

**Steve Wolosky, Andrew Freedman
and Ron S. Berenblat**

Members of Olshan Frome Wolosky's
Activist & Equity Investment Group



Future of shareholder activism in Europe

The gloves are coming off as full-blooded, US-style activism attacks EU boardrooms. But are they prepared?

Shareholder activism is no longer just a US phenomenon and continues to spread across the globe. In this article, we discuss our views on the future of shareholder activism in Europe, drawing from our experience as the leading law firm to activists in the US.

According to *Activist Insight*, 97 European companies were publicly targeted by activists during 2016, representing a 35 per cent increase compared to 2015. Homegrown investment funds engaged in shareholder activism, such as TCI Fund Management, Crystal Amber and Cevian Capital, are leading the crusade to maximise shareholder value and protect the interests of all shareholders. Blue chip US activists have also recently been involved in European campaigns with successful outcomes, including ValueAct Capital's US-style settlement agreement for board representation at Rolls-Royce in the UK.

As more seasoned activists take the plunge into activism in Europe, we believe smaller players from both the US and other jurisdictions will follow suit. For example, Active Ownership Capital, a relatively new activist fund, based in Luxembourg, successfully replaced the chairman of the supervisory board of German pharmaceutical company STADA Arzneimittel at its 2016 annual general meeting.

The noticeable uptick in shareholder activism in Europe is not only evidenced by the growing number of publicly disclosed activist situations. We see signs of a boom beyond these numbers. Advisers

specialising in activism are bolstering their European presence. Media coverage of activist situations unfolding across Europe is a daily occurrence.

A recent wave of corporate governance reforms and awareness in various jurisdictions in Europe could make it a natural breeding ground for activist situations. For example, Germany is in the process of amending its corporate governance code (Deutsche Corporate Governance Kodex) to require more transparency at listed companies with the goal of allowing investors to better assess and provide feedback to the supervisory board on corporate governance matters.

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The preamble of the code is being amended to emphasise the 'particular importance' of institutional investors to their portfolio companies and to specifically state that 'it is expected of them that they exercise their ownership rights actively and responsibly on the basis of transparent principles which take into consideration the concept of sustainability'. Similar policies encouraging institutional investors to serve as active stewards of shareholder interests, if adopted by other European countries, could give added staying power to European activism.

Based on our experience in the US, we predict that over the next two to three

years, various trends will emerge in Europe consistent with those that we saw during the early stages of the US activism cycle in the early 2000s.

Wolves and lambs

While more confrontational campaigns are beginning to surface in Europe, they still occur less frequently than in the US. Most activist situations in Europe are relatively tame by US standards and behind-the-scenes discussions have been the preferred means of engagement. We sometimes hear people say that due to cultural differences between the US and European countries, a more hostile US-style approach will generally not be successful in Europe and a more subtle, private approach is required for an activist to be effective.

We believe that activism in Europe will become more confrontational as it proliferates throughout the region and activists get more comfortable navigating the regulations, voting mechanics and cultures specific to each jurisdiction. Kinder and gentler activism strategies will be replaced by somewhat more aggressive tactics, including the public issuance of fight letters and detailed white papers and slide presentations that are common in US proxy fights today. Newer and younger activists that will follow the more mature activists that are currently taking a leading role in the space could be instrumental in escalating things.

We are already seeing more aggressive US-style activist situations in Europe. TCI Fund Management, one of the more prolific European activists, is publicly opposing Safran S.A.'s proposed acquisition of Zodiac Aerospace. Both Safran and Zodiac are French corporations listed on the Euronext Paris exchange. In a highly critical public

UP FOR A FIGHT

Gentle activism strategies will be replaced with more aggressive tactics

intervene in the event that the tender offer is in fact initiated before the merger vote. More recently, following Zodiac's announcement of poor financial results, TCI Fund sent a public letter to Safran's chairman, threatening to seek his removal at the upcoming annual general meeting if he did not pull the plug on the deal. TCI Fund also sent a letter to all the Safran board members, warning them that they would be held personally responsible for the full amount of any losses suffered by Safran as a result of the transaction. Similar to US activist campaigns today, these public letters, together with a 49-page slide presentation condemning the transaction, were posted by TCI Fund to a website it created specifically for the campaign.¹

Ruffled feathers

As we saw in the US during the early 2000s, when activism was beginning to gain traction, we believe boards and management teams of European companies, particularly those of smaller-cap companies, will need to be prepared for this more aggressive style of activism. Feathers will be ruffled and the knee-jerk reaction of many target companies will be to put up defences designed to ward off the dissident. The types of defences that may be implemented by targets will vary, depending on the laws of the local jurisdiction.

Companies may also take advantage of existing laws that could insulate them from attack. For example, in Spain, public companies (*sociedades anónimas*), both listed and unlisted, are permitted under the Spanish Companies Act (*Ley de Sociedades de Capital*) to adopt bylaws imposing a ceiling on the number of votes that may be cast by a single shareholder, group of shareholders or shareholders acting in concert (without prejudice to certain rules only applicable to listed companies in the context of a takeover bid). However, if the voting limitation is not already contained in the bylaws, shareholder approval is required to amend the bylaws in order to adopt the voting limitation.

We may also see more targets commence lawsuits against activists as part of their defence strategies, similar to what we used to see being used often in the US, alleging undisclosed groups, violations of 'early warning' reporting obligations and other disclosure deficiencies. More aggressive activist campaigns that call into question the personal reputation and integrity of members of the board and management in public fight letters could be met with defamation proceedings against the dissident. »

fight letter addressed to the chairman of Safran, TCI Fund argues that Safran is 'significantly overpaying' for Zodiac. In addition, TCI Fund argues that the deal is structured to force the hands of Safran shareholders as it claims the Safran board has intentionally decided to hold the merger vote after the consummation of Safran's tender offer for Zodiac.

Since a successful tender offer would result in Safran owning a majority of Zodiac, TCI Fund claims that even if Safran shareholders oppose the merger, they will be inclined to vote in favour of the deal to avoid a precipitous drop in Zodiac's share price that would result if the merger is rejected.

According to TCI Fund: "The sequencing has been designed specifically to ambush the public shareholders of Safran in an unethical manner. The fact that the board has agreed to ransom the company and its shareholders in such a way is underhand, unfair, unscrupulous and unbecoming of a company with such a long and impressive history of success."

TCI Fund subsequently issued a public letter urging shareholders to demand that the merger vote take place before the tender offer, vote against the merger and transfer their shares into registered form in order to qualify for double voting.

TCI Fund also sent public letters to France's *Autorité des Marchés Financiers* alerting it of the situation and urging it to

» Just as in the US, it may take a few years before these companies take things less personally and realise that they are better off engaging with activists rather than commencing legal proceedings to silence them.

Activism strategies will evolve

The evolution of the specific types of activist strategies that will be utilised in Europe during the coming years will be very interesting to watch. In the US, the predominant activist strategy has always been to obtain board representation. In the early stages of the US activism cycle, it was extremely common for activists to use a corporate governance platform to make their case for seeking such board representation. The types of activist strategies being utilised in Europe vary, but according to FTI Consulting, the strategies of choice include seeking board representation, attempting to remove the CEO or other board members and expressing opposition to proposed business combinations.

Of course, the order of predominance of these and other strategies varies depending on the regulatory frameworks, economic state of affairs and other factors specific to each country. For example, in Germany, where a two-tiered board structure is mandatory, activists have been less inclined to seek board representation and, according to FTI Consulting, campaigns focussed on corporate governance concerns, such as excessive remuneration and lack of transparency, are more common.

Offensives mounted by various funds against Volkswagen in reaction to these types of corporate governance concerns following its emissions scandal especially come to mind. Following the emissions scandal, Hermes Investment Management and other institutional investors demanded that Volkswagen conduct a truly transparent and independent investigation of both the management and supervisory boards' involvement in the matter. Prior to Volkswagen's 2016 annual general meeting, Hermes reiterated its concerns with Volkswagen's corporate governance and the effectiveness of the supervisory board. Hermes asserted that the 'questionable composition of the supervisory board' and the company's 'continuous disregard of fundamental corporate governance principles' may have contributed to the emissions scandal. TCI Fund has pressed Volkswagen to revamp its executive remuneration policies, which it contended are excessive, incentivise risky behaviour and also contributed to the emissions scandal. Volkswagen recently announced the restructuring of its remuneration policies, but many believe the company has not gone far enough.

Over the past few years, activists in the US have lightened up on their corporate governance platforms in connection with seeking board representation and have pivoted towards platforms identifying operational changes that

should be implemented to maximise value (referred to as 'operational activism') as well as alternatives for preserving cash or deploying excess cash in ways that are accretive to shareholders (referred to as 'balance sheet activism'). During the next few years, we may see more activists in Europe emulate these strategies.

These two strategies have already been deployed by Crown Ocean Capital in its recently concluded proxy fight against Bowleven PLC, a UK oil and gas exploration company focussed on Africa. In January 2017, Crown Ocean requisitioned a general meeting of shareholders for the purpose of removing six directors from the seven-member board and appointing two independent director candidates. Crown Ocean utilised an operational activism strategy by arguing that

Activists in the US have lightened up on corporate governance platforms and pivoted towards platforms identifying operational changes



Bowleven should focus on its highly promising Etinde asset and openly and objectively re-evaluate its Bomono project.

At the same time, Crown Ocean utilised a balance sheet activism strategy by arguing that management had overseen a cash burn of more than \$100million during the previous two fiscal years 'without tangible, successful results' and that it should preserve cash. According to Crown Ocean, cash should be distributed to shareholders in a tax-efficient manner only to the extent a 'prudent board' determines the cash is not required to advance the Etinde project. At the general meeting, both of Crown Ocean's candidates were appointed to the board and five incumbent directors were removed. Notably,

Crown Ocean failed to remove William Allan, the chairman of the board. Crown Ocean then submitted a notice to Bowleven, requisitioning a second general meeting for the purpose of removing Chairman Allan, stating that 'the incumbent Chairman is reluctant to accept the verdict of shareholders over the future strategy of Bowleven' and appointing two additional independent directors. Shortly thereafter, Allan resigned from the board and Crown Ocean withdrew its requisition notice for a general meeting. Similarly structured platforms could be used by activists in Europe to bolster their case for effecting change on the board.

Local proxy rules will be tested

Particularly in countries where proxy fights are currently a rarity, controversies of a substantive as well as procedural nature relating to election contests will surface. For example, issues relating to voting thresholds required to elect directors when the number of candidates up for election exceeds the number of directorships to be filled at a meeting may not be clearly addressed by applicable laws.

Similarly, a company's organisational documents and applicable law may not adequately address matters of meeting procedure when a dissident is running a competing slate of directors. Can management or the dissident validly adjourn a meeting in a contested situation if a quorum is already present? Once votes have been tallied, are there procedures for the losing party to contest the results of the meeting? As proxy contests become more commonplace, companies' organisational documents and local regulations will evolve in order to address these uncertainties. www.aStrongerSafran.com