of alternatives, including a potential sale of the company. In October 2018, there was speculation that athenahealth was close to finding a buyer. In November 2018, athenahealth announced that it was being acquired by Veritas Capital and Elliott for US$5.7 billion. The deal closed in February 2019.

V REGULATORY DEVELOPMENTS

The US corporate regulatory and governance landscape is constantly undergoing reform. In the past few years, and especially in 2018, several governmental entities have also demonstrated an appetite for enforcing their existing regulations against activists.

Section 8 of the Clayton Act restricts interlocking directors on the boards of competitors, which may become an issue for activist hedge funds, even where different individuals are serving on different company boards, if the activist is deemed to have ‘deputised’ the individuals because those directors may be seen as a conduit for sharing competitive sensitive information among competitors.

Although not directed at activists, the Commissioners of both the Federal Trade Commission and the SEC have noted that the competitive effects of common ownership by institutional investors, especially index funds, deserve to be studied. This issue has become an area of focus due to assertions that having such large shareholders exerting common influence could dampen competition among public companies.

Both the US legislature and the SEC have recently discussed the regulation of proxy advisers such as ISS and Glass Lewis. In May 2019, the SEC announced that its short-term agenda includes considering possible rule amendments to address proxy advisers’ reliance on certain proxy solicitation exemptions in the SEC rules. The SEC also noted that it would consider possible amendments to the thresholds for filing shareholder proposals under Rule 14a-8.

In October 2016, the SEC released a proposal for universal proxies, which would require the use of a proxy card in contested elections at listed US public companies that includes the director candidates nominated by both the company and the shareholder activist. Universal proxies would result in a significant change to voting practices in US proxy contests, but it is not on the SEC’s short-term agenda.25

VI OUTLOOK

All indications are that shareholder activism will continue to play a prominent, and most likely permanent, role in the US corporate landscape. US public companies have devoted considerable resources to shareholder engagement and activism preparedness, and their enhanced focus on corporate governance, other ESP issues and strategic review may further push the envelope of good governance practices. It is important to remain alert to developments in shareholder activism as the types of activists, companies targeted by activism and activist campaigns evolve.

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In December 2018, the *Financial Times* described Mr Aquila as ‘one of the most influential and high-profile M&A and corporate lawyers in the US’ who has ‘played a role in many of the largest and most complex deals’, and *The Wall Street Journal* profiled him as one of the seven top dealmakers of the year. Mr Aquila is recognised as one of the world’s leading M&A lawyers, including being ranked by *Chambers Global* as Band 1 (the top tier), as *The American Lawyer* ‘Dealmaker of the Year’, as a recipient of the Atlas Award as ‘Global M&A Lawyer of the Year’ and as a three-time Law360 MVP. In 2015, the *Financial Times* recognised his representation of Kraft as one of the most innovative in North America. For his work in corporate governance, Mr Aquila has been regularly named by the National Association of Corporate Directors to its ‘Directorship 100’. *Best Lawyers in America* named Mr Aquila as its 2017 corporate governance law ‘Lawyer of the Year’. In 2014, Global M&A Network recognised Mr Aquila as one of the top 50 lawyers in the world.

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Prior to joining the firm in 2004, Mr Cho lectured in international business strategy and multinational business administration at Seoul National University. Further, he worked as the head of the Business Case Center and as the vice president of the Institute for Industrial Policy Studies under the Ministry of Commerce, Industry and Energy.

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He acts on cross-border M&A, JVs, VC and other investments, as well as governance, across the United Kingdom, Europe and Africa. Gavin represents financial investors, corporates and government agencies. His matters regularly involve complex or novel structures, contentious situations or distressed situations.

Gavin has particularly strong experience in shareholder activism situations in the United Kingdom, having acted on a number of the most significant campaigns in the United Kingdom in the past 10 years.

Gavin is cited as a leading M&A lawyer in *The Legal 500* and is identified in *Who’s Who Legal* as a leading practitioner in the field of international M&A.

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Quentin Digby is a partner at Herbert Smith Freehills’ Sydney corporate practice and established the firm’s head office advisory team (HOAT) in 1998. HOAT specialises in strategic corporate governance issues, including board reporting and advice, market disclosure (both continuous and periodic), director and executive appointments, remuneration and disclosure, and shareholder communications and relations.
HOAT has established an unparalleled reputation for providing focused advice and guidance on not only legal and regulatory requirements but also market practice and emerging trends. HOAT advises the majority of the ASX 20 on corporate governance issues and is the principal governance adviser to approximately one-third of ASX 100 companies.

Quentin acts as a trusted adviser for the corporate secretariat, and general counsel teams and boards of a number of the firm’s significant ASX-listed clients, and is the delegate for the Law Council of Australia on the ASX Corporate Governance Council.

ANKE GEPPERT-LUCIANI

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Anke Geppert-Luciani is a professional support lawyer with NautaDutilh Avocats Luxembourg. She ensures that the firm’s corporate, IP, IT, labour and competition law practice groups are kept informed of the latest developments in Luxembourg and EU law.

Further, she contributes to various newsletters and publications, and she coordinates and assists on projects focused on know-how, business development and innovation. Anke is a qualified German lawyer, admitted to both the Saxon Bar and the Luxembourg Bar (Liste IV). Besides the two German state examinations, Anke holds a master’s in European law from the University of Paris I, Panthéon-Sorbonne (2005) and a certificate in international human rights law from the University of Nottingham (2016). Prior to joining NautaDutilh Avocats Luxembourg, Anke worked as a legal officer and law clerk with the European Court of Justice. She also practised as a senior associate at another reputable law firm in Luxembourg.

MAX GUTBROD

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Dr Max Gutbrod is a German-trained lawyer working in Russia for more than 20 years. He started his career in Stuttgart in 1990 with Gleiss Lutz and moved to Russia in 1995. He has represented shareholders and investors in mergers and acquisitions, and disputes; has negotiated and drafted charters for joint venture companies, shareholders and investment contracts; and has given advice on regulatory matters relating to securities holdings, depositary business, securities settlement issues and related disputes. In addition, he has frequently advised on legislative issues related to corporate, banking and capital markets law as well as corporate governance, and has participated in discussions aimed at improving the infrastructure of Russian capital markets. Furthermore, Mr Gutbrod was a member of the group that drafted the CIS Model Law on Joint-Stock Companies, has published comments on the draft law in a specialist journal and has been a member of the Commission on Corporate Governance. Currently, Mr Gutbrod is focusing in particular on legislation on credit cards and mentoring startups.

FRANK HAMMING

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Frank Hamming is a senior associate in De Brauw Blackstone Westbroek’s corporate department. Frank has a primary focus on corporate law, including corporate governance, shareholder activism, and private and public mergers and acquisitions. Frank regularly advises listed companies, large multinationals and private equity funds on complex public and private transactions in a variety of industries.
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Joon B Kim is a member of the firm’s corporate advisory practice group. Mr Kim extensively advises foreign corporations, financial investors and large domestic conglomerates on a range of issues in connection with mergers and acquisitions, corporate governance and shareholder activism defence, real estate transactions, fair trade law and cross-border corporate transactions.

Mr Kim’s primary areas of expertise include both inbound and outbound mergers and acquisitions of public and private companies as well as disputes and investigations relating to foreign direct investment, outbound investment transactions and antitrust issues involving multinational corporations.

Mr Kim received a JD from Vanderbilt University Law School in 2002, an MBA from Seoul National University in 1999 and a BA in economics from Seoul National University in 1993. Before joining the firm in 2006, Mr Kim was associated with the New York and Hong Kong offices of Milbank LLP.

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Lee Suet-Fern is the senior director of Morgan Lewis Stamford LLC and a partner of Morgan, Lewis & Bockius, where she chairs the international leadership team and is a member of the global board. Ms Lee advises clients on mergers and acquisitions, equity and debt capital markets, and corporate finance. She routinely leads some of the largest corporate transactions in Singapore and the Asia-Pacific region. She has been named a leading practitioner in Chambers Global: The World’s Leading Lawyers for Business, Euromoney’s World’s Leading M&A Lawyers and World’s Leading Capital Markets Lawyers, PLC’s Cross-border Private Equity Handbook and Who’s Who Legal: Capital Markets. She was awarded the inaugural Asian Legal Business Life Time Achievement Award in 2007, the Lifetime Achievement Award by Chambers Asia-Pacific in 2016 and the Lifetime Achievement Award by Euromoney in 2017. Euromoney also honoured her with its Asia Women Business Law Award for mergers and acquisitions and private equity in 2012 and 2013, and Best Lawyers Mergers & Acquisitions
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Akira Matsushita is a partner at the Tokyo office of Mori Hamada & Matsumoto. He focuses on cross-border and domestic mergers and acquisitions transactions, corporate governance, shareholder activism, takeover defence, and general corporate and securities law matters. He has extensive experience in advising listed companies subject to shareholder activism, proxy fights or unsolicited takeovers, and in representing clients in high-profile inbound and outbound cross-border mergers and acquisitions transactions.

Mr Matsushita was admitted to the Japanese Bar in 2006 and the New York Bar in 2013. He received his LLB from Keio University in 2005 and his LLM from Cornell Law School in 2012. He also worked at Kirkland & Ellis LLP, Chicago, from 2012 to 2013.

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Karin Mattle is a senior associate in Homburger’s corporate and M&A practice team. She joined Homburger in 2014 after completing her MBA at the Australian Graduate School of Management and London Business School in 2014. Her practice focuses on corporate and commercial law, mergers and acquisitions as well as capital markets law. She advises clients in connection with public takeovers, private M&A transactions as well as shareholder activism campaigns. Her practice also includes private share placements and initial public offers. She is a member of Homburger’s employment law working group, whereby her main focus in this area is employee participation plans and transfers of employees in connection with business transfers.

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Greg Mulley is a corporate partner with particular experience in advising listed corporate clients on their most complex, cross-border transactions, capital raisings and corporate governance issues (including regulatory investigations); leading banks in their roles on major transactions; and issuers on initial public offerings, and has been closely involved in a range of securities and corporate law regulatory issues.

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As a senior member of HOAT, Timothy advises ASX-listed companies on market disclosure and shareholder engagement issues, including in relation to sales downgrades, contentious general meetings, environmental, social and governance issues, economic
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In 2010, Timothy was one of two Australians to receive a Young Leaders Program scholarship from the Japanese Ministry of Education to study for his master’s in business administration in Tokyo. He also holds a Bachelor of Laws (Hons.) and a Bachelor of Commerce from Monash University, Melbourne.

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His work extends to a broad range of industries and clients, including leading German corporates, *Mittelstand* companies, and domestic and international financial and strategic investors. He has vast experience in assisting clients from the Middle East with outbound investments.

Dr Ulmer is widely published. Among others, he is the author of the quarterly released *Cleary Gottlieb M&A Telegram* and co-author of *Cleary Gottlieb’s Public Bids and Squeeze-Outs in Germany, a Statistical Survey* (2002–2016).

*JUVE*, the leading publication on German law firms, distinguishes Dr Ulmer as an ‘M&A Heavyweight’ and frequently recommended lawyer for M&A and corporate, and *Chambers Europe* recommends him as a notable practitioner for ‘Corporate/M&A: High-end Capability’, describing him as ‘really good at finding and labelling risks and knows how to translate the legal aspects into business language’.

Dr Ulmer joined Cleary Gottlieb as a partner in 2016. He started his career at Hengeler Mueller and joined Allen & Overy as a partner in 2006.

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Ms Wilkenhuysen received her law degree from the University of Leuven in 1991, a master’s degree in business and tax law from the Free University of Brussels in 1993 and an LLM from Duke Law School in North Carolina in 1996. She joined NautaDutilh in 1997 and was named partner in 2007.

Ms Wilkenhuysen is a frequent writer and speaker, and has published various books and articles on selected topics of corporate law. She is a member of the International Bar Association, the European Private Equity and Venture Capital Association, and the Duke Alumni Association.
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