

# Shareholder Activism

Dealing with Activist Investors: Legal Strategies  
and Communication Aspects

*Börsianer Messe 18*

RA Dr. Christoph Nauer, LL.M.

RA Dr. Elke Napokoj, LL.M.

19. September 2018

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# 1. What is Shareholder Activism

- The Phenomenon of Shareholder Activism is well known in the USA
- In Continental Europe, the importance of Shareholder Activism is becoming ever more prevalent, particularly in Germany (see u.a. thyssenkrupp, Stada Arzneimittel, Wirecard, Bilfinger, Deutsche Börse, etc)
  - However, in Austria, it is in the early stages.
- Definition of terms: Active shareholders who protect their interests not only through legal and statutory shareholder rights, but also through additional – usually publicity-effective – measures
- Active Shareholders vs Activist Shareholders
  - Broad spectrum of active shareholders (including investment funds, private equity investors, family offices, hedge funds (depending on strategy))
  - Activist shareholders – tend to be more critical, more effective in raising public awareness with a generally short-term investment and strategy approach (measures/activities to increase the share price for exit)
- Activist shareholder attempts to exert influence that goes well beyond the voting power of their share position

## 2. Strategies (1)

- "Traditionally" activist investments were driven by speculative expectations in special situations (takeovers, structural measures e.g. mergers)
- Tendency towards activist participations independent of special situations
- Objective: 'short-term' increase in value
- Frequent target companies
  - Conglomerate structure (fragmentation)
  - High Cash Position
  - Below-average share price development or company growth compared to competitors in the market (peer group)
- Exploitation of "false valuations" of a target company

## 2. Strategies (2)

- Typical Demands of an Activist Shareholder
  - Selling/split-off parts of companies/significant assets
  - Strategy Changes
  - Capital Repayment: Special dividend, share buyback programmes
  - Management change, reduction in management compensation
  - Cost reduction measures: Staff reductions, reduction of long-term investments and research and development expenses
  - Representation on the Supervisory Board: Pressure/Control to implement the measures
- Also use of statutory shareholder rights/minority rights – due to (alleged) governance weaknesses
  - Trend towards Corporate Governance Activism
  - Improving Corporate Governance – an argument often used as an excuse
  - Exercise of shareholder and minority rights is (also) used as "leverage"

# 3. Procedure of Activist Shareholder – Overview (1)

- Structure of investment position
  - Maximum exploitation of undervaluation
  - Participation extent different: 1% to 25% (generally in the range of 5 - 10%)
- If threshold value is exceeded - notification of voting rights (§ 130 ff BörseG)
  - Thresholds 4%, 5%, 10%, ...
  - Appearance of several shareholders – so-called "Wolf Pack"; Aggregation for notification of voting rights due to acting in concert generally only if material control possibility exists
- Communication to corporate bodies – Invitation to the Executive Board/Supervisory Board
  - Public (press, open letter) or initially non-public
  - Presentation of demands, strategic plans
  - Request for representation on the Supervisory Board

### 3. Procedure of Activist Shareholder (2)

- Public Campaigns – Public Letters, interviews and media information
  - (Aggressive) criticism of management, corporate strategy, business development - presentation of own suggestions
- Establishing contact with institutional investors, equity analysts, proxy advisors
- General Meeting
  - Request convening extraordinary General Meeting; ordinary General Meeting in advance
  - Dismissal of members of the Supervisory Board, elections to the Supervisory Board
  - *Proxy fight: Advertising for voting rights proxies, obtaining support (positive voting rights recommendation) from proxy advisors (ISS, Glass Lewis, etc.)*
- Litigation – Use of shareholder rights (special audit, rescission of GM resolutions, etc.) – Exertion of pressure
- Exit

## 4. Preparation – Company interests

- Preparation for defense/response is crucial
  - „response ... is an art, not a science“  
(Martin Lipton/Sabastian V. Niles, Wachtell, Lipton, Rosen & Katz)
- Preparation in the interests of the company/enterprise is necessary
- Appearance of activist shareholders threaten the company with costs/disadvantages
  - Public perception of the company (impact on capital market and creditors, customers/suppliers, employees and management)
  - Impairment of business activity
  - "Consumption" management capacity – required for business and corporate management
  - Consultancy fees – PR, legal advice, investor communications (proxy fights)
- Self-dynamics of activist campaigns – pure defensive measures often come too late



## 4. Preparation – Measures (1)

- Setup work team – enables rapid response
  - Composition: Key position from companies (Board of Directors, IR, Legal, etc.), external consultants (lawyers, public relations consultants, investment bankers)
  - Elaboration of defense manual – comprehensive response and defense strategy including procedures and responsibilities
  - Preparation for "usual" speeches by activist shareholders including subsequent communication (also internal communication – employees)
- Investor-/Shareholder-Relations
  - Investor-/Shareholder-Relations, in particular to identify risks of activist activity and in proxy fights
  - Active and transparent public communication
  - Regular contact with anchor shareholders, institutional investors, voting rights advisors, stock analysts
  - Possibility to contact the management to find out whether the management strategy is supported

## 4. Preparation – Measures (2)



- Communication
  - Consistent with the fundamental strategic orientation of the company
  - Stringent presentation of significant events within the company
  - Pro-active: Reasons/Countermeasures in the event of missed targets, performance below peer group benchmarks
  - In the event of incorrect external representations – appropriate objective, transparent correction
- Evaluation of critical statements, in particular of institutional shareholders
- Anticipation core issues/requirements of investors, analysts, activists
  - Preparation of reply proposals
- Review of distribution policy (dividends, share buybacks)
- Financing Structure – Capital Allocation

## 4. Preparation – Measures (3)

- Regular Monitoring
  - Peer Group (Business activities, comparison parameters, equity analysts, proxy agents (proxy advisors))
  - Market activity of activist shareholders, media reports
- Monitoring shareholder base and trading movements
  - Voting rights notifications
  - Trading volumes
  - Net short positions (EU Short Selling Regulation); FMA website: <https://webhost.fma.gv.at/ShortSelling/pub/www/QryNetShortPositions.aspx>
  - Activist activity – especially in comparable industries and/or companies with similar structures (structural problems)
- Regular review of Supervisory Board composition
  - Consideration of proxy advisor guidelines (ISS, etc)
  - Composition Supervisory Board/proposed candidates decisive in proxy fight

## 4. Preparation – Bodies (Supervisory Board)



- Preparation/Information of Board Members – activist environment, preparation, strategy, approach/response to activist speech
- On the same page, „*one voice-policy*“.
  - Uniform communication/avoidance of contradictory statements
  - Attention when addressing individual Supervisory/Management Board-Members – avoid uncoordinated comments
  - Information to Management Board about establishing contact – enables preparation time
- Regular information of the Supervisory Board
  - Evaluation of strategic options, alternatives, policy strategy
  - Management analysis of "usual" activist demands - divestiture, dividend policy, share buybacks, financing structure, special dividends, structural changes, cost reductions, etc.
  - Attempt of activist shareholders - "wedge" in executive bodies through doubts about strategic orientation and performance

## 5. Dealing with Activist Dialogue

- Working team – examination of requirements/proposals, definition of strategy, immediate preparation of public communication
- Activist can make receivables "public" at any time – per active approach by companies?
- “Taking into account” the contacting of shareholders, analysts, proxy advisors, business partners, employees, etc. by activists
- No obligation to talk to activist shareholder – Considerations
  - Suppression of escalation – possibility of "private" communication channel
  - Refusal to talk may be viewed negatively by institutional investors
  - Backgrounds/Conceptions/Plans can be discussed, analysed in more detail
  - **Attention:** Activists generally have no interest in confidentiality. Information/Talk contents are exploited in later public disputes. Basis of work: Conversation does not remain confidential!
  - No disclosure of company information/documents (including restrictions under stock corporation law)

# 5. Dealing with Activist Dialogue – Public Communication (1)



- For public communication relating to Activists
  - Initial response such as: "Suggestions from shareholders are welcome and will be examined".
- Development of coordinated communication/reaction of the company
  - Definition of uniform communication/statements – Maintenance of credibility in corporate communication
  - Determining which groups are addressed – investors, analysts, employees, etc.
- Careful preparation of responses – but swift action required
  - Avoidance of uncertainty (shareholders, employees, ...)
  - Preventing the dominance of public debate by activists
- Avoiding impressions – Activist has new strategy in shareholder interest
  - Identification of analysis/studies already carried out – Claims are not pursued for reasons in the interests of the company/shareholders

## 5. Dealing with Activist Dialogue – Public Communication (2)



- Countering "attacks" with reasonable, economically and legally sound arguments
  - Comprehensible/Credible presentation of own position and strategy
  - In the case of a "short selling attack" – appropriate and transparent information for market participants about short selling positions
  - Attracting support from investors, proxy advisors
- Consideration of asymmetric public discussion
  - Aggressive/Personal attacks by activists possible
  - Whereas company has to have a balanced approach to communication
- Regular consideration of the situation
  - Enforcement of defence
  - Integration/Implementation of activist proposals in the interests of the company – avoidance of escalation, proxy fight, etc.
- Strong/Positive business development best defense strategy

## 6. Use of Shareholder Rights (1)

- Use of shareholder rights/minority rights ("Corporate Governance Activism")
  - often "means of pressure"
- Convening extraordinary GM, supplement to GM agenda (5%)
  - Supervisory Board elections, Supervisory Board dismissal
  - Withdrawal of confidence of Management Board members by GM
  - Special audit, assertion of claims against bodies/shareholders, special representatives
- Elections in Supervisory Board
  - Composition of Supervisory Board/proposed Supervisory Board candidates
  - *Proxy fight – Consideration of proxy advisor guidelines for contested elections (ISS, etc)*
  - Mobilisation of shareholders
  - Special regulation on minority representatives for the election of at least 3 Supervisory Board-Members in a General Meeting



## 6. Use of Shareholder Rights (2)

- Application for appointment of special auditors
  - Extra agenda item or to agenda item “*Template annual accounts, discharge*”
  - In case of rejection by GM 10%-minority right to judicial appointment (in case of suspicion of dishonesty or gross violation of law or breach of statute)
  - Voting ban for board members
  - **Attention:** "Passiveness" Proxies for ad-hoc motions in GMs (Abstention)
- Assertion of claims by the company against board members (from management) and/or shareholders (return of contributions, exertion of influence to the detriment of the Company in order to obtain advantages outside the Company)
  - 10%-minority right in AGM if claims are not manifestly unfounded
  - Appointment of special representative to conduct legal dispute – GM-Resolution, 10%-minority right to judicial appointment

## 7. Excursus – Investor Agreements (1)

- Activist shareholders also seek agreements with the Company ("Investor Agreement") in order to enforce substantive demands.
- Limits under stock corporation law
  - Legal obligation of the Management Board to manage the company independently and on own responsibility
  - Binding towards third parties only after prior independent examination; applies to obligations of the Supervisory Board accordingly
  - Competence regulations must be observed – approval required by Supervisory Board, GM
- Agreement on the composition of the Supervisory Board/refund of election proposals
  - Obligation of the Supervisory Board to make a nomination for election on the basis of an independent, autonomous decision
  - Commitment permissible after independent positive review – subject to material change in material circumstances
  - Commitment to effort permissible – subject to independent audit in compliance with duties

## 7. Excursus – Investor Agreements (2)

- Agreement to pass on information to shareholders
  - Confidentiality obligation under stock corporation law – ongoing disclosure of information inadmissible
  - Information may be provided on specific occasions, if required in the company's interest
  - Consideration of risk of abuse (also for public disputes); confidentiality agreement required in any case
- Agreement of dividend proposal to GM
  - Commitment permissible after careful conductor measurement – subject to change of relevant parameters
  - In the event of a deviation from previous dividend policy – higher justification requirement and consideration within the framework of management measurement (consideration of changed framework conditions, shareholder structure, cost structure, etc.)

## 7. Excursus – Investor Agreements (3)

- Agreement on the disinvestment of shareholdings/assets
  - Management Board responsibility and generally approval requirement for Supervisory Board
  - General Meeting responsibility for the transfer of all company assets and Holzmüller/Gelatine-Doctrine
  - Commitment permissible in the context of management measurement - subject to material change in relevant circumstances
- Commitments utilization/non-utilization of authorized capital
  - In principle, in the management measurement of the board of directors/AR - admissibility of a pre-conditionality disputed (German case law: impermissible self-obligation)
  - At most permissible, if with reservation in case of substantial changes
- Commitment to sell/repurchase own shares
  - See above on authorized capital

# Contact



## Please contact:



**Christoph Nauer**, Partner  
Tel. (+43-2236) 8933 77  
Fax. (+43-2236) 8933 77-40  
christoph.nauer@bpv-huegel.com



**Elke Napokoj**, Partner  
Tel. (+43-1) 260 50-0  
Fax. (+43-1) 260 50-133  
elke.napokoj@bpv-huegel.com

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**Vienna**  
ARES-Tower, Donau-City-Str. 11  
A-1220 Vienna  
Tel. (+43-1) 260 50-0  
Fax. (+43-1) 260 50-133

**Mödling**  
Enzersdorferstraße 4  
A-2340 Mödling  
Tel. (+43-2236) 893 377-0  
Fax. (+43-2236) 893 377-40

**Baden**  
Hauptplatz 9-13  
A-2500 Baden  
Tel. (+43-2252) 209 899  
Fax. (+43-2252) 209 899-99

**Brussels**  
Rond Point Schuman 9, Postbox 14  
B-1040 Brussels  
Tel. (+32-2) 286 81-10  
Fax. (+32-2) 286 81-18