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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, activism campaigns directed at non-US companies continue to make up a large share of global activism. This movement is being driven by, among other things, a search by hedge funds for new investment opportunities and a cultural shift towards increased shareholder engagement in Europe, Australia and Asia.

The outbreak of the covid-19 pandemic in early 2020 caused an unprecedented economic crisis that has further heightened focus on corporate governance. The crisis has significantly tested companies’ oversight, coordination and leadership capabilities to manage a fluid and complex situation impacting companies’ business, operations, prospects, employees, stockholders, other stakeholders and government relationships – and activists have been paying attention. Although the covid-19 pandemic has decreased activist campaign activity in the short-term, practitioners generally expect to see activism activity return with full force in the next year. Furthermore, activists are likely to incorporate critique over a company’s pandemic response into their campaign thesis.

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 fifth 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.

Francis J Aquila
Sullivan & Cromwell LLP
New York
August 2020
Chapter 1

AUSTRALIA

Quentin Digby, Timothy Stutt and Barry Wang

I OVERVIEW

Over the past several years, the governance landscape in Australia has been marked by an intense focus on corporate culture and accountability, in large part driven by systemic non-financial risk management failings identified by the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Financial Services Royal Commission). During 2019, this overarching trend resulted in many institutional investors taking more activist stances with respect to potential areas of financial, non-financial and reputational risk at listed Australian companies, particularly with respect to climate change risk exposures. It also resulted in retail shareholder activists continuing apace with campaigns directed at environmental, social and governance (ESG) issues.

This focus on non-financial and reputational risk management has coincided with a number of developments in the ESG space and disruption catalysed by the covid-19 pandemic. On the human rights front, Australian companies’ first reporting periods under the federal modern slavery reporting regime have commenced, and covid-19 has shone a spotlight on businesses’ supply chain resiliency and workforce practices. On the environmental front, a particularly severe bushfire season and a temporary (and unsustainable) drop in greenhouse gas emissions during covid-19 have also enlivened debate about the role of Australian companies in combating climate change. While there were calls for investors to allow boards some space to focus on crisis management at the height of the pandemic, activist campaigns have largely continued in Australia unimpeded and, in the lead-up to the 2020 annual general meeting (AGM) season, it is expected that the number of campaigns will increase.

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 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

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1 Quentin Digby is a partner, Timothy Stutt is a senior associate and Barry Wang is a solicitor at Herbert Smith Freehills. The authors would like to acknowledge the assistance of Eloise O’Brien, a solicitor at Herbert Smith Freehills.
shares, as required by the Australian Securities Exchange (ASX). However, despite 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 and request copies of their 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), a person would obtain each shareholder’s name and address, as well as details regarding his or her holding in the company. At present, the information does not include email addresses as these are not prescribed details for inclusion in the register. A law reform proposal introduced in 2017 to include email addresses on company registers has stalled for the time being.

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. However, activist proposals will generally comply with this requirement because 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 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 because 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).

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

Shareholders holding 5 per cent of the votes in a company can requisition a shareholders’ meeting. 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 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 this process, decisions regarding the content of the notice of meeting will be determined by the board (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, 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 and thereby control the conduct of proceedings of the meeting.

The Corporations Act also includes an alternative process for shareholders with at least 5 per cent of the votes 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). Again, the chair of the company is likely to be able to chair the meeting under its constitution and control the conduct of the meeting. Despite its procedural 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., an AGM), an alternative process, commonly used by retail shareholder activists, is to requisition additional resolutions for consideration at that meeting. One hundred 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 resolution.

This is the preferred mechanism for social and environmental shareholder activists to agitate for changes in companies’ 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 Market Forces and the Australasian Centre for Corporate Responsibility (ACCR) have become relatively common for ASX-listed companies.

Where a requisition is received by a listed company 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.

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 need to be enshrined in the constitution (with a special resolution requisitioned to amend the
Nominating and removing directors

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 company’s constitution will permit a single shareholder (with a holding of any size) to nominate a person for election to the board 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 a 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.

The external candidate will typically be elected by securing a simple majority of votes cast at the shareholders’ meeting, unless the company is at its constitutionally mandated maximum board size, in which case the candidate will need to outpoll one of the incumbent directors standing for re-election.

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

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, which 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). 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 all non-executive directors to stand for re-election at a special ‘board spill meeting’ if they wish to continue in office. Although intended to address remuneration-related issues, this mechanism is open to abuse by shareholder activists as an
indirect means of 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 best interests of the company.

In extreme circumstances, shareholder activists may bring derivative proceedings against the company’s directors (being a claim brought on behalf of the company) or seek court orders to address conduct that is oppressive to shareholders. Although these types of proceedings rarely proceed to trial in Australia, hostile shareholder activists will occasionally threaten such proceedings to encourage the swift resolution of issues under negotiation. In some cases, proceedings may be instituted; however, this is a high-stakes manoeuvre for activist shareholders because 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 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.

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 Advance Bank, 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 does allow for:

- 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
- 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 or other activist proposal would typically include:

- formulation of a board recommendation in relation to the external nomination or shareholder requisition;
- high-level meetings between directors and substantial shareholders;
- the sending of specific communications to shareholders; and

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5 See, for example, the case of RBC Investor Services Australia Nominees Pty Limited v. Brickworks Limited [2017] FCA 756.
establishment of a shareholder hotline to answer shareholder questions regarding the external nomination or shareholder-requisitioned resolutions.

In some cases, companies may also engage a proxy solicitation firm to make 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 banking, 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.

A notable example in 2019 was Origin’s AGM, which saw simultaneous campaigns from ACCR and Market Forces that between them requisitioned seven resolutions, covering issues as diverse as indigenous people’s informed consent to fracking, public health risks of coal operations, Paris goals and targets, lobbying in relation to energy policy, and transition planning. None of the resolutions were approved by shareholders.

Shareholder-requisitioned resolutions are also gaining increasingly high levels of support. A significant example was ACCR’s 2020 campaign against oil and gas producer Santos. The activists requisitioned resolutions requesting additional disclosure concerning the company’s alignment with the Paris Climate Agreement and emissions targets, as well as a review of its lobbying in relation to energy policy. The resolutions, backed by a number of major proxy advisers, were respectively supported by 43.39 per cent and 46.35 per cent of directed proxies. However, the proposed constitutional amendment on which these resolutions depended was overwhelmingly defeated by 93.32 per cent of the votes. These contrasting results, which are part of a trend, demonstrate that some investors are voting in favour of requisitioned resolutions to ‘send a message’ to boards about ESG issues without intending for change to be actually effected in a binding way.

In addition to supporting requisitioned resolutions, institutional investors have continued to use portfolio reviews and divestments as tactics to apply pressure on companies about environmental matters. A prominent example was Norwegian Government Pension Fund Global’s decision in May 2020 to sell its interest in several listed resources and energy companies or place them ‘under observation’ over concerns about their greenhouse gas emissions.

On the whole, major listed Australian listed companies are aware of the importance of ESG issues for shareholders and eager to address substantive concerns. Some of the companies that have been targeted by ESG groups are among the most advanced in terms of having a genuine ESG focus, yet are still attracting activist campaigns due to the high profile that such campaigns could generate. This can create dilemmas for directors where a campaign is supported by a significant number of shareholders but the directors do not consider it to be in the company’s best interests. Some institutional investors are themselves increasingly feeling
the pressure to support activist campaigns because the same social interest groups organising the campaigns have begun targeting and publicly naming institutional investors that oppose them.

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 statutory mechanisms to provide them with a platform to agitate for social or environmental change. However, American-style hedge fund activism has become increasingly prominent in the Australian market. As well as Elliott Management’s public campaign against BHP launched in April 2017, a number of other activists in the region have been generating significant media attention – including value campaigns targeting Australian firms launched by Lone Star Funds, Janchor Partners and Coliseum Capital Management, and short campaigns against Australian companies launched by firms such as 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. Historically, the vast majority of activist campaigns against Australian companies were waged against small-cap companies. However, recent campaigns have also targeted much larger companies, such as BHP (BHP Group Limited market cap: A$105.1 billion; BHP Group Plc market cap: £34.8 billion) and Iluka Resources (market cap: A$3.56 billion).7 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 shareholders, such as Dr Gary Weiss, have been in the market for decades through various investment vehicles. Prominent local activist shareholders include Merlon Capital, Ariadne (which is Weiss-linked), MH Carnegie, Sandon Capital, Thorney Opportunities, and the local branches of Allan Gray, Lazard Asset Management and Aberdeen Asset Management. The growth in this space is evidenced by the continued emergence of relatively new players, such as diversified alternative asset investment firm Tanarra Capital, which has taken an activist approach to its investment in listed construction-materials firm, Boral.

Activist campaigns by local investors continue to be 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 Tanarra (in relation to Boral), Merlon (in relation to financial services institution AMP), and Sandon Capital (in relation to Iluka Resources).

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:

a persuading companies to make a capital return or pay a special dividend;

7 Market capitalisations presented as at 19 June 2020.
b changing the business strategy (which may involve 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.

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 to build momentum for change and increase pressure on the company’s board.

In Australia, it has historically been rare for shareholder activists to 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:

a publicly criticising of the board, individual directors and management;

b forming informal investor alliances and voting blocs;

c proposing or supporting candidates for appointment to the board;

d advocating for (or formally proposing) removal of existing directors;

e requisitioning shareholder resolutions and members’ statements;

f requisitioning extraordinary general meetings of shareholders; and

g 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:
a 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

b 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,\(^8\) 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 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 Coles

Coles was subject to the first modern slavery-related shareholder requisition against an Australian company at its 2019 AGM. The resolution was co-filed by ACCR, the Labour Union Co-operative Retirement Fund (LUCRF), Mercy Investments Services, and St Columban’s Mission Society, and proposed a review of Coles’ sourcing practices in its fresh food supply chain.

\(^8\) Activist Insight, 9 April 2019.
Coles responded by announcing an accord signed with three of Australia’s largest unions in the week before its 2019 AGM to promote ethical employment practices and protect the rights of workers in its supply chain, with a particular focus on those engaged by labour hire organisations. Coles also committed to convening regular town halls to enable workers to air grievances and meeting regularly with the unions to discuss and develop new initiatives and investigate complaints in relation to the company’s suppliers.

Despite this, the requisitioners did not withdraw the resolution. The resolution was ultimately unsuccessful, although it gained the support of 17.78 per cent of directed proxy votes.

ii Major banks

Whereas shareholder activists’ key focuses at major Australian banks’ 2018 AGMs were accountability and corporate conduct as the Financial Services Royal Commission conducted its hearings, there was a renewed focus on environmental matters in the 2019 AGM season.

Market Forces led a campaign against NAB, ANZ and Westpac, three of the ‘Big Four’ Australian banks, to requisition shareholder resolutions about annual disclosures on strategies and targets to reduce exposure to fossil fuel in line with the Paris Agreement. Separately, ACCR submitted shareholder requisitions that called on NAB and ANZ to suspend memberships of industrial associations that engage in lobbying alleged to be inconsistent with the Paris Agreement’s goals. None of the relevant resolutions were ultimately passed.

The banks’ responses were similar to those often taken by energy and resources companies when faced with these types of requisitions (i.e., highlighting their existing actions on environmental issues and explaining why their boards do not consider the proposed resolution to be in the company’s best interests). NAB also pledged to exit financing for thermal coal projects by 2035, but was unable to convince the requisitioning shareholders to withdraw their requisitions. By way of contrast, the Commonwealth Bank of Australia, the only ‘Big Four’ bank to have avoided a requisitioned resolution at its 2019 AGM, had pledged to exit thermal coal lending by 2030.

iii Qantas

The issue of Qantas’ involvement in the deportation of refugees and asylum seekers was the subject of a second shareholder requisition at its 2019 AGM. The ACCR requisitioned a resolution that Qantas review its policies relating to involuntary transportation undertaken for the Department of Home Affairs and disclose the results to shareholders.

Although Qantas had updated its due diligence guidelines to note that it would now receive information from the Department of Home Affairs about any pending court proceedings involving a deportee, the requisition still attracted the support of institutional investors, including US-based asset manager Mercy Investment Services. Whereas the 2018 requisition was only supported by 6.43 per cent of the vote, the 2019 requisition was supported by 23.56 per cent.

iv Energy and resources companies

For examples of recent campaigns against major Australian energy and resources companies, see Section III.
V REGULATORY DEVELOPMENTS

i Virtual general meetings during covid-19
The Australian Government’s covid-19 response has included temporary legislative changes to facilitate the holding of virtual general meetings.

By eliminating the need for physical travel, these changes can make it easier for shareholder activists to participate in general meetings. Conversely, virtual meetings protect companies from some of the more disruptive tactics that activists may use, such as protests and interruptions.

Many companies are encouraging shareholders to submit questions before their virtual meetings. This gives them an opportunity to consider the questions in advance of the meeting and to remove duplicative questions. Australian companies have largely resisted calls for all submitted questions to be published due to concerns that some questions may include defamatory or misleading materials (and are not legally required to be published).

ii Fourth edition of the Corporate Governance Principles and Recommendations
The fourth edition of the ASX Corporate Governance Council’s Corporate Governance Principles and Recommendations (the Fourth Edition Principles) comes into effect for listed entities’ first full financial year commencing on or after 1 January 2020. A number of aspects of the Fourth Edition Principles have the potential to catalyse further activism against ASX-listed companies, including a recommendation for ASX 300 entities to target having 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.

iii Modern slavery legislation
The Modern Slavery Act 2018 (Cth) (Commonwealth Act) commenced on 1 January 2019. 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 are required to prepare their first modern slavery statements in respect of their first full financial year commencing after 1 January 2019. Normally, a company has six months after the end of a financial year to prepare and file a modern slavery statement, although in light of covid-19, a special three-month extension has been granted to reporting entities with a financial year ending on or before 30 June 2020.

In parallel, the Modern Slavery Act 2018 (NSW) (NSW Act) is currently anticipated to commence by 1 January 2021. The NSW Act provides for a similar obligation for commercial organisations (other than those covered by the Commonwealth Act) 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.

Modern slavery legislation will improve reporting standards in relation to human rights risks, which is currently a focus for shareholder activists. 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.

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. Covid-19, which has generated broader discussions about businesses’ role in society, is likely to contribute to this trend.

Activist campaigns are increasingly enjoying the support of institutional investors, as reflected in a number of strong results in favour of shareholder-requisitioned resolutions at recent AGMs. Simultaneous campaigns by separate ESG activist groups targeting the same company are also becoming regular occurrences.

In light of these developments, strategic preparation, self-assessment and challenge remain important tools for pre-empting and responding to activist campaigns. As the experience of a number of companies during 2019 demonstrated, these steps are not silver bullets that will always succeed at preventing activist campaigns. However, companies that take steps to proactively address shareholder activists’ underlying concerns will almost invariably be better placed to reach an acceptable outcome and limit attendant reputation risk factors.
Chapter 2

AUSTRIA

Sarah Wared

I OVERVIEW

Globally, last year was down from 2018 peak level, although there was record activity in the third quarter of 2019, and we saw an essential number of investors employing activism as a tactic. A record of 99 campaigns launched in 2019 corresponding to 47 per cent of campaigns launched in 2019 by activist shareholders were merger and acquisition (M&A)-driven, with pushing for a sale (QEP, HP, Ceasars) or break-up (AT&T, Marathon, Sony) or entering into a live M&A transaction (Altran, Bristol-Myers Squibb) being the most common objectives.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 2019 Review of Shareholder Activism, Lazard.
It can be expected that Austria will see more activism in the future. In particular, the EU Shareholder Rights Directive II (2017/828), amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement, which has already been implemented into national law (SRR), 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:

a convocation of a shareholders’ meeting;
b inclusion of items on the agendas of shareholders’ meetings;
c audit of the annual accounts by a different auditor for good cause; and
d 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 purely 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.

### iv Lack of gender diversity

Most recently, an activist shareholder of a large Austrian listed company initiated a law suit to challenge a resolution to appoint members of the supervisory board for lack of gender diversity.

### V REGULATORY DEVELOPMENTS

The SRR, which is intended to improve shareholder participation in listed companies, may have an impact on campaigns of activist shareholders. The SRR 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.

The SRR 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. Pursuant to SRR, shareholders 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.

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.

The decision on the remuneration policy and report by the annual general meeting and the associated increased transparency may strengthen the position of activist shareholders. The risk of a negative recommendation alone can be sufficient to put pressure on the supervisory board and thereby influence the remuneration policy.

VI OUTLOOK

First, because of the new regulations pursuant to the SRR, 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 above-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

BRAZIL

Lior Pinsky, Levi Santos and Victor Meneguelli

I OVERVIEW

i General perception

It is a common perception that shareholder activism is still incipient in the Brazilian business environment. Activist campaigns are extremely rare because, among the possible explanations (putting aside the implausible one that Brazilian companies are flawlessly managed and shareholders are completely satisfied with them), the typical capital structure of Brazilian companies makes activism ineffective; or the Brazilian regulatory framework on the subject offers few instruments to make activism worth its while. In this chapter, the potential causes will be analysed, without seeking to conclude whether corporate activism is a net positive or negative, and the above reasons (or a combination of them) will be considered to understand whether any of them justify the relative lack of activist campaigns in Brazil.

ii Are there too few targets for activist campaigns?

Currently, there is only one stock exchange in Brazil: the B3 (Brasil, Bolsa, Balcão). There are around 350 companies listed in the B3. Although that number is average among OECD countries, the general perception is that the Brazilian capital markets remain underdeveloped (representing only 32 per cent of GDP traded on the stock exchange). This is perhaps due to the high interest rates historically paid by the Brazilian government, contributing to most investors preferring fixed income government debt, which (on a much smaller scale) was

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1 Lior Pinsky, Levi Santos and Victor Meneguelli are partner, junior associate and legal intern at Veirano Advogados, respectively. The authors would like to acknowledge Robson Barreto’s valuable input to this chapter.

2 For the purposes of this chapter, we consider shareholder activism from three main angles: (1) shareholders’ intervention in the management of the company, especially by defining the composition of the board of directors; (2) supervision of the acts of the directors; and (3) liability of the controlling shareholders and directors who cause damage to the company and its shareholders.


4 OECD. Corporate Governance Factbook 2019, p. 19, available at <https://www.oecd.org/corporate/Corporate-Governance-Factbook.pdf>. In countries where there is more than one stock exchange, only the one with the largest number of listed companies was considered.

5 Since November 2016, the base interest rate in Brazil was progressively lowered (currently at 2.25 per cent per year), which prompted a mass migration of investors to the stock markets (the number of investors holding shares in Brazilian companies has risen from 500,000 in 2016 to 2.4 million today).
recently amplified by the flight of essentially Brazilian businesses to foreign stock exchanges due to the adoption of shareholder models that allow multiple voting (such as XP Inc, StoneCo Ltd and Pag Seguro Digital Ltd).

<table>
<thead>
<tr>
<th>Country</th>
<th>% of GDP traded</th>
</tr>
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<tbody>
<tr>
<td>USA</td>
<td>205.20</td>
</tr>
<tr>
<td>South Africa</td>
<td>118.10</td>
</tr>
<tr>
<td>China</td>
<td>74.60</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>66</td>
</tr>
<tr>
<td>Australia</td>
<td>61.15</td>
</tr>
<tr>
<td>Germany</td>
<td>42.40</td>
</tr>
<tr>
<td>India</td>
<td>52</td>
</tr>
<tr>
<td>Brazil</td>
<td>32.20</td>
</tr>
<tr>
<td>Mexico</td>
<td>9.90</td>
</tr>
<tr>
<td>Russia</td>
<td>9.20</td>
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</tbody>
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Another relevant factor is the capital structure of Brazilian companies. Historically, most Brazilian companies were controlled by families or small groups of shareholders linked by a shareholders’ agreement. True corporations were less than a handful. This is changing and the proportion of pulverized control companies in the Novo Mercado listing segment of the B3 rose from 19 per cent in 2009 to 53 per cent in 2019, although (according to the Corporate Governance Yearbook of the Public Companies 2019–2020) from a sample of 150 Brazilian companies, only 6 per cent of the company’s capital is dispersed (i.e., no shareholders hold more than 10 per cent of the shares).

Thus, despite the relative historical scarcity of opportunities for activism, Brazil’s business environment may be moving towards a phase in which the equity structure of publicly traded companies allows for greater opportunities for shareholder activism. Whether the law and regulations in force foster – or, conversely, discourage – activist campaigns will be examined next.

II LEGAL AND REGULATORY FRAMEWORK

Brazilian Corporate Law (Law 6,404 of 15 December 1976, as amended) (BCL) and the regulations issued by the Brazilian Securities Commission (CVM) contain legal provisions available on the activist toolkit, such as relating to the supervision right, a very broad

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preemptive right that applies in any situation except, practically, stock option plans and public offerings,8 and the right to withdraw from the company in certain circumstances (such as mergers, changes in the business or changes to mandatory dividends). 9

These broad principles give rise to a number of specific rights:

*Toolkit on shareholders’ meeting*

BCL sets forth that generally it is the board of directors that may call a shareholders’ meeting. However, it also allows the shareholders and the fiscal council to call the shareholders’ general meeting in certain cases. General meetings serve to dismiss and elect board and fiscal council members,10 make changes to the company’s bylaws, determine guidelines for management, and initiate investigations, among other matters. In all such cases, shareholders must always exercise their voting rights in accordance with the company’s interests and not their own (BCL, Article 115).

The fiscal council can call the shareholders general meeting (1) in case of delay of more than one month to call the annual general meeting by management, and (2) whenever the fiscal council identifies any serious or urgent reasons (Section 123 of BCL).

Shareholders may also call general meetings if management does not call in 60 days or by shareholders representing at least 5 per cent11 of the share capital when (1) management fails to attend a call request made by shareholders within eight days, or (2) when a general meeting call requested by the fiscal council is not carried out by the management.

Even if minority shareholders are able to call meetings to discuss issues that may affect the company, there is no guarantee they will be able to form a majority capable of approving such resolutions, especially in companies with large shareholder groups that are friendly to management.

The BCL also allows shareholders to request the CVM to extend or interrupt the general meeting calling period. The extension is for up to 30 days from the date of disclosure of documents relating to such general meeting. The interruption is for up to 15 days to allow the CVM to review the proposals of the meeting and evaluate if they violate legal or regulatory provisions. Both tools are often requested to be used by minorities dissatisfied

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8 Even a non-registered public offering (similar to a 144A offering in the U.S.) pursuant to I-CVM 476, the preemptive right can only be waived if the existing shareholders are granted priority rights in the offer (Section 9-A).

9 The withdrawal right has been reduced by (1) a legal reform (since 2001, it is no longer available for shares that have liquidity (i.e., form part of the IBOVESPA or IBRX index) and dispersion (i.e., the controlling shareholder holds less than 50% of such shares); or (2) by interpretation by the CVM (since the shareholder may, at the limit, sell his position in the stock exchange). For example, CVM has decided that ‘minor’ changes in the business purpose of companies do not give rise to the right to withdraw (RJ2015/3074, SEI Case 19957.000175/2018-83), but only to substantially modify the business purpose.

10 According to CVM Instruction 617, this percentage can be reduced to (1) 4 per cent if the company’s share capital is between 100 million reais and 1 billion reais; (2) 3 per cent if the company’s share capital is between 1 billion reais and 5 billion reais; (3) 2 per cent if company’s share capital is between 5 billion reais and 10 billion reais; and (4) 1 per cent if the company’s share capital is higher than 10 billion reais.
with proposals put forth by management or by controlling shareholders, and can serve as an effective pressure point if granted by the CVM, which is somewhat common but by no means guaranteed.12

**Supervision and control**

The shareholders also have the essential right of supervision, pursuant to Item III of Article 109 of the BCL. To this end, BCL created the fiscal council, a corporate body dedicated to the supervision of management and financial statements (shareholders can supervise management directly in some limited forms, such as reviewing corporate books).

The fiscal council can be composed of three to five members. Minority shareholders representing 10 per cent of the voting share capital (or shareholders holding non-voting capital, regardless of percentage) may elect one member each. The actual functioning of the fiscal council is optional, but shareholders may request it (provided they represent 10 per cent of the voting shares or 5 per cent of the non-voting shares).13

Although the fiscal council is a collegiate, members can act individually in supervising, denouncing, and requesting clarification to management.14 In practical terms, the fiscal council is an important instrument in improving transparency and oversight, especially in companies with controlling shareholders.15

**Liability of the controlling shareholders and directors**

An avenue often used by activists in Brazil is the threat of liability of the controlling shareholder or management for damages caused to the company or its shareholders, or both.

A controlling shareholder (Section 116 of the BCL) is one that holds the majority of votes at shareholders’ meeting, and that has the power to appoint the company’s directors and effectively uses such powers to direct the company’s social activities.

The BCL sets extensive fiduciary duties to the controlling shareholder. The breach of such fiduciary duties constitutes an abuse of power and can give rise to liability of the controlling shareholder for losses and damages caused.

Claims for liability of controlling shareholder are somewhat rare in the activist scenario as the incentives are, mostly, skewed: claims will often generate little or no compensation to the shareholder that filed the suit and had to support its costs.

A currently more fashionable tool is found in Section 246 of the BCL, which sets forth the possibility of imposing liability to controlling companies. Shareholders representing

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12 CVM will often grant an extension in cases where it found an omission of relevant information necessary for the meeting (Proceedings SEI 19957.011269/2017-05; RJ2012/3718 and RJ2012/3718) and will authorise the interruption when there is clear evidence of illegality (the CVM has recently denied this in a number of situations, such as in cases RJ 2007/14245, RJ2009/2905, RJ2003/5352, RJ2009/3455, RJ2015/12295, RJ2015/12383, RJ2013/5608, 19957.000716/2019-54, RJ2014/3059, SEI 19957.007756/2018-46 and SEI 19957.007885/2018-34).
13 Instruction 324/2000 of the CVM.
15 EIZIRIK (2015, Vol. III, 198) highlights that the fiscal committee constitutes the internal, organic and institutionalized instrument for the exercise of supervision by the shareholders.
5 per cent or more of the share capital\textsuperscript{16} can start the suit (also even shareholders holding any number of shares, as long as they offer security for the costs and attorney’s fees due in the event the action is dismissed\textsuperscript{17}).

For this type of suit the BCL creates an economic incentive: a 5 per cent prize to the shareholder that starts the suit and 20 per cent for its lawyers, calculated on the compensation paid to the company. This claim is therefore more attractive to shareholders and has been used recently, for example, by the minority shareholders of Braskem SA, whose parent company (Odebrecht SA) admitted corruption. Certain shareholders of Braskem claimed that the corruption acts were a true abuse of control power held by Odebrecht and that Braskem was used as a means of obtaining undue benefits for Odebrecht managers, seeking compensation of 3.65 billion reais.

In addition to the civil liability of the controlling shareholder, the BCL provides for a specific suit for the liability of directors for breach of fiduciary duties. Such suit, provided for in Section 159 of the BCL, must be proposed by the company after a decision of the general meeting\textsuperscript{18}. If the company does not take any action after three months from the approval by the shareholders, then any shareholder may propose it. Shareholders representing 5 per cent\textsuperscript{19} of the share capital can file such suit if it has been rejected by the shareholders’ meeting (Section 159, § 4º of the BCL and Section 2 of CVM Instruction 627/2020).

**Appointment of Directors**

Shareholders can and often do interfere in the management of companies by appointing members of the board of directors. Generally, directors are chosen by majority vote, but the BCL has two procedures for minority representation in the board.

The first of these is multiple voting (Section 141 of BCL). In such a procedure, the voting is done individually, not by slate, and the number of voting shares is multiplied by the number of candidates to the board. This enables shareholders to concentrate their votes on one or few candidates. Such voting must be requested by the voting shareholders that represent at least a certain percentage of the share capital (depending on the amount of capital stock of the company; in most Brazilian listed companies, the percentage is 5 per cent).

The second procedure is separate voting, which is intended for companies with a controlling shareholder. If a separate voting is requested, up to two additional directors may be appointed. One by voting shareholders representing at least 15 per cent of the capital stock (in Novo Mercado companies that have only voting common shares the CVM interpreted this provision of law to reduce the threshold from 15 per cent to 10 per cent) and the other by non-voting shareholders representing 10 per cent of the capital stock. If the shareholders with and without voting rights do not reach such levels, then they may unite and elect one

\textsuperscript{16} This percentage can be reduced according to the company’s share capital, as mentioned above in footnote 11.

\textsuperscript{17} Some of the ongoing claims based on Section 246 of the BCL argue that the requirement to post security is illegal as it disincentives smaller minorities to exercise their rights. The law on this is not yet settled.


\textsuperscript{19} This percentage can be reduced according to the companies’ share capital, as mentioned above in footnote 11.
director, provided that they represent, in aggregate, 10 per cent of the capital stock. This procedure is only available for shareholders that prove they held their shares for at least three months.

In any event, the controlling shareholder (if applicable) is granted the right to elect the same number of directors as the minorities plus one.

**Approval of management report and remuneration**

An important procedure for mitigating the agency conflict between directors and shareholders is set forth in Section 152 of the BCL and determines that the management’s compensation must be approved by the shareholders’ meeting. This model established by the BCL since 1976 was a milestone at the time and is still advanced today.

The directors shall also submit to the approval of shareholders the management report and the financial statements. If the management report and financial statements are approved without reservations, then the management can no longer be held liable for past actions (except error, fraud, willful misconduct or sham).  

For this reason, the members of management who are also shareholders cannot vote for the approval of the management report and financial statements (Sections 115, 134, § 1 and 156). The CVM has recently interpreted such restriction to apply to entities controlled by a member of management.

**Conflict of Interest**

Section 115 of the BCL prohibits shareholders from voting in certain circumstances. In addition to voting for approval of their accounts if they are members of management, a shareholder cannot vote in any situations in which they may ‘benefit particularly’ or if they have conflicting interests with those of the company.

The ‘particular benefit’ is a lawful benefit but one that serves the interests of one or a group of shareholders and no one else. An example of what the CVM considered a ‘particular benefit’ was a proposed different exchange ratio (for the controlling shareholder) on a merger.

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20 The *Sadia* case illustrates this well. Sadia – the largest food processing company at the time in Brazil - famously lost 3.8 billion reais in 2008 with leveraged exchange rate financial derivatives. The company tried to sue its former CFO based on Section 159 of BCL, but the suit was ultimately rejected by the courts (including the STJ) because the shareholders had approved the management report of the year into which the derivatives had been entered.

21 Specifically, the CVM barred entrepreneur Eike Batista to act in public companies for five years for violation of Section 115, § 1 of the BCL. Eike was chairman of the board of directors of Óleo e Gás Participações S.A. and also a shareholder through two companies (Centennial Asset Mining Fund LLC and Centennial Asset Brazilian Equity Fund LLC). Such companies voted favourably to approve the management report of the company, something that was common at the time. The bar was later reduced to a fine of 500,000 reais after Eike appealed to the Appeal Council of the National Financial System (CRSFN).

22 The landmark case is *Duratex/ Satipel*. The ratio that was proposed to Duratex common and preferred shares held by minority shareholders was lower than that proposed to the shares held by the controlling shareholder of Duratex. The CVM decided that the proposal was legal, but that Duratex’s controlling shareholders were prohibited from voting in the merger, and Duratex would have to call a special meeting of preferred shareholders to resolve on the transaction.
The ‘conflicting interest doctrine’ is a contentious issue at the CVM. Historically, most decisions established that the shareholder is not prohibited from voting, but an analysis should be made of whether any vote cast was detrimental to the company after the event. CVM’s recent position on the nature of the prohibition in this case is that there exists an absolute and previous prohibition on the exercise of votes by shareholders that have conflicting interests with those of the Company.23

Thus, shareholders can use administrative and judicial methods to prevent votes that conflict with social interests from being cast. In cases where the controlling shareholder is in a position of conflict, the minority shareholders are able to decide on the specific resolution in which the controlling shareholder is prevented from voting.

III RECENT SHAREHOLDERS ACTIVISM CAMPAIGNS

To illustrate recent activism campaigns, two cases are presented that occurred in 2020 and that exemplify the types of issues that shareholders face in Brazilian public companies. These are by no means exhaustive of what an activist may find in the Brazilian market.

i Eneva and AES Tietê

In March 2020, the energy company Eneva S.A. (Eneva) presented a hostile proposal to merge with AES Tietê Energia S.A. (AES Tietê) for 6.6 billion reais, 40 per cent of it in cash. AES Tietê had a controlling shareholder (AES Corp.) that held 61 per cent of the voting shares (but only 24 per cent of the total shares) and was against the deal. Eneva, however, believed that the deal should be submitted to the shareholder to decide based on majority voting, as the text of the by-laws of AES Tietê (and the Nivel 2 Regulations of B3, to which AES Tietê was admitted) implied that all shareholders would have equal voting rights in case of mergers. AES Tietê’s Board of Directors rejected Eneva’s management proposal, preventing this discussion by its shareholders at general meeting.

By means of Circular 137/2020 – DIE, B3 issued a guidance to the market clarifying its reading of the Nível 2 Regulation as it relates to votes in mergers, in which non-voting shares have full voting rights in matters relating to the transformation, merger, consolidation or spin-off of listed companies.

This issue is far from being settled because immediately after B3’s guidance, a group of companies (including Klabin, Alupar, Energisa, Celesc, and Marcopolo) questioned B3’s understanding that would allow the usurpation of the power of the companies’ management by non-voting shareholders.

ii IRB and Squadra

In 2020, a discussion on the possible conflict of interest between the fund management company Squadra Investimentos (Squadra) and IRB Brazil (IRB) began. The conflict was initiated after Squadra set up a short position on the shares of IRB.

After that, Squadra released a report stating that the profits reported by IRB did not reflect its earnings power and that the profitability of its business was much lower than most of the market would believe.

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23 According the CVM position in Administrative Proceeding RJ2209/13179.
After the release of the report, IRB shares dropped 30 per cent. Afterwards, Squadra released another report stating that it had found evidence that IRB’s profits were significantly lower than the accounting profits reported in its financial statements.

The second claim made by Squadra has caused a great impact on IRB shares value. Large fund management companies that operate in the Brazilian market reviewed their recommendations for IRB’s shares.

IRB accused Squadra of trying to influence the market in the fall of the price and consequently benefit from its short position. In addition, IRB stated that Squadra increased its short position before the release of the report, which would configure insider trading because Squadra had inside information that would result in the fall of the IRB shares.

CVM has set up two administrative proceedings to ascertain Squadra’s conflict of interest in relation to IRB. Short activists will be very interested on how the CVM judges this case.24

IV OUTLOOK

There seems to be no empirical evidence to suggest (one way or another) that the levels of activism in Brazil are low due to the excellent management of the companies. However, despite the increase in the number of companies without a majority controlling shareholder, true corporations are still rare in Brazil. Thus, the capital structure is still a relevant obstacle to the emergence of activist campaigns.

The activist toolkit certainly looks robust in terms of legal instruments available, but the reality is that the measures to convene meetings and to hold directors and controlling shareholders accountable will rarely make sense from a cost-benefit perspective. This is because they will depend on a long and exhaustive judicial processes (in which management can access the funds of the company itself), while the fruits of such campaigns are, in the most part, destined to the company or divided among the other shareholders, which generates a strong disincentive to activism.25

Conversely, the mechanisms for minority shareholders to contribute to the composition of the board of directors through multiple voting and separate elections are an effective way of allowing shareholder participation. Furthermore, Brazilian law has a powerful alignment incentive in relation to the definition of management remuneration, which may prevent the extraction of private benefits and reduce agency conflicts, particularly in true corporations.

Finally, CVM has recently issued Instruction 627/2020 to facilitate activism by reducing the minimum percentages for the exercise of certain rights. According to CVM’s study,26 the new rule would encompass 77 per cent of publicly held companies in Brazil.

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24 An administrative proceeding was set to verify IRB’s financial statements. Since then, the Chairman of the Board of IRB has resigned.

25 Also, on 22 June 2020, Petrobras disclosed that an arbitral panel determined that Petrobras will reimburse certain shareholders for the depreciation of their shares due to Petrobras’ managers acts of corruption. Petrobras continues to fight this decision and did not provide more details about the case (arbitration claims are generally confidential in Brazil), but this shows that shareholders are starting to get more creative in terms of going after their rights.

26 The study is named ‘Conditions for Shareholders’ Attendance in Meetings of Public Companies’ and it is available at: <http://www.cvm.gov.br/export/sites/cvm/menu/acesso_informacao/serieshistoricas/estudos/anexos/Criterios_para_a_participacao_de_acionistas_em_assembleias_de_companhias_de_capital_aberto.pdf>.

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and more than 64 per cent of Brazilian companies would have a reduction of at least 1 per cent on the percentage required for the exercising of rights. However, CVM has also started proceedings against short activists (in the IRB/Squadra matter). Activists eagerly wait for a resolution of such a matter to get guidance on potential limits to their actions.
Chapter 4

CANADA

Alex Moore and Galen Miller

I OVERVIEW

Canadian corporate and securities laws have provided shareholders with robust rights for many decades. Yet, it has only been more recently that Canadian companies have seen a dramatic rise in shareholders availing themselves of these rights. Institutional shareholders have increasingly used their rights and influence to propose corporate governance changes, to reform executive compensation and adopt say-on-pay policies, and to push for improved environmental social and governance (ESG) practices. At the same time, and particularly since the 2008–2009 financial crisis, shareholders have increasingly resorted to proxy contests, or wielded threats to do so, to effect governance changes.

Canadian companies are well aware that a dissatisfied shareholder basis will not be patient for long, and boards have become more sophisticated in understanding how to deal with an activist attack. Indeed, it has become increasingly common for boards to have one or more directors who have lived the drama of a public shareholder activism campaign, either while serving on another board, in an executive capacity, or even as a nominee for a dissident.

More boards are accepting that part of their job is to know the shareholder base and to participate in direct shareholder engagement. Boards that leave all shareholder interaction to senior management or the investor relations team are much less likely to win the support of shareholders when problems arise and a dissident has emerged.

The Canadian market is considerably influenced by developments in the United States and trends in corporate governance often flow north across the border. However, with respect to shareholder rights, the Canadian legal regime takes a lighter regulatory approach in numerous respects, allowing shareholders to act more freely than under comparable rules in the United States.

II LEGAL AND REGULATORY FRAMEWORK

The Canadian legal landscape is an accommodating one for shareholder activists, providing significant freedom for shareholder activists to seek governance change.

The legislative and regulatory framework in Canada governing public companies primarily comprises corporate and securities laws. The key legal tools relating to shareholder rights, shareholder activism and shareholder engagement are contained in corporate law

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1 Alex Moore is a partner and Galen Miller is an associate at Blake, Cassels & Graydon LLP.
statutes, which are enacted federally and by each province and territory. These tools include the right to requisition a meeting, make a shareholder proposal, solicit proxies, and pursue the oppression remedy and derivative action in courts.

Canadian securities laws govern the disclosure obligations of companies and also impose disclosure obligations on significant shareholders and dissident shareholders who engage in proxy solicitation. Securities laws are the responsibility of the provincial and territorial governments, with no central federal regulating authority; however, relevant laws are substantially uniform across Canada’s provinces and territories.

In addition to setting out prescribed rules governing public companies and their shareholders, securities legislation also empowers securities regulators with a general power to make orders that are in the public interest. This public interest jurisdiction has been used by securities regulators in situations where actions by market participants are found to be abusive of the capital markets or inconsistent with the animating principles of securities laws, even if an actual breach of law is not established.

Rules and policies set by stock exchanges supplement the securities law obligations of public companies, and include requirements aimed at protecting shareholder interests, for example, by establishing rules governing dilutive acquisitions, private placements, timely disclosure and shareholder approval of equity compensation plans.

i Shareholder proposals
All but two provincial corporate law statutes provide for the submission of shareholder proposals to be considered at the next meeting of shareholders. Generally, the only requirement for a person to be able to submit a proposal is that the person be entitled to vote at the meeting of shareholders. A public corporation is obligated to include a properly submitted proposal in its management circular and to submit it for a vote at the meeting.

Shareholder proposals are frequently used to advance environmental, social and governance objectives of shareholders. While proposals are a less important tactic for shareholder activist campaigns, they can be used to submit nominations for election to the board.

ii Meeting requisitions
Canadian corporate law statutes entitle holders of at least 5 per cent of the issued and outstanding shares of a corporation to requisition the directors to call a meeting of shareholders for the purposes set out in the requisition. A requisition may be made by one

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or more shareholders and must state the business to be transacted at the meeting. Upon receiving the requisition, the directors of the corporation have 21 days to announce the date of the meeting, although they are not required to call the meeting if, for example, the purpose of the requisition does not relate in a significant way to the business or affairs of the corporation or is to address a personal claim or grievance that a shareholder has against the corporation or its directors and officers.

The power to requisition a shareholders’ meeting represents a powerful tool in the hands of an activist shareholder. Although requisitioned meetings are not frequently held, the threat of a requisition is frequently wielded by activists to bring a company to the negotiating table in circumstances where an annual meeting is far off.

iii Solicitation of proxies

To solicit proxies, shareholders are generally required to send a dissident’s information circular to every shareholder whose proxy is solicited. Two exceptions to this formal solicitation requirement are the ‘quiet’ solicitation and the public broadcast solicitation.

Quiet solicitations permit a person to solicit up to 15 shareholders without following formal solicitation requirements under Canadian corporate and securities laws. Quiet solicitations are a powerful activist tool as a substantial proportion of votes can typically be solicited by reaching out only to the 15 largest shareholders, even in the case of some of Canada’s largest companies. Historically, an activist could use the quiet solicitation to conduct a stealth campaign and ambush the incumbent board at a shareholders’ meeting with the dissident nominating its own slate of directors from the floor and support from up to 15 large shareholders. However, the ambush strategy is ineffective where the corporation has adopted a by-law requiring advance notice of director nominations.

Public broadcast solicitations permit an activist to solicit proxies in certain circumstances if the solicitation is conveyed by public broadcast, speech or publication, including, for example, by way of a press release. An activist soliciting by public broadcast must file prescribed disclosure with securities regulators as well as copies of the soliciting material. However, the cost of printing and mailing materials to all shareholders can be avoided by using this exemption.

Activists seeking to solicit shareholders broadly may do so by mailing a dissident proxy circular and form of proxy. Dissident proxy circulars have limited disclosure requirements, but if the solicitation relates to the election of directors, then it must include biographical information on the dissident’s nominees as well as information regarding share ownership and prior regulatory or bankruptcy proceedings. Activists commonly wait until after the company has mailed its circular before completing their dissident circular, in order to respond to specific management points in their dissident circular.

iv Contacting shareholders

Any person may, on payment of a fee, require that a corporation provide within 10 business days a list setting out the names of the registered shareholders of the corporation, the number of shares owned by each shareholder and their addresses. The requester must swear in an affidavit that use of the list will be limited to matters relating to the affairs of the corporation. A similar request may be made with respect to beneficial shareholders who hold shares indirectly through an intermediary, however the list would contain only shareholders who have not objected to their identity being made known to the corporation.
Although shareholder lists may be readily obtained, many shareholders are difficult to reach directly because they are objecting beneficial owners, whose identities are known only to the brokerage firms or investment adviser through whom they own their shares.

v  Majority voting

The Toronto Stock Exchange (TSX) requires that each director of an issuer listed on the exchange be elected by a majority of the votes cast in respect of their election. This rule does not apply to contested meetings. As such, issuers are required to adopt a majority voting policy to comply with this rule.

If a director is not elected by at least a majority of the votes cast in respect of his or her election, such director must tender his or her resignation immediately, subject to certain exceptions. Failure to resign could lead to the TSX reviewing the director's qualifications to be a director or officer of other TSX-listed issuers. An issuer is permitted to establish a committee to consider the resignation of the director in question, but such committee would be expected to accept the director’s resignation absent exceptional circumstances. Such exceptional circumstances include: the resignation would cause the issuer to be non-compliant with corporate or securities laws; and the director is an important member of an active special committee and the director's resignation would negatively impact the special committee’s ability to fulfil its mandate. An issuer may not simply reject a resignation on the basis of the director’s exceptional qualifications or experience.

vi  Remedies and minority protections

When a shareholder claims that a corporation or its directors or officers have committed some form of wrong, Canadian corporate law statutes provide shareholders two related remedies. The first remedy, the oppression remedy, provides broad protection to minority shareholders from conduct by a corporation and its board that is inconsistent with the reasonable expectations of shareholders. The second, the derivative action, is an extraordinary remedy that allows a shareholder to bring an action in the name and on behalf of a corporation, including against the directors for a breach of their duties to the corporation.

A shareholder may also request that securities regulators intervene where there has been a breach of securities laws or actions not in the public interest. In addition, the securities law regime in Canada establishes certain procedural protections for minority shareholders in connection with transactions where there is a potential for conflicts of interest. Such conflicts may arise because the transaction involves a party that is a ‘related party’ with a potential informational or other advantage or that is otherwise entitled to receive different consideration. The procedural safeguards include requirements for formal valuations, enhanced disclosure regarding the procedure followed by the board in negotiating the transaction and a requirement that a majority of shareholders who do not have an interest in the transaction vote in favour of it.

vii  Structural defences

Few structural defences are available to Canadian boards against activists. Canadian public companies generally do not have classified boards, such that all directors are subject to removal at annual shareholder meetings. In addition, the right of shareholders to requisition meetings to remove directors (discussed above) leaves boards exposed to attack even between annual meetings. Majority voting policies even leave incumbent directors at risk of removal in uncontested elections.
The use of shareholder rights plans, or ‘poison pills’, is closely regulated by Canadian securities regulators. While poison pills can be effective at preventing shareholders from acquiring more than 20 per cent ownership without making a formal takeover offer to all shareholders, securities regulators will not allow them to prevent shareholders from acting as a group with respect to the voting of their shares.

Canadian companies may adopt by-laws requiring advance notice by shareholders of an intention to propose nominees for election. Changes to by-laws may initially be implemented by a board but must subsequently be ratified by shareholders. The adoption of advance notice by-laws has become a corporate governance best practice and Canadian courts have accepted these by-laws as being fair to shareholders by ensuring that they receive advance notice of the existence a proxy contest. Typically, these by-laws require written notice of an intention to nominate a director to be provided at least 30 days prior to the meeting.

Private placements of shares into friendly hands, while uncommon as a defensive tactic, can be effective in shoring up support for the incumbent board, particularly if coupled with voting agreements committing participating shareholders to vote in accordance with the board’s recommendations. However, securities regulators in British Columbia and Ontario have rendered decisions indicating that, where there is no non-defensive purpose to a private placement or there are mixed defensive and non-defensive purposes, they will consider whether the public interest requires them to intervene and unwind the private placements in order to protect the interests of shareholders. The use of private placements as a defensive tactic may also be challenged by shareholders in the courts under the oppression remedy.

While not a structural defence, companies do have a significant information advantage over activists in a proxy contest. Canadian corporate law allows companies to establish cutoffs for the submission of proxies up to two business days prior to the meeting. While dissident shareholders are required to submit their proxies with the company’s transfer agent prior to the cutoff, there is no requirement that the company share the results of the solicitation.

Influential governance organisations

Although Canada is a large country, with several regional financial centres, the corporate governance community is fairly close-knit, with the result that as corporate governance best practices evolve, they tend to propagate across the country fairly quickly. The Canadian Coalition of Good Governance (CCGG) and the Institute of Corporate Directors are notable governance organisations that are influential in establishing best practices and advocating for their adoption.

The CCGG is a member organisation representing the interests of Canadian institutional investors in matters of corporate governance in Canadian public companies, with the mission of improving alignment of boards and management with the interests of shareholders. In recent years, the CCGG has played an influential role in advocating for majority voting standards for board elections, the adoption of shareholder engagement policies, improved board diversity, and ‘say on pay’ advisory votes on executive compensation.

Global shareholder advisory firms, such as ISS and Glass Lewis, are also well established in Canada and play an influential role in the development of corporate governance best practices.

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practices and in providing voting recommendations. Many Canadian institutional investors give significant weight to these recommendations and in proxy contests boards and activists devote considerable energy to winning favourable recommendations.

III KEY TRENDS IN SHAREHOLDER ACTIVISM

i Continued sustained levels of activism

The Canadian market saw a sharp spike in activism campaigns during the financial crisis of 2008 and 2009. Since then, the number of proxy contests in the Canadian market annually has remained above pre-crisis levels, averaging around 30–40 public contests per year. Market caps of companies targeted are weighted heavily towards the small- and mid-cap sector, with only a handful of companies valued above US$1 billion being targeted in any year.

Despite activism being a reality of the Canadian public markets, the level of shareholder activism in the Canadian market tends to lag levels that have been seen in the United States and Europe in recent years, particularly among large-cap Canadian companies.

ii Targeted industries

The lower rate at which large Canadian companies are subjected to activist campaigns is likely attributable to the selection of companies available for investment in Canada. Large international activist funds seem to be finding their preferred targets in their home markets or in international markets other than Canada.

The mix of companies traded on Canada’s senior securities exchange, the TSX, may shed some light. The TSX Composite Index comprises 29 per cent of financial services firms (dominated by banking and insurance). Another 14.1 per cent of the TSX index comprises companies in the basic materials sector, and energy and industrial sectors represent 13.5 per cent and 11.7 per cent, respectively. Despite their large share of the Canadian market, financial firms are infrequently targeted by activists. Firms in the materials sector, particularly mining, are frequent targets, particularly when changes in the commodity cycle put companies under pressure.

Real estate investment trusts (REITs) have also generated a notable number of proxy contests, including contests initiated by activist Sandpiper Asset Management at several REITs (Granite REIT, Agellan Commercial REIT and Artis REIT) and the successful demand of FrontFour Capital Group for board seats at Cominar REIT in 2019. Disruption in the real estate market due to the covid-19 pandemic could prompt further activity as valuations in this sector, particularly the office and retail real estate markets, have come down significantly.

Kingsdale Advisors, 2019 Proxy Season Review. Kingsdale Advisors defines a contest broadly, and considers a proxy fight to have been initiated when a shareholder in opposition to management makes a public filing of its activist intent, requisitions a shareholder meeting, publicly announces an intent to nominate alternate directors, solicits alternative proxies, conducts a vote no campaign or announces an intention to launch a hostile bid.

ibid. In the past three years, there have only been four contests involving financial firms; compared with over 40 resource firms.
iii Activist success rates
Proxy contest outcomes in public contests, where an activist has made a public demand, are generally split between dissidents and management. In 2019, management was successful in resisting the activist in 60 per cent of public contests, compared with an average management success rate of 54 per cent in the three year period 2017–2019.9 While this suggests that management holds a slight edge, the significant level of activist success gives management a strong incentive to explore acceptable settlement terms.

iv Growing prominence of Canadian activists
Historically, the Canadian market has not been home to dedicated activist investors; that is, investors who look for investments with a view to employing activism to create value. Rather, Canadian activists have generally been occasional or situational activists; investors driven to activism by circumstances of an existing investment, such as a pension fund deciding to take a more activist role with respect to a floundering portfolio position, or a former CEO seeking to take back the reins of a company.

While Canada still lacks a critical mass of dedicated activist funds of notable size, a number of Canadian headquartered managers with explicit activist strategies have emerged in the past 10 years. Smoothwater Capital Corporation based in Toronto was one of the first funds to emerge as a dedicated Canadian activist fund. It waged successful campaigns at Genesis Land Development and later at Equity Financial, eventually acquiring the latter in 2017.

Sandpiper Asset Management, a Vancouver based fund established in 2016, has run several successful campaigns in the Canadian real estate sector, including Agellan Commercial REIT and Granite REIT in 2017, Artis REIT in 2018, and Extendicare in 2019.

Waterton Global Resource Management, Inc., a Toronto based private equity firm with US$1.75 billion under management, is focused on investments in the resource sector and has pursued activism as a strategy in its successful 2019 proxy contest against HudBay Resources.

Another Canadian firm, Catalyst Capital Group, has used activism to oppose two recent M&A transactions: the privatisation of Hudson’s Bay Company (discussed below) and the acquisition by Corus Entertainment of media assets from a company under common control with Corus. In these transactions, Catalyst has demonstrated its willingness to devote substantial resources to its campaigns, taking full advantage of minority shareholder protections, including through applications to securities regulators to make rulings under Canadian rules governing related party transactions.

v US activists in Canada
US hedge funds focused on activist strategies frequently target Canadian companies and many have recognised the advantage of Canada’s activist-friendly legal regime. The Canadian market also makes for an attractive hunting ground for smaller hedge funds that are able to take larger stakes in Canada’s typically smaller companies.

Large US activists, including Carl Icahn, Pershing Square Capital Partners and Jana Partners, have largely led the expansion of activism to Canadian large-cap companies. Pershing Square’s 2012 campaign to elect a dissident slate and install a new CEO at Canadian Pacific Railway continues to stand as a landmark proxy contest. Pershing Square’s success in

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9 Kingsdale Advisors, 2019 Proxy Season Review.
elected its slate with overwhelming shareholder support signaled to the boards of established Canadian companies that their market caps and the unmatched pedigrees of their board members did not assure them the loyalty of their shareholder base.

Despite Pershing Square’s success and Canada’s shareholder friendly regime, public contests at large-cap Canadian companies have been more episodic than frequent, with the level of shareholder activism by large US activists in the Canadian market tending to lag levels that have been seen in other jurisdictions in recent years.

vi Activism in controlled companies

Several large Canadian companies are controlled by founding families or shareholders holding controlling stakes, either through majority ownership or through classes of multiple-voting shares. Strictly speaking, these companies are immune from activist attack, with their controlling shareholders holding the power to exclude dissidents from the board room and to defeat their proposals. However, in recent years, numerous controlled companies in Canada have been targeted by activists undaunted by the impossibility of winning a vote.

In spring of 2020, Tribeca Investment Partners of Australia and Impala Asset Management of the United States launched a campaign advocating the removal of Teck Resources’ CEO, alleging a decade of underperformance relative to other diversified miners, and urging the divestment of Teck’s oil investments. Although the company is controlled by the family of the founding shareholder through multiple voting shares, the activists are waging their campaign through public pressure.

Some activists are even willing to run proxy contests that they are unable to win. For example, Pentwater Capital submitted shareholder proposals seeking both the election of its portfolio manager to the board of Turquoise Hill Resources and an amendment to the company’s charter that would give minority shareholders the power to elect a minority of the board in future elections. Without the support of Rio Tinto plc, Turquoise Hill’s majority shareholder, these proposals inevitably failed. Yet Pentwater has carried out a formal campaign to encourage other minority shareholders to support its proposals.

IV RECENT SHAREHOLDER ACTIVISM CAMPAIGNS

i Detour Gold

Following a series of setbacks that negatively impacted Detour Gold Corp.’s share price, in 2018, US hedge fund Paulson & Co. succeeded in its campaign to replace the board of Detour and pursue a sale of the company.

In July 2018, months of agitation by Paulson evolved into an open proxy battle between the hedge fund and Detour. Paulson requisitioned a special meeting of shareholders and proposed a slate of eight directors. In letters to shareholders, Paulson outlined its reasons for proposing a wholesale change to the company’s board, including the poor performance of Detour’s shares relative to peers, operational setbacks, poor disclosure practices, insider sales of shares and discordant executive remuneration. In response, Detour warned against a ‘fire sale’ of the company and argued that continuity was needed to execute the company’s business plan. The proxy advisory firm Glass Lewis & Co. ultimately supported three of the hedge fund’s eight nominees, while Institutional Shareholder Services supported the company’s proposed slate of directors.
Paulson effectively won the proxy contest at the 13 December 2018 special meeting, with five of its eight nominees elected to Detour's board. Following the proxy contest, the newly constituted board hired a new management team and, in late 2019, explored strategic alternatives, ultimately leading to a sale of the company to Kirkland Lake Gold in 2020.

**ii Hudbay Minerals**

In October 2018, Waterton Global Resource Management, Inc. launched a proxy contest at Hudbay Minerals Inc. that ultimately resulted in the private equity firm obtaining minority representation on the board. Waterton feared that Hudbay was on the verge of entering into a dilutive acquisition, and initially requisitioned a special meeting of shareholders of Hudbay to adopt an advisory resolution against such a transaction.

Waterton later withdrew the requisition and instead commenced a proxy contest to place eight nominees on Hudbay’s 10-person board, later downsizing its slate to five nominees. Waterton’s key criticisms were that Hudbay had underperformed relative to its peers and had not allocated sufficient capital to its existing projects.

In May 2019, four days before the meeting of shareholders, Hudbay and Waterton announced a settlement in which they agreed to a mutually acceptable board of eleven and to initiate a process to identify a suitable successor for the chair of the board.

**iii Hudson's Bay Co.**

Catalyst Capital Group and a group of investors led by Hudson's Bay Co. (HBC) executive chairman Richard Baker recently engaged in a takeover battle of HBC. In June 2019, the Baker group made an insider bid to take HBC private. Although the Baker group held approximately 57 per cent of the company’s voting shares, acquiring the remainder required a majority of the minority shareholders to vote in favour of the bid under Canadian rules governing going private transactions that involve related parties.

Catalyst made various attempts to block the Baker group from acquiring HBC. Catalyst argued that the Baker group’s offer undervalued the company, and particularly its real estate holdings, and acquired a 16 per cent ownership block through a tender offer for less than 20 per cent of the outstanding shares (thus avoiding Canadian formal bid rules). After acquiring this block, Catalyst then made a formal take-over bid at a higher price than the Baker group was offering, and also solicited votes in opposition to the approval of the Baker group transaction. A special committee of HBC’s board rejected Catalyst’s bid for not being reasonably capable of consummation due to the Baker group’s control of 57 per cent of the outstanding shares.

Ahead of the HBC shareholders meeting to approve the transaction, Catalyst also filed an application with the Ontario Securities Commission claiming that the HBC board’s process in reaching agreement with the Baker group and HBC’s disclosure had been inadequate, and that the transaction was abusive to minority shareholders. Although the Ontario Securities Commission declined to block the Baker group transaction, it ordered that HBC provide additional disclosure to HBC shareholders.

The Baker group subsequently increased its bid to equal Catalyst’s counter offer, and HBC and Catalyst eventually entered into an agreement supporting the revised Baker bid. On 27 February 2020, HBC’s shareholders voted overwhelmingly in favour of the privatisation transaction.
While not a traditional proxy contest for board control, the Catalyst campaign against the Baker group demonstrated the robust minority shareholder rights enjoyed by shareholders of Canadian companies in a going private transaction.

V REGULATORY DEVELOPMENTS

i Directors’ duties and the interests of stakeholders

In 2019, the Canadian Parliament amended the Canada Business Corporations Act (CBCA), the leading corporate statute governing most large Canadian public companies. The amendments codify the common law principle that Boards of Directors, in discharging their duty to act with a view to the best interests of the corporation, are not beholden to the interests of shareholders, but may consider the interests of other corporate stakeholders beyond shareholders, including employees, retirees and pensioners, creditors, consumers and governments, as well as impacts on the environment and the long-term interests of the corporation.

As a codification of common law principles that had been enunciated by the Supreme Court of Canada over a decade previously in *BCE v. 1976 Debentureholders*, 2008 SCC 69 (BCE), the amendments do not represent a substantial change to the way in which corporations are governed. However, the move to codify stakeholder interests signals the endorsement of the federal government of the stakeholder model of corporate governance and support for dilution of shareholder primacy as a principle underlying Canadian corporate law.

While the amendments codified the board’s ability to consider non-shareholder interests over the interests of shareholders, no amendments were made that would weaken the tools of control that shareholders have over the election and removal of directors, and other stakeholder groups such as employees still have no right of board representation. Accordingly, the CBCA, like other Canadian corporate legislation, continues to leave boards primarily accountable to shareholders.

ii Majority voting – CBCA requirements

Although the TSX began requiring that all TSX-listed companies implement majority voting policies prior to the 2015 proxy season, some institutional investors and the CCGG continued to see these policies as inadequate because they relied on a system of director resignations that leaves open the possibility that resignations are declined in exceptional circumstances. In response to lobbying by institutional investors and the CCGG, the Canadian parliament amended the CBCA in 2016 such that directors receiving less than majority support from shareholders in an uncontested election would not be elected as a matter of law, eliminating the need for reliance on resignations. While these amendments have been passed, they have not yet been declared in force.

The strict requirement for majority approval in order to gain election could prove to be a powerful tool for dissident shareholders and controlling shareholders because it provides a means to target directors for removal, without having to run a rival slate of directors or to rely on the target board accepting a resignation of the targeted director.
iii Diversity disclosure

In January 2020, expanded diversity disclosure requirements came into effect for companies incorporated under the CBCA. Under these new requirements, companies must disclose detailed information regarding the diversity of their boards and executive officer ranks, descriptions of the company’s diversity policy or why it has not adopted one, and the measures that the company is taking to improve its diversity. Prescribed categories of diversity that companies are required to consider include women, Aboriginal people, persons with disabilities and persons who are visible minorities.

The new diversity disclosure rules do not have a direct bearing on activist campaigns or tactics. However, the legislative changes are consistent with the movement within the Canadian investment industry to encourage greater board diversity and initiatives by the Ontario Securities Commission to improve diversity (particularly gender diversity) on Canadian public company boards.

VI OUTLOOK

The global disruption caused by the covid-19 pandemic in the first and second quarter of 2020 has drastically altered the plans and expectations of companies and shareholders, and has presented many businesses with truly existential challenges. The recognition that companies needed to be given some space to focus on the immediate challenges has likely dissuaded activists from initiating campaigns in the current proxy season. This reprieve may not endure however, with companies that emerge from lockdown weakened by the pandemic likely having to face intense scrutiny. Activism targeting vulnerable companies may lead to another spike in contests, similar to the reaction witnessed following the financial crisis.

Both the pandemic and recent anti-racism protests in the United States and around the world have also started to turn the spotlight on the social responsibilities of corporations. Viewing corporations and private enterprises independently of their relationships with government and wider society has become untenable and business leaders and boards are taking note. Boards will undoubtedly be facing increased expectations from institutional shareholders and other stakeholders that corporations should pay more than lip service to their ESG initiatives. In particular, corporations will likely face greater expectations in addressing racial diversity and the elimination of anti-black systemic racism.
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,

1 Michael J Ulmer is a partner at Cleary Gottlieb Steen & Hamilton LLP.
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

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.

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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.

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.
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 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

\(^8\) All notifications must be made by 15.30 on the trading day following the respective transaction.
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 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

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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. 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.

10 Including the shares held by the bidder already that usually count against this 75 per cent condition.
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.

i  Ströer/Muddy Waters; AURELIUS/Gotham City; ProSiebenSat.1/Viceroy

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.

ii  ThyssenKrupp/Cevian and Elliott

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 (2017–2020).

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 and that did not ultimately
obtain antitrust clearance. 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. Owing to adverse market conditions, the new CEO's plan was finally renounced and the CEO was replaced by the chair of the supervisory board. Under her lead the precious elevator business was sold. The search for partners or even buyers interested in the steel, ship building and certain other businesses has now started.

iii  GEA, SAP, Uniper and Scout24/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. Fortum agreed to buy them out (2019).

At online trading platform Scout24, Pelham Capital together with Elliott and others, found a majority within the shareholders’ meeting to elect their nominee as member of the supervisory board. In a second step, Elliott successfully pressed for the sale of Autoscout24, the company’s profitable car trading business (2019).

Rumours that Elliott is pursuing a split of Bayer, making use of the challenges following Bayer’s acquisition of Monsanto, have not proven true (2018–2020).

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, was 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 Commerzbank/Cerberus

In response to the struggle of German lender Commerzbank during the financial crisis, the German state took a significant stake in the company. Later, Cerberus took an interest in the German banking market and acquired stakes in both Deutsche Bank and Commerzbank. As performance targets for both banks were not being met, Cerberus, with support of the German state, pushed for a merger of the two banks. Merger talks failed and instead as an alternative, Commerzbank looked towards restructuring the company.

Cerberus was critical that this approach would not go far enough and consequently, in two letters to the bank’s boards, Cerberus called for significant change to the supervisory board, the management board and the company’s strategic plan. Additionally, Cerberus demanded a right to fill two seats on the supervisory board. This turn of events finally led to the resignation of the chair of the supervisory board as well as to the CEO offering to step down by the end of 2020.

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.11 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.

VI OUTLOOK

Not least because of the considerable success of recent campaigns and, most recently, low valuations caused by the covid-19 crisis, 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

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

Historically, certain particular features of the Indian market have affected shareholder activism. First, there has been little separation of ownership and management. Many Indian listed companies are controlled by ‘promoters’ (i.e., their original founders) and the interests of the public shareholders have often been subordinated to those of the promoters. Second, until recently, hostile takeovers have been rare and promoters have previously operated with little fear of a non-consensual change of control. 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. However, a number of developments over the past decade have changed certain market dynamics and have diluted a number of traditional promoter strengths. These factors have given rise to a nascent form of shareholder activism in India, and there have been a number of instances of shareholders successfully challenging promoters and management.

These developments include changes introduced in the Companies Act 2013 (CA 2013) and various regulations issued by India’s securities markets regulator, the Securities and Exchange Board of India (SEBI). These have improved corporate governance standards, enhanced minority shareholder rights, created new shareholder remedies and codified directors’ duties. Also, proxy firms are now active in the Indian market and investors have become more adept at using the media. In addition, many promoters have been weakened as a result of their over-leveraged position and the advent of a new insolvency regime in India. In certain situations, the exercise of share pledges by lenders has diluted the promoters’ control. There have also 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.

Therefore, although shareholder activism is nascent in comparison with the United States and the United Kingdom, it is clear that Indian 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

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1 Nikhil Narayanan is a partner at Khaitan & Co.
for a term of up to five years,\(^2\) 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.\(^3\) 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. However, in the recent past, there have been a number of instances where investors have been more active with regard to the appointment and removal of directors of listed companies (see Section IV iii).

In addition to the traditional board appointment route discussed above, an investor can also seek board representation as a ‘small shareholder’ by acquiring a 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.\(^4\) In August 2017, Unifi Capital, attempted to seek the appointment of such a small shareholder director on the board of Alembic.\(^5\) Although the board successfully resisted this (the small shareholders were allegedly clients of Unifi Capital), this indicates that activists are thinking creatively about board representation.

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 first have been given an opportunity to be heard.\(^6\) 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 required shareholder approval).

**ii Control over executive remuneration**

Shareholders have voted down executive remuneration packages in a number of instances. In 2018, shareholders rejected the compensation of Neeraj Kanwar (managing director and promoter of the Apollo Group), leading to a 30 per cent reduction in his compensation, which was subsequently approved. Other instances include the rejection of executive remuneration resolutions in Tata Motors’ annual general meeting in 2014 and the withdrawal of executive

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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.
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).
remuneration resolutions by Seamac and ARSS Infrastructure in 2011.\(^7\) In 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).\(^8\)

Also, the alignment of incentives and compensation in financial institutions is now an area of regulatory focus. In November 2019, the Reserve Bank of India published guidelines governing compensation in private sector banks. These guidelines stipulate committee requirements and requirements to balance fixed and variable compensation, and have introduced 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.

**iii The ability to requisition shareholders’ meetings and postal ballots**

Shareholders holding at least one-tenth of voting paid-up share capital can notify the board to requisition an extraordinary general meeting (EGM),\(^9\) 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).\(^10\) If the directors fail to convene an EGM following a valid requisition notice, they become liable for any requisition-related expenses.\(^11\) Although a useful tool for activists, ironically, the requisitioning of an EGM has also been used in one case to strengthen the promoter’s position by removing certain directors (see Section III.i).

Indian company law does not expressly provide shareholders the ability to pass written resolutions, but there are provisions permitting postal ballots.\(^12\) 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

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\(^7\) Allirajan Muthsamy, ‘Shareholder Activism stalls promoter moves’, *The Economic Times*, 5 July 2014.

\(^8\) 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.

\(^9\) Section 100(2)(a) of CA 2013.

\(^10\) Section 100(4) of CA 2013.

\(^11\) Section 100 (6) of CA 2013.

\(^12\) Section 110 of CA 2013 and Rule 22 of the Companies (Management and Administration) Rules 2014.
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.

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.

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, and 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 a majority of shareholders holding 75 per cent in value of the shares. 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.

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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.

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) and Section 232(1) of CA 2013.
Despite the availability of these rights, hostile takeovers have historically been 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. 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 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, cases on oppression and mismanagement under the preceding company law (CA 1956) indicate that claimants have historically found success difficult. Such claims are also likely to be resisted by management (see Sections III and IV on the Tata Sons affair). Therefore, even if shareholders initiate such action, they may need to tactically consider whether settlement might offer advantages over a lengthy litigation process.

Also, CA 2013 has introduced a ‘class action’ concept in Indian company law. Shareholders holding 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 remains to be seen.

**vii Other issues**

Similar to 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.

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21 Section 213 of CA 2013.
23 In 2019, minority shareholders of Associated Broadcasting Company challenged the sale of the company and the appointment nominees of the acquirer on the board, alleging oppression and mismanagement and the NCLT passed a restraining order. However, press reports suggest that, subsequently, a settlement occurred with SAIF Partners, a key minority shareholder, pursuant to which the transaction appears to have completed.
24 Section 245 of CA 2013.
25 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.
26 (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).
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  Fissures in corporate India

The rise of shareholder activism in India has coincided with succession issues, over-leveraged balance sheets and other issues that have made promoters and professional management of listed companies vulnerable. These have even affected companies with a better governance history.

For instance, in late 2016 and 2017, Infosys, a US and Indian listed IT company with a good governance reputation, 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, was removed as a director of Tata Sons pursuant to an EGM held on 6 February 2017, although this removal is still being litigated.

27 Section 88 of CA 2013.
28 Section 90 of CA 2013.
29 The National Company Law Appellate Tribunal issued an order in December 2019 restoring Cyrus Mistry to office, although the Supreme Court stayed this decision in January 2020. On 29 May 2020, Cyrus Mistry has initiated certain further challenges before the Supreme Court and thus the matter is still being considered by the Supreme Court as at the start of July 2020.
ii Litigation v. other 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 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, and the Bombay High Court refused to entertain a separate representative suit against Ratan Tata (Cyrus Mistry's predecessor) for damages. 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. A more effective technique that certain shareholders have used is to register complaints with regulatory authorities. For instance, in July 2019, the shareholders of Bharat Nidhi Limited objected to a share buy-back scheme and asked SEBI to investigate.

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).

iii Proxy firms

Several proxy advisory firms are now active in India and are regulated by SEBI under the SEBI (Research Analysts) Regulation 2014.

Proxy advisory firms recommended that shareholders vote against the Tata Motors executive remuneration resolutions in 2014 and claimed credit for the outcome. They have also been vocal on governance matters; for instance, in commenting on the leave of absence taken by the CEO of ICICI Bank (while allegations of impropriety are investigated). More recently, in 2019, proxy firms challenged the management of Sterling Wilson over the failure to repay debt out of its IPO proceeds.

They do not have the same level of influence as in the United States but proxy firms are emerging as important market participants.

However, these firms have also faced criticism around perceptions of their own conflicts of interest in June 2019, SEBI published a consultation paper on the regulation of proxy advisers and subsequently, in August 2020, published guidelines in this regard.

31 Pramod Premchand Shah and others v. Ratan N Tata and others, 2018 (1) ALLMR 255. Note that as at the start of July 2020, litigation with Cyrus Mistry continues in the Supreme Court as regards his removal.
32 Khushboo Narayan, 'Bombay HC asks Cadbury to pay Rs 2,014.50 per share for buyback', Livemint, 18 July 2014.
33 Subsequently, in January 2020, the Supreme Court ordered SEBI to complete the investigation in four months.
34 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).
35 'Shareholders reject Tata Motors pay plan', The Business Standard, 4 July 2014.
These guidelines require proxy advisors to formulate and publish voting recommendation policies, disclose conflicts and establish processes to mitigate conflicts, among others. Listed companies have also been given the ability to approach SEBI to investigate any breaches of these guidelines and the code of conduct under the SEBI (Research Analysts) Regulations 2014, so it does appear that there will be greater regulatory scrutiny of these firms.

iv Role of the media

Although public campaigns by shareholders seeking strategic changes are uncommon, 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).

v 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 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. 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 long-only 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). In 2019, the asset sale of the Leela Hotels to Brookfield was challenged by ITC, a non-financial investor, and Life Insurance Corporation, a state owned insurer, on the grounds that certain deal participants were related parties and hence could not vote in favour of the sale. This challenge and its subsequent appeal were dismissed, but it does illustrate that the extent of shareholders asserting their rights has now expanded.

IV RECENT SHAREHOLDER ACTIVISM CAMPAIGNS

i 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 can sometimes be 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.

36 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.


38 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.  

Finally, in 2016, HDFC Standard Life Insurance Company Limited and Max Life Insurance Company Limited announced a merger to create a new insurer and the deal terms included 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 strongly opposed the payment of this fee.

ii 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 for failing to seek shareholder approval for the transaction. Some of the largest funds in India wrote a letter to Maruti Suzuki challenging the proposed transaction. Even Life Insurance Corporation of India, a state-owned insurer, not known for activism, reportedly engaged with the company.  

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. Siemens India amended the terms of the transaction to increase the sale price and finally obtained shareholder approval in December 2014.

In the public M&A context, minority shareholders threatened to challenge a mandatory share swap scheme (announced in December 2019) between Reliance Industries Limited (RIL) and Reliance Retail Limited, on the basis that they had not been provided an exit option. In January 2020, as a result of this shareholder opposition, RIL made this scheme optional.

iii Changes to board composition
Investors have had one notable success in removing a director of Fortis Healthcare in May 2018. This was in the context of investor concerns as to the board assessment of certain bids for the company, so this is a significant shareholder activism landmark in India. Also, in 2019, the board of CG Power and Industrial Solutions removed its promoter from his role as chairman (although this was not the removal of a directorship) in the wake of allegations of certain irregularities.

However, the question is whether attempts to change the composition of the board outside the particular circumstances set out above will work. In the past, this has not proved easy in practice. For instance, the attempt of a 20 per cent investor to seek board representation

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43 He subsequently resigned from his non-executive directorship.
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).44

In certain cases, shareholders have opposed the reappointment of senior incumbent management as directors. For instance, in July 2018, 22.64 per cent45 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 re-election of Kumar Mangalam Birla (head of Aditya Birla Group) to the board of UltraTech Cement.46 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 force a change in board composition, although these are harder to achieve.

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 on collaborations with other institutional investors and also to have a clear voting policy. These are likely to encourage insurers to be more engaged.

Second, SEBI is implementing a number of recommendations of the Kotak Committee (constituted in June 2017, which has suggested various reforms to improve the governance of listed companies, among others). This should have a positive impact on the corporate governance landscape.

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). Although this development would increase the influence of activist shareholders, it has not yet been implemented.

Fourth, in August 2020, SEBI published certain guidelines for proxy advisers as well as a grievance resolution procedure. This follows on from a consultation paper SEBI published in July 2020, where SEBI appeared to favour a ‘light touch’ approach in relation to proxy firms. These measures, which focus on greater disclosure by proxy advisers (rather than imposing greater restrictions upon them) together with a SEBI scrutiny mechanism to ensure compliance, are a step in the right direction and will create greater transparency, but time will tell how they play out in practice.

44 Ingovern, India Proxy Season 2017.
VI OUTLOOK

Although nascent, shareholder activism in India is evolving quickly. Regulatory changes, increased levels of investment by global 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.

So far, most activism has been event-driven (opposing related party transactions, share repurchases and acquisitions) and in relation to the larger listed companies, but it has also broadened to cover executive remuneration, strategy, succession planning and abuse of position. It remains to be seen as to whether this will develop further to ‘US style’ challenges to corporate strategy, with activists driving change to enhance shareholder value.

Boards of Indian listed companies will also need to improve their shareholder engagement by setting up investor relations teams, improving their governance and regularly engaging with key shareholders. Corporate India will need to adapt to meet the challenge of activism.
Chapter 7

JAPAN

Akira Matsushita

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 is also experiencing changes because the ownership of shares in listed companies in Japan by institutional investors has increased 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 needs 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.2

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.3 This request right enables activist shareholders to access information on other shareholders in the company when waging a proxy fight.

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 such access is necessary to exercise the rights of such shareholders.4 Shareholders

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1 Akira Matsushita is a partner at Mori Hamada & Matsumoto.
2 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.
3 Article 125(2–3) of the Companies Act.
4 Article 371(2) of the Companies Act.
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.\(^5\) 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.\(^6\) 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.\(^7\)

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 such shareholder conducting a proxy solicitation by itself at its expense.

Under the current Companies Act, the number of proposals that an eligible shareholder can submit to the company is unlimited. In response to recent cases of abusive exercises by shareholders of such shareholder proposal right, the Diet in December 2019 approved an amendment to the Companies Act to limit to 10 the number of proposals that each shareholder can demand the directors to provide summaries thereof, in the convocation notice of the shareholders’ meeting. The amendment is expected to become effective in early 2021.

**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 the date of the shareholders’ meeting to fall within 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.\(^8\)

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\(^5\) Article 433 of the Companies Act.

\(^6\) Articles 303 and 305 of the Companies Act.

\(^7\) Article 304 of the Companies Act.

\(^8\) Article 297 of the Companies Act.
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 any share in the company 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.9 Violations of a director’s duties of care and loyalty may constitute a violation of such laws and regulations.

Derivative actions and direct claims
A shareholder who owns any share in the company 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.10

If directors have acted in bad faith or with gross negligence in the performance of their duties, such directors are jointly and severally liable for damages suffered by any third party arising as a result of such performance of their duties;11 and shareholders may be eligible to directly claim damages from the directors pursuant to such provision.

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 relating to 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 (FIEA) (Act No. 25 of 13 April 1948). 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 (joint holders). 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 360 of the Companies Act.
10 Article 847 of the Companies Act.
11 Article 429 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 its officers, including the directors and the executive officers, 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.

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13 FSA, Q&A Regarding Large Scale Shareholding Report of Share Certificates, etc., 31 March 2010, at 10.
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, 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, as amended on 29 May 2017, 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 seems to have affected the voting behaviour of institutional investors and, consequently, supportive votes for listed companies seem to have decreased. 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.

The Stewardship Code was further amended on 24 March 2020 to enhance qualities of services provided by proxy advisers to institutional investors by addressing concerns about proxy advisers’ conflicts of interests and the appropriateness of their recommendations.

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 (a standstill agreement), have not often been entered into between activist shareholders and listed companies in Japan. However, management of companies may more frequently consider entering into such settlement agreements in
the near future because the mindset of management towards shareholder activism has been gradually shifting to more constructive engagement with activist shareholders, due to the corporate governance reform and the growth of influence of activist shareholders in Japan.

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, 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 due to opposition by institutional investors (whereas 567 listed companies had adopted such measures as at 2009, 329 listed companies had adopted such measures as at July 2019).16

**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 prominent foreign activist funds that manage a large amount of assets 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.

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15 Articles 120 and 970 of the Companies Act.
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. In the past, activist shareholders often focused on building large stakes in small- or medium-cap companies to apply pressure on the management of those companies. In recent years, activist shareholders have also been targeting large prominent companies, including companies with market capitalisation of over US$50 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.

Objectives of shareholder activism

The most common objective of shareholder activism in Japan is to improve capital efficiency of Japanese companies. While ROEs of many Japanese companies are low compared with the average ROEs of US companies, the management of listed companies has become more conscious of a company’s capital efficiency in recent years due to the corporate governance reform. Activist shareholders usually demand that Japanese companies conduct a buy-back of their shares or increase the amount of dividends to improve their ROEs. Activist shareholders also 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.

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. Also, activist shareholders often demand that management conduct a strategic review of the company’s businesses and business plans by retaining an outside consulting firm. 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,

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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.
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 announced 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 (bumpitrage). Activist shareholders 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.

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 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

Non-public 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 engagements 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:

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

Given that the support of public opinion, especially institutional investors, 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 that provide summaries of the proposals at the company’s expense. However, there are practical advantages for an activist shareholder to engage in proxy solicitation, including:

a. 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;
b. 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
c. 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), and Glass, Lewis & Co. Foreign institutional investors tend to refer to recommendations by the proxy advisers whereas Japanese institutional investors tend to vote according to their internal voting policies. The proxy advisers often recommend that investors vote against proposals made by the board of directors and that they should 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 enjoinement 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. Historically, 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; however, in the past few years, a number of hostile takeovers have gradually increased.

IV RECENT SHAREHOLDER ACTIVISM CAMPAIGNS

i Campaigns against large-cap companies
Activist shareholders have recently targeted large-cap companies in Japan. One of the most well-known activist hedge funds in the United States, Third Point, proposed Sony Corporation (Sony) to spin-off its entertainment business in 2013 and to spin-off its semiconductors business in 2019; however, in these cases, Sony refused to carry out the proposals. The press has reported that another well-known activist hedge fund in the United States, Elliott Management (Elliott), urged SoftBank Group Corp. (Softbank Group) to buy back its shares in 2020, and after the demand, SoftBank Group announced a plan for the repurchase of up to JPY 2 trillion of its shares.

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 (Effissimo), a Singapore-based activist fund, as a director. Toshiba Corporation (Toshiba) 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 (Reno) (which is considered to have some connection with the former well-known Japanese activist fund Murakami Fund and owned approximately 35 per cent of the shares in Kuroda Electric Co, Ltd (Kuroda Electric) with Reno’s joint holders) submitted a shareholder proposal to elect an outside director designated by Reno for the annual shareholders’ meeting of Kuroda Electric in June 2017, which was approved at the shareholders’ meeting. In April 2020, a Hong Kong-based activist fund, Oasis Management Company Ltd (Oasis), which owned approximately 9 per cent of Suncorporation, submitted
shareholder proposals to the company to dismiss the company’s executive directors and elect directors designated by Oasis. The shareholder proposals were approved at an extraordinary shareholders meeting with approximately 70 per cent of shareholders providing affirmative votes. These examples suggest that shareholders in Japan are becoming comfortable with, and supportive of, shareholder activism.

iii Litigation
Effissimo has acquired shares in a number of listed companies that have a parent company. Effissimo, which owned approximately 30 per cent of the shares in car manufacturer Nissan Shatai Co, Ltd (Nissan Shatai), 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 Effissiomo claimed that the directors were violating their duties because Nissan Shatai deposited a large amount of cash bearing a low interest rate in a subsidiary of Nissan Motor Co, Ltd (Nissan), which is a parent company of Nissan Shatai, the directors were causing the company to participate in the cash management system of the Nissan group without reasonable reasons, and the directors did not manage the cash of Nissan Shatai efficiently. Yokohama District Court dismissed the case in favour of the directors in February 2012.18 According to news reports, Oasis filed a provisional injunction against the directors of Toshiba Plant Systems & Services Corporation (Toshiba Plant Systems) with the Yokohama District Court in March 2017 to prevent it from depositing funds with the parent company, Toshiba. As a result, Toshiba Plant Systems withdrew the deposit amount, which was, as at 31 March 2016, approximately US$760 million, from Toshiba. These cases indicate that activist shareholders are willing to engage in court and litigation procedures to accomplish their goals.

iv M&A activism
Oasis waged a public campaign in 2016–2017 against the acquisition by Panasonic Corporation (Panasonic) of its listed subsidiary, PanaHome Corporation (PanaHome), by asserting that the consideration to be paid was lower than the fair value of the shares in PanaHome. Panasonic 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 commenced the public campaign. Oasis also waged a public campaign in 2017–2018 against the integration of a business through a share exchange in which Alps Electric Co, Ltd (Alps Electric) would acquire all the shares in its listed subsidiary, Alpine Electronics Inc (Alpine). In this case, Elliott also purchased approximately 9.8 per cent of the shares in Alpine as well as approximately 11.2 percent of the shares in Alps Electric after the public announcement of the share exchange. Oasis 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 purchased shares in Hitachi Kokusai Electric Inc (Hitachi Kokusai) representing approximately 8.6 per cent of the issued shares of the company in 2017 after the public announcement by KKR of a tender offer for the shares in Hitachi Kokusai. KKR eventually increased the tender offer price by approximately 25 per cent to facilitate the success of

18 Yokohama District Court, judgment, 28 February 2012, not cited in digests.
the tender offer transaction. Reno launched a tender offer for shares in Kosaido Co Ltd (Kosaido) after a management buyout by the management of Kosaido, sponsored by Bain Capital through a tender offer that was commenced in 2019. As a result, although Bain Capital increased its tender offer price, the tender offers of both Bain Capital and Reno ultimately failed.

V REGULATORY DEVELOPMENTS

The FIEA was amended on 1 April 2018. This amendment provides a fair disclosure rule pursuant to which if a listed company transfers a certain amount of its unpublicised material information to certain persons, including certain 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 has been moving 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 any increase.

Under the Foreign Exchange and Foreign Trade Act (FEFTA), when foreign investors acquire certain amounts of shares or voting rights in companies that engage in certain restricted businesses that relate to the national security of Japan, such investors are required to file a prior notification to, and undergo examination by, the competent ministers. In line with the global trend of tightening foreign investment regulations, the FEFTA was amended in 2020 to lower the threshold for the prior notification requirement for acquisition of shares or voting rights of a listed company from 10 per cent to 1 per cent. The amendment also established exemptions from such prior notification requirements for investments that satisfy certain requirements to be considered a passive investment; such requirements include the investors or their closely related persons will not become board members of the company, and the investors will not propose at shareholders meetings the transfer or disposition of the company's restricted businesses. Furthermore, the amendment newly introduced prior notification requirements for votes at shareholders meetings by any foreign investor holding 1 per cent or more of shares in a company engaged in any restricted business with respect to the following: nomination by the foreign investor of itself or its closely related person as a board member, and any proposal made by itself to transfer or dispose the company's restricted businesses. While critics have contended the amendment will limit shareholder activism from foreign investors, we need more time to see in practice how strictly the authorities will conduct such examinations of foreign investors' investments to assess the impact of the amendment on shareholder activism.

VI OUTLOOK

The mindset of the management of Japanese listed companies towards shareholder activism has been gradually shifting to more constructive engagement with activist shareholders since the influence of shareholder activism on such companies has increased in the past several years. This trend is expected to continue partly because more cross shareholdings may be
dissolved in light of the Japanese government’s policy for the reduction of cross shareholdings. In particular, given that institutional investors have expanded their shares in the Japanese stock market, institutional investors, including those that manage their assets from mid- to long-term perspectives, may have more important roles in situations of shareholder activism and corporate management.

Regarding the short-term outlook, it is not easy to predict the impact of covid-19 on shareholder activism. If the volatility of share prices of Japanese companies continues over a long period, activist shareholders may be able to acquire large amounts of shares at lower prices, and the number of companies that are subject to shareholder activism might increase. Conversely, because many Japanese companies are facing performance difficulties in their businesses due to covid-19, it might become difficult for activist shareholders to gain support for their positions to increase shareholder returns from other shareholders, including the mid- to long-term institutional investors.
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). The Shareholder Act of 24 May 2011 has been amended by the Act of 1 August 2019 setting out a number of shareholders’ rights and aiming to increase long-term shareholder engagement, transposing the Second Shareholders’ Rights Directive into Luxembourg law. This is another important step in corporate social responsibility legislation and may potentially lead to more shareholder activism in Luxembourg where, until now, shareholder engagement does not seem to be a current practice.4

1 Margaretha Wilkenhuysen is a partner and Anke Geppert-Luciani is a professional support lawyer at NautaDutilh Avocats Luxembourg.
2 Act of 24 May 2011 on shareholders rights in listed companies, as last amended by the Act of 1 August 2019.
4 See on the distinction between shareholder activism and acting in concert: Jenny Conrath, Differentiating between acting in concert and shareholder activism: a difficult task for shareholders and competent authorities, ACE 2020 3-4, p. 2.
II LEGAL AND REGULATORY FRAMEWORK

i The corporate governance regime

Shareholder activism is a pre-requisite to sound corporate governance.\(^5\) Next to the Shareholder Act, Luxembourg’s main statutes on corporate governance include the 10 August 1915 Act on commercial companies (the Companies Act)\(^6\) and the Market Abuse Regulation.\(^7\)

Over the years, the shareholders’ role has evolved and shareholders’ rights have been increasingly strengthened. The first version of the Shareholder Act came into force on 1 July 2011 and 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 went 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.

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. After the transposition of Directive 2017/828, this scope has now been 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

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6 The Act of 10 August 1915 on commercial companies.
8 Article 1 (5) of the Shareholder Act.
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.
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 board needs to reconcile and combine the Luxembourg rules with the rules of the exchange, which in some cases may be challenging.

iii 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.

iv The board of directors

Structure

Although public limited liability companies may choose between a two-tier board structure and a one-tier board structure, the latter 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 in a one-tier board structure

The board is composed of appointed members (the company’s directors). A public limited-liability company can be managed by one director as long as it has a sole shareholder. Otherwise, the Companies Act requires a minimum of three directors; the maximum

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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, Paragraph 1 of the Companies Act.
17 Article 441-2(1) of the Companies Act.
number of directors is undefined (the LuxSE Principles advise 16 directors as a reasonable limit).\textsuperscript{18} Although the directors are appointed by the shareholders of the company,\textsuperscript{19} the directors choose a chair among their members.\textsuperscript{20}

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.\textsuperscript{21}

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 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’.\textsuperscript{22} 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.\textsuperscript{23} Under this non-compulsory guideline, the chair should ensure the proper application of the rules of governance and provide advice to the board.

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.\textsuperscript{24}

Liability 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

\textsuperscript{18} LuxSE Principle 3, guideline to Recommendation 3.3.
\textsuperscript{19} Article 441-2(3) of the Companies Act.
\textsuperscript{20} Article 444-3(2) of the Companies Act.
\textsuperscript{21} Article 4 of the Shareholder Act.
\textsuperscript{22} LuxSE Principle 3, guideline to Recommendation 3.5.
\textsuperscript{23} LuxSE Principle 2, guideline to Recommendation 2.4.
\textsuperscript{24} LuxSE Principle 10.
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.25

The Luxembourg legislature has remained silent on what should be considered a company’s best corporate interest. In its judgment delivered in 2015,26 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 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 Act27 and the Market Abuse EU Regulation,28 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’.29

Directors are jointly and severally liable in accordance with the general provisions on civil liability and the provisions of the Companies Act,30 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.31

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

25 Articles 441-7 and 441-12 of the Companies Act.
26 Luxembourg District Court, 23 December 2015, Nos. 145 724 and 145 725.
27 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.
29 LuxSE Principle 2.
30 Article 441-9(2) of the Companies Act.
31 Article 441-9(1) of the Companies Act.
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{32} Besides, each director is individually liable in accordance with the general provisions on tort liability.\textsuperscript{33}

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{34}

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.

\section*{III \ KEY TRENDS IN SHAREHOLDER ACTIVISM}

In line with the developments in EU law, over the years, shareholders rights have gradually increased. Luxembourg law offers a comprehensive framework for more transparency, accountability and increased shareholder rights, especially in listed companies. By transposing the Second Shareholder Rights Directive into Luxembourg law, shareholders rights have been further strengthened, in particular with regard to the possibility of expressing their view on directors’ remuneration and the need to approve important transactions with related parties to a shareholders’ vote. Institutional investors, asset managers and proxy advisers must now also meet transparency requirements. Furthermore, minority shareholders have additional rights further to the changes to the Companies Act in 2016. It is too early to assess whether these changes will lead in practice to more public campaigns led by activist shareholders. However it is certain that boards will now, after the transposition of Second Shareholder Rights Directive into Luxembourg law, more than ever have to take into account the potential involvement and action from their shareholders, including minority shareholders.

\textsuperscript{32} Article 1166 of the Civil Code.
\textsuperscript{33} Articles 1382 and 1383 of the Civil Code.
\textsuperscript{34} Article 444-2 of the Companies Act.
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 2006.35

A more recent example is Deer Park Road’s investment in a Luxembourg-based company in 2017.36

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 STADA37 and recently became the most important shareholder of Agfa.38

V REGULATORY DEVELOPMENTS

i Contact with, and identification of, shareholders

One of the main objectives of the Second Shareholder Rights Directive and the amended Shareholder Act is to give listed companies the right to identify their shareholders and, at 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.39 They must also provide the shareholders with information to facilitate the exercise of shareholder rights.40 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. Luxembourg does not use this option, meaning that all shareholders can be identified.41

ii Shareholder rights and powers

Shareholder meetings and equality of voting rights

The Shareholder Act aims, 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.42 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.43 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.’

Pursuant to the Shareholder Act, listed companies must give at least 30 calendar days’ notice before holding a meeting (notwithstanding particular requirements under the Takeover Bid Act). 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. The convening notice must be published in the Electronic Digest 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. If all the shares are registered, convening notices may be sent by registered letter to the shareholders, members of the board (or the 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:

1. 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;
2. The postal and email addresses that can be used to obtain documents in relation to the meeting;
3. 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
4. The company’s website address, which must contain all of the above information, as well as a full copy of the draft resolutions.

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. From now on, when votes are cast electronically a confirmation of receipt of the vote must be sent within two months of the vote.

44 LuxSE Principle 10.
45 Article 3(1) of the Shareholder Act.
47 Article 3(1)(2) of the Shareholder Act.
48 ibid.
49 Article 3(3) of the Shareholder Act.
50 Article 6 of the Shareholder Act.
51 Article 1(c) (2) of the Shareholder Act.
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.\textsuperscript{52}

\textit{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.

The LuxSE Principles recommend establishing a remuneration committee to deal with these questions relating to directors’ remuneration. The LuxSE Principles state that the company must ‘secure the services of qualified directors and executive managers by means of a fair remuneration policy that is compatible with the long-term interests of the company’, thereby introducing a sustainable aspect rather than concentrating on short-term gains.\textsuperscript{53}

Concerning listed companies, following the transposition of the Second Shareholder Directive, shareholders must now be informed in detail of the remuneration of directors and the company’s remuneration policy. Companies must prepare a management remuneration policy describing all components, criteria, methods and modalities applied to determine the fixed and variable remuneration of the directors. Shareholders have an advisory vote on this policy, unless the company’s articles of association provide for a binding vote. The remuneration policy must be submitted to the general meeting of shareholders for approval each time there is a significant change thereto and at least every four years. In addition, companies must prepare a report for the annual general meeting on the remuneration and benefits granted to directors.\textsuperscript{54}

Besides, shareholders must approve material transactions with related parties. With regard to the definition of ‘material transaction’, Luxembourg Law takes into account the nature of the transaction as well as the position of the related party.\textsuperscript{55}

\textit{The powers of shareholders to influence the board}

The Companies Act reserves the management of the company, in principle, to its board.\textsuperscript{56} 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.

\begin{itemize}
\item \textsuperscript{52} Article 8 of the Shareholder Act.
\item \textsuperscript{53} LuxSE Principle 7.
\item \textsuperscript{54} Articles 7(a) and (b) of the Shareholder Act of 24 May 2011, as amended.
\item \textsuperscript{55} Article 7(c) of the Shareholder Act as amended.
\item \textsuperscript{56} Article 441-5 of the Companies Act.
\end{itemize}
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. 57 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. 58

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. 59

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. 60

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. 61 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. 62

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). 63

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 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. 64

57 Article 441-2(3) of the Companies Act.
58 Article 450-1(6) of the Companies Act.
59 Article 7 of the Shareholder Act.
60 Article 7(2) of the Shareholder Act.
61 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.
62 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.
63 Article 441-7(2) of the Companies Act.
64 Article 444-2 of the Companies Act.
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, 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.  

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), 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.

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 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.

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

65 Article 441-5 of the Companies Act.
66 Article 100-22 of the Companies Act.
67 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.
68 Article 5 of the Squeeze-out Act.
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:

a. a shareholders’ agreement that violates the provisions of the Companies Act or that is contrary to a company’s corporate interest;
b. 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
c. an undertaking by a shareholder to those same companies or corporate organs to approve proposals made by the company’s corporate bodies.⁷⁰

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.⁷¹ 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.

### iii 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.⁷²

**Institutional investors’ duties and best practice**

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.⁷³ Institutional investors as well as asset managers and proxy advisers will be bound by accrued transparency obligations.

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⁷⁰ Article 450-2(1) of the Companies Act.
⁷¹ Article 450-2(2) of the Companies Act.
⁷² Article 5 of the Squeeze-out Act.
⁷³ Article 1(e) Shareholder Act.
Besides, it is to note that a number of Luxembourg-based investors have signed the United Nations-supported Principles for Responsible Investment. 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.

**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.

**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 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.

74 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.

75 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.

76 Article 420-22 of the Companies Act.
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**

After the transposition of the Second Shareholders Rights Directive into national law, Luxembourg law offers an even more comprehensive legal framework for transparency, accountability and increased shareholder rights, especially in listed companies. Although campaigns of activist shareholders do not seem to be a standard practice in Luxembourg, time will tell whether the changes in Luxembourg law will lead to more campaigns led by activist shareholders. It is certain that boards will, in any case, have to be aware of potential involvement and action from their shareholders.

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77 Article 441-2(4) of the Companies Act.
Chapter 9

NETHERLANDS

Paul Cronheim, Willem Bijveld and Frank Hamming

I OVERVIEW

Shareholder activism is a hot topic in many Dutch boardrooms. In the past five years, 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 the campaigns of Elliott Advisors against AkzoNobel, NXP and NN Group. Following these campaigns the level of public shareholder activism seems to have decreased, even more so as a result of the covid-19 pandemic. Given the current unstable global economic situation, it is difficult to predict what the level of shareholder activism activity will be in this and the coming year. In any case, discussions between boards and shareholders on matters such as strategy, capital returns, executive compensation and environmental, social and governance (ESG) matters, will continue to dominate the agendas within Dutch listed companies. Aside from shareholder activism, we have also witnessed a global wave of increased protectionism in recent years. In the Netherlands, this development was partly fuelled by numerous (unsuccessful) hostile approaches in recent years, including for PostNL, Unilever and AkzoNobel, after which both the general public and the government called for increased protection of (certain) Dutch companies. In 2020, we see that the first steps towards legislation have been taken.

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.

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1 Paul Cronheim is a partner, and Willem Bijveld and Frank Hamming are senior associates at De Brauw Blackstone Westbroek NV.
**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 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 entered into force at the end of 2019. The new rules on remuneration and related party transactions are effective as of 1 December 2019. The provisions relating to electronic voting, shareholder identification and transmission of information to shareholders take effect on 3 September 2020. A remuneration policy needs to be in place for the executive and supervisory boards and must be approved by the general meeting at least every four years. The general meeting will have an annual advisory vote on the remuneration report. 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.

**Dutch Stewardship Code**

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.

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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 (2018).
ii  **Division of powers – roles of the executive and supervisory boards, and the general meeting**

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). Most Dutch public limited liability companies with a listing on the Amsterdam Stock Exchange have a two-tier board. In a two-tier board, 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, although Dutch companies may deviate from this principle in the articles of association. The vast majority of Dutch listed companies have limited the power of the general meeting to appoint and dismiss board members, 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.

iii  **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. Yet, in recent years, in these jurisdictions there is a debate around the role of a company and its purpose in modern-day society, in particular if companies, asset managers and asset owners should commit to sustainable long-term investment.6

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5 On the Amsterdam Stock Exchange, eighteen Dutch public limited liability companies have a two-tier board structure and two have a one-tier board structure. 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.

6 See for example The UK Stewardship Code 2020 that aims ‘to create long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society’, and the statement of the US Business Roundtable that ‘moves away from shareholder primacy and includes commitment to all stakeholders’.
The Dutch stakeholder model also applies in takeover and activist situations, as was confirmed in the case of Elliott Advisors v. AkzoNobel (see Section V.ii).

III TOOLBOXES OF ACTIVIST SHAREHOLDERS AND COMPANIES

i The activist shareholder’s toolbox

The following are tools that activist shareholders commonly use in pursuing their agenda, either alone or, for example, together with other activist shareholders, forming a ‘wolf pack’:

- private discussions and engagement with the company;
- public engagement with the company;
- stake building;
- right to participate in and vote at the general meeting;
- right to place an item on the agenda;
- right to convene a meeting; and
- initiate litigation.

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 inbound calls to the company’s CEO or chair to discuss strategy and measures to maximise shareholder value, or more formal communication by sending private ‘Dear Board’ letters.

Companies experiencing this form of shareholder activism are often faced with the question whether they should engage in a dialogue with the activist about their demands or take a more defensive approach by rejecting their demands, which is likely to trigger the activist initiating a public campaign. A private dialogue between a company and an activist shareholder can be very intensive and drag on for months. To get detailed information from the company regarding the topics targeted in their campaigns, activists will often seek to conclude a confidentiality agreement. In order to induce the targeted company to provide such information and enter into a confidentiality agreement, the activist may agree to refrain from initiating a public campaign during the duration of the discussions. While this form of activism may appear ‘friendly’ from a distance, it may from time to time become as aggressive as the more well-known public activist campaigns.

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. Prominent recent examples are the campaigns 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, and against NN Group claiming that the company is undervalued and should reset its trajectory.
Stake building

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. Stake building 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 ‘toehold’ 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. 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. A draft bill is currently under consultation.

An activist shareholder building up its stake or partnering with other large shareholders 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).

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,

7 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.
8 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.
9 As a result of the covid-19 pandemic, the Dutch government introduced an emergency bill that allows Dutch companies to organise virtual general meetings. Anyone attending the meeting, including directors and shareholders, can only do so electronically. This includes providing shareholders with the option to follow the general meeting by video or audio webcast.
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\textsuperscript{10} 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.

In light of the covid-19 pandemic, Dutch companies face increasing investor pressure on their remuneration policies and board or senior leadership compensation. As a result, boards have voluntarily cancelled bonuses and took pay reductions for 2020. For example, Heineken cancelled bonuses for 2020 for their senior managers, including the executive board and the executive team, and the supervisory board of ForFarmers withdrew a proposal from the 2020 AGM agenda regarding remuneration increase.

\textit{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 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 and the statutory time-out period (see subsection ii).

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 \textit{Boskalis v. Fugro}, discussed in Section V.i.

A notable example of shareholders submitting items for the agenda of the general meeting 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 recent years social activist Follow This has 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 previous year, in line with institutional investors’ higher prioritisation of ESG issues. After the resolution was withdrawn in 2019 to give Shell more time to achieve its climate ambitions, Follow This again put forward its resolution at the 2020 AGM; the resolution got the support of 14.4 per cent of Shell’s shareholders (2017: 6 per cent; 2018: 5.5 per cent).

\textsuperscript{10} Press release, ‘ING reaches settlement agreement with Dutch authorities on regulatory issues in the ING Netherlands business’, 4 September 2018.
**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 V.ii).

**Initiate litigation**

Shareholder litigation typically takes place in inquiry (mismanagement) proceedings before the Enterprise Chamber, a chamber of the Amsterdam Court of Appeal specialised in corporate proceedings.11 Any shareholder that alone or acting jointly holds sufficient shares12 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.

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11 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.

12 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.
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 company is immune to shareholder activism even with such structural mechanisms in place. In the following we describe some typical response measures that boards of targeted companies could use:13

- **a** enter into a dialogue with the activist shareholder;
- **b** get the company’s message out to shareholder;
- **c** relationship, standstill or settlement agreements;
- **d** ‘just say no’ strategy;
- **e** invoke response time or statutory time-out period;
- **f** issue ordinary shares;
- **g** sell treasury shares;
- **h** trigger call option on anti-takeover preferred shares; and
- **i** initiate litigation.

**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 cooperative relationship 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. Companies faced with shareholder activism often want to avoid a public activist campaign by first engaging in private discussions.

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13 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.
Get the company’s message out to shareholders

A company dealing with shareholder activism could reiterate and emphasise its current or revised strategy, for example in combination with private discussions or 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 the sustainable success of its business taking into account the interests of 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. Companies faced with shareholder activism, therefore, often closely monitor their shareholder base to assess the presence of other shareholders that are likely to support an activist campaign or form a wolf pack with other activist shareholders. In addition, companies will often actively engage with their long-term large shareholders to endorse their agenda and retain their support.

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 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, 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.
**Statutory time-out period**

In December 2019, a bill was submitted to parliament 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 executive or supervisory boards, or a non-supported public offer for their shares, which, in the opinion of the executive board, conflict with the interests of the company and its stakeholders. The decision of the executive board to invoke the time-out period is subject to approval of the supervisory board and needs to be motivated by the executive board. During the time-out period, the general meeting cannot appoint, suspend or dismiss members of the executive or supervisory boards, or amend the articles of association of the company on these topics. The executive board is required to consult shareholders holding more than 3 per cent during the time-out period to gather their views. Shareholders that hold at least 3 per cent of a company’s share capital (i.e. those who have the right to submit items for the agenda of the general meeting) can initiate proceedings with the Enterprise Chamber to challenge the executive board invoking the statutory time-out period.

Although the proposed statutory time-out period overlaps with the response time in the Corporate Governance Code, the Minister for Legal Protection wishes to give boards of Dutch companies the option to choose between the two response measures. However, it is not obvious that boards will invoke both measures at the same time; in that case, it would be logical that the 180 days of the response time will be deducted from the maximum of 250 days of the statutory time-out period, so that unreasonable accumulation of the measures will be prevented.

**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 (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 in this regard 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.

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14 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.
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 what the foundation would not find acceptable, or to give an opportunity to an activist or bidder to clarify its 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 mere presence of a defence foundation may have a deterrent effect on a hostile activist or 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.

IV 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.
This wave is partly explained by the (global) surge in the early 2000s of changes in corporate law and corporate governance practice aiming to readjust the balance of power between shareholders and boards of directors by enforcing shareholder rights. In the Netherlands, this new way of thinking resulted in, among others, the introduction of the right to place an item on the agenda in 2004. Not surprisingly, this also had an effect on the relationship between companies and its shareholders and, in some cases, even led to (long-term) conflicts between companies and activist shareholders. After the takeover saga concerning ABN AMRO (UK hedge fund TCI holding 1 per cent of ABN AMRO’s stock demanded that the board actively pursued certain transactions, including a sale of the company, to maximise shareholder value), the pendulum regarding shareholder rights swung. By the end of the first decade of this century, the Dutch government introduced measures that limited shareholder rights, for example raising the threshold for shareholder to invoke the right to put an item on the agenda from 1 to 3 per cent. Together with case law that limited the areas where shareholders could effectively exercise their right to put an item on the agenda, this had a large impact on the tactics used by activist shareholders (see subsection iv).

More generally, a surge in shareholder activism must also be seen in light of the stance of the global economy and macroeconomic conditions. The period after the 2007–2012 financial and economic crisis was characterised by an uplift in the global economy that, in combination with low interest rates, generated a boost in M&A activity and, consequently, increased shareholder activism activity. JPMorgan reported 676 campaigns globally in 2018 and 590 in 2019, as opposed to 381 campaigns globally in 2012. From those numbers, in Europe, there were 62 campaigns in 2012 and 139 and 129 in, respectively, 2018 and 2019.15

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.

ii 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 1

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### iii Institutional investors – active behind the scenes

Over the years, we have seen increased attention to shareholder activism from institutional investors. 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. Private engagement to challenge boards remains preferred whereby institutional investors tend to focus on corporate governance issues, such as remuneration policy and corporate social responsibility. In line with a recent global trend, Dutch institutional investors show an increasing focus on remuneration and ESG issues; 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.

The trend of increased attention to shareholder activism from institutional investors is mainly driven by the fact that a vast majority of institutional investors invest through index funds in listed companies. Because positions in index funds cannot immediately...
be offloaded when a company’s stock is underperforming, institutional investors turn to activism to bring the stock price back in line with, what they think, the value of a company’s assets. Globally, we have witnessed several examples of traditional long-only funds embracing activist tactics and other institutional investors publicly supporting activist campaigns.\(^{16}\) Although 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.

\textbf{iv 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 new activist campaigns in 2019 amounted to US$42 billion and in Q1 2020 it amounted to US$14.4 billion.\(^{17}\)

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) and in 2020 Elliott Advisors targeted NN Group (market cap around €10 billion). A company’s large size thus does not deter activist shareholders.

\textbf{v Objectives of activist shareholders – five common themes}

\textit{M&A situations}

M&A has been 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

\(^{16}\) ibid.

the recommended offer made by Qualcomm for NXP, arguing that it had undervalued NXP. We have seen similar dynamics at QIAGEN, where Davidson Kempner opposed the recommended offer made by Thermo Fisher for QIAGEN. The significant slowdown of M&A activity as a result of the covid-19 pandemic will generally reduce the number of M&A opportunities for activist shareholders in the short term. However, activists may find new opportunities in certain industries with potential for further consolidation due to the weakened competition and lower takeover prices, resulting from the impact of the covid-19 pandemic.

**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.

**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.

**Capital returns and financial targets**

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, SBM Offshore, where Centaurus pressured the board to adopt a different financing structure for its fleet, and NN Group, where Elliott Advisors pushed for additional capital returns on an ongoing basis. As a result of the covid-19 pandemic, most Dutch public listed companies have scaled back their share buy-back programmes and have suspended or decreased their dividend in 2020 to maintain sufficient levels of cash to conquer the effects of the covid-19 pandemic.18

**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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18 In this regard see also: Press release, ‘ECB asks banks not to pay dividends until at least October 2020’, 27 March 2020.
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, trying to influence the company’s strategy through private or public engagement with the boards and sometimes demanding changes in the board’s composition.

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 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 in 2017 and against NN Group in 2020.

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 executive 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.

vii 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’.19 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. It is yet to be seen whether the covid-19 pandemic will be a catalyst for change towards a more ‘green’ economy, or whether these topics are being moved more to the background.

V RECENT SHAREHOLDER ACTIVISM CAMPAIGNS

i 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 – because 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.

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ii 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 had reached a standstill agreement with Elliott Advisors.20

iii 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 AkzoNobel 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.

**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

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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.\footnote{For the shareholder base of Air France-KLM see: www.airfranceklm.com/en/finance/financial-information/capital-structure.} 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. In May 2020, the Netherlands Court of Audit concluded that the Dutch government acted irregularly by not informing parliament in advance of the acquisition.\footnote{Press release, ‘State’s 2019 acquisition of Air France-KLM shares was irregular’, 20 May 2020.}

\textbf{v Elliott Advisors v. NN Group (2020)}

On 17 February 2020, Elliott Advisors reported that it had acquired a stake of more than 3 per cent in the Dutch insurance company NN Group. Elliott Advisors later announced that it had teamed up with Dieter Wemmer, a veteran in the insurance industry and former executive at Allianz and Zurich Insurance Group – a tactic more commonly used by activist shareholders.

After several months of private discussions with the management of NN Group, Elliott Advisors launched a public campaign on 12 June 2020 only two weeks before NN Group was to present its strategic priorities and new targets at its Capital Markets Day.\footnote{See the website launched by Elliott Advisors on www.thetimeisnowfornngroup.com.} Rather than placing a frontal attack on NN Group, Elliott Advisors stressed its conviction in NN Group’s underlying value and future prospects, which it believed not to be properly reflected in NN Group’s current stock price. In a presentation counting 67 pages, Elliott Advisors outlined its views on NN Group’s strengths and alleged persistent undervaluation and urged NN Group to use the Capital Markets Day to address these issues. Elliott Advisors also pushed for increased capital returns and portfolio optimisation.

In a response, NN Group stated that it had taken note of the publication by Elliott Advisors and confirmed that it had engaged with Elliott Advisors. At the Capital Markets Day, NN Group seemingly presented its own plans focused on creating sustainable value and did not mention Elliott Advisors once in its presentation. In an interview with the Dutch financial newspaper, NN Group’s CEO, David Knibbe, explained that NN Group had already been working on many of the topics addressed in Elliott Advisors’ presentation for a while.
VI 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. Following 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, on 19 May 2020 the Dutch parliament approved an amendment of the Telecommunications Act, which is soon likely to enter into force. The Telecommunications Act will enable 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 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, for example, a new EU Regulation for the screening of foreign direct investments (FDI Regulation) officially entered into force on 10 April 2019 and will apply as from 11 October 2020. Although the FDI Regulation 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. In response to the covid-19 outbreak, the EU Commission has indicated that member states need to be vigilant and use all tools at EU and national level to use or set up screening mechanisms where acquisitions or investments would be a risk to critical health infrastructures.27

The Dutch government submitted a draft bill implementing the FDI Regulation mid-January 2020; it has not yet been submitted to parliament. In addition, the Dutch government has announced that it will submit a draft bill on M&A screening mechanisms for takeovers or investments regarding vital infrastructure or technology affecting national security. Early June 2020, the Dutch government announced that it intends to introduce a reference date in the draft bill on M&A screening mechanisms.28 The reference date is set on 2 June 2020 and the government would retroactively screen takeovers and investments if there is reason to do so based on national security grounds, as per that date once the bill enters into force.

VII OUTLOOK

Over the past two decades, there have been several high-profile cases in the Dutch market 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) have been forced to shift their approach to some extent: from having confrontations over a company’s strategy at general meetings (by proposing agenda items), to engaging privately and publicly with boards to change the target company’s direction. As a result of these landmark cases, tools available to activists may seem to have lost some of their power over the years. But that’s not all. The introduction of the principle of long-term value creation in the Corporate Governance Code; the efforts made to restore the balance of power between boards and shareholders after the financial crisis; and, more recently, the regulatory developments in light of the protection of (certain) Dutch companies, have all contributed to changing how activist shareholders operate and execute their campaigns.

Despite all these changes, the continuous rise of shareholder activism over the years highlights the simple fact that it is here to stay. With this in mind, boards, management teams and general counsel of leading Dutch multinational corporations have to be vigilant and well prepared for the unexpected. Especially, considering that today, activist shareholders are — given these changed circumstances — more comfortable to engage in private negotiations with company boards. The fact that activist shareholders choose to fly under the radar makes them less predictable and makes it harder for the outside world to draw lessons from a company’s experience in dealing with an activist shareholder. Apart from continuously monitoring the company’s share price and shareholder base and, more frequently, taking a careful look at the company’s strategy and vulnerabilities, boards must actively prepare for activist shareholders and unwanted bidders, for example, by conducting simulations and trainings together with their advisors.

There is, however, one thing shareholder activism has not been proven immune to: the covid-19 pandemic and its effects on the global economy. In the immediate aftermath of the covid-19 outbreak, shareholder activist campaigns seem to have declined in Europe. One explanation for this is that M&A activity is now down across the globe, which historically has been one of the most important drivers for shareholder activism. The current volatility and instability of the public equity markets could, however, eventually lead to an increase in opportunistic moves by activist shareholders and strategic and financial parties because they could sweep up a company’s stock at a relatively low price, as compared with the underlying value of the company’s assets and value creation potential. Companies facing difficult financial situations may also increasingly be confronted with activist shareholders demanding changes to the company’s management or strategic path, in an attempt to turn the company around and creating shareholder value on the short- to medium-term. Whether activists will be successful in doing so and whether this will have positive effects on the company on the long term remain to be seen.

All in all, it is likely that the covid-19 pandemic will have an impact on shareholder activism for the next few years — both in terms of activity levels and activist themes. While the covid-19 pandemic has taught us to hold back on crystal ball gazing, a careful prediction is that while shareholder activism may dip on the immediate short-term it is expected to come back to pre-covid-19 levels in the years to come. Especially given the many challenges that companies are facing in the near future, it will be critical for companies to be prepared for when that moment comes and an activist shareholder is — remotely — knocking on the door.
Chapter 10

RUSSIA

Max Gutbrod

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 notable practical implications aimed at satisfying private shareholders interest. Also, it has become commonplace that if disclosure of information could be useful to take action, then requirements that force disclosure can be lifted, so that information relating to politically sensitive topics is not made available. Specifically, the risk of criminal procedures being started for seemingly insufficient reasons, an occurrence that has been happening more frequently.

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 because 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.

1 Max Gutbrod is self-employed lawyer.
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-reputaciia-kazahstana-inostrannye-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.
for companies with their main business in Russia. In addition to Russian corporate law, sometimes Russian rules on listing may 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’ 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 represented 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

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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

Furthermore, when purchasing 30 per cent or more of the total amount of the shares, the shareholder taking over must make an obligatory tender offer.10 Accordingly, shareholders could try, by being aggressive, to prompt such an offer. However, the number of related offers has been decreasing in recent years.11

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.12 Political tensions have been given as a reason for the proposal to declare further information as being confidential.13

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.14 Additionally, court practice has allowed companies to refuse shareholders information in cases of lack of ‘legitimate interest’ to receive the requested information.15 Moreover, companies can refuse to provide information to their shareholders referring to commercial confidentiality, and sometimes companies use this right extensively.16

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).
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 требования 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.
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. Because 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.\(^\text{17}\) However, attention to the detail of implementation of these rights was low and no stable funds or associations to represent minority shareholders emerged.

In the early years of stabilisation (2000–2005),\(^\text{18}\) 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.\(^\text{19}\) 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,\(^\text{20}\) and in particular the United States imposing countersanctions against individuals allegedly involved.\(^\text{21}\) While not actually directly related to shareholder activism, procedures against Mr Calvey and his partners that were started in 2019 and linked to a joint venture have also substantially increased the reluctance of investors to rely on the Russian legal system, and have rather strengthened the view that more influential parties have an ability to influence the outcome of legal procedures.\(^\text{22}\) The negative view of law implementation practice has further been exacerbated by criminal procedures related to the Russian Venture Capital Company.\(^\text{23}\)

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In sum,²⁴ it appears that the mentioned cases have showcased that any action bears major risks. While previously there had been an interest in shareholder activism, where a political motive for the activism was at least likely and such shareholder activism was used for political or private interests,²⁵ this type of politically motivated activism has not been seen in recent years. Furthermore, 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.

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.²⁶ 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 information²⁷ or to a shareholders’ meeting.²⁸ Also, there has been some argument that shareholders have a right to correction of the accounts of companies.²⁹ 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.³⁰

²⁶ 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/chatham/public_html/sites/default/files/20140300AssetGrabbingRussiaHanson1.pdf (accessed on 5 September 2016).
²⁷ 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=1OijwCQAAQBAJ&pg=PA428&lpg=PA428&dq=transneft+access+to+shareholders+meeting&source=bl&ots=6H5g392klHiS6dE2aXAI8UgZvsl&hl=ru&sa=X&ved=0ahUKEwj-5bV-evOAhV1KcAKHaeDBxEQ6AEILTAC#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.
²⁸ Information about important act can be found at www.transneft.ru/u/important_fact_file/5902/15-08-2016.pdf (accessed on 5 September 2016).

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V  REGULATORY DEVELOPMENTS

There have been many changes in corporate law over the past few years and, similarly to what was concluded in another context, it is not always easy to determine what purpose the many changes in 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 in the future.

31  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.’


I OVERVIEW

Shareholders play an important role in preserving balance in the corporate governance of a company. Even small minority shareholders have a legitimate interest in the governance of a company and a right to hold the board accountable. Substantial shareholders or management, or both, have historically been able to push through agendas without much shareholder resistance in Singapore, but this is changing: Singapore, like elsewhere in the world, is currently witnessing growing shareholder activism.

Recent noteworthy cases involving shareholder activism include Noble Group (Noble), Hyflux Ltd (Hyflux), Challenger Technologies Ltd (Challenger), HC Surgical Specialists Ltd (HC Surgical) and Magnus Energy Group Ltd (Magnus), as further described in Section IV.

II 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) with which companies listed on the Singapore Exchange (SGX) have to comply. 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:

- requiring a company to make specified disclosures;
- objecting to the appointment of individual directors or executive officers for a period not exceeding three years;
- requiring an issuer to appoint special auditors, compliance advisers, legal advisers or other independent professionals for specified purposes; and
- halting or suspending trading of listed securities of a company.

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1 Lee Suet-Fern is a director at Morgan Lewis Stamford LLC.
Singapore

i Restrictions on shareholding

Generally, there are no restrictions on shareholding ownership for Singapore companies. However, in certain key sectors including telecommunications, media, banking and real estate, there are specific legislative restrictions on foreign ownership. Such restrictions include requiring prior approval from the relevant regulatory authority:

a before a person can become a substantial shareholder (who has an interest of five per cent or more of the total voting shares of the company) or controller of a company operating in the key sector; and

b in respect of any funds from a foreign source invested into such a company. For property companies that own residential properties that are subject to foreign ownership restrictions under the Residential Property Act, foreign ownership of such property companies will be prohibited except in limited cases (such as where such property companies are housing developers developing the residential properties for sale).

These requirements may limit foreign ownership in these key industries and the possibility of foreign-based activists.

ii 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 at least 10 per cent of the total number of issued shares of the company. When requisitioning for a general meeting, the requisitioning shareholders will need to give the company’s directors up to 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 requisitioning shareholders 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 requisitioning shareholders 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 general meeting will require 14 days’ notice or a longer period as may be 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.

iii Shareholder transparency

Under the SFA, public disclosure is required of substantial shareholders. This interest of 5 per cent or more must be disclosed by a substantial shareholder even if the shares are held through nominees. However, in respect of a shareholder who holds an interest of less than 5 per cent as a nominee, the actual beneficial shareholder(s) may not be apparent. A listed company is also required to disclose all interests in shares and other securities issued that its directors and chief executive officer have in the company.
iv  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.

v  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.

vi  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. The CA, therefore, 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. Such action 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 require the complainant to establish the higher threshold that the errant directors committed fraud on the minority.

vii  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 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.

viii  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 others, 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 and other shareholders, it is possible that insider information may have been divulged, in which case the activist shareholder must not deal or encourage another to deal in the company’s securities until the material price-sensitive or trade-sensitive information has been disseminated to the public.

ix  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 suits. Though defences such as justification and fair comment are available, the law in this area in Singapore is very extensive and an activist shareholder should seek expert advice.

III  KEY TRENDS IN SHAREHOLDER ACTIVISM

i  Hedge fund activism
The corporate landscape in Singapore is changing as new hedge funds are set up with a focus on influencing the way local listed companies are run and maximising returns for its investors. For example, smaller companies with substantial cash or reserves may be targeted by activists who may push for payment of special dividends or share buy-backs. Though such activist pressure on companies is generally welcomed by minority shareholders, these initiatives may not be successful given that it is quite common for Singapore companies to have significant controlling blocks of shares.

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, primarily on strategy, financials and corporate governance. SIAS also conducts workshops on the analysis of 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.

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 stated that it prefers a conciliatory approach to resolving investors’ rights issues.
iii Media and commentators

Corporate governance analysts and commentators are often 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. When such issues are highlighted, companies may be requested by regulatory bodies to publicly address its shareholders’ concerns or may be compelled to make appropriate disclosure.

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 garner support from other investors to call for a meeting to change the REIT manager. As a result, key changes were made by the REIT manager, including the departure of its CEO, partial waiver of management fees and termination of a contentious acquisition.

IV RECENT SHAREHOLDER ACTIVISM CAMPAIGNS

i Noble

Noble announced a debt restructuring plan in January 2018, which would dilute existing shareholders to a mere 10 per cent stake in the restructured entity, whereas Noble’s management stood to receive a 20 per cent stake in the restructured entity without any capital injections. This 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 previous financial year and a payout of over US$35 million to the directors.2 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 technically 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 of 20 per cent in the restructured entity, 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.

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ii Hyflux

Since filing for bankruptcy protection in May 2018, Hyflux has entered into agreements with the investor consortium Salim-Medco (in October 2019) and UAE utilities provider Utico FZC (Utico) (in November 2019) for its restructuring. Retail investors comprising Hyflux's perpetual securities and preference shares actively sought to rally support to reject the company's restructuring plans due to the steep haircuts that would have been imposed. They also protested the Public Utilities Board's decision to take over Tuaspring, Hyflux's desalination and power plant for zero cost, and their activism included organising a public demonstration. Neither restructuring plans proceeded – with Hyflux cancelling its restructuring agreement with Salim-Medco, citing 'no confidence'\(^3\) that the investor will complete the deal in April 2019, and Utico's restructuring agreement ceasing in May 2020 following the lapse of the long-stop date.

Hyflux and its current and former directors are now under criminal investigation by the Criminal Affairs Department, Accounting and Corporate Regulatory Authority (ACRA) and Monetary Authority of Singapore (MAS) over corporate governance lapses. SIAS has called for the directors of Hyflux to step down and has stated that it had been approached by investors to initiate legal action against Hyflux's directors.

iii Challenger Technologies Ltd

In March 2019, Challenger, together with Digileap Capital Limited (a partnership between Loo family that founded Challenger and Dymon Asia Private Equity) (Digileap), announced a voluntary delisting proposal, under which Digileap will make an exit offer for Challenger's shares. Shortly after the announcement, Pangolin Investment Management (Pangolin), a minority shareholder, engaged the media to proffer its views that the offer price was too low and unfair for minority shareholders, notwithstanding that the exit offer was ultimately opined by the independent financial adviser appointed by the company to be ‘fair and reasonable’. Reaching out to other like-minded minority shareholders, Pangolin managed to consolidate a shareholding block of more than 10 per cent and were able to derail the privatisation of Challenger by voting down the voluntary delisting resolution at the general meeting (based on the voluntary delisting regime prior to the changes implemented by the SGX in July 2019).

iv HC Surgical

In April 2020, an article by a corporate governance analyst raised the implications of the dismissal of a defamation suit filed against Ms Serene Tiong by Dr Julian Ong on HC Surgical. Dr Ong previously sold a total of 70 per cent shareholding stake in his medical practice Julian Ong Endoscopy & Surgery Pte Ltd (JOES) to HC Surgical. It surfaced in the dismissed defamation suit that Ms Tiong had filed a complaint to Singapore Medical Council in June 2018 against Dr Ong and another doctor, alleging that they had been taking advantage of vulnerable female patients. The article raised questions on whether HC Surgical had made necessary timely disclosures and if the board had acted in its shareholders’ interests when it purchased a further 19 per cent shareholding in JOES in September 2019, notwithstanding knowledge of the serious complaint made against Dr Ong. This triggered a list of queries from the SGX to HC Surgical, resulting in more detailed disclosure from

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3 Hyflux announcement of 4 April 2019.
HC Surgical. Subsequently, Ms Tiong (as a shareholder) gave notice to HC Surgical of her intention to apply to the Court under Section 216A(2) of the CA to bring an action on behalf of the company against Dr Heah Sieu Min (CEO and Executive Director of HC Surgical), for breaching his duties as a director in relation to the acquisition of the additional interest in JOES.

v Various shareholder-initiated general meetings

Another indicator of growing shareholder activism in Singapore is the increasing number of shareholder-initiated meetings. These shareholder-initiated meetings involved, among others, proposals to remove existing directors and to appoint new directors on the board of the relevant companies.

One such recent case involved Magnus and a group of its minority shareholders. Unhappy with the poor financial performance of Magnus, the minority shareholders garnered sufficient support to reject all resolutions put forward at Magnus’ AGM in October 2019. This resulted in the ousting of three directors, blocking the reappointment of the auditor as well as the mandate to issue shares or pay directors’ fees. These minority shareholders then pressed on to requisition Magnus’ board for a general meeting to appoint their own directors. They also initiated a proceeding against present and past directors of Magnus for breaches of their fiduciary duties. In January 2020, all resolutions proposed by requisitioning shareholders at a general meeting were passed, and the new shareholder-elected board took over management of Magnus.

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, which meant that not all views of their investors were represented. Under the multiple proxies regime, specified intermediaries, such as banks whose business includes the provision of nominee services and hold shares in that capacity, and capital markets services licence holders providing custodial services and hold shares in that capacity, are allowed to appoint more than two proxies to attend and vote at general meetings. This legislative change enfranchises such 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.

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. 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.
iii  Enhanced continuous disclosure obligations for listed companies

In February 2020, amendments were made to the Listing Manual to strengthen the continuous disclosure requirements. Specifically, the SGX updated its guidance on continuing obligations of listed companies in respect of the disclosure of material information to explicitly include information necessary to avoid the establishment of a false market in listed securities – ‘trade-sensitive information’, and information likely to materially affect the price or value of listed securities – ‘materially price-sensitive information’. The corporate disclosure policy in the Listing Manual was amended to provide assistance to listed companies in the determination of whether information is trade-sensitive or materially price-sensitive. Additional events requiring immediate disclosure were also included. Since then, RegCo has issued some guidance on its expectations of disclosure of information:

- on significant litigation;
- during covid-19 outbreak; and
- to shareholders in connection with a general offer.

iv  Enhanced audit disclosure

Two key changes have been made to audit reports to provide more pertinent information on companies to investors and other users in their decision-making.

First, auditors of listed companies will be required to communicate ‘key audit matters’ (KAMs) in their audit reports beyond the current ‘pass or fail’ opinion. KAMs are matters that auditors judge to be of significance in the audit of financial statements. This move to compel the disclosure of KAMs enables investors to gain insights on the significant audit risks identified and to have more focused and meaningful discussions with the board.

Second, auditors are 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.

vi  Revised Code of Corporate Governance

The MAS revised and streamlined the Governance Code in August 2018 to make it more concise and less prescriptive. This was to encourage thoughtful application and move away from a ‘box-ticking’ mindset. Important requirements and baseline corporate governance practices have been shifted to the Listing Manual for mandatory compliance. It will also be mandatory to comply with the core broad principles of corporate governance set out in the Governance Code.

The changes put 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.
vii 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 has an advisory role, without 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 chair and members are appointed by the MAS.

viii Changes to the voluntary delisting regime
Following the delisting of Vard Holdings, whereby its controlling shareholder, Fincantieri Oil & Gas, pushed through the delisting as it could vote on the offer despite an outcry from minority investors and opposition over what they considered was a low ball offer, RegCo sought feedback on proposed amendments to the voluntary delisting regime to protect the interests of minority shareholders in privatisations. Consequently, the SGX implemented changes to the voluntary delisting regime in July 2019. Under the revised rules, the SGX may agree to a voluntary delisting application if the voluntary delisting resolution has been approved by a majority of at least 75 per cent of the listed company's total number of issued shares (excluding treasury shares and subsidiary holdings) held by the shareholders present and voting at the general meeting. Although the 10 per cent blocking threshold has been removed, the offeror and parties acting in concert with it are now required to abstain from voting on such resolution. Additionally, the rules have been enhanced such that an independent financial adviser must be appointed to opine that an exit offer is not merely reasonable but also fair. The practice to require an exit offer to include a cash alternative as the default alternative has also been codified as a Listing Manual requirement.

VI OUTLOOK
Shareholder activism has risen and is expected to continue to increase in Singapore as a result of a confluence of factors, including increasing investor sophistication, louder voices by investor lobby groups and some facilitative regulatory changes. Companies and their boards in Singapore need to prepare for a changing corporate landscape by proactively developing a shareholder engagement plan, so that mutual understanding and different expertise can converge. 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.
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;\(^2\)
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. monetising assets (e.g., by forcing divestitures or spin-offs); and
h. 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 De Bruyn and Christopher White for their helpful research assistance.


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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. In 2019, 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, within

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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.
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. 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.

Similarly, a shareholder may apply to court for appropriate relief if:

a  any act or omission of the company has had a result;
b  the business of the company is being carried on in a manner; or
c  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.

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. A company may apply to court to set aside the demand only on the grounds that it is frivolous, vexatious or without merit.

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
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. 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.

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. Additionally, it seeks to ‘balance the rights and obligations of shareholders and directors within companies’.

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

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10 The issuer then has 48 hours to disclose the acquisition to the market and shareholders.
12 See the purposes of the Companies Act, Section 7(i).
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.

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 assets of the Government Employees Pension Fund and other social security funds – 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 2019, the PIC reported having assets under management worth 2.131 trillion rand.\(^\text{13}\)


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

The objectives of activists vary, and activists will use different tactics and strategies in pursuit of their objectives. Shareholder engagement is more often than not private, ‘behind closed doors’, but may play out in public. Institutional investors are very influential, particularly when acting collaboratively.
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 have had to reconsider their remuneration policies following significant shareholder opposition to such policies or implementation reports.\(^\text{14}\)

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. A noteworthy example of this was in 2014, involving PPC, a cement manufacturer, where activists sought to remove the entire board.\(^\text{15}\) Additionally, JSE-listed engineering firm PSV Holdings experienced a dramatic turn of events at its November 2019 AGM, when the recently ousted CEO managed to secure enough shareholder support to regain control and vote down resolutions for the election of four directors to the board.\(^\text{16}\)

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,\(^\text{17}\) and Prudential’s opposition to an attempted takeover of poultry producer Sovereign Foods by Country Bird Holdings.\(^\text{18}\) An example of the latter is Grand Parade Investment’s (GPI) disposal of its interests in certain franchises (described in Section IV).

Recent campaigns, for example that against La Concorde (described in Section IV), also 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.

\(^\text{14}\) 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 any part of this remuneration policy, the board must engage with shareholders in good faith to understand shareholder dissatisfaction and the reasons for dissenting votes. The board is required to appropriately address reasonable and legitimate concerns raised in the evaluation of performance. Although the advisory vote given to shareholders is non-binding, this vote coupled with increased disclosure enables greater shareholder activism in that it encourages the board to engage with shareholders, promotes transparency and provides shareholders with a platform to express their dissatisfaction.

\(^\text{15}\) 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.


\(^\text{17}\) 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.

Outcomes and the path to resolution

Recent campaigns relating to climate-related matters, particularly in the banking sector, demonstrate that activists can use a variety of different approaches to pursue the same ends, with varying degrees of success and a range of possible outcomes. Outcomes also depend to a large extent on the approach adopted by the target company in responding to an activist campaign: responses vary from summary dismissal, to collaborative engagement, to active opposition.

As noted above, shareholder activists who hold even nominal stakes in companies are afforded relatively strong rights and protections. Companies should focus on 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 preparing for increased shareholder activism in South Africa, companies should continually and carefully monitor their shareholder portfolios for activists, assess potential vulnerabilities, and anticipate and prepare for campaigns on a case-by-case basis. Boards and companies that can demonstrate value creation over time, adherence to principles of good governance, including careful stakeholder engagement and responsible corporate citizenship, are less likely to find themselves vulnerable to activism. They are also more likely to have anticipated and planned for activism, and to be able to successfully communicate a well-articulated, carefully prepared and strategic response to particular instances of activism.

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. 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

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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.20

**ii Standard Bank**

In 2019, 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).21 Following this campaign, in March 2020, Standard Bank became the first major South African lender to release a coal-lending policy.


21 See Notice of Standard Bank 2019 AGM, available at: https://thenvault.exchange/?get_group_doc=18/1555481722-SBGShareholdersinfoandnoticeofAGMLORESingles.pdf, and results of the AGM, available at: http://research.mcgregorbfa.com/NewLibraryDocuments/SENS/SENS_20190530_S415606.pdf. See also www.moneyweb.co.za/news/companies-and-deals/standard-bank-shareholders-vote-down-climate-risk-resolution; and www.businesslive.co.za/bd/companies/financial-services/2019-05-30-greens-to-standard-bank-well-be-back. In April 2018, the same activists combined to propose a resolution at the AGM of Sasol, a JSE-listed energy and chemical company. The proposed resolution sought to have Sasol, currently one of the largest contributors to greenhouse gas emissions in South Africa, prepare an annual report detailing its plans for addressing climate-related 'transition risks'. However, Sasol declined to table the proposed resolution on the basis that it addressed matters falling solely within the purview of board and management, and therefore did not meet the statutory requirement of being a matter on which the proposing shareholders were entitled to vote. Weeks later, Tencor, a global leader in the container industry, used the same argument as Sasol to justify its refusal to table at its AGM a resolution proposed by a small group of shareholder activists. The proposed resolution sought to compel Tencor to use its position as a substantial shareholder of Textainer to, among other things, compel Textainer to remove its 'poison pill' by-laws and takeover defence provisions by making board consent a prerequisite to a
This year, prior to Standard Bank’s AGM, the Raith Foundation and Just Share sought to table a resolution to require the bank to adopt a policy on lending to carbon-intensive, fossil fuels activities, and to commit to a deadline for enhanced disclosures related to climate risk. The board of Standard Bank declined to table the resolution at its AGM, on the basis that the proposed resolution did not meet the statutory requirement of being a matter on which the proposing shareholders were entitled to vote. The resolution would, in effect, usurp the role of the board, which has primary responsibility for managing the business and affairs of Standard Bank, and ignored the significant work already being undertaken by the bank in these areas.

After the bank declined to table the resolutions, Just Share and other NGOs publicly called for shareholders not to elect or re-elect five of Standard Bank’s board members on the basis that the directors are conflicted on climate-related matters due to their ties to the fossil fuels industry.22 Standard Bank recommended the re-election of the directors on the basis that the directors concerned are all nonexecutive directors who inevitably serve on different companies’ boards and, in any event, the Companies Act has mechanisms in place to deal with conflict of interest issues.23 Shareholders overwhelmingly voted to approve the election and re-election of the directors concerned at Standard Bank’s AGM on 26 June 2020.

iii Sasol

In April 2018, Theo Botha and the Raith Foundation combined to propose a resolution at the AGM of Sasol, a JSE-listed energy and chemical company. The proposed resolution sought to have Sasol, currently one of the largest contributors to greenhouse gas emissions in South Africa, prepare an annual report detailing its plans for addressing climate-related ‘transition risks’. Sasol declined to table the proposed resolution on the basis that it addressed matters falling solely within the purview of board and management, and therefore did not meet the statutory requirement of being a matter on which the proposing shareholders were entitled to vote.24

The following year, six major South African institutional investors – Old Mutual, Sanlam, Abax Investments, Coronation, AEON Investment Management and Mergence Investment Managers – tabled a shareholder resolution for the Sasol AGM in November

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24 Weeks later, Tencor, a global leader in the container industry, used the same argument as Sasol to justify its refusal to table at its AGM a resolution proposed by a small group of shareholder activists. The proposed resolution sought to compel Tencor to use its position as a substantial shareholder of Textainer to, among other things, compel Textainer to remove its ‘poison pill’ by-laws and takeover defence provisions by making board consent a prerequisite to a third party’s acquisition of control. See Business Day, 18 July 2018, Ann Crotty, ‘Tencor rejects minorities’ bid for resolutions on protection by-laws’, available at: www.businesslive.co.za/bd/opinion/2020-06-22-standard-bank-is-helping-africa-chart-a-green-energy-path/.

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2019. The six had rejected Sasol’s climate change plan on the grounds that the plan was not comprehensive enough and did not align with the Paris Climate Agreement. The resolution therefore sought ‘greater transparency from the company on how its long-term greenhouse gas emission reduction strategy and executive rewards align with the Paris Climate Agreement’. It sought to require Sasol to publish its annual climate risk reports from 2020 onwards and its quantitative greenhouse gas targets aligned with the Paris Agreement. The board, however, declined to table the resolution on the basis that the matters raised by the shareholders ‘have been addressed and there is no longer any necessity to consider the legality of those resolutions for the upcoming AGM’.25

Shortly after the campaign Sasol pledged further action on climate-related issues (it had already pledged to reduce greenhouse gas emissions by at least 10 per cent by 2030), and in May this year invited bids from independent power producers for the supply of renewable energy to its local operations.

iv 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.26 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).27

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 from 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

26 See Cilliers v. La Concorde Holdings Ltd and Others 2018 (6) SA 97 (WCC).
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 active 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 June 2019, the FSCA published Guidance Notice 1 of 2019 for pension funds on Regulation 28 of the Pension Funds Act 24 of 1956. The latter imposes a legal obligation on pension funds to, before making an investment in and while invested in an asset, consider any factor that may materially affect the sustainable long-term performance of the asset, including ESG factors. The Guidance Notice recommends ‘active ownership’ by pension funds, being the prudent fulfilment of responsibilities relating to the ownership of, or an interest in, an asset. These responsibilities include guidelines to be applied for the identification of sustainability concerns in that asset, and mechanisms of intervention and engagement with the responsible persons in respect of the asset when concerns have been identified.

In November 2018, following 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’. These rules are still under discussion.

VI  OUTLOOK

While globally and locally there has been a dip in activist campaigns due to the impact of the covid-19 pandemic, activity is expected to pick up as the economy recovers.

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.

28 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).


Shareholders are becoming increasingly active on such matters as diversity, board composition, performance and tenure, executive remuneration policies, transparency, ESG and sustainability. This is being driven in part by increasing civic action on high levels of inequality, climate and sustainability, ongoing debates about corporate purpose, enhanced reporting and disclosure requirements, and the recent changes introduced by the King Code.

Issues relating to ESG and sustainability are the focus of many recent campaigns and will remain high on the agenda. We expect local and international institutional investors, in particular pension funds, mutual funds, and insurers, to play an increasingly active and pivotal role in influencing corporate strategy and M&A with reference to sustainability and ESG factors. Careful consideration of these issues has become essential to corporate strategy and governance. Companies that pay inadequate attention to these issues are increasingly likely to become exposed to physical and transition risks (business, credit, market, reputational and legal), which could have a material adverse effect on their businesses over the medium- to long-term.
Chapter 13

SOUTH KOREA

Hyeon Deog Cho, Joon B Kim, Byoung Kwon Park and Eun-Young Lee1

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\(^5\) 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.

The current KCC has not adopted a multi-step derivative lawsuit claim. However, on 11 June 2020, the MOJ issued a pre-announcement of the proposed amendment to the KCC, which will allow a shareholder of a parent company that holds at least a certain number of shares to file a derivative lawsuit against a director of a subsidiary if, for example, the director of the subsidiary causes damages to the subsidiary due to dereliction of his or her duties.

**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\(^6\) 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).\(^7\) The Seoul High Court took a similar stance in the case concerning KCGI’s\(^8\) request for a preliminary injunction for presentation of agendas against Hanjin KAL.\(^9\) However, the trial court of the

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\(^5\) For an unlisted company, a shareholder holding at 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.
Hanjin KAL case\textsuperscript{10} 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.

**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 a set period. In the past, the FSCMA had classified the purpose of shareholding based on whether or not the holder(s) of such shareholding intends to influence corporate management. However, with the amendment to the Enforcement Decree to the FSCMA (FSCMA-ED) in January 2020, the purpose of shareholding is now further divided into:

\begin{enumerate}
\item management influence (in cases where its purpose is to influence corporate management as described in the FSCMA-ED\textsuperscript{11});
\item general investment (in cases where its purpose is to implement active shareholder engagement without an intent to influence corporate management); and
\item simple investment (in cases where its purpose is to exercise voting and other rights that are irrespective of the shareholding ratio), and disclosure obligations are imposed on a differentiated basis, reflecting the latest trends toward increase in shareholder engagement by the NPS and other institutional investors.\textsuperscript{12}
\end{enumerate}

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.

\begin{itemize}
\item Seoul Central District Court Decision No. 2019Kahap20313, rendered on 28 February 2019.
\item The amended FSCMA-ED excludes shareholder activities related to, for example, issuance of dividends, amendment to the articles of incorporation to improve corporate governance in line with pre-disclosed principles, and exercise of the right to request dismissal against a director’s unlawful conduct from activities ‘to influence corporate management’.
\item Since the amendment to the FSCMA-ED, the NPS has changed its purpose of shareholding from ‘Simple Investment’ to ‘General Investment’ with respect to 56 major listed companies including Samsung Electronics, SK Hynix, and Hyundai Motor Company.
\end{itemize}
**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 (such as direct solicitation, requesting shareholders to vote in a certain manner and sending proxy forms to shareholders) 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 trustor 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.

**ii Other sources of practice guidelines**

**Korea Stewardship Code**

On 16 December 2016, the Korea Corporate Governance Service (KCGS) 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:

- **a** formulate and disclose a clear policy to implement their stewardship responsibility;
- **b** formulate and disclose a voting policy; and
- **c** regularly report their voting and stewardship responsibilities.

The Korean Stewardship Code is not legally binding as it 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.

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13 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.
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.

iii 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 and from friendly shareholders, adopting shareholder-friendly policies, securing a favourable impression from general shareholders and the market by disclosing financial or non-financial (environmental, social, governance – ESG) information in an open manner and actively conducting IR activities, and effectively communicating with institutional investors.

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.\textsuperscript{14} In the traditional investment climate of Korea, participation in corporate management was perceived as an intrusion into corporate control,\textsuperscript{15} 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 (see table in Section V for major NPS activities in the second-half of 2019 and the first-half of 2020). In addition to the NPS, the Teachers’ Pension (TP) and the Government Employees Pension Service (GEPS) each adopted the Korean Stewardship Code in December 2019 and February 2020 respectively,\textsuperscript{16} signalling the potential commencement of more active exercise of shareholder rights. As such, shareholder activism from institutional investors is likely to increase.

\textbf{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:

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

\textbf{iii Shareholders’ campaigns}

\textbf{Key objectives of activist campaigns}

The objectives of the activist campaigns in Korea do not differ significantly from those of other jurisdictions. They encompass:

\begin{itemize}
  \item[a] 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;
  \item[b] dividend increase, treasury stock acquisition and optimisation of capital structure; and
  \item[c] disposal of non-core assets and pursuing mergers and acquisitions as business strategies.
\end{itemize}


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. Despite the opposition from Elliot Management, the merger of Samsung C&T and Cheil Industries was approved by the extraordinary general meeting of shareholders of Samsung C&T.

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).\textsuperscript{17} The per share dividend payment planned by Hyundai Motor Company was approved by the ordinary general meeting of shareholders. In 2020, KB Shareholder Value Focus Fund proposed that Hyosung TNC increase the dividend rate to 30 per cent to pay out a dividend of 12,500 won per share and demanded that Hyosung TNC justify the basis of the decision by its management to lower the dividend rate from 20 per cent to 9 per cent, but the cash dividend of 2,000 per share (dividend rate: 9 per cent) decided by the management was approved by the 2020 ordinary general meeting of shareholders of Hyosung TNC.

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. KCGI proposed an agenda to place its preferred outside director on Hanjin KAL’s board in 2019\textsuperscript{18} and also proposed an agenda to appoint inside, outside, and other non-executive directors in 2020, together with friendly shareholders with whom it entered into a joint equity agreement, but the proposal was rejected at the 2020 ordinary general meeting of shareholders.

\textbf{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.

\textbf{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.

\textsuperscript{17} Announcement of the general meeting of shareholders, 26 February 2019, http://dart.fss.or.kr/dsafo01/main.do?rcpNo=20190226002697.

\textsuperscript{18} 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 KCC).
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 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. In South Korea, in order to secure enough shares to compete with the largest shareholder and its friendly shareholders or compete for corporate control at the general meetings of shareholders, some activist funds are moving a step further from a mere proxy fight to an active formation of alliances by signing joint equity agreements early on with major shareholders other than the shareholder that has control over the company.

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 are also among the key strategies used by activist shareholders.

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 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.

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19 See Value Hanjin (http://valuehanjin.com) opened by KCGI, and Accelerate Hyundai (www.acceleratehyundai.com) opened by Elliott Management.

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).21

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 million22 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

21 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).
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, except for the establishment of compensation and management transparency committees, which was not opposed by Hyundai Motor Company and Hyundai Mobis, 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 shareholder of Hanjin KAL by acquiring a 9 per cent stake in the company.23 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 2019.24 It has consistently been calling for improvement of Hanjin KAL’s corporate governance.

In December 2019, KCGI increased its stake in Hanjin KAL to 17.29 per cent.25 Then, in January 2020, KCGI entered into a joint equity agreement with respect to Hanjin KAL shares with Heather Cho (the older sister of Walter Cho, who is the incumbent Chairman / CEO, and the largest individual shareholder of Hanjin KAL) and Bando Group’s affiliates to increase the shareholding ratio to as high as 32.06 per cent26 in order to make a shareholder’s

proposal in the 2020 ordinary general meeting of shareholders and actively exercise its voting rights. In February 2020, KCGI proposed agenda to appoint eight inside and outside directors and to amend the articles of incorporation, which included the adoption of the electronic voting system and strengthened qualification requirements that were to be applied to directors. In its board of directors’ meeting held in March 2020, Hanjin KAL decided to present the whole agenda proposed by KCGI at the 2020 ordinary general meeting of shareholders, but they were all voted down by the 2020 ordinary general meeting of shareholders. In April 2020, KCGI again acquired Hanjin KAL shares to increase its shareholding ratio to as high as 42.74 per cent, signalling further shareholder engagement.27

V  REGULATORY DEVELOPMENTS

A number of bills designed to amend the KCC for stronger minority shareholders’ rights that were pending at the 20th National Assembly (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) failed to ultimately pass at the National Assembly and were automatically abolished with the ending of the 20th National Assembly on 29 May 2020.28

Since the NPS’ adoption of the Korean Stewardship Code in July 2018, the TP and the GEPS that are representative public pension funds have each adopted the Korean Stewardship Code in December 2019 and February 2020. As such, a growing number of institutional investors are adopting the Korean Stewardship Code.29 In December 2019, the NPS adopted a resolution to prepare a ‘guideline for active shareholder activism’ that aims to promote transparent and fair shareholder engagement in compliance with the Stewardship Code.30 The NPS is expected to engage in shareholder activities when there are issues that can undermine corporate value involving, for example, dividend policy and remuneration paid to executives ESG. (See the table below for major activities of the NPS in the second-half of 2019 and the first-half of 2020).

<table>
<thead>
<tr>
<th>Major activities of the NPS in 2020</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Type</strong></td>
</tr>
<tr>
<td>Prior disclosure of voting direction and actual voting</td>
</tr>
<tr>
<td>Change of objective of shareholding</td>
</tr>
</tbody>
</table>

28 However, the proposed amendment to the KCC is part of the major campaign pledges of the ruling party, which won majority seats in the 21st National Assembly (see Campaign Pledge Booklet of the Democratic Party); this is why the 21st National Assembly could push ahead with the same amendment.
30 NPS Resolution dated December 27, 2019, https://fund.nps.or.kr/jppage/fund/fundCms/view.jsp?seq=23738&cPage=1&cmsId=KD860&S=7K=&&SW=
Announcement of NPS guidelines for active shareholder activism

The NPS prepared a ‘guideline for active shareholder activism’ that would serve as a criteria for shareholder activism with regard to: (1) dividend policy; (2) appropriateness of remuneration paid to executives; (3) undermining of corporate value/rights and interests of shareholders; (4) failure to make improvements despite the exercise of opposing voting rights; and (5) drop in ESG ratings given by the NPS.


VI OUTLOOK

It is expected that shareholder activism in Korea will continue to become more active given that major Korean companies continue to have corporate governance issues and many stakeholders are 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.

However, due to covid-19, the situation for many companies has worsened and the business environment is expected to greatly change amid the prolonged pandemic. This may also change the way activists engage in shareholder activities and types of their activities.

31 On 11 June 2020, the MOJ issued a pre-announcement of the following proposed amendment to the KCC: (1) Separate election of audit committee members of a listed company: One or more directors who will also sit on the audit committee shall be separately elected from other directors, and restriction on voting rights will be applied from the election stage; (2) Strengthening restrictions on voting rights of the largest shareholder when electing audit committee members of a listed company: Regardless of whether the audit committee member elected by a listed company is an inside director or an outside director, the largest shareholder cannot exercise his or her voting rights for shares exceeding 3 per cent (including all the shares held by his or her related parties); (3) Introduction of multi-step derivative suit: Allows a shareholder of a parent company to file a derivative suit against a director of a subsidiary; (4) Relaxation of requirements for passing resolution when introducing electronic voting: Relaxes the requirements for passing resolution at a general meeting of shareholders only if electronic voting is conducted when electing statutory auditors or members of audit committee; and (5) Clarifications of minority shareholders right related provisions: Explicitly stipulates that minority shareholders’ rights based on general provisions and minority shareholders’ rights based on special provisions may be selectively applied.
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 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  the company's structure seems improvable, that is, by pursuing or preventing M&A activities; and

f  corporate governance issues, in particular if the company does not meet 'best practices' recommended by proxy advisory firms or if the management’s performance is below average.

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.

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1  David Oser is a partner and Karin Mattle is a senior associate at Homburger AG.
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 activist shareholders of listed companies.² 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. 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.

² Pursuant to the bill modernizing Swiss corporate law, which was approved by the Swiss parliament on June 19, 2020 and which is expected to enter into force in the second half of 2021 at the earliest (the Swiss Corporate Law Reform Bill), the Ordinance will become part of the CO.
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.

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.³

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.⁴

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.⁵ If the board does

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³ Pursuant to the Swiss Corporate Law Reform Bill, the thresholds will be lowered to 0.5 per cent of the share capital or votes (for non-listed companies to 5 per cent).

⁴ Pursuant to the Swiss Corporate Law Reform Bill, the thresholds will be lowered to 5 per cent of the share capital or votes (for non-listed companies to 10 per cent).

⁵ Pursuant to the Swiss Corporate Law Reform Bill, the board must comply with the request at the latest within 60 calendar days.
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.

**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.

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6 This obligation, however, is expected to be introduced pursuant to the Swiss Corporate Law Reform Bill.
7 Pursuant to the Swiss Corporate Law Reform Bill, shareholders holding 5 per cent of the share capital may inspect books and records of a company without board or shareholder approval, unless business secrets or other protection-worthy interests of the company are at risk.
8 With the Swiss Corporate Law Reform Bill, the threshold will be lowered to 5 per cent of the share capital or voting rights (for non-listed companies to 10 per cent).
**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

Switzerland has seen a significant increase in campaigns of activist shareholders up to 2016, a stabilisation in 2017 and 2018, and a slight decrease in campaigns in 2019.9 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 public tender offers (Syngenta/Monsanto and Panalpina Welttransport (Holding) AG/DSV A/S).

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 not often 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 targeted by shareholder activists because 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 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 Nestlé
This 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. Since then Third Point has eased its pressure on Nestlé.

iii 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. 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 to SABIC, which in the meantime had increased its stake to 25.67 per cent.

iv Panalpina
In 2019 activist investor Cevian Capital (Cevian), who previously succeeded in replacing the chairman of Panalpina Welttransport (Holding) AG (Panalpina), became active in connection with the planned takeover by DSV A/S (DSV), with which Cevian wanted to proceed but Panalpina’s largest shareholder, the Ernst-Göhner-Stiftung (ESG), rejected. Due to diverging views with respect to the planned takeover, the question whether or not the voting cap of 5 per cent of the shares in Panalpina, which was included in Panalpina’s articles of association, was applicable to ESG or not, became significant. In the past, ESG, who held approximately 46 per cent of the shares in Panalpina, had been voting its full stake in reliance upon a so-called ‘grandfathering’ although the articles of association of Panalpina contain a 5 per cent voting cap. ESG proposed the abolition of the voting cap at an extraordinary shareholders’ meeting (EGM). In view of the EGM, Cevian commissioned various legal studies concluding that the initial decision to exempt ESG from the voting cap was incorrect. The EGM never took place because Panalpina reached a deal with DSV, which both Cevian and ESG accepted irrevocably, immediately before the EGM. Even before the stock exchange settlement of the transaction in October 2019, Cevian sold its stake in DSV Panalpina.
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. After its unsuccessful campaign against Credit Suisse, RBR ceased its activities as activist investor.

Sunrise

In 2019, the planned acquisition of UPC by Sunrise Communications Group AG (Sunrise) failed because Sunrise’s main shareholder, Freenet, and activist shareholder Active Ownership Capital (AOC) opposed the acquisition. In order to finance the acquisition, a capital increase of Sunrise in the amount of 2.8 billion Swiss francs, and hence shareholder approval of the deal, was required. After announcement by a coalition of shareholders, including Freenet, to vote against the capital increase, Liberty Global – the owner of UPC – tried to save the deal by announcing its intention to subscribe 500 million Swiss francs in the capital increase. The proposed investment of Liberty Global was not sufficient to change the shareholders’ view. The board of Sunrise concluded that a clear majority of shareholders who had registered their shares to vote at the EGM would not support the capital increase and therefore, cancelled the EGM. Sunrise then terminated the share purchase agreement against payment of a 50 million Swiss francs break-up fee.

Aryzta

On 6 May 2020, Veraison Capital AG (Veraison), a Swiss activist shareholder that had previously launched activist shareholder campaigns against Comet, Implenia, Orell Füssli, Calida, Zehnder and Swatch Group, announced that it holds 3.2 per cent of the share capital of ARYZTA AG (ARYZTA), a food business company specialising in baked goods. It subsequently increased its participation to 7.3 per cent and formed a shareholder group with the Spanish investor Cobas Asset Management (Cobas), which has held a participation in ARYZTA since 2017 and was the main opponent against Aryzta’s share capital increase in 2018, and Hainer and Michaela Kamps. The group, which holds as of 2 July 2020 20 per cent of the shares in ARYZTA, requested an extraordinary general meeting and proposed the replacement of five board members (including the CEO) by three new board members, and the election of two of these three proposed new board members as members of the remuneration committee. On 20 July 2020, ARYZTA published the invitation to an extraordinary general meeting to be held on 16 September 2020. Although the board is of the opinion that continuity on the board is in the best interests of ARYZTA and, therefore, no board member should be dismissed, two of the current board members of ARYZTA have declared their resignation with effect as of the conclusion of the extraordinary general

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meeting. Further, the chair announced that he will declare his resignation as chair and board member, unless ARYZTA can present to the shareholders a transaction that is in the best interests of its shareholders and stakeholders. Although the board would support the election of up to two new board members as a consequence of the resignations, it proposes the rejection of the proposals of the shareholder group for election of new board members because the shareholder group has not agreed to submit its candidates for evaluation by ARYZTA’s nomination process. The board further rejects the dismissal of board members proposed by the shareholder group.

V REGULATORY DEVELOPMENTS

A significant overhaul of the rules and regulations governing activist shareholders’ campaigns is currently not expected. The Parliament, however, has approved the Swiss Corporate Law Reform Bill as further described in footnotes 2–8, which are expected to come into effect in the second half of 2021 at the earliest. Besides the changes mentioned in the footnotes, the delisting of a company’s shares from a stock exchange, which today is in the board’s sole authority, would pursuant to the Swiss Corporate Law Reform Bill require shareholder approval (two-thirds of the votes represented and the majority of the capital, each as represented at the general meeting).

VI OUTLOOK

On the basis of 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, campaigns of shareholder activists are expected to increase and become more of a mainstay of Swiss corporate law. 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 currently experienced by shareholder activists, owing to the lack of a direct access to the company’s share register.
I OVERVIEW

Shareholder activism in the UK has developed significantly in recent years to become a more prominent feature of listed company life. Originally seen as something of an import from the United States, activism within the UK has developed along a slightly different path to that in the US, not least due to the differences in legal framework between the two countries. The Companies Act 2006 (and its predecessors) contain numerous ways in which a shareholder can utilise even a relatively small shareholding to ensure that its voice is heard; as such, compared to the US (where there is a stronger deference to board decision-making, for example), the UK legal and regulatory framework provides a fairly benign environment within which activism can flourish. One of the dominant themes in the area of activism more recently has been the change in perception as to what constitutes activism or what renders someone an activist. Many of those who are termed activists by the media or the companies targeted would instead argue that they are engaged investors, providing the type of oversight and engagement that is actively encouraged by the new Stewardship Code. Others consider themselves as indistinguishable from private equity funds or other institutional investors.

While we use the terms ‘activist’ and ‘activism’ for the purpose of this chapter, it is notable how the traditional, somewhat pugilistic vocabulary of ‘campaigns’, ‘defence’ and ‘defeat’ are gradually giving way to terminology more reflective of a constructive dialogue intended to yield positive results.

Another aspect of the improvement in reputation of the activist is that, whilst undoubtedly many activists are pursuing an agenda of value-release through some sort of corporate event, increasingly there are instances of activist shareholders championing environmental social and governance (ESG) causes and longer-term issues of sustainability. This can increase the activist’s chances of winning the support of major institutional shareholders – who may be seeking similar outcomes themselves or might use the activist campaign as the impetus to reiterate broader concerns with management. At the time of writing, the country is just beginning to emerge from the lock-down due to the covid-19 pandemic and it remains difficult to predict with any certainty precisely what longer-term economic effects will result; however, a continuation of depressed and volatile share prices, the impact of actions taken by companies in response to the crisis, plus the overlay of Brexit, have the potential to create fertile conditions for activism to flourish.

1 Filippo de Falco, Claire Jackson and Christian Boney are partners at Slaughter and May. Special thanks go to Gillian Fairfield for her valuable assistance in preparing this chapter.
II LEGAL AND REGULATORY FRAMEWORK

The paths along which activism has developed in the UK have reflected the fact that the UK’s legislative framework, particularly as compared with the one that exists in the US for example, provides numerous statutory and common law devices for shareholders to express their views and garner the attention of both directors and other shareholders. The Companies Act 2006 (the Companies Act or the Act) provides numerous tools that empower shareholders to make their views known and to drive particular courses of action. Such methods are rarely used in isolation, but are very often combined with other, non-legal options of engagement, such as engaging with the board (whether privately or through public channels), conducting a press campaign and eliciting the views of other shareholders. However, while these non-legal options frequently do, in practical terms, pile often enormous amounts of pressure on the company to act and respond, they do not oblige it to do so. As such, the various shareholder rights enshrined in English company law are often combined with these non-legal, ‘softer’ options to act as a whip in case the company does not engage of its own volition.

i The Companies Act – shareholder rights

Almost without exception, activists will buy shares in the object of their attention. The intention may be to build a stake significant enough that it can be used to affect the outcome of voting on matters at general meetings, hopefully yielding a future profit, should the activist’s intervention achieve the desired uptick in share price. Whatever the size of stake that is built, holding shares will furnish the activist with various rights. Perhaps the most relevant shareholder rights under the Companies Act within the activist’s toolkit, and the ones that have been most commonly used of late, are those that relate to general meetings. Any shareholder can attend a company’s general meetings and may use the opportunity to pose questions to the board of directors and its chair (non-shareholders such as journalists, advisers and lobbyists may be granted entry at the chair’s discretion, which is not always forthcoming). Section 319A of the Companies Act provides that a traded company must cause to be answered its members’ questions relating to the business being dealt with at the meeting. There is some scope to push back on this, including if answering would involve disclosing confidential information or if the question has already been answered (i.e., this provides some protection against haranguing or time-wasting). Members holding 5 per cent of paid up share capital may, pursuant to Sections 303–306 of the Act, requisition a general meeting and suggest the text of a proposed resolution. Under Sections 338–340 of the Act, members of public companies who hold 5 per cent (or at least 100 members who have a right to vote and hold shares on which an average of at least £100 per member is paid up) can require resolutions to be put before an annual general meeting. These tools are being used more frequently in practice, with resolutions ranging from the appointment of a new, activist-nominated director, to resolutions to phase out activities that are not in alignment with the Paris Climate Agreement.

Those shareholders can also, under Sections 314–317 of the Act, require the circulation of a statement of up to 1,000 words regarding a matter to be dealt with at a general meeting and can, under Section 527 of the Act, require the company to publish a statement on its website about audit matters. At shareholdings above a certain level, activists may have the power to block certain resolutions or corporate activity, for example, those holding more than 10 per cent can, under Section 979 of the Act, block the squeeze-out of minority holdings.
following a takeover offer and those holding more than 25 per cent can block a special resolution in a general meeting, as well as being able to block an attempted takeover by way of scheme of arrangement.

ii Unfair prejudice

Section 994 of the Companies Act provides for a shareholder of a company to petition for relief against unfair prejudice, where the affairs of the company are being conducted in a manner that is unfairly prejudicial to the interests of members generally (or a subsection of them). Successful petitions are comparatively rare (although by no means unknown) and tend to be mainly confined to private companies, where relationships between the shareholders have soured and one faction is unhappy at the direction the company is taking. The most common order made by the court where it is satisfied that an unfair prejudice petition is with merit is to order the shares of the petitioner to be bought out.

iii Shareholder derivative actions

In extremis, a shareholder may also bring a derivative claim against the directors of a company under Section 260 of the Companies Act. This is a means by which the court may use its discretion to permit a member of the company to bring a claim – on behalf of the company itself – for certain wrongs committed by the directors. Claims may be brought for directors’ breach of fiduciary duty, without any need for the director in question to have benefited from the alleged breach. However, the fact that any relief granted is for the benefit of the company, rather than the shareholder bringing the derivative claim, means that this is clearly not a route through which an activist may pursue their own personal agenda or grievances (and indeed if the court felt this was the case, they would generally refuse to permit the claim to proceed). As such, derivative claims may often be threatened but are rarely pursued.

iv Shareholder group action

Recently, however, there has been an increase in the number of shareholder group actions, particularly in relation to aggrieved investors who feel that they have suffered losses, due to a listed company falling short of its obligations to provide accurate and timely disclosure of matters relating to its securities. Two key weapons in relation to such claims are available to investors. One is Section 90 of the Financial Services and Markets Act 2000 (FSMA), which grants shareholders who have suffered loss because of untrue or misleading statements or omissions in a prospectus a right to be compensated, regardless of the shareholder’s ability to show reliance on the prospectus in question (this is the closest UK law comes to the ‘fraud on the market’ theory that underpins US securities law class actions). The second is Section 90A FSMA, which creates a similar, but less claimant-friendly, regime for other market announcements (requiring the claimant to be able to show reliance). Importantly, under both sections, compensation is paid directly to the claimant-shareholder (and not to the company, as would be the case in a derivative action). Owing to the costs that litigation under either of these sections entails, litigation is likely to be affordable only where undertaken collectively by a large group of claimants. Institutional investors are increasingly showing willingness to lead the way, such as in the recent litigation brought under Section 90A FSMA against Tesco plc., in respect of a 2014 market announcement of income and trading profits.
Another example was the claim brought by thousands of institutional and retail investors against RBS under Section 90 FSMA, alleging that the prospectus from its 2008 rights issue did not properly and fairly present the bank’s financial position and omitted relevant information (the claims were settled in 2017 before the matter got to trial).

AGMs

The annual general meeting of a listed company inevitably becomes a central arena for the activist shareholder, not only because of the Companies Act rights the activist may have by virtue of their shareholding, but also because of various governance elements, which the activist can deploy to good effect. The AGM will include as part of its business the election or re-election of the company’s directors (the UK Corporate Governance Code requires that listed company directors should be re-elected annually). This provides a powerful outlet for shareholder discontent. In addition, the Investment Association’s launching of a public register of FTSE All-Share companies, to show where those companies have had significant (i.e., 20 per cent or more) votes against any of their AGM resolutions, has increased public and media scrutiny of these instances of shareholder dissent. The register stemmed from the Department for Business, Energy & Industrial Strategy’s green paper on corporate governance, which focused on ways of strengthening the stakeholder voice in the boardroom. Any company that has a significant vote against any of its AGM resolutions is required by the UK Corporate Governance Code to explain, at the time of announcing the voting results, what consultation it will undertake with shareholders to understand the reasons behind the vote against, and will need to publish an update statement six months after that to describe what actions it has taken. Since its inception, the most commonly featured resolutions on the register have related to executive remuneration, with those relating to director re-election featuring a close second. Dissent on the subject of remuneration has intensified with the covid-19 crisis, as economic hardship and loss of workers’ livelihoods have increased the scrutiny on whether executives are being too lavishly remunerated; where ‘say on pay’ resolutions to approve remuneration policies are opposed, this generally leads to agitation to vote against the re-election of the chair of the remuneration committee and in some instances against the chair of the board.

Disclosure of holding

Both activists building a stake and the companies in whom they are stakebuilding will be observing disclosure thresholds set by The Financial Conduct Authority (FCA) in its Disclosure and Transparency Rules (DTR). Under DTR 5.1.2, shareholders must disclose their percentage of the voting rights in a UK incorporated listed company if the percentage of those voting rights reaches, exceeds or falls below 3 per cent (and every 1 per cent thereafter) as a result of an acquisition or disposal in shares of that company. Such disclosure is often the first indication that a target company has an activist shareholder on its register. The continued disclosure requirement ensures that the target company receives updates as and when the activist changes its position. An important point to note here is that there is an exception to the 3 per cent threshold contained in DTR 5.1.5. This exception provides that where the shareholder is an investment manager (e.g., the investment management arm of the activist investing the assets of the activist investment fund), disclosure is only required where the percentage of voting rights reaches, exceeds or falls below 5 per cent and 10 per cent and above.
Activists will often hold their interest in a target company through a combination of shares and other derivate financial instruments. In the run-up to a general meeting, an activist may need to convert its holding to shares in order to exercise votes at the meeting. The relevant TR-1 disclosure forms do distinguish between voting rights held through shares and through financial instruments, however they are comparatively light on detail and it is often difficult to ascertain what types of financial instruments are being used (in contrast to the US regime that prescribes more detailed disclosures).

vii Disclosure – market abuse and insider dealing
On broader disclosure issues, activists will be subject to the restrictions contained under the Market Abuse Regime relating to insider dealing, control of inside information and other offences such as market manipulation (although many listed issuers that are the subject of a public spat with an activist will be acutely aware of the feeling that the listed issuer’s every statement is carefully verified and vetted whereas certain activists may be less scrupulously accurate and, assuming they are not falling foul of the Market Abuse Regime or committing any offences under the Criminal Justice Act of 1993, may appear to have a much greater freedom as to what they can say).

viii The Stewardship Code and the Takeover Code
Care is clearly also required when communicating one’s own investment decisions with other investors. Some activists will themselves be signatories to the Financial Reporting Council’s new Stewardship Code, applicable from the beginning of 2020; in any event, many activists will be aware of the Code’s tenets as they affect the other institutional investors, with which the activist may engage. The type of activities that the new Stewardship Code envisages include not only engaging issuers and holding them to account on material issues but also working with others to influence issuers.

Here, inside information restrictions become relevant as well. Although a safe harbour is available to the extent that the only information that is in a stakebuilder’s possession is knowledge of its own intentions, activists in possession of other information will need to assess it carefully to determine if they are in a position to carry on dealing.

Activists will also wish to assess whether they may be ‘acting in concert’ with other shareholders, for the purposes of determining whether any obligations under the City Code on Takeovers and Mergers are triggered. To this end, the Takeover Panel’s Practice Statement No. 26 clarifies that when a group of shareholders requisition (or threaten to requisition) a ‘board control-seeking’ proposal, a concert party may come into existence.

III KEY TRENDS IN SHAREHOLDER ACTIVISM
Activist activity continues to be strong, even if activity recorded as activism in 2019 showed a decline from the amount of activism seen in 2018 (representing a high point in activism thus far). The blurring of lines as to who counts as an activist means that a record number of those considered to be new to activism launched campaigns in the past year (approximately 147 investors).2 The size of companies being targeted is also on the rise. The year 2018 saw

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2 Lazard’s 2019 Review of Shareholder Activism.
a record number of campaigns (226 out of a total of 248)\(^3\) having as their targets companies whose market capitalisations were greater than $500 million at the time of announcement of the campaign. Activists themselves seem more prepared than ever to diversify the markets they target, as they seek out hitherto untapped opportunities. The more traditional paths for activists are still well trodden, with US funds such as ValueAct and Elliott Management continuing to be active in Europe as well as in their ‘home markets’. As fund names become more established, so the reaction to them changes because their previous track record in their campaigns (whether their ‘success’ involved securing a particular transactional outcome, or gaining a board seat, or being seen to drive an uptick in the share price) means that they may find themselves dismissed less readily, with boards of directors showing a greater willingness to hear them out and, if appropriate, accommodate their suggestions.

### i Transactional/event-driven activism

Transformative transactions, such as M&A, takeovers of the company concerned, demergers of particular business units, or even something that requires a secondary equity raise, continue to provide fertile breeding grounds for activism as the activist investor has ample opportunity to lobby for a particular outcome and to seek to influence their fellow shareholders as to their voting on the matter in question. A classic example of this is what has become known as ‘bumpitrage’, which refers to the long-established practice where an activist takes a stake in a target company then agitates publicly that the consideration being offered by the bidder undervalues that target and should be increased. This will typically involve the activist both agitating with the target board that it has not adequately discharged its duties and is ‘rolling over’ too easily on price and urging them to negotiate for a better deal, while at the same time publicly announcing their view that the offer is inadequate and often indicating that they themselves would not accept it.

Examples of this include both Elliott Management’s intervention in the ABInbev takeover of SABMiller and also Sand Grove Capital Management’s stance in PT Medco Energi International’s takeover bid for Ophir Energy, where Sand Grove built their stake to 19 per cent during the course of the offer and agitated that the existing offer was too low, eventually securing an increased offer, which they irrevocably undertook to support. In a related strategy, there have been instances of activists (publicly) encouraging a public company to seek a take-private transaction, such as ValueAct’s open letter to Merlin Entertainment’s chair, following a series of earnings downgrades, which is widely seen as having acted as the catalyst to the agreed bid from KIRKBI and Blackstone Core Equity Partners; or to seek a merger partner, such as US hedge fund Cat Rock’s stance towards Just Eat, even going so far as to set up a website under the name ‘Justeatmustdeliver.com’, which sets out its views on what needed to be done. The highly public stances taken in these examples also echo another key trend in shareholder activism, namely, an increase in public engagement with boards and public airing of views, rather than the more technical (and more time-consuming and expensive) engagement in proxy battles waged in respect of general meetings.

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\(^3\) Lazard’s 2019 Review of Shareholder Activism.

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ii  A focus on longer-term sustainability issues rather than simply short-term gain

The traditional complaint that activists are simply peddling a short-term agenda to profit at the cost of the overall good of the company no longer holds true in all cases. An increased investor interest in ESG and long-term sustainability (in all its myriad forms, from climate change to discussions about corporate purpose and social licence to operate) means that activists are picking up the refrain. There has been a sense that covid-19 (including the resulting economic fall-out) has presented a crisis of such magnitude that it has pushed other more fundamental questions to the forefront of collective business consciousness and has meant that a pure shareholder primacy model has ceded to a more pluralistic consideration of wider stakeholders. Furthermore, these developments coincide with some significant governance developments arising from various government green papers and consultations on governance, which preceded the 2018 version of the Corporate Governance Code; for example, for the first time, this Code required a company to articulate its purpose, values and strategy, and ensure its culture and behaviour were aligned. In addition, the Companies (Miscellaneous Reporting) Regulations 2018 required directors to report on how stakeholder interests had been taken into account in board decision-making. This reporting may well act as a catalyst for more investor attention on perceived good and bad behaviours. It therefore seems likely that the trend of activists adopting a platform of championing long-term sustainable goals as a way of increasing shareholder value looks set to continue.

iii  The activist as a welcome presence (from the point of view of other shareholders)

While target boards may lament the drain on time that activism can entail, shareholders and the market may welcome the presence of a sophisticated activist on the register of an underperforming company – with the expectation that the activist will scrutinise company performance and agitate for a strategic turnaround or other value creating event. If an activist is also seen by the wider market as achieving results, that activist is more likely to attract followers. The volatility in the markets over recent years has meant that activists have been able to use depressed share prices to establish attractive entry points in the market – their success, combined with the fact that other investors often view them as a predictor of corporate activity of some sort, means that they bring followers with them. This can lead to an element of churn on the target company’s shareholder register, which can cause unease among management and makes it harder to track who is in which camp, and what messages will resonate with them.

iv  An increased focus on the mechanics of how activists structure their holdings

The rhetoric of an activist being a longer-term investor whose interests are aligned with other shareholders only holds true if the activist investor’s exposure to share price performance is consistent with that of other shareholders. There have been instances recently where the leverage, stock-borrowing and hedging structures used by activists have been the focus of attention and adverse commentary, particularly to the extent that these mean that the activist’s time-horizon and economic exposure is not aligned with the majority of institutional long-term holders. This was particularly the case in Sherborne Investors’ campaign against Barclays (see below).
Interactions with boards: nominee directors and ‘settlement agreements’

A further development over the past few years is that a number of instances of activism have resulted in the target company agreeing a relationship agreement (sometimes referred to by its US name as a settlement agreement) with the activist in situations where that relationship agreement is not mandated by the Listing Rules, but is a way of establishing the terms between activist and target in a way that avoids the negative effects of a protracted proxy battle or public campaign. Such relationship agreements may include provisions determining the rights of the activist to appoint a nominee director to the target board, a standstill agreement in respect of the activist’s purchasing of shares in the target and potentially non-disparagement clauses.

Examples of the relationship agreement route being used in practice include ValueAct’s relationship agreement with Rolls-Royce and Oasis Management’s relationship agreement with Premier Foods. Getting a director onto the board is seen by many activists as a key step to evidencing the ‘success’ of their campaigns. Julian Dunkerton, the original founder of Superdry, succeeded in being reappointed as its CEO, also Browning West’s Usman Nabi was successful in being appointed to Domino’s Pizza Group; by contrast, Edward Bramson’s attempt to be appointed to Barclays’ board was conclusively voted down, similarly, Coast Capital failed to have its nominees appointed to First Group’s board.

Shareholders discussing their voting intentions in advance

The Financial Reporting Council’s new Stewardship Code, applicable from the beginning of 2020, establishes a number of yardsticks as to what stewardship activities its signatories should be undertaking. The type of activities that the new Stewardship Code envisages include not only engaging issuers and holding them to account on material issues but also working with others to influence issuers. By way of example, Norges Bank Investment Management already publishes its voting intentions for certain ‘fundamental issues that [they] emphasise in particular’4 ahead of the general meeting in question and announced5 at a seminar recently on activism that it was their intention from 2022 onwards to announce their voting intentions approximately five days in advance of each general meeting, to inform others as to those intentions. Signatories to the new Stewardship Code may well follow this approach, meaning that institutional discussion on the ‘hot topics’ of the day could become the norm rather than the exception.

Proxy advisers: influence and regulation

Recent years have shown a marked increase in the influence wielded by proxy advisers (such as Institutional Shareholder Services and Glass Lewis) through the way they guide major shareholders as to how to respond and vote on the key issues of the moment. This has meant that market participants have increasingly called attention to how the proxy advisers are regulated and have queried whether there is adequate transparency as regards the methodology used by such firms in preparing their reports. Critics have said that there is insufficient transparency around how proxy advisers make their recommendations, while supporters commend their analysis of corporate governance issues and their role in streamlining shareholder voting

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5 ActivistMonitor seminar, Wednesday 9 October 2019.
decisions. In the UK, the impact of the Shareholder Rights Directive II is that asset managers will have to disclose their use of proxy advisers annually, with proxy advisers being required to disclose (among other things) information regarding their processes and codes of conduct.

IV RECENT SHAREHOLDER ACTIVISM CAMPAIGNS

i EasyJet

The ongoing campaign of opposition to EasyJet’s board being waged by EasyJet’s founder, Stelios Haji-Ioannou, is a live example of a company founder-turned-activist. The dynamic between the company and its founder is to a large extent dominated by Mr Haji-Ioannou’s sizeable shareholding in EasyJet plc.

Mr Haji-Ioannou publicly stated his opposition to the board’s plan to acquire £4.5 billion worth of aircraft from Airbus, on the grounds that it was inappropriate at a time when the airline had grounded all of its planes as a result of covid-19 restrictions and when the company has had to secure a £600 million loan from the Bank of England’s emergency coronavirus fund. On 8 April 2020, Mr Haji-Ioannou requisitioned a general meeting, proposing the removal of its Chairman John Barton, CEO Johan Lundgren, CFO Andrew Findlay and non-executive director Andreas Bierwirth. Subsequently, Mr Haji-Ioannou published an open letter to all shareholders giving his rationale for the removal of the four directors, claiming that this ‘is the only method a shareholder has to require the remaining 7 directors to serve notice of termination to Airbus for the order for 107 additional completely unnecessary aircraft’, which in his view would provide EasyJet with its ‘best chance of avoiding bankruptcy’.

On 22 May 2020, EasyJet held the general meeting and rejected Mr Haji-Ioannou’s resolutions, with more than 57 per cent of votes cast as against it. However, Andrew Findlay has since announced his resignation as CFO, effective in May 2021. Mr Haji-Ioannou has also since made a public offer of financial rewards to employees and related parties willing to give ‘whistleblowing’ inside information that would lead to the cancellation of the Airbus order.

ii Superdry

In contrast, the Superdry co-founder achieved the end result he sought (albeit only by a narrow margin). Superdry co-founder Julian Dunkerton stepped down from the board in March 2018 following a disagreement with the board on how to run the company. Mr Dunkerton did not agree with the board’s strategy on diversifying its range into children’s wear and other products, and away from the company’s core product range. On 1 March 2019, Mr Dunkerton along with co-founder James Holder requisitioned a general meeting requesting that Dunkerton be re-appointed as a non-executive director. At the general meeting on 2 April 2019, Mr Dunkerton received a simple majority of 51.15 per cent in favour of his re-appointment, and just hours afterwards the Chairman Peter Bamford and CEO Euan Sutherland resigned. Mr Dunkerton was subsequently appointed as CEO.

iii Barclays

Sherborne’s Barclays campaign provides an interesting example not only of an activist seeking a board seat and advocating structural changes, but also of the method in which activists hedge and structure their holding in the target coming under scrutiny. In April 2018, Sherborne Investors partner, Edward Bramson, made public calls for a restructuring of
Barclays’ investment banking business and urged Barclays’ shareholders to support his attempt to secure a board seat. Mr Bramson had built up an approximately 5.5 per cent position through a ‘funded equity collar’. This arrangement involved Bank of America borrowing the Barclays shares and selling them to Mr Bramson while also providing him with financing in the form of the loan. As part of the arrangement, Mr Bramson took out a series of ‘put’ and ‘call’ options that protected him from losses if the shares were to fall below a certain level while also limiting his upside. The arrangement garnered criticism (from both Barclays itself and institutional shareholders) on the grounds that Mr Bramson had structured his holding in such a way that his interests could no longer be seen as aligned with those of other shareholders. The shareholder advisory group Glass Lewis advised investors to vote against Mr Bramson, in part due to his ‘questionable ownership framework’. After Mr Bramson made several informal attempts to have himself appointed to the board, on 5 February 2019, Sherborne Investors submitted a resolution to appoint him as a board member at the 2019 AGM. However, at its AGM on 2 May 2019, the resolution was defeated with more than 87 per cent of shareholders voting against it.

iv  Rolls-Royce

ValueAct’s investment in Rolls-Royce is noteworthy as being an example of an active investor entering into a US-style ‘settlement agreement’ or relationship agreement with its target. ValueAct Capital spent several months building its stake in Rolls-Royce, becoming its largest shareholder with a stake of 10 per cent in November 2015. On 2 March 2016, Rolls-Royce appointed Bradley Singer of ValueAct as non-executive director to its board. Notably, the two parties entered into a relationship agreement, which provided inter alia that Mr Singer’s appointment was subject to ValueAct continuing to hold a 10 per cent stake in the company. In addition, during a ‘standstill period’, ValueAct agreed to certain provisions, namely, that it would not acquire a stake in the company in excess of 12.5 per cent, that it would be bound by certain corporate governance provisions and that it would vote in favour of all commonly proposed resolutions recommended by the board at the company’s 2016 and 2017 AGMs. The relationship agreement expired in 2018 and ValueAct retained its board seat until 2019.

v  Domino’s Pizza Group

A more recent example of the relationship agreement is Browning West with Domino’s Pizza Group. On 23 October 2019, the US fund announced that it had acquired a 5.3 per cent stake in Domino’s. On the 12 November 2019, the company announced the appointment of Usman Nabi of Browning West as a non-executive director. The parties also entered into a relationship agreement, which included terms with respect to corporate actions, non-disparagement, share dealings and other corporate governance matters.

vi  AB InBev/SABMiller

AB InBev’s £71 billion takeover of SABMiller involved an example of M&A based activism, often colloquially referred to as ‘bumpitrage’, whereby an activist takes a stake in a live takeover situation and agitates for greater value to be offered to the target shareholders. In November 2015, AB InBev announced a £71 billion offer for SABMiller, comprising cash consideration and an alternative of share consideration in a new holding company of AB

InBev (with SABMiller’s two largest shareholders opting for the share consideration). The Brexit referendum of 2016 significantly impacted the value of sterling, which, combined with AB InBev’s Euro-denominated revenues, meant that in effect the cash consideration on offer was less attractive than the alternative share offer. The share offer had been structured in such a way that the shares in question would not trade publicly for five years, meaning that many shareholders felt that to switch from accepting cash to accepting shares was not a tenable alternative. In July 2016, Elliott Management acquired an interest in SABMiller. It was then widely reported in the media, among growing unease as to the disparity between the cash offer and the share offer, that Elliott had written a private letter to the SABMiller board to voice its concerns. The outcome of Elliott Management’s campaign was that AB InBev increased its cash offer by 100 pence per share to 4,500 pence per share, which valued SABMiller at £79 billion.

vii  Merlin Entertainments

A more recent example of an activist deploying the tactic of M&A ‘bumpitrage’ is ValueAct Capital’s campaign in relation to Merlin Entertainments plc. ValueAct had increased its stake to 9.3 per cent on 23 May 2019, and on the same day, publicly issued an open letter to the board of Merlin, urging it to find a buyer to take the company private, asserting that the public markets could not value Merlin’s business accurately enough and citing concerns around the focus on short-term metrics, which a public listing inevitably entailed. Subsequently on 28 June 2019, Merlin announced a recommended £5.9 billion enterprise value offer from a consortium of Kirkbi (the Lego family), Blackstone and CPPIB (a Canadian pension fund).

V  REGULATORY DEVELOPMENTS

Many of the most significant recent regulatory developments and corporate governance reforms affecting activism have already been mentioned above. Of particular note in terms of recent developments are the following. The new Stewardship Code’s focus on engaging issuers and holding them to account on material issues, as well as working with others to influence issuers, will see more disclosure from the Code’s signatories (likely generating more debate about whether those signatories are doing enough to hold companies to account, as well as focusing media and shareholder attention on what are seen by the investment community as the ‘burning platforms’ of the day). Moreover, the Stewardship Code’s focus on working with others to influence issuers will deepen a trend that is already in evidence, of activists working in close coordination with other institutional shareholders of a company. This gradual shifting of more ‘mainstream’ asset managers into the field of activism is also likely to be heightened by the Shareholder Rights Directive II, which asset managers have been required to comply with in the UK since 10 June 2019, with its focus on engagement activities and voting decisions.

The increasing importance of proxy advisers in this ecosystem has already been noted: given institutional investors’ widespread use of their services and the need to continue doing so (due to a combination of cost, ever-increasing amounts of disclosure and the need to compare and analyse disclosures across a multiplicity of companies, sectors and geographies), their importance will not likely diminish and calls may be renewed for greater transparency as to their operation. The Market Abuse Regulation will continue to be a key facet in the regulation of activism; the UK’s departure from the European Union may affect this, although most market participants expect no significant divergence from the existing regime.
In the post-covid-19 environment, a company’s social licence to operate and its statement of purpose, which has only recently been required by the Corporate Governance Code, will continue to be the subject of scrutiny, while in parallel ESG focus is likely to intensify, which may prompt more active shareholders to requisition resolutions focusing on these areas. Climate change will clearly form a huge part of this, with the European Parliament recently adopting new legislation on sustainable investments, aimed at creating a common classification against which businesses and investors can determine whether economic activity can be labelled as environmentally sustainable based on whether it contributes to certain objectives. The Task Force on Climate-related Financial Disclosures (TCFD)’s work continues, with the FCA recently issuing proposals requiring premium-listed companies to make climate-related disclosures in line with the approach set out by the TCFD or to explain why not. As regards board diversity, ethnic diversity is clearly still a significant issue for boards of directors to address, as the 2020 update from the Parker Review Committee indicates.

VI OUTLOOK

The direction of travel of the above regulatory developments suggests that the UK market will see a continued increase in activism, including from many who hitherto would not have termed themselves ‘activists’. Factors such as the economic fall-out of the covid-19 crisis, the impact of Brexit, and the ensuing volatility in share prices all have the potential to create a turbulence in which many more opportunities for activism will present themselves. The increased focus on stewardship and engagement on key issues means that constructive activism will be encouraged rather than discouraged, but may also provide a helpful yardstick for what is considered ‘constructive engagement’ as opposed to ‘short-term opportunism’. Finally, it is likely that ESG concerns are set to become an even more prominent feature of activist campaigns. As we have already noted, covid-19 (including the resulting economic fall-out) has presented a crisis of such magnitude that it has pushed other more fundamental questions to the forefront of collective business consciousness and has meant that a pure shareholder primacy model has ceded to a more pluralistic consideration of wider stakeholders. Certain mainstream institutional investors have publicly stated that they will examine how companies have responded to the crisis with, for example, Legal & General Investment Management flagging that they will scrutinise the actions that companies take during the covid-19 crisis and will ‘hold companies to account for their stakeholder responsibilities’. This trend will likely see activists agitating on a platform of ESG reform, combining with more mainstream institutional shareholders to achieve their goals; it will also bolster activists’ ability to present themselves as a force for good in the market rather than as a predatory force, motivated by short-term profits.

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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 total number of activist campaigns has been remarkably consistent over the past five years, with an average of approximately 272 campaigns announced per year. 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 and John W Karol for their assistance in drafting this chapter and Ms Boehmke for her overall assistance with this chapter.

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 primarily comprises 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$94 million for 2020. 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’. 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. 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.

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 for books and records, and appraisal rights. As described further in Subsection (iv), a

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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.
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 it had reasonable grounds to believe a threat to corporate policy and effectiveness existed, and that its defensive response was reasonable in relation to the threat posed.7 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, State Street 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.

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iv 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 defence 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 p. 17.
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 2019 proxy season, corporate governance-related proposals continued to represent approximately half of the Rule 14a-8 proposals voted on, and approximately 21 per cent of these proposals received sufficient shareholder support to pass.10 Other 2019 Rule 14a-8 proposals included environmental, social and political (ESP) proposals as well as compensation proposals, which have a very low pass rate. However, ESP proposals continued to gain momentum in 2019, with the ESP proposals that went to a vote receiving record average support of 28 per cent and a record nine proposals passing.11 The vast majority of Rule 14a-8 proposals are targeted at S&P 500 companies.12

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 2019, 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 19.2 per cent of all shares in the S&P 500.13 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.

In recent years there has also been a noticeable blending of investment strategies by investors with historically distinct investment strategies, particularly activist hedge funds and private equity firms. While certain activist investors such as Paul Singer of Elliott Capital Management and Carl Icahn have long been selectively acquisitive due to their size, other activist investors are also starting to employ private equity-like strategies. For their part, some private equity firms have recently taken up their own form of activist investing, including acquiring minority stakes. Despite their historical differences, private equity firms and hedge funds share a common ultimate objective of acquiring an ownership stake in a company they consider to be undervalued, effecting certain changes at the company designed to boost value, and then realising a return on their original investment by exiting the company at a higher valuation. Other traditionally passive investors could also move towards an activist approach, paving the way for a further convergence of investment strategies.

11 id., at p. 7.
12 id., at p. 6.
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. BlackRock’s Larry Fink has described ‘purpose’ as ‘a company’s fundamental reason for being – what it does every day to create value for its stakeholders’. In his 2020 annual letter to CEOs, Fink wrote that ‘purpose is the engine of long-term profitability.’

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 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. On average, approximately 10 per cent of the activist campaigns in each of the past five years targeted companies with market caps of greater than US $10 billion. 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. Activists have targeted a wide variety of industries, with investment vehicles, pharmaceutical companies, software companies and other commercial service providers being the most targeted industries since 2014.

iii Activist campaigns

The general consistency of the data in recent years suggests that activism will continue to be an important consideration for companies going forward. 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

18 id., at p. 14.
board representation or seeking changes in management – often used as a means of achieving economic objectives. Mergers and acquisitions activity was a particular focus of activists in 2019, more than ever before, demonstrated by activists both calling for companies to initiate a sale or divestiture process and opposing previously announced transactions.19

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 are also adept at using media, including social and alternative electronic media, to their advantage.

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 – but not less common – scenarios, trying to replace at least a majority of the board of directors (a control slate contest). 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. As discussed further in Subsection (i), 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 2019.20 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.

It is 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

19 id., at p. 4.
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.21

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. 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.22

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.23

i eBay/Elliott and Starboard Value

In January 2019, Elliott published a letter revealing a 4 per cent stake in eBay Inc. (eBay) and outlining Elliott’s ‘Enhancing eBay Plan’ to unlock value-creation at the company. The plan called for, among other things, divestment of eBay’s Stubhub and eBay Classifieds Group franchises and renewed focus on eBay’s core Marketplace business. Starboard Value LP was also reported to have a large position in eBay and to have urged the same changes at the company. On 1 March 2019, eBay announced that it had entered into cooperation agreements with both Elliott and Starboard, pursuant to which it would immediately add two new directors to the board, with Elliott also having the right to privately recommend to the company an additional independent director later in the year. eBay also announced a strategy review of its asset portfolio, including Stubhub and eBay Classifieds Group. In September 2019, eBay’s CEO resigned after disagreements with the new board. In announcing the leadership transition, eBay noted that its strategic review of StubHub and Ebay Classifieds Group continued to move forward. On 25 November 2019, eBay announced an agreement to sell Stubhub to Viagogo for a purchase price of approximately US$4.05 billion in cash. The deal closed in February 2020.

23 The campaign detail included in this section was sourced from FactSet Research Systems Inc and other public filings.
EQT Corporation/Rice Investment Group

The year 2019 saw the first successful use of a universal proxy card for a control slate in the US when a shareholder group led by Toby Rice and Derek Rice (the Rice Team) prevailed in their proxy contest at EQT Corporation (EQT). In November 2017, the Rice Team sold Rice Energy, the company they had founded, to EQT for approximately US$6.7 billion. In December 2018, after EQT’s stock price had fallen more than 50 per cent since the merger and EQT lowered its five-year outlook, the Rice Team began publicly calling for a ‘course correction’ and for EQT’s CEO to be replaced with Toby Rice. In March 2019, the Rice Team nominated a control slate of nine director candidates for election at the 2019 annual meeting, including Toby Rice and Derek Rice. In April 2019, Toby Rice filed a lawsuit against the EQT board of directors, alleging an unfair playing field and refusal by EQT to use a universal proxy card for the election. A universal proxy card is 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, which is different from the default in which each side has its own proxy card. EQT and the Rice Team ultimately agreed to adopt a universal proxy card for the annual meeting. In May 2019, EQT announced that it had nominated three new director candidates for election and that three long-tenured board members (including the chairman) would retire. As a result, the Rice Team revised its director slate down to seven nominees (out of 12 board seats). The Rice Team’s slate was supported by ISS and several large shareholders, including T Rowe Price and D E Shaw. On 10 July 2019, EQT announced that its shareholders had elected all seven of the Rice Team’s nominees as well as the five EQT nominees it supported, with the Rice Team’s slate receiving more than 80 per cent of the votes cast at the annual meeting. The board of directors elected Toby Rice as the President and CEO of EQT.

REGULATORY DEVELOPMENTS

The US corporate regulatory and governance landscape is constantly undergoing reform. In the past few years, several governmental entities have also demonstrated an appetite for enforcing their existing regulations against activists.

In 2019, the SEC issued important guidance on proxy advisers. The guidance affirms that voting recommendations from proxy advisers, such as ISS and Glass Lewis, constitute a ‘solicitation’ under the SEC’s proxy rules, and the interpretation reiterates the SEC’s previously stated view that a ‘solicitation’ includes a communication by a person seeking to influence the voting of proxies by shareholders, regardless of whether that person is seeking authorisation to act as a proxy. Notably, this means that proxy adviser voting recommendations will be subject to anti-fraud rules and are prohibited from containing any ‘false or misleading’ statements and omitting any necessary material facts.24

The SEC also proposed amendments to the thresholds for filing shareholder proposals under Rule 14a-8. The proposed amendments would eliminate the 1 per cent ownership threshold under Rule 14a-8(b) and introduce a three-tiered approach to determining when shareholders are eligible to submit proposals to a company, under which a shareholder is eligible to submit proposals if it has continuously held:

a at least US$2,000 of the company’s securities for at least three years;

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at least US$15,000 of the company’s securities for at least two years; or
at least US$25,000 of the company’s securities for at least one year. 25

VI OUTLOOK

The unprecedented covid-19 pandemic and its aftermath will heighten focus on corporate governance and the role of a talented management team and an engaged board as companies forge a path through the uncertain times ahead. While the covid-19 pandemic has slowed activist campaign activity in the short-term, practitioners fully expect that activists will attempt to capitalise on market volatility and other opportunities created by the crisis and resume campaigns with full force. In addition, the US is in the midst of presidential and congressional elections that will take place on 3 November 2020. It remains to be seen how the results of the elections will impact the federal and legislative agenda and influence the US corporate landscape, including the shareholder activism and engagement regimes, moving forward into 2021 and beyond. It is important to remain alert to developments in shareholder activism as the types of activists, companies targeted by activism and activist campaigns evolve.

ABOUT THE AUTHORS

FRANCIS J AQUILA
*Sullivan & Cromwell LLP*

Francis J Aquila is the Global Head of Sullivan & Cromwell’s M&A practice and a member of the firm’s management committee. Mr Aquila has a multidisciplinary practice, including experience in negotiated and unsolicited mergers and acquisitions, and corporate governance, and has been engaged in many high-profile matters. He regularly counsels boards of directors and board committees on corporate governance matters, crisis management and matters affecting corporate policy and strategy.

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’. In December 2019, Mr Aquila was one of the dealmakers profiled in an article in the *Financial Times* titled ‘Deal lawyers are masters of seeing the next move’. The *Wall Street Journal* profiled him as one of the six top dealmakers of the year in 2019 and one of the seven top dealmakers of the year in 2018. Mr Aquila is recognised as one of the world’s leading M&A lawyers, including being ranked by *Chambers Global* in 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 2018, Mr Aquila was recognised by the *Financial Times* as one of the ‘Top 10 Legal Innovators in North America’. In 2015, the *Financial Times* also 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.

WILLEM BIJVELD
*De Brauw Blackstone Westbroek NV*

Willem Bijveld is a senior associate in De Brauw Blackstone Westbroek’s Corporate/M&A department. Willem advises corporate clients and financial sponsors on private and public mergers and acquisitions, corporate governance, and corporate and securities matters. He has particular experience in bilateral and auction sale processes, public-to-private transactions, corporate governance and matters concerning shareholder activism.
CHRISTIAN BONEY

_Slaughter and May_

Christian Boney is a partner at Slaughter and May. He has a broad corporate and commercial practice, with particular experience in public and private M&A, joint ventures, international capital markets work, corporate governance and other general advisory matters.

HYEON DEOG CHO

_Kim & Chang_

Hyeon Deog Cho is an attorney at Kim & Chang. Mr Cho is leading the corporate governance team of the firm. His practice focuses on governance reform, corporate transformation (including spin-off and split-off), holding companies, takeover defence, planning for and defending against shareholder activism, mergers and acquisitions, capital market and corporate financing, restructuring and insolvency, and white-collar crime defence, and he has represented most of the top-tier big business groups in Korea.

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.

Mr Cho earned a BA (1990), an MBA (1992) and a PhD (1999) in business administration (with a specialisation in international business and business strategy) from Seoul National University, and received his LLM from Boston University School of Law in 2009. He also completed an international lawyer programme at Cleary Gottlieb Steen & Hamilton LLP’s New York office in 2009 and 2010. He was admitted to the Korean Bar in 2004.

PAUL CRONHEIM

_De Brauw Blackstone Westbroek NV_

Paul Cronheim is a partner in De Brauw Blackstone Westbroek’s Corporate/M&A department. Paul has a well-established international corporate practice, representing listed companies, large multinationals and private equity firms. His practice focuses on corporate law and mergers and acquisitions, including corporate governance and shareholder matters. Paul has handled a wide range of Dutch and cross-border public takeovers, private acquisitions and disposals, auctions and joint ventures. He has also acted as counsel or arbitrator in numerous ICC, AAA and NAI arbitrations.

EZRA DAVIDS

_Bowmans_

Ezra Davids is the chair of corporate/M&A at Bowmans, specialising in mergers and acquisitions, capital markets and securities law.
FILIPPO DE FALCO
Slaughter and May

Filippo de Falco is a partner at Slaughter and May. He has a broad corporate and commercial practice, with a particular focus on public and private M&A, private equity transactions, joint ventures, international capital markets work and corporate governance and other general advisory matters.

QUENTIN DIGBY
Herbert Smith Freehills

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
NautaDutilh Avocats Luxembourg

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, Ms Geppert-Luciani contributes to various newsletters and publications, and she coordinates and assists on projects focused on know-how, business development and innovation. She is a qualified German lawyer, admitted to both the Saxon Bar and the Luxembourg Bar. Besides the two German state examinations, she holds a master’s degree 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, Ms Geppert-Luciani 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
Self-employed

Dr Max Gutbrod is a German-trained lawyer working in or with Russia for more than 25 years. He was a partner at Baker & McKenzie – CIS, Limited and has since left the company to become self-employed. 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 start-ups.

FRANK HAMMING
De Brauw Blackstone Westbroek NV
Frank Hamming is a senior associate in De Brauw Blackstone Westbroek’s Corporate/M&A department. Frank has a primary focus on corporate law and public and private mergers and acquisitions. Frank regularly advises listed companies, private equity funds and governments on complex cross-border transactions in a variety of industries. He also regularly advises listed companies on shareholder activism and contested takeover situations.

CLAIRE JACKSON
Slaughter and May
Claire Jackson is a partner at Slaughter and May. She has a broad corporate practice, advising on all forms of M&A, including public takeovers, private acquisitions and disposals, joint ventures and equity financings. She also advises clients on company law, corporate governance, and general advisory matters.

JOON B KIM
Kim & Chang
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.

Mr Kim is fluent in English and Korean.
RYAN KITCAT
Bowmans
Ryan Kitcat is a senior associate in Bowmans’ corporate/M&A practice, specialising in mergers and acquisitions (public and private), and general corporate and commercial law. He recently completed a short course on impact investing in Africa at University of Cape Town Graduate School of Business.

EUN-YOUNG LEE
Kim & Chang
Eun-Young Lee is an attorney at Kim & Chang. She belongs to the corporate governance team of the firm and her practice focuses on governance reform, corporate restructuring (including spin-off and split-off), holding companies, planning for and defending against shareholder activism, mergers and acquisitions, and capital market and corporate financing.

Ms Lee received a BA in economics from Seoul National University in 2010. She was admitted to the Korean Bar in 2014.

AKIRA MATSUSHITA
Mori Hamada & Matsumoto
Akira Matsushita is a corporate and M&A partner at the Tokyo office of Mori Hamada & Matsumoto. He focuses on cross-border and domestic mergers and acquisitions, corporate governance, shareholder activism, takeover defence and general corporate and securities law matters. He has diverse experience representing public and private companies and private equity firms in cross-border and domestic M&A transactions, including contested M&As and transactions that were subject to M&A activism. He also has extensive experience in advising listed companies subject to shareholder activism, proxy fights or unsolicited takeovers.

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. His many publications include ‘M&A Contract – Model Clauses and Commentary’, ‘Comprehensive Analysis of M&A Laws of Japan’, ‘TOBs in Japan – Systems and Demonstrations’ and ‘Shareholder Proposal and Proxy Fight’. He is recognised as a notable practitioner of Corporate M&A in Asialaw Leading Lawyers 2020 and one of the leading lawyers of Corporate and M&A in The 2021 Edition of Best Lawyers.

KARIN MATTLE
Homburger AG
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.
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.

VICTOR MENEGUELLI
Veirano Advogados
Mr. Meneguelli is a legal intern at Veirano Advogados and is currently studying for an LLB at Fundação Armando Alvares Penteado (FAAP).

GALEN MILLER
Blake, Cassels & Graydon LLP
Galen Miller is an associate in the Toronto securities law practice group of Blake, Cassels & Graydon LLP. His practice is mainly focused on mergers and acquisitions, capital market transactions including offerings of equity and debt, corporate governance, and continuous disclosure compliance. He also assists clients with general corporate and commercial matters.

Mr. Miller joined Blakes in 2016 after completing his bachelor's degree in civil law (BCL) and bachelor's degree in law (LLB) at McGill University's faculty of law the same year.

ALEX MOORE
Blake, Cassels & Graydon LLP
Alex Moore is a partner in the Toronto office of Blake, Cassels & Graydon LLP. His practice focuses on mergers and acquisitions, capital markets, and corporate governance. Alex is a key member of Blakes’ corporate governance team and has represented boards and shareholders in many shareholder activism matters and has played a central role in some of Canada’s most high-profile proxy contests.

Alex is a fellow of the American College of Governance Counsel and has taught securities regulation at Western Law School and was an adjunct professor at Osgoode Hall Law School, where he taught the advanced business law workshop on mergers and acquisitions. Alex is a frequent speaker and author on the topic of mergers and acquisitions, corporate governance, and shareholder activism.

Prior to joining Blakes, Alex practised corporate and securities law at other leading law firms in Toronto and San Francisco.

NIKHIL NARAYANAN
Khaitan & Co
Nikhil Narayanan is a partner in Khaitan and Co’s corporate practice. He has extensive international and cross-border experience, having advised corporate clients, financial sponsors and investment banks on high-value and often market-leading public and private merger and acquisition, joint ventures and equity capital markets transactions, in both London and India. He also has extensive public company experience, having advised international listed clients on listing rules and disclosure-related issues, and corporate governance and activist-related issues. Nikhil received his BCL degree from St Catherine’s College, Oxford (where he was a Radhakrishnan/Chevening scholar) and his MBA degree from London Business School (where he was a Merrill Lynch scholar). Nikhil is ranked as a ‘leading individual’ by Legal
About the Authors

500 and Asialaw Leading Lawyers 2020 recognises him as a ‘Distinguished Practitioner’. He has also received the ‘RSG Emerging Leader Award’ in 2019. Legal 500 refers to him as ‘stand out’ and notes that he ‘offers immediate solutions’. RSG notes that he provides ‘top tier international levels of service’ and acts with ‘the utmost integrity’.

DAVID OSER
Homburger AG

David Oser joined Homburger in 2003 and has been a partner in Homburger’s corporate and M&A practice team since 2009. His practice focuses on domestic and international mergers and acquisitions (both public and private), capital markets, corporate governance and general corporate law matters. He is the co-author of the leading treatise on the Swiss Ordinance against Excessive Compensation. At Homburger, he heads its regional focus group on Japan. David Oser was admitted to the Bar in 1998 (Basel, Switzerland) and 2001 (New York), and received his LLM from Columbia Law School in 2000.

BYOUNG KWON PARK
Kim & Chang

Byoung Kwon Park is an attorney at Kim & Chang. Mr Park belongs to the corporate governance team of the firm and his practice focuses on governance reform, corporate restructuring (including spin-off and split-off), holding companies, planning for and defending against shareholder activism, mergers and acquisitions, and capital market and corporate financing, and he has represented many of the top-tier big business groups in Korea.

Mr Park earned his LLB (2004) from Seoul National University, and received his LLM from UC Berkeley School of law in 2016. He was admitted to the Korean Bar in 2007.

LIOR PINSKY
Veirano Advogados

Mr. Pinsky is a partner at Veirano Advogados and a member of its Board of Directors. He obtained an LLB from Pontificia Universidade Catolica de São Paulo (PUC-SP) in 1997 and an LLM with merit from the London School of Economics (UK) in 2000. He practised as a foreign associate at Cravath, Swaine & Moore LLP from 2004 to 2006.

LEVI SANTOS
Veirano Advogados

Mr. Santos is a junior associate at Veirano Advogados. He obtained an LLB from the Universidade de São Paulo (USP) in 2019 and was certified in corporate governance, compliance and risks by Saint Paul Business School in 2020.

TIMOTHY STUTT
Herbert Smith Freehills

Timothy Stutt is the Australian lead for Herbert Smith Freehills' environmental, social and governance (ESG) practice and a senior member of the firm’s head office advisory team.
About the Authors

(HOAT). Timothy specialises in strategic advice for major companies on corporation law, ESG, and shareholder engagement and activism matters. He is also a regular presenter on governance and remuneration matters for clients and at industry seminars (including at the Governance Institute of Australia). Timothy was a Japanese Ministry of Education scholar and received his master of business administration (MBA) in Tokyo. He also holds a law degree (BA hons) and commerce degrees from Monash University, Melbourne, and has previous experience working as a financial analyst for a San Francisco Bay Area-based investment manager.

LEE SUET-FERN

Morgan Lewis Stamford LLC

Lee Suet-Fern is the founder and a director of Morgan Lewis Stamford LLC and a partner of Morgan, Lewis & Bockius, where she was chair of the international leadership team and a member of the global board. Ms Lee advises clients on mergers and acquisitions, equity and debt capital markets, and corporate finance. She has led 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 named her Lawyer of the Year in those years. In 2020, IFLR1000 Women Leaders recognised Ms Lee as one of 300 global leading practitioners for the third consecutive year since its inaugural edition launched in 2018.

She has served as a member of the executive committee of the Senate of the Singapore Academy of Law where she also chaired the Committees on Legal Education and Studies and Convergence and Harmonisation of Laws in Asia. She is a director of the World Justice Project, a global organisation promoting the rule of law. She has considerable experience serving on boards and audit committees of large global, as well as Singapore, listed companies. She has chaired the Asian Civilisation Museum Singapore and is a trustee of Nanyang Technological University in Singapore. She has also served on the Advisory Board of the SMU’s Law School. Ms Lee graduated with a double first in law from Cambridge University in 1980. She qualified as a barrister-at-law at Gray’s Inn, London in 1981 and was admitted to the Singapore Bar in 1982.

MICHAEL J ULMER

Cleary Gottlieb Steen & Hamilton LLP

Dr Michael J Ulmer is a partner at Cleary Gottlieb Steen & Hamilton. His practice focuses on domestic and international private and public M&A transactions, joint ventures, general corporate advice and private equity transactions.

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.

BARRY WANG
Herbert Smith Freehills

Barry Wang is a member of Herbert Smith Freehills’ head office advisory team (HOAT) team and has experience in advising clients across a broad range of industries and sectors on environmental, social and governance (ESG), corporate disclosure, remuneration and other governance matters. Barry holds a law degree (BA first class hons) and a bachelor’s degree in commerce from the University of Sydney. In 2016, he received scholarships from the Westpac Bicentennial Foundation (now Westpac Scholars) and the University of Sydney to study at the National University of Singapore, and has since worked in Herbert Smith Freehills’ Singapore and Sydney offices.

SARAH WARED
Wolf Theiss

Sarah Wared is a partner in the corporate/M&A team based in Vienna, Austria. She specialises in M&A, corporate, takeover law, capital markets law and private foundation law. Her experience includes numerous cross border public and private M&A transactions and structuring complex joint ventures in a wide range of industry sectors, including financial institutions, health care and technology, media and telecom.

Before joining Wolf Theiss, she worked for other major law firms in Vienna and also gained international experience in the United States, Singapore and Germany. Sarah is admitted to the Bar in both Austria and Germany. Sarah is the author of various publications on selected issues of Austrian corporate law, and regularly contributes to industry publications in Austrian and international law journals in her area of expertise.

MARGARETHA WILKENHUYSEN
NautaDutilh Avocats Luxembourg

Margaretha (Greet) Wilkenhuysen is a partner and heads NautaDutilh’s Corporate practice in Luxembourg. She specialises in cross-border corporate transactions, with a particular focus on mergers and acquisitions, joint ventures and international corporate restructuring. She also has extensive experience in corporate finance and the provision of corporate governance advice to listed companies. She represents both domestic and international clients in a wide range of high-end transactions. Her extensive experience and knowledge resulted in her being nominated as a ‘Leading Lawyer’ by IFLR1000 since 2011.
Ms Wilkenhuysen received her law degree from the University of Leuven in 1991, a master’s degree in business and tax law from the 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.
CONTRIBUTORS’ CONTACT DETAILS

BLAKE, CASSELS & GRAYDON LLP
199 Bay Street
Commerce Court West
Toronto
Ontario
Canada
M5L 1A9
Tel: +416-863-2754
Fax: +416-863-0871
alex.moore@blakes.com
galen.miller@blakes.com
www.blakes.com

CLEARY GOTTLIEB STEEN & HAMILTON LLP
Main Tower
Neue Mainzer Straße 52
60311 Frankfurt am Main
Germany
Tel: +49 69 97103 180
Fax: +49 69 97103 199
mulmer@cgsh.com
www.clearygottlieb.com

BOWMANS
11 Alice Lane
Sandton
Johannesburg 2146
South Africa
Tel: +27 11 669 9000 / 9320
Fax: +27 11 669 9001
ezra.davids@bowmanslaw.com
ryan.kitcat@bowmanslaw.com
www.bowmanslaw.com

DE BRAUW BLACKSTONE WESTBROEK NV
Claude Debussylaan 80
1082 Amsterdam
Netherlands
Tel: +31 20 577 1519 / 1713 / 1788
Fax: +31 20 577 1775
paul.cronheim@debrauw.com
willem.bijveld@debrauw.com
frank.hamming@debrauw.com
www.debrauw.com
HERBERT SMITH FREEHILLS
Level 34, ANZ Tower
161 Castlereagh Street,
Sydney
NSW 2000
Australia
Tel: +61 2 9225 5000
Fax: +61 2 9322 4000
quentin.digby@hsf.com
timothy.stutt@hsf.com
barry.wang@hsf.com
www.herbertsmithfreehills.com

HOMBURGER AG
Prime Tower
Hardstrasse 201
8005 Zurich
Switzerland
Tel: +41 43 222 10 00
Fax: +41 43 222 15 00
david.oser@homburger.ch
karin.mattle@homburger.ch
www.homburger.ch

KHAITAN & CO
Max Towers, 7th and 8th Floors
Delhi One, Plot No. C-001, A/1
Sector 16B, Noida
Gautam Buddha Nagar
Uttar Pradesh 201301
India
Tel: +91 11 4151 5454
Fax: +91 11 4151 5318
nikhil.narayanan@khaitanco.com
www.khaitanco.com

KIM & CHANG
39, Sajik-ro 8-gil
Jongno-gu
Seoul 03170
Korea
Tel: +82 2 3703 1114
Fax: +82 2 737 9091 / 9092
hdcho@kimchang.com
jbkim@kimchang.com
byoungkwon.park@kimchang.com
ey.lee@kimchang.com
www.kimchang.com

MAX GUTBROD
Tel: +7 895 923 5103
gutbrod.max@gmail.com

MORGAN LEWIS STAMFORD LLC
10 Collyer Quay
#27-00 Ocean Financial Centre
Singapore 049315
Tel: +65 6389 3000
Fax: +65 6389 3099
suetfern.lee@morganlewis.com
www.morganlewis.com

MORI HAMADA & MATSUMOTO
16th Floor, Marunouchi Park Building
2-6-1 Marunouchi
Chiyoda-ku
Tokyo 100-8222
Japan
Tel: +81 3 6266 8553
Fax: +81 3 6266 8453
akira.matsushita@mhm-global.com
www.mhmjapan.com
Contributors’ Contact Details

**NAUTADUTILH AVOCATS**
Luxembourg
2 rue Jean Bertholet
Luxembourg 1233
Luxembourg
Tel: +352 26 12 29 1
Fax: +352 26 12 29 90
greet.wilkenhuysen@nautadutilh.com
anke.geppert@nautadutilh.com
www.nautadutilh.com

**VEIRANO ADVOGADOS**
Brigadeiro Faria Lima Avenue
3477, 16th floor
04538-133
São Paulo
Brazil
Tel: +55 11 2313-5700
lior.pinsky@veirano.com.br
levi.santos@veirano.com.br
victor.meneguelli@veirano.com.br
www.veirano.com.br/

**SLAUGHTER AND MAY**
One Bunhill Row
London EC1Y 8YY
Tel: +44 207 600 1200
Fax: +44 207 090 5000
filippo.defalco@slaughterandmay.com
claire.jackson@slaughterandmay.com
christian.boney@slaughterandmay.com
www.slaughterandmay.com

**WOLF THEISS**
Schubertring 6
1010 Vienna
Austria
Tel: +43 1 51510 5200
Fax: +43 1 51510 665200
sarah.wared@wolftheiss.com
www.wolftheiss.com

**SULLIVAN & CROMWELL LLP**
125 Broad Street
New York
NY 10004-2498
United States
Tel: +1 212 558 4048
Fax: +1 212 558 3588
aquila@sullcrom.com
www.sullcrom.com
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