Shareholder Activism & Engagement

Contributing editors
Arthur F Golden, Thomas J Reid, Laura C Turano and Thomas D Malinowsky

2017

GETTING THE DEAL THROUGH

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Second edition

Getting the Deal Through is delighted to publish the second edition of *Shareholder Activism & Engagement*, which is available in print, as an e-book, and online at www.gettingthedealthrough.com.

Getting the Deal Through provides international expert analysis in key areas of law, practice and regulation for corporate counsel, cross-border legal practitioners, and company directors and officers.

Throughout this edition, and following the unique **Getting the Deal Through** format, the same key questions are answered by leading practitioners in each of the jurisdictions featured. Our coverage this year includes new chapters on Brazil and Korea.

Getting the Deal Through titles are published annually in print. Please ensure you are referring to the latest edition or to the online version at www.gettingthedealthrough.com.

Every effort has been made to cover all matters of concern to readers. However, specific legal advice should always be sought from experienced local advisers.

Getting the Deal Through gratefully acknowledges the efforts of all the contributors to this volume, who were chosen for their recognised expertise. We also extend special thanks to the contributing editors, Arthur F Golden, Thomas J Reid, Laura C Turano and Thomas D Malinowsky of Davis Polk & Wardwell LLP, for their continued assistance with this volume.

GETTING THE
DEAL THROUGH

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Introduction

Arthur F Golden, Thomas J Reid, Laura C Turano and Thomas D Malinowsky

Davis Polk & Wardwell LLP

While in recent years the story surrounding shareholder activism has been its rapid growth, much of 2016 has been characterised by tales of shareholder activism headwinds. Examples include activist mainstay Pershing Square realising public losses in its investment in Valeant Pharmaceuticals (among other investments) and suffering public defeat in connection with the attempted bid by Canadian Pacific for Norfolk Southern, ValueAct facing litigation and agreeing to a concessionary settlement over its investment in connection with the terminated merger between Baker Hughes and Halliburton (in addition to ValueAct's own substantial losses on its investment in Valeant) and well-known activist Carl Icahn's investment fund falling 18 per cent in just the first half of the year. In our inaugural edition of *Shareholder Activism & Engagement*, we predicted that shareholder activism was here to stay. Despite the headwinds experienced by shareholder activists in 2016, we continue to believe that this is clearly the case. 2016 has also strengthened our belief that as shareholder activists experience losses and reduced – even if still positive – performance levels, there will be sharper focus on the low investment diversification, liquidity challenges and personality-dependent strategies that feature prominently in the shareholder activism asset class.

The chapters of this second edition of *Shareholder Activism & Engagement* are again a product of the efforts of esteemed practitioners throughout the world, including some of the foremost experts in the expanding field of shareholder activism. This introduction identifies some of the trends and topics that we have seen as 2016 comes to a close, and we look forward to providing readers with in-depth, country-by-country coverage in the chapters that follow.

Mid-cap companies increasingly in the crosshairs of shareholder activists

In 2016, we continued to see examples of large-cap companies with household names being targeted by shareholder activists (for example, United Continental, Viacom and Yahoo). However, a trend has emerged in which shareholder activists are increasingly retreating to the relative safety of smaller targets, often with high success. Market-wide, a total of 58 per cent of the companies targeted by shareholder activists in 2016 have market caps below US$2 billion, compared with 49 per cent in the three-year period prior; and only 7 per cent of companies targeted by activists in 2016 have market caps above US$20 billion, compared with 12 per cent in the three-year period prior. This trend appears to be, in large part, a combined product of seasoned veterans seeking novel opportunities and new firms entering the activist space. Activist firms Jana Partners, Land and Buildings, Marcato and ValueAct, among others, have each targeted companies with average market caps of less than 50 per cent of their targets in the three-year period prior, and in fact, of the top 10 activist funds (measured by campaigns initiated in 2016), only Elliott Management and GAMCO Investors targeted companies with higher average market caps than they did in the three-year period prior. These activist titans are, however, being joined in the market by an expanding group of peers. Large firms with more traditional investment portfolios and new, smaller firms entering the activist space have each found room in the market. Campaigns by 'occasional' activists have ballooned in recent years, and by some metrics there has been more than double the volume of such campaigns in 2016 as compared with 2014. As this growing pool of activist shareholders looks for opportunities, companies outside of the United States may also find themselves to be increasingly in the crosshairs of investors. In 2016 approximately 33 per cent of all activist campaigns were levied against non-US companies. As a result, the market for shareholder activism in 2016 is very much one where activists are everywhere and anyone can be an activist. It is also a market in which no company is too big or small to be a target.

A related trend we are following is what changes shareholder activists are actually pursuing in the companies they target. In years past, many noteworthy firms' primary strategy for generating returns was to identify and pursue companies with salient capital structure or management weaknesses, taking a short-term view to generate immediate returns by encouraging leverage where appropriate or forcing change at the top. This has decreased in 2016, with only 23 per cent of shareholder activists indicating an interest in modifying their target's capital structure (down from an average of 47 per cent in the three-year period prior) and only 13 per cent leading with an open intention to change management (down from 16 per cent in the same time frame). Instead, shareholder activists are more often seeking a seat at the table and pushing for board representation and governance changes in 49 per cent of target situations (up from 41 per cent in the same time frame) as well as strategic changes in 50 per cent of targets (up from 46 per cent in the same time frame). We see this trend as linked to the broadening of the activist population. As shareholder militancy for change becomes more and more common, we expect the population of activists to continue to expand and include more and more traditional large investors.

Increased role of institutional investors in the activist landscape

As the population of activist investors expands and broadens we are paying close attention to the evolving role of institutional investors in the activist marketplace. Previously resigned to maintaining passive, long-sighted investments, index, mutual and pension funds are among the market constituents most rapidly shifting to add activist investments to their portfolio. As early as the first quarter of 2015, institutional investors Vanguard and BlackRock indicated their increasing willingness to engage in opportunistic activism, and true to form, in April 2016, BlackRock launched its first activist campaign, targeting the G-Resources Group based out of Hong Kong, while in June 2016, Vanguard issued a summary of its activist efforts, indicating a 19 per cent increase in engagement over the 12-month period prior and a 67 per cent increase over the three-year period prior.

This uptick in engagement efforts is even more revealing when one considers the breadth and scale of investments within these institutional investor portfolios. In the 11-year period prior to June 2016, Vanguard alone went from holding a greater-than-5 per cent stake in less than 1 per cent of all S&P 500 companies to holding such stake in more than 90 per cent of S&P 500 companies today. Clearly, these institutional investors are forces to be reckoned with now and going forward, but their strategy is not without challenges. In April 2016, the US Department of Justice brought a civil action against ValueAct in connection with its purchase of shares of Halliburton and Baker Hughes, alleging a plan to 'take steps to influence the business decisions of both companies.' As the line between shareholder activists such as ValueAct and institutional investors begins to blur, institutional investors will need to be mindful of potential additional limitations and compliance requirements as they plan their interactions with the companies they invest in and what a portfolio with mixed strategies looks like in practice.

Proxy access by-laws gain further support

Proxy access has quickly evolved from uncharted territory to inevitable. Rule 14a-8 shareholder activists made nearly 200 proposals to enact proxy access at 2016 annual shareholder meetings. (Rule 14a-8 refers to US Securities Exchange Act Rule 14a-8, which requires a company to include a shareholder proposal in its proxy materials if certain minimum requirements are met, including the shareholder owning at least US$2,000 or 1 per cent of the securities entitled to vote on the proposal.) At this point, it is widely expected that a majority of S&P 500 companies will have adopted proxy access by the end of 2016. This increase is put into greater perspective when we consider that merely a dozen companies had made a similar adoption prior to 2015. However, the explosion of proxy access by-laws has not yet been accompanied by a similar increase in proxy contests and we do not expect that to happen. Many boards seem to have a similar view and have approached proxy access with relative equanimity. In addition, in many ways, this rapid shift is not unexpected. At a time when proxy advisory firms hold great sway and institutional investors have detailed 'no exception' in-house voting guidelines, one-size-fits-all governance is an increasingly powerful force.

On 10 November 2016, activist fund GAMCO Investors filed the first proxy access director nomination, proposing a candidate for the board of National Fuel Gas Company (NFG). GAMCO ultimately withdrew the nomination after NFG declared the nomination to be invalid on the basis that GAMCO did not satisfy NFG's proxy access by-law's 'passive investment' requirement (which required a nominating shareholder (i) to have acquired shares 'in the ordinary course of business and not with the intent to change or influence control of [NFG]' and (ii) to 'not presently have such intent'). Even though the GAMCO nomination was withdrawn, we believe that it is important to note for two reasons. First, it illustrates the importance of proxy access eligibility requirements – both for companies as they design and enforce such requirements, and for potential nominating shareholders as they plan their interactions with the companies they invest in (similar to our point above regarding the Hard-Scott-Rodino 'passive investment' exemption). Second, it is further evidence that shareholder activists may attempt to use whatever tools are at their disposal (even tools, such as proxy access, that were not originally intended as an activism tool for those seeking to change or influence control). While many believed that the holding period requirements and other proxy access by-law restrictions (including limitations on solicitation) would make proxy access unattractive to traditional shareholder activists, we do not think that GAMCO will be the last traditional shareholder activist to attempt to use proxy access. Especially in cases where a shareholder activist has not had to file a Schedule 13D (for example, because the target company is a mega cap company and the activist has not crossed the 13D filing threshold), we may see traditional shareholder activists calibrating or delaying their contacts with target company management to avoid leaving a trail of breadcrumbs regarding their intentions that could later be used by the target company to reject their proxy access nomination.

Settlements become mainstream

As we predicted last year, shareholder activists have increasingly been able to effect change without instigating a full-scale proxy fight. Companies are settling with activists early and often, viewing the threat of a costly fight as more harmful than the certainty of negotiating and accommodating demands up front. In the first three quarters of 2016, there were 107 board seats awarded to shareholder activists – already a higher total than was awarded to such investors in 2015 – only seven of which derived from an actual proxy contest. We have also seen increasing scrutiny of boards quickly acquiescing to shareholder activist demands, with State Street even issuing a report on settlements. We will continue to monitor developments in this area, including in how settlement practices in the United States influence such practices in other jurisdictions. We continue to believe, as some investors have said, that boards may now be too quick to raise the flag of surrender in many cases.

Universal ballot

In October 2016, the US Securities Exchange Commission proposed changes to proxy rules to require the use of universal proxy cards in contested proxy elections. The proposal is designed to address the current inability of shareholders of US public companies to vote for the combination of board nominees of their choice in an election involving a proxy contest. We believe this is an important development to monitor, especially because of its potential interaction with proxy access developments (despite the differences between proxy access and universal proxy) and the potential impact of the US presidential election.

Final note

We are excited to add Brazil and Korea to this second edition of *Shareholder Activism & Engagement* and are eager to share the updates that we and our fellow contributors have prepared regarding jurisdictions covered in last year's inaugural edition. Our aim in this second edition is to provide an updated analysis of the global shareholder activism and engagement landscape and to identify key changes over the past year to help our readers understand and evaluate the evolving marketplace. We look forward to following future developments as shareholder activist and engagement strategies continue to mature.

France

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General

1 What are the primary sources of laws and regulations relating to shareholder activism and engagement? Who makes and enforces them?

Shareholder activism is not as widespread in France as it is in the United States. However, France has recently become the second largest market for shareholder activism in Europe, following the United Kingdom (Les Echos, '*Le poids des acteurs*', 9 February 2016). Between 2010 and October 2016, there were approximately 30 shareholder activism campaigns in France. These campaigns included, in particular, Vector Capital's campaign regarding JP Morgan's proposed private investment in media and entertainment technology leader Technicolor in 2012, Cevian Capital's campaign against French electrical-equipment company Rexel in 2016 which resulted in the removal of Rexel's chief executive officer, and the campaigns led by the French investor Association for the Defence of Minority Shareholders (ADAM) (i) in 2014 to increase the price of the takeover bid for the French holiday resort Club Med and (ii) in 2016 to increase the price of Eurosic's takeover bid for Foncière de Paris.

Over the past 20 years, the French legal environment has changed significantly and increased the rights of shareholders with respect to governance-related matters. French shareholder activism legislation began with the recognition of the right for investor associations to claim collective damages for expropriated shareholders (Law No. 89-421, 23 June 1989). Shareholder activism was further strengthened by the possibility granted to shareholders holding at least 5 per cent of the share capital or voting rights of a listed company to prevent a squeeze-out offer (Law No. 89-531, 2 August 1989) and the right granted to investor associations mandated by expropriated shareholders to claim individual damages (Law No. 94-679, 8 August 1994).

In addition, the New Economic Regulation Law of 2001 increased the rights of shareholders and in effect permitted proxy fights in France. This reform enabled shareholders to vote by mail, and reduced from 10 per cent to 5 per cent the percentage of voting rights required to propose a resolution at shareholders' meetings. Furthermore, a 2006 decree provided that the record date for a shareholders' meeting must be set three days before the meeting, thereby permitting shareholder activists to continue to acquire shares until just a few days before the shareholders' meeting.

Finally, the implementation in the French Commercial Code in 2011 of Directive No. 2007/36/EU on the exercise of certain shareholder rights in listed companies (i) further increased shareholders' rights at general meetings, by providing expanded information to shareholders and facilitating the addition of draft resolutions to a shareholders' meeting agenda by shareholders and (ii) created a legal framework for active proxy solicitation, by requiring that anyone who actively solicits proxies must announce his or her voting policy (see question 21).

In France, shareholder activism legislation and regulation are enforced by the courts.

2 What are the other primary sources of practices relating to shareholder activism and engagement?

Over the past few years, new practices relating to shareholder activism have emerged. In particular, governance codes (such as the AFEP-MEDEF and AFG codes), which recommend best practices for executive compensation and appointment of board representatives, offered a new source for shareholder activism. The best example of the power of governance codes on shareholder activism is the introduction of the 'say-on-pay' by the AFEP-MEDEF corporate governance code, in the aftermath of several scandals concerning executive compensation.

Proxy agencies also use their voting recommendations in favour of, or against, company resolutions to reduce information asymmetry between shareholders, thus potentially affecting the outcome of general meetings.

3 Are some industries more or less prone to shareholder activism? Why?

In France, no industry leans more or less towards shareholder activism, and shareholder activists usually target specific governance and M&A issues rather than specific companies (see question 5).

4 What are the typical characteristics of shareholder activists in your jurisdiction?

Investor associations (such as ADAM, the Association of Small Bearing Assets and SOS Small Carriers) have had a crucial role in French shareholder activism for more than two decades. From 1989 to 2000, ADAM initiated campaigns in 32.4 per cent of 97 French companies that were subject to shareholder activism, and had a 59.38 per cent success rate. In 2013, ADAM challenged the price of the €939 million takeover bid initiated by Chinese private equity fund Fosun on Club Med, and finally secured a 41 per cent increase of the offer price (€24.6 per share, instead of €17 per share at the outset). ADAM also requested – without success – the opening of an investigation by the French securities regulator (the Financial Markets Authority (AMF)) against XPO Logistics for having allegedly provided misleading information in connection with its €3.24 billion takeover bid for French global transportation provider Norbert Dentressangle. However, even if the role of investor associations remains important in France, new actors, such as hedge funds and proxy agencies, are emerging in the French market. Very recently, ADAM requested from the AMF the withdrawal of the compliance statement granted on 26 April 2016 to Eurosic's proposed tender offer on Foncière de Paris. ADAM notably unsuccessfully required the AMF to rule that the share tender agreements involving certain common shareholders of Foncière de Paris and Eurosic constituted evidence of an action in concert and, given the large equity interest owned by these common shareholders, de facto deprived Foncière de Paris' other shareholders from any alternative offer, including the more attractive offer made by Gecina.

With the 2001 reduction to 5 per cent of the percentage of voting rights required to submit resolution proposals at a shareholders' meeting, investment entities and hedge funds (such as Vector Capital, Knight Vinke, Pardus and Colony Capital) have started targeting French companies and playing an important role in their governance. They typically hold minority shareholdings in undervalued companies and demand that they take governance and strategic actions to improve the share price. In 2012, Vector Capital successfully fought against the proposed private investment in public equity by JP Morgan in Technicolor, by proposing additional resolutions for its own competitive private investment. As a result, Vector Capital became Technicolor's largest shareholder and obtained from Technicolor's management the implementation of various strategic actions. In 2013, private equity fund

Colony Capital successfully removed Accor's CEO. In 2015, Amber Capital successfully obtained the separation of the chairman and CEO positions at the cable manufacturer Nexans and the replacement of its CEO.

Since asset management companies are required under French law to exercise voting rights attached to shares of companies in which they invest, proxy agencies have also become major actors of shareholder activism in France because asset management companies rely principally on voting recommendations provided by proxy agencies. The most influential proxy agencies are: Proxinvest; Glass, Lewis & Co; PhiTrust Active Investors; the French Asset Management Association (AFG); and RiskMetrics. Proxy agencies analyse corporate governance practices and resolutions proposed at general meetings of listed firms and provide advisory services, including voting recommendations and solicitation services. Their principal objective is often viewed as not so much to improve a company's share price but rather to promote and encourage better corporate governance practices generally. They are usually considered to have a long-term investment horizon.

5 What are the main operational, governance and socio-political areas that shareholder activism focuses on?

In France, shareholder activism focuses principally on CEO and top management compensation and mergers and acquisitions activities (including takeover bids and capital increases). This trend is consistent with the figures provided in 2016 by Activist Insight for Europe (*Option Droit & Affaires*, 'Les activistes: un mal necessaire?', October 2016) which show that European shareholder activism addresses particularly board-related matters (50.9 per cent), M&A-related issues (18.9 per cent), and compensation topics (9.4 per cent). As in Europe, French shareholder activism rarely focuses on environmental and political issues.

In addition to the campaign led by ADAM in connection with the takeover bid on Club Med described above, the ongoing battle between Elliott Capital Management and XPO Logistics relating to the acquisition of Norbert Dentressangle is a good illustration of shareholder activism in connection with takeover bids in France. XPO Logistics bought a 67 per cent stake in Norbert Dentressangle in April 2015 and then launched a mandatory buy-out offer for the shares held by the minority shareholders. The stated objective of XPO Logistics was to reach ownership of at least 95 per cent of Norbert Dentressangle through this buyout offer so it could then do a squeeze-out and take the company private. However, Elliott Capital Management purchased a 9.06 per cent interest in Norbert Dentressangle in July 2015 and is thereby in a position to block the squeeze-out and delisting of the company.

Finally, in France, shareholder activists often address executive compensation and golden parachute issues.

Shareholder activist strategies

6 Describe the general processes and guidelines for shareholders' proposals.

Except with regard to the removal of one or more directors or supervisory board members and their replacement, the shareholders' meeting cannot deliberate on an item that is not on the agenda.

One or more shareholders representing at least 5 per cent of the capital of a company, or a recognised shareholders' association, is entitled to request the inclusion of items for discussion or draft resolutions to the agenda of a shareholders' meeting.

For companies listed on an exchange, the request must be sent at least 25 days prior to the date of the meeting. Any such items and draft resolutions must be included in the agenda and sent to shareholders with all of the other documents relating to the meeting. Companies whose stock is listed on an exchange are also encouraged to include the names and addresses of the proposing shareholders (so that other shareholders can reach out to them) and, to the extent available, an explanation of the proposed resolutions.

Shareholders' items for discussion are always precatory or non-binding, and do not require implementation. Shareholders' draft resolutions may be binding if the proposal is with respect to an action reserved for the shareholders and if the proposal receives majority support.

Processes and guidelines do not change according to the type of shareholder.

7 What common strategies do activist shareholders use to pursue their objectives?

The activist shareholders' strategy is typically based on two stages.

The first stage is confidential and consists of private discussions between activist shareholders and the management in order for activist shareholders to present their claims. Since it is in the management's interest to keep those claims confidential, managers will often accept and discuss these claims with activist shareholders. If they cannot reach an agreement, then the second stage begins.

The second stage is hostile: activist shareholders and managers publicly confront their positions. In addition to exercising their right to submit discussion items and resolution proposals, as discussed above, in order to pursue their objectives, shareholder activists mostly make use of their right to submit written questions prior to general meetings. They also often use the public media (press releases, open letters, interviews, etc) to advertise their positions. In extreme cases, activist shareholders do not hesitate to bring the action before the Commercial Court in order to add pressure on the target company and, in particular, file a claim for (i) the appointment by way of summary judgement of one or more experts to submit a report on one or more management transactions or (ii) the appointment of a designee to convene a general meeting if the board of directors or the executive board failed to do so (see question 8).

The board of directors of a French company is required to respond during a shareholders' meeting to written questions submitted by shareholders prior to the meeting. By way of example, PhiTrust submitted five written questions to the CEO of Alstom prior to the 2015 shareholders' meeting relating to his exceptional bonus payment of €4 million and the information provided to shareholders concerning the sale by Alstom of its energy business to General Electric. Certain shareholder activists also write directly to the AMF to allege that certain practices of a target company are contrary to best corporate governance practices and shareholder rights. For instance, in 2015, Proxinvest submitted five written questions to the AMF and Alcatel concerning the information provided to Alcatel's shareholders concerning the golden parachute and the non-competition payment to be made to its departing CEO.

Also, shareholder activists in France often publicise their positions and use two principal means to achieve this goal: issuers' annual reports; and press releases and media interviews.

Proxy agencies publish annual reports on their websites. In these reports, proxy agencies present their analysis of the governance practices of listed companies, sometimes even using the 'name and shame' card to draw attention to what they believe are undeserving companies. They sometimes also provide advice to companies in order to improve their governance. Proxinvest, the leading French proxy agency, also publishes an annual report on the compensation of senior executives of companies included in the French SBF 120 index and an annual report of general meetings of listed companies.

More generally, activist investors in France often use the media to spearhead their voting campaigns. For example, in 2014, proxy agencies went public to criticise the automatic allocation of double voting rights to shares held in the registered form for at least two years provided by the 'Florange Law' and, together with investment companies and hedge funds, encouraged shareholders to vote against double voting rights.

Finally, the use of social media by French activists remains in the early stages as shown by the very limited number of Twitter followers of Proxinvest and PhiTrust followers: 577 and 422, respectively, at the time of writing.

8 May shareholders call a special shareholders' meeting? What are the requirements? May shareholders act by written consent in lieu of a meeting?

First, shareholders' meetings may be called by a successful bidder who holds more than 50 per cent of the shares or voting rights of a company following a tender offer or the acquisition of a majority interest in the relevant issuer, if the board of directors of the issuer has failed to so convene a shareholders' meeting despite a request by the new majority shareholder. This provision enables successful bidders to quickly dismiss and replace board members (and, as applicable, senior management) if they do not resign or no amicable arrangement is found for their replacement.

In addition, as a general French corporate law matter, if the board of directors or the executive board failed to do so, shareholders' meetings may be convened either:

- by any interested party in the event of an emergency; or
- by one or more shareholders who together hold more than 5 per cent of the share capital, including, with respect to listed companies, through an association of shareholders.

In order to call a shareholders' meeting, the applicant must file, at its expense, a request with the president of the commercial court acting in summary proceedings. The president of the court will verify that the request is in the interests of the company and does not relate solely to the private interests of the claimant. If the president of the commercial court grants the request, he or she then appoints a designee responsible for convening the meeting and determining the agenda.

9 May directors accept direct compensation from shareholders who nominate them?

In their capacity as directors of a French corporation, directors are compensated by the company and cannot receive any direct compensation from the shareholders who nominate them.

10 May shareholders nominate directors for election to the board and use the company's proxy or shareholder circular infrastructure, at the company's expense, to do so?

Shareholders are entitled to request the inclusion of a draft resolution proposing the appointment of a director to the agenda of a shareholders' meeting, in which case the draft resolution must be circulated by the company to all shareholders. See question 6, concerning the right of shareholders to submit resolution proposals.

11 May shareholders bring derivative actions on behalf of the corporation or class actions on behalf of all shareholders? What defences against, or policies regarding, strike suits are applicable?

Shareholders, individually or collectively through an association of shareholders who together hold at least 5 per cent of the share capital, may bring a derivative action known as the ut singuli action to seek damages to compensate the company for the losses it suffered as a result of mismanagement by the company's CEO or members of the board in the fulfilment of their duties. Any damages awarded are paid to the company despite the fact that the legal action is brought at the shareholders' expense. This explains why these legal actions remain relatively rare in practice.

Shareholders are not entitled to bring class actions on behalf of all shareholders. The new class actions regime introduced in France by the Hamon Law in 2014 only allows consumer associations to bring class actions against companies, and only with respect to damage to goods.

Company response strategies

12 What advice do you give to companies to prepare for shareholder activism? Is shareholder activism and engagement a matter of heightened concern in the boardroom?

It is imperative that companies be well prepared, and thus that they try and identify the issues which could attract activists' attention. To that end, executives should (i) regularly review corporate governance policies (composition of the board, appointment and removal of directors, executive compensation, etc), (ii) evaluate strategic and transaction alternatives to improve the company's performance and (iii) pay attention to proxy agencies' recommendations in order to anticipate institutional investors' voting policy.

Companies might also consider establishing a White Paper listing ideas and suggestions for enhancing shareholder value. For instance, this paper could analyse the strategic initiatives to be undertaken by the company to maximise shareholder value and whether or not:

- management has recently become distracted by non-core businesses and needs a strengthened focus on the company's core business;
- executive compensation has been sufficiently correlated with the company's performance;
- executives are sufficiently motivated to enhance shareholder value; and
- the company has been proactive enough in publicly disclosing its recent successes and accomplishments.

In addition, executives should pay attention to their relationships with the company's major shareholders and maintain an ongoing dialogue with all shareholders to provide them with feedback on significant company issues (eg, by posting reports and videos on the company's website, platforms and social media). This communication will enable management to better understand the view of the market and help investors to understand the business model of the company and its capital allocation decisions.

Finally, executives should be attentive to the policies and recommendations of institutional shareholders.

13 What structural defences are available to companies to avoid being the target of shareholder activism or respond to shareholder activism?

Structural defences available to French companies are very limited. While some companies have adopted the equivalent of US poison pills, they remain a small minority.

Current structural defences used to fight shareholder activism include:

- the introduction of an article in the by-laws to require the disclosure of certain shareholdings thresholds which are not covered by the law (ie, between 0.5 per cent and 5 per cent; see question 19);
- the implementation of a double voting rights system to the benefit of long-term shareholders whose shares are held for a longer period than the period provided by law (currently, shares held in a directly registered account for two years or more are entitled to double voting rights at shareholders' meetings unless otherwise provided for in the by-laws) in order to slow down the influence of a new activist shareholder. For example, Pernod Ricard's by-laws provide shareholders with double voting rights for each share held in a directly registered account for a 10-year period; and
- the capping of voting rights to limit the activist shareholder's power to cause trouble. For example, voting rights are capped at 30 per cent per shareholder at Pernod Ricard regardless of how many shares are held by such shareholder.

Other companies have adopted the corporate form of a French *société en commandite par actions*, in other words, a partnership with general partners bearing unlimited liability and shareholders with limited liability, to protect the incumbent management. Indeed, the articles of association of this form of company may validly include provisions that make it very difficult to replace management. Finally, certain French issuers include in their global portfolio regulated activities (eg, sensitive contracts with the French government) so that a change in their control may only occur with the prior approval of the French government or other regulatory authorities.

14 May shareholders have designees appointed to boards?

Significant shareholders often seek board representation rights with the issuer. If the situation is not hostile and the circumstances warrant it, companies are sometimes amenable to entering into an agreement providing for board representation rights. Pursuant to these agreements, which must be disclosed publicly, the issuer typically undertakes to propose and support the appointment of a designee of the large shareholder. In exchange, the large shareholder typically agrees to support the strategy of the company.

While some of these agreements provide for a standstill obligation by the large shareholder (ie, an undertaking not to purchase shares of the company beyond an agreed threshold), standstill obligations are not always negotiated (and, when they are, they typically provide for customary exceptions; eg, if a third party acquires a significant interest in the company or launches a takeover bid).

Update and trends

Shareholder activism is likely to become a permanent and important feature in the French market.

Indeed, the development of new corporate governance rules in the French legal environment, such as the introduction of say-on-pay in 2013, encourages the development of shareholder activism. In this respect, the new 8 November 2016 law (the Loi Sapin II) implemented a mandatory say-on-pay system in the French Commercial Code through a binding shareholder vote on all forms of compensation paid or granted to the company's officers, including the chairman.

An expected increase in shareholder activism is also likely to result from the future implementation in France of the EU directive on shareholders' rights that is currently under review.

Finally, activists who have gained significant experience in other jurisdictions such as the US are likely to continue to try to import their strategies in France in order to attempt to extract additional value from companies that have been weakened by the current economic environment.

Disclosure and transparency

15 Are the corporate charter and by-laws of the company publicly available? Where?

The AMF recommends that listed companies publish an updated version of their by-laws on their website. In any event, company by-laws are publicly available on the website of the companies and commercial register (at www.infogreffe.com).

16 Must companies, generally or at a shareholder's request, provide a list of registered shareholders or a list of beneficial ownership? How may this request be resisted?

The AMF recommends that listed companies provide in their annual reports a table setting out the allocation of their share capital and voting rights as of the end of the past three years.

This ownership table lists shareholders in order of decreasing level of ownership. It also shows the most important sub-categories of shareholders (eg, shareholders belonging to the same group of companies, family groups and shareholders acting in concert) and, as applicable, certain specific groups of shareholders (eg, employee shareholding and treasury shares).

Finally, the ownership table may provide an explanation of significant changes in share capital and voting rights over the last three years (including acquisitions, transfers, allocation of double voting rights) together with references to threshold-crossing notices and, if applicable, statements of intent (see question 19).

Moreover, companies must establish a list of their shareholders 16 days before the shareholders' meeting and make it available until the meeting. The list must individually identify the shareholders holding their shares in the registered form and indicate the number of shares held, together, by the shareholders holding their shares in the bearer form.

17 Must companies disclose shareholder engagement efforts or how shareholders may communicate directly with the board? Must companies avoid selective or unequal disclosure? When companies disclose shareholder engagement efforts, what form does the disclosure take?

The AMF recommends that listed companies create a shareholder consultative committee in order to improve the quality of the company's communications with its individual shareholders (better organisation of the general meetings or studies to better address shareholder expectations). Listed companies usually disclose information on this committee either in their annual report (eg, shareholder consultative committee's role, members, etc) or on their websites (eg, shareholder consultative committee's internal regulation, dates of meeting, minutes, materials of presentations, etc).

Companies also regularly interact with shareholders through different forms and tools ranging from the company website to the shareholder newsletter, the shareholder guide, the shareholder club, preferred dividends, shareholder meetings, financing training courses, and so on. Each company aims to choose the solutions that offer the best fit with its shareholder relations strategy.

Even if companies have closer relationships with certain shareholders (see question 22), they must make sure that all shareholders are provided with the same level of information. Equality of information is at the cornerstone of French securities and corporate laws.

18 Do companies receive daily or periodic reports of proxy votes during the voting period?

During the period of time that precedes a shareholders' meeting, companies receive written voting proxy forms from shareholders who cannot attend the meeting. These proxy forms must be:

- mailed to the company at least three days prior to the meeting, unless a shorter period has been provided by the by-laws; or
- electronically sent to the company by three o'clock in the afternoon on the day prior to the meeting, in the case of electronic voting proxy forms.

Consequently, based on a review of the proxy forms so received, companies are aware shortly before the meeting of the position of these shareholders who voted by proxy.

Moreover, as the authority responsible for monitoring the quality of information provided to investors in France, the AMF has issued a recommendation for proxy advisors addressing (i) the establishment and the implementation of voting policies, (ii) the issuance of voting recommendations, (iii) the communication channels with listed companies, and (iv) the prevention of conflicts of interest. In this respect, the AMF recommends that proxy agencies send their report on the proposed resolutions to the companies and their shareholders. In their reports, proxy agencies should provide their voting recommendations for each resolution, thereby allowing issuers to be aware of the likely position of those shareholders who follow proxy agencies reports.

19 Must shareholders disclose significant shareholdings?

Under French law, any person or legal entity who, acting alone or in concert, holds shares representing more than 5 per cent, 10 per cent, 15 percent, 20 per cent, 25 per cent, 30 per cent, one-third, 50 per cent, two-thirds, 90 per cent or 95 per cent of the capital or voting rights of a listed company must inform the company and the AMF of the total number of shares and voting rights so held within four trading days. The determination of these thresholds includes derivative holdings.

A failure to comply with this disclosure requirement:

- results in the removal of the voting rights attached to the shares exceeding the threshold for which notice has not been duly made for all shareholders' meetings held during a two-year period following the due information of the company and the AMF as per a regularisation notice;
- may result in all or part of the shares held by the defaulting shareholder being deprived of voting rights for a maximum period of five years, if the competent Commercial Court decides this following a motion to that effect from the AMF, the company's chairman or any of its shareholders;
- may expose the defaulting shareholder (as well as its directors and executive officers) to administrative sanctions by the AMF; or
- may, after consultation of the AMF by the public prosecutor, expose the defaulting individuals, as well as the chairman, executive officers and directors of a defaulting company, to a criminal fine of €18,000.

In addition, upon crossing the thresholds of 10 per cent, 15 per cent, 20 per cent and 25 per cent of the capital or voting rights, the relevant shareholder must also inform the company and the AMF within five trading days, of its objectives for the following six-month period, by stating:

- the means of financing the share purchases;
- whether it is acting alone or in concert;
- whether it intends to continue to purchase shares or not;
- whether it intends to take the control of the target;
- whether it intends to request the appointment of new board members;
- its planned strategy relating to the target and actions required to implement it;
- any temporary securities transfer agreement; and

- its intention with respect to the settlement of any equity or cash-settled derivatives it may own.

If the acquirer's stated objectives change during the six-month period, it should file a new statement to run for a further six-month period.

20 Are shareholders acting in concert subject to any mandatory bid requirements in your jurisdiction?

Shareholders who, acting alone or in concert, cross the threshold of 30 per cent of share capital or voting rights of a listed company, or for those who hold between 30 per cent and 50 per cent of the share capital or voting rights of a listed company, increase their shares or voting rights by more than 1 per cent over a rolling 12-month period, must file a mandatory tender offer for the remainder of the share capital and voting rights of the company.

Under French law, persons acting in concert are those who have entered into an agreement to buy or sell or exercise voting rights in order to implement a common policy or to acquire control of a company. The following persons are deemed to be acting in concert (which presumption may be rebutted):
- a company, the chairman of its board of directors and its chief executive officer;
- a company and the companies it controls;
- companies controlled by the same person or people; and
- the shareholders of a simplified joint-stock company and the companies controlled by this company.

Shareholders acting in concert are jointly and severally bound by the obligations imposed on them by the laws and regulations, including the above-mentioned mandatory bid requirements.

21 What are the primary rules relating to communications to obtain support from other shareholders? How do companies solicit votes from shareholders?

As stated in question 7, the use of social media by French activists remains in the early stages (see question 7).

French law provides for a formal soliciting votes procedure. Anyone who actively solicits proxies, by proposing directly or indirectly to one or more shareholders, in any form and by any means whatsoever, to receive a proxy to represent them at the meeting of a company mentioned, shall announce his voting policy on his or her website.

That person can also announce their voting intentions on the draft resolutions presented to the shareholders. In that case, for any proxy received without voting instructions, the person shall vote consistent with the voting intentions announced.

22 Is it common to have organised shareholder engagement efforts as a matter of course? What do outreach efforts typically entail?

Over the past few years, French companies (such as Accor, Carrefour, LVMH, Vinci and Total) have tried to strengthen their relationships with individual shareholders by creating shareholders' clubs. These clubs not only offer minor perks to shareholders (visits of current and completed projects of the companies (Vinci, LVMH) and special discounts on company goods and services), but also develop an ongoing communication channel between companies and shareholders through newsletters, a dedicated information website, specific newspapers (Total) and private meetings with top management teams regarding strategic priorities, outlook, results and dividend policy (Vinci).

In addition, where a known shareholder activist has acquired a stake in a French issuer, it is not uncommon for representatives of the issuer to engage in a dialogue with the activist in order to ensure that there is no misunderstanding on the strategy pursued by the company.

23 Are directors commonly involved in shareholder engagement efforts?

Shareholder engagement efforts are typically led by the senior management of the company, and sometimes with the chairman of the board. However, it remains rare for directors to have a significant involvement in the implementation of shareholder engagement efforts (even though directors are very much involved, in their capacity as board members, in the strategy to be adopted with respect to shareholder engagement efforts).

Fiduciary duties

24 Must directors consider an activist proposal under any different standard of care compared with other board decisions? Do shareholder activists, if they are a majority or significant shareholder or otherwise, owe fiduciary duties to the company?

As a general matter, directors of French companies must consider activists' proposals with the same standard of care as that applied to other board decisions. In practice, given the potential strategic or governance impact of many activists' proposals, directors are likely to pay special attention to these proposals.

Activists who are significant or majority shareholders have a duty not to abuse their positions in a manner that is contrary to the interest of the issuer. Where an activist shareholder is in a position to designate a board member, he or she must also do so with a view to pursue the best interests of the company, for the benefit of all of its shareholders, and not in a self-interested manner.

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General

1 What are the primary sources of laws and regulations relating to shareholder activism and engagement? Who makes and enforces them?

The primary sources of law and regulation that are relevant to shareholder activism and engagement are the Companies Act 2006 (the Companies Act), the Listing Rules, the Disclosure Guidance and Transparency Rules (DTRs), the EU Market Abuse Regulation (MAR) and the City Code on Takeovers and Mergers (the Takeover Code).

The Companies Act was introduced by Parliament and applies to all companies incorporated in the UK.

The Listing Rules and the DTRs are made and enforced by the Financial Conduct Authority (FCA). The Listing Rules apply to all companies (whether incorporated in the UK or elsewhere) with a listing on the premium segment of the Official List. Chapter 5 of the DTRs (DTR 5) is particularly relevant in the context of shareholder activism and applies to:

- UK companies with shares admitted to trading on a 'regulated market' (such as the Main Market of the London Stock Exchange);
- UK public companies with shares admitted to trading on a 'prescribed market' (such as AIM); and
- non-UK companies whose shares are admitted to trading on a 'regulated market' whose home state is the UK.

MAR is an EU regulation that is directly applicable in the UK. It is enforced by the FCA.

The Takeover Code is a set of rules administered and enforced by the Takeover Panel and applies, inter alia, to takeover offers for:

- companies incorporated in the UK, Channel Islands or Isle of Man if any of their securities are admitted to trading on a regulated market or multilateral trading facility (such as AIM) in those jurisdictions; and
- public companies incorporated in the UK, Channel Islands or Isle of Man that are considered by the Takeover Panel to have their central place of management and control in any of those jurisdictions.

2 What are the other primary sources of practices relating to shareholder activism and engagement?

Corporate governance rules and market guidance and institutional investor expectations on 'best practice' for listed companies are also relevant in the context of shareholder activism and engagement.

All companies (whether incorporated in the UK or elsewhere) with a listing of equity shares on the premium segment of the Official List are subject, on a 'comply or explain' basis, to the UK Corporate Governance Code (the Governance Code) issued by the Financial Reporting Council (FRC). However, certain provisions of the Governance Code apply only to FTSE 350 companies, including, for example, provisions requiring the annual re-election of directors.

In addition, the FRC's UK Stewardship Code (the Stewardship Code) sets out good practice for institutional investors seeking to engage with boards of listed companies and also applies on a 'comply or explain' basis.

Representative bodies, such as the National Association of Pension Funds (NAPF), Pensions Investment Research Consultants, Hermes and the Investment Association, formed in 2014 through the merger of the Investment Management Association with the Investment Affairs Division of the Association of British Insurers (ABI), regularly issue voting guidelines for their members recommending what positions to take in various circumstances. These guidelines carry significant influence in practice.

Institutional Shareholder Service, the US-based proxy advisory service, published its first UK voting guidelines in January 2015, which became effective for meetings held on or after 1 February 2016.

3 Are some industries more or less prone to shareholder activism? Why?

Activists in the UK are not restricted to any particular industries. Natural targets are characterised by poor share price performance compared with industry peers, high cash reserves, business lines that can be sold or spun off, corporate governance concerns or a receptive shareholder base.

4 What are the typical characteristics of shareholder activists in your jurisdiction?

US hedge funds and alternative investors with event-driven strategies are often considered to be the principal shareholder activists in the UK. However, in recent years, long-term institutional investors have become increasingly involved in activist campaigns (outside takeover or merger arbitrage situations) and, on occasion, have formed alliances with hedge funds or alternative investors for this purpose.

The apparent behavioural shift of institutional shareholders is due to a number of factors, including the publication of best practice guidance aimed at promoting effective engagement between institutional shareholders and listed companies (see question 22) and the introduction of 'say-on-pay' legislation (see question 6).

5 What are the main operational, governance and sociopolitical areas that shareholder activism focuses on?

Activism in the UK has focused primarily on board composition and remuneration. However, there has also been significant activity in operational areas in recent years. This includes strategic reviews, restructurings, spin-offs and other divestitures, and (in a takeover context) actions to increase the takeover offer price. Balance sheet strategies, such as share repurchases, dividends and leveraged recapitalisations, are not uncommon.

While low in number, there have also been examples of sociopolitical activism in the oil and gas industry. The 'Aiming for A' coalition, for example, requisitioned special resolutions at BP and Royal Dutch Shell relating to climate risks.

Shareholder activist strategies

6 Describe the general processes and guidelines for shareholders' proposals.

Certain matters are reserved for shareholders of a UK company under the Companies Act and must be approved by ordinary resolution (passed by a simple majority) or special resolution (passed by a 75 per cent majority). These thresholds are determined by reference to those who vote at the meeting in question which, in reality, would typically represent a much lower percentage of the overall shareholder base.

An ordinary resolution is the more common and is used inter alia to authorise directors to allot shares, approve the board's remuneration policy, remove directors from office, ratify board decisions and, for premium-listed companies under Listing Rules 10 and 11, respectively, approve significant (Class 1) transactions or transactions with related parties. Special resolutions, on the other hand, are required to reduce a company's share capital (which is commonly used to create or increase distributable reserves) and to amend the company's constitution. In addition, as a result of guidance issued by the Institutional Investor Committee, listed companies are expected to approve share repurchases by way of special (rather than ordinary) resolution.

The requirement that the board's remuneration policy is subject to a binding vote by way of ordinary resolution, which must be passed every three years, is particularly significant in an activism context as it provides an effective means for shareholders to express their dissatisfaction with the performance of management. It is coupled with an annual advisory (non-binding) vote on the company's implementation report, which sets out how the remuneration policy has been implemented during the previous financial year. Advisory votes are otherwise uncommon in the UK, but may be used by shareholders to request (rather than formally require) the board to take particular actions as an indication of their collective wish.

If a shareholder (or shareholders) of a UK company wishes to make a proposal, it can require the company to call a general meeting under the Companies Act, provided that it holds at least 5 per cent of the paid-up share capital which carries voting rights (excluding treasury shares). The requisition must state the business to be dealt with at the meeting and may include the text of any ordinary or special resolution which the relevant shareholder proposes to be tabled. Any such resolution must not be ineffective (eg, due to illegality), defamatory, frivolous or vexatious, although a company's board may be accused of obstructing shareholder engagement if it were to challenge a resolution on this basis. If a valid requisition request is made, the board must call a general meeting within 21 days and the meeting itself must be held not more than 28 days after the date of the notice of the meeting. Where the board fails to do so, the shareholder who requisitioned the meeting (or, where more than one shareholder, any of them representing more than half of the total voting rights of the requisitionists) may himself or herself call the meeting.

Additional rights are available to a shareholder (or shareholders) holding at least 5 per cent of the total voting rights (excluding voting rights attached to treasury shares) and to any group of 100 shareholders with the right to vote on the resolution (provided that each holds, on average, £100 of paid-up share capital). The latter may be satisfied by an activist shareholder holding less than 5 per cent voting rights by splitting its shares between nominee accounts. A shareholder satisfying these criteria is permitted to require resolutions to be put before an AGM of a public company or to require the company to circulate a statement to shareholders. Any resolution to be put before an AGM must not be ineffective, defamatory, frivolous or vexatious and must be received by the company at least six weeks before the later of the AGM and the circulation of the AGM notice. A statement to shareholders, on the other hand, must be limited to 1,000 words and relate to a matter referred to in a proposed resolution or other business to be dealt with at the meeting. The company must send the statement to every member entitled to receive notice of the meeting in the same manner as the notice of meeting and at the same time as, or as soon as reasonably practicable after, it circulates the notice of meeting. Subject to limited exceptions, the shareholder who requests the circulation of the statement will be responsible for the costs associated with its circulation, unless the company determines otherwise.

As described above, the availability of certain procedures to investors will depend on whether they hold a sufficient stake in the company or can gather a sufficient amount of support among other shareholders. Culturally, US activist shareholders are more likely to use public measures at an early stage in the campaign process, such as requisitioning general meetings and voting against resolutions for the appointment of new directors. On the contrary, UK institutional investors tend to first engage in private discussions with the board before submitting a formal proposal.

7 What common strategies do activist shareholders use to pursue their objectives?

In general, activist tactics are more cooperative than in the US. Any public form of engagement would usually represent a last resort, largely because it involves considerably more expense and risk (both in execution and reputation). Typically, therefore, an activist would pursue its objectives through private engagement with the company's board. While there is a multiplicity of private engagement strategies, it would be common for the activist not to involve other shareholders in the first instance in order to reduce the risk of leaks and divergent views on solutions and objectives. However, where collective engagement is preferred, an activist shareholder will be entitled to request a copy of the shareholder register under the Companies Act (see question 16) and review notifications of significant shareholdings in public announcements made in accordance with DTR 5 (see question 19) with a view to contacting other shareholders.

If the activist is satisfied that its objectives will not be met through private engagement, it may use public announcements, open letters, website campaigns and even social media to voice its concerns and obtain support for its proposals from other shareholders and representative bodies (such as the Investment Association and NAPF).

Depending on the activist's percentage shareholding, it may be able (either alone or with other shareholders) to requisition a resolution at the AGM or convene a general meeting to consider resolutions to effect changes. Ideally, the activist will have received letters of intent or voting undertakings from other shareholders to support its proposals at the meeting. Legal action of the kind described in question 11 is uncommon.

8 May shareholders call a special shareholders' meeting? What are the requirements? May shareholders act by written consent in lieu of a meeting?

Shareholders of a UK company may call shareholder meetings in accordance with the process outlined in question 6.

There is no statutory procedure for shareholders of a UK public company to pass written resolutions in lieu of a meeting. However, a written record of the passing of a resolution, which has been signed by all shareholders of the company in full knowledge of what they are resolving, should be accepted as a valid expression of member approval.

9 May directors accept direct compensation from shareholders who nominate them?

It would be highly unusual for a listed company not to remunerate board members for the services they perform in their capacity as directors of the company. Ordinarily, executive directors are remunerated under the terms of their service contracts with the company, and non-executive directors receive a fee for their services to the company under letters of appointment.

However, a director nominee or designee may be separately employed by the relevant shareholder and directly remunerated by that shareholder under the terms of his or her employment contract. If a director nominee is separately employed and remunerated by a shareholder, the director will need to ensure compliance with the requirements of the Companies Act relating to conflicts of interest and, in particular, the positive duty to avoid a conflict.

10 May shareholders nominate directors for election to the board and use the company's proxy or shareholder circular infrastructure, at the company's expense, to do so?

Shareholders of a UK company may nominate directors for election to the board by requisitioning a shareholder meeting or a resolution to be tabled at the meeting in accordance with the process outlined in question 6.

11 May shareholders bring derivative actions on behalf of the corporation or class actions on behalf of all shareholders? What defences against, or policies regarding, strike suits are applicable?

Under the Companies Act, a shareholder may bring a derivative action on behalf of a UK company for negligence, default, breach of duty or breach of trust by a director (even if the director has not benefited personally from the breach). Only a single share needs to be held for this purpose, and this can be acquired after the event in question.

Two facets of the English legal system operate to reduce the likelihood of shareholders bringing derivative actions for nuisance value (akin to a US 'strike suit'). First, the shareholder must demonstrate that it has a prima facie case. The court will dismiss the claim where it is satisfied that the director's action has been authorised or ratified by the company (which would therefore operate as a defence against the claim) or where no director of the company would seek to continue the claim on the company's behalf. If the action has not been ratified but is capable of ratification, it is likely that the court will adjourn to enable the shareholders to hold a meeting. Second, while a derivative action is brought in the name of the company, the shareholder bringing the claim is responsible for funding the action unless the court orders the company to reimburse its costs.

In the UK, multiparty litigation (akin to US class actions) may be brought only in respect of competition claims in the Competition Appeal Tribunal. Outside competition claims, the UK rules would permit shareholder actions to be managed collectively under a group litigation order, but each such action would have to be issued separately and to a significant extent would still be treated individually, which can increase cost and complexity.

Company response strategies

12 What advice do you give companies to prepare for shareholder activism? Is shareholder activism and engagement a matter of heightened concern in the boardroom?

The principle of shareholder engagement is a key feature of UK corporate governance (see question 22). A company will be less vulnerable to challenge from an activist shareholder if it engages regularly with its major shareholders, and we advise our clients to do so.

We also advise certain clients to take additional proactive steps to protect themselves from being challenged by activist shareholders – for example, by conducting regular strategic reviews to identify potential areas of challenge (including, if appropriate, through a 'fire-drill' exercise, where management is put through mock attack scenarios); and by monitoring unusual trading (or other) activity which may indicate that the company is being targeted.

The directors of UK listed companies are becoming increasingly focused on this area.

13 What structural defences are available to companies to avoid being the target of shareholder activism or respond to shareholder activism?

Notwithstanding a rise in shareholder activism in the UK generally, structural or 'poison pill' defences are not prevalent in the UK. Their adoption would, in all but extreme cases, constitute a breach of fiduciary duty by the directors of a UK company.

Further, and in the context of a possible takeover offer for a UK-listed company, General Principle 3 of the Takeover Code prohibits a target company's board from denying its shareholders the opportunity to decide on the merits of a bid. This General Principle is supplemented by Rule 21 of the Takeover Code, which prohibits the board from taking certain actions without shareholder approval during the course of an offer or if it believes that an offer might be imminent, which would include issuing shares, selling material assets or entering into non-ordinary course contractual arrangements.

In any event, shareholder consent would be required to implement any poison pill involving an amendment to the company's capital structure or the rights attaching to its share capital, which is unlikely to be granted by UK institutional investors; and for companies with or seeking a premium listing it is unlikely to be consistent with the requirements of the Listing Rules.

For completeness, we note that a classified or 'staggered' board is not a concept embedded within English company law: directors of a UK company may always be removed by ordinary resolution under the Companies Act notwithstanding any agreement to the contrary between the company and the director. We also note that the Governance Code provides that all directors of FTSE 350 companies should be elected (or re-elected) annually.

14 May shareholders have designees appointed to boards?

The composition and structure of the board of a UK-listed company is governed by the Governance Code. This requires that the board consist of directors with the appropriate balance of skills, experience, independence and knowledge of the company to enable it to discharge its duties and responsibilities effectively. Ancillary to this requirement, the board should include an appropriate combination of executive and non-executive directors (and, in particular, independent non-executive directors) such that no individual or small group of individuals can dominate the board's decision-making. For FTSE 350 companies, the Governance Code requires that at least half the board, excluding the chairman, comprise independent non-executive directors.

Notwithstanding this, UK-listed companies have been willing to grant board representation to significant shareholders (typically, shareholders holding at least 10 per cent of the company's shares) by the appointment of a non-executive director nominated by that shareholder. In the context of an initial public offering and listing, it is relatively common for large shareholders to retain board representation. It is less common for board representation to be granted to an investor who actively builds a stake in a UK-listed company.

Where a shareholder is entitled to nominate or appoint a non-executive director, the shareholder would be expected to enter into a relationship agreement with the company, which would regulate their future interaction and support the company's independence. The relationship agreement would typically impose non-compete, non-solicitation, confidentiality or standstill commitments on the shareholder and require the shareholder to procure compliance with corporate governance standards. In return, the shareholder's right to nominate or appoint a director would be enshrined in the contract, together with information and consultation rights.

For premium listed companies with a 'controlling shareholder' (meaning any person who, together with its concert parties, controls at least 30 per cent of the votes of the company), there is a mandatory requirement under the Listing Rules to have a relationship agreement in place. They must also have a dual voting structure for the election or re-election of independent non-executive directors to ensure that they are separately approved by both the shareholders as a whole and independently of any controlling shareholder.

Disclosure and transparency

15 Are the corporate charter and by-laws of the company publicly available? Where?

A UK company's constitutional documents are publicly available at Companies House, the UK Registrar of Companies. These documents can be accessed online on the Companies House website.

16 Must companies, generally or at a shareholder's request, provide a list of registered shareholders or a list of beneficial ownership? How may this request be resisted?

A UK company is required by the Companies Act to comply with any request from a shareholder to inspect or receive a copy of the company's shareholder register. The company may resist the request only if it has not been made for a 'proper purpose'; in which case the company must apply to the court and demonstrate that, on the balance of probabilities, this is the case. The words 'proper purpose' are given their ordinary meaning in this context. A non-binding (non-exhaustive) list of matters constituting a 'proper purpose' has been published by the Institute of Chartered Secretaries and Administrators, which includes shareholders seeking to contact other shareholders generally about matters relating to the company, their shareholding or a related exercise of rights.

The shareholder register will only show the legal owners of the shares. However, under the Companies Act, a UK public company must also make available to shareholders on request (either for inspection or by providing copies of entries) a register of interests in its shares that has been disclosed to the company, unless the request is not made for a proper purpose. An interest in shares will have been disclosed only where the company has required, by service of notice, that such disclosure is made by a person who it knows or suspects is interested in its shares beneficially or otherwise. A significant proportion of UK public companies instruct brokers to serve such notices on a monthly basis.

In addition, since April 2016, UK companies (other than those that are subject to DTR 5) are required to maintain a publicly available register of persons with significant control over the company. A person with significant control includes any individual who:

- holds (directly or indirectly) 25 per cent of the company's shares or voting rights;
- has the power (directly or indirectly) to appoint or remove a majority of the board; or
- otherwise has the right to, or actually does, exercise significant influence or control over the company.

17 Must companies disclose shareholder engagement efforts or how shareholders may communicate directly with the board? Must companies avoid selective or unequal disclosure? When companies disclose shareholder engagement efforts, what form does the disclosure take?

As detailed further under questions 22 and 23, it is best practice for a UK-listed company's board to ensure that there is an effective mechanism to facilitate direct communication between shareholders and the board, and for the board to provide details of its engagement with shareholders in the company's annual report.

Generally, a UK-listed company must not selectively disclose information to third parties, including to shareholders. With effect from 6 July 2016, MAR became directly applicable in the UK. MAR sets out a pan-EU regime dealing, among other items, with the disclosure of 'inside information'. Under MAR, a UK-listed company must generally disclose inside information (that a reasonable investor would use when making investment decisions) to the market as soon as possible through a Regulatory Information Service (RIS).

MAR does allow the disclosure of inside information to be delayed where immediate disclosure is likely to prejudice the issuer's legitimate interests; delay of disclosure is not likely to mislead the public; and the issuer is able to ensure the confidentiality of the information. Selective disclosure of inside information is permitted where the person receiving the information owes the company a duty of confidentiality and requires the information to carry out duties for the company. In any event, UK-listed companies must draw up and update 'insider lists' indicating the persons working for or on behalf of the company who have access to inside information.

In addition to the obligations of the UK-listed company, it is also critical that any recipient does not trade on the basis of the selective disclosure, which would likely constitute an offence under MAR. See question 21 for further information.

18 Do companies receive daily or periodic reports of proxy votes during the voting period?

A UK company's registrar would typically provide daily proxy updates to a company in advance of a general meeting.

A proxy vote is usually given in favour of the chairman of the company and is confidential to the company in the period prior to a general meeting. The quantum of the proxy votes for or against a resolution could constitute inside information (see question 17).

19 Must shareholders disclose significant shareholdings?

DTR 5 imposes an obligation on a person to give notice of an acquisition within two trading days where that person acquires (directly or indirectly through other group entities) in aggregate 3 per cent or more of the voting rights in a UK company to which DTR 5 applies. A further notice has to be given each time a percentage holding above 3 per cent increases or decreases through a 1 per cent threshold (rounding down to the nearest whole percentage point). The notification thresholds for non-UK companies to which DTR 5 applies are 5, 10, 15 per cent, 20 per cent, 25, 30, 50 and 75 per cent; and the deadline for making the notification is four trading days. In either case, the company must then disclose any notifications to the market.

For the purposes of making a notification, an investor is required to aggregate voting rights held by any third party with whom that investor has agreed to adopt, by concerted exercise of voting rights, a lasting common policy towards the management of the company. Helpfully, the Financial Services Authority, the predecessor to the FCA, previously indicated that a high threshold would be applied in this context: it is unlikely to include the kind of ad hoc discussion and understandings which might be reached between institutional shareholders in relation to particular issues or corporate events. However, advice should be sought at an early stage where shareholders adopt an agreed approach to voting at an upcoming general meeting.

Notification obligations under DTR 5 also extend to financial instruments, provided that they give the holder a long position on the economic performance of the company's shares, whether the instrument is settled physically in shares or in cash. In effect, anyone holding a financial instrument that may provide access to the company's shares (eg, as a result of the counterparty having hedged the underlying shares) is intended to be captured.

Notifications under DTR 5 must include, inter alia, details of the resulting situation in terms of voting rights, the chain of controlled undertakings through which voting rights are effectively held and the date on which the threshold was reached or crossed. The notification must be sent to the FCA and the company. Failure to do so may result in the FCA imposing a penalty on the relevant person or issuing a public censure. The investor might also find himself or herself in breach of the market abuse rules (see question 20 for further information).

In addition, where the company is subject to the Takeover Code, a person interested in 1 per cent or more of its securities must disclose details of his or her interest under the Takeover Code no later than 12pm on the 10th business day after the company enters an offer period or an announcement is made that first identifies the bidder. Thereafter, the relevant person must report any dealings to an RIS no later than 3:30pm on the following business day and an electronic copy of such disclosure must be sent to the Takeover Panel. An 'interest' is broadly defined to include options and long derivative positions.

As detailed in question 16, a UK public company may also require a person to disclose his or her interest in the company's shares by service of a notice.

Certain companies in the defence and civil aviation industries impose restrictions on the percentage of their shares in which a person may be interested. For example, a 15 per cent limit has been incorporated into the constitutional documents of Rolls-Royce, BAE Systems and NATS Holdings (although, in respect of Rolls-Royce Holdings and BAE Systems, this limitation applies only to non-UK persons). In addition, the approval of the FCA is required where a person seeks to become a 'controller' (by acquiring 10 per cent or more of the shares or voting power) of a company authorised to carry on banking, insurance or investment services or seeks to increase its control through a notification threshold (at 20 per cent, 30 per cent or 50 per cent).

20 Are shareholders acting in concert subject to any mandatory bid requirements in your jurisdiction?

If shareholders acting in concert acquire an interest in shares of a UK public company (or any other company subject to the Takeover Code) and such interest carries, in aggregate, 30 per cent or more of the voting rights, they will be required by the Takeover Code to make a cash offer to acquire the remainder of the shares.

The Takeover Panel will not normally regard shareholders voting together on a particular resolution as acting in concert. However, shareholders who requisition or threaten to requisition a 'board control-seeking' proposal at a general meeting will be presumed to be acting in concert with each other and with any proposed directors. This would ordinarily require the replacement of existing board members with directors who have a significant relationship with the requisitioning shareholders.

A 'white list' of activities on which shareholders should be able to cooperate without being presumed to be acting in concert was published by the European Securities and Markets Authority in 2013.

21 What are the primary rules relating to communications to obtain support from other shareholders? How do companies solicit votes from shareholders?

Where a communication by a listed company or an investor includes non-public, price-sensitive information, the recipient is prohibited from dealing on the basis of that information by the market abuse and insider dealing rules under MAR, the Financial Services and Markets Act 2000, the Criminal Justice Act 1993 and the Financial Services Act 2012.

Under MAR, insider dealing arises where a person possesses inside information and uses that information to acquire or dispose of (for its own account or for the account of a third party), directly or indirectly, financial instruments to which that information relates. In the context of communication between shareholders, the recitals to MAR explain that information regarding a third party's plans and strategies for trading may amount to inside information. Albeit in the context of the

Update and trends

UK institutional shareholders and activists alike remain focused on executive remuneration and perceived corporate governance failings at UK-listed companies – as illustrated by the Investor Forum's involvement in the continued scrutiny of Sports Direct with a call for an independent, comprehensive review of corporate goverance at the company – but they have also focused on securing board representation to achieve strategic change and on building stakes to lobby for improved terms in public M&A situations (commonly referred to in the US as 'bumpitrage').

An example of a high-profile campaign for board representation is that run by Sherborne Investors in relation to Electra Private Equity. Having built an initial shareholding, Sherborne claimed that Electra would be able to unlock significant value through a strategic change in approach. It requisitioned a general meeting in October 2014 for shareholders to consider the appointment of two of its nominees to the board. This proposal was defeated, in part due to the efforts made by Electra's board to warn shareholders against the consequences of changes to the company's existing management structure. However, having increased its shareholding further and requisitioned a further meeting, Electra's shareholders eventually agreed to the appointment of two Sherborne nominees at a meeting in November 2015.

Elsewhere, after building a stake in August 2015 and a lengthy process of engagement over a period of over six months, ValueAct Capital successfully managed to secure the appointment of its chief operating officer as a non-executive director of Rolls-Royce Holdings. The appointment came after Rolls-Royce's fifth profit warning in two years. Mirroring provisions often found in US-style settlement agreements between public companies and shareholder activists, in exchange for the appointment of ValueAct Capital's nominee to the board, Rolls-Royce obtained an undertaking from ValueAct that it would not lobby for a break-up of the company and that it would not increase its stake above 12.5 per cent.

In part because of the sharp depreciation of the pound sterling after the referendum on the UK's membership in the EU, many UK institutional investors and shareholders believe that the Brexit vote has created opportunities for activism by driving down the share prices and valuations of some UK-listed companies. For example, in August 2016, Elliott became one of Meggitt's five largest shareholders by entering into a derivative contract over stock amounting to a 5.2 per cent stake in the company. Elliott also intervened to raise concerns about the terms of Anheuser-Busch InBev's bid for SABMiller; the larger US rival increased its offer, which had arguably become less attractive as a result of the fall in the pound post-Brexit. Similarly in July 2016, Elliott bumped up its stake in Poundland within days of the company agreeing to be bought by Steinhoff in order to push for a higher bid.

Despite the fact that the majority of activist investors still hail from the US, trends in 2016 show that homegrown activism is on the rise in the UK. Examples have included Crystal Amber's takeover of Pinewood Studios and Toscafund's call for the resignation of the executive chairman of Speedy Hire in July 2016.

pre-MAR regime, the FCA has also previously indicated that an investor's strategy for investing in a UK-listed company can itself constitute inside information. An activist, therefore, often makes details of its strategy public at the outset of a campaign by writing an open letter to obtain support from other shareholders. In doing so, it must ensure that it is not giving shareholders a misleading impression or expectation in order to take advantage of the resulting share price movements.

Where communication is between shareholders and the company, institutional shareholders would typically have appropriate procedures in place to enable them to receive inside information and become insiders with appropriate safeguards. According to the ABI, 60 per cent of its members have developed Chinese wall procedures to enable their corporate finance or corporate governance team to be contemporaneously inside while the portfolio managers continue to be able to trade in the company's securities. This enables investors to give non-binding feedback to companies and reflect investment views without having to implement stock restrictions.

The FCA has adopted an increasingly robust approach to the enforcement of market abuse and insider dealing offences, and the rigorous requirements relating to the control and dissemination of inside information (see question 17) and insider dealing under MAR will likely reinforce this trend. While market abuse is a civil offence for which the FCA may impose an unlimited fine, public censure or a restitution order, insider dealing may result in criminal prosecution.

Accordingly, communications are usually private and involve a small number of shareholders (see question 7). Where the company or a shareholder decides to make a communication public, electronic communications and websites are often used. Activists increasingly use social media to voice concerns and persuade other shareholders of their viewpoint.

To overcome various limitations associated with obtaining copies of and inspecting the register of shareholders of a UK company, activist investors may engage proxy solicitation agents and financial advisers to help obtain information on the company's shareholder base. In addition, activist investors, together with their advisers, typically use a company's announcements made under DTR 5 as well as information in the company's annual reports and accounts to collect and analyse information on the company's shareholder base. Once identified, the activist investors or proxy solicitation agents, or both, as the case may be, make contact with the other shareholders.

22 Is it common to have organised shareholder engagement efforts as a matter of course? What do outreach efforts typically entail?

Organised shareholder engagement has become increasingly common in recent years and now forms a key feature of best practice guidance. The Governance Code recommends that companies ensure satisfactory dialogue with shareholders as one of its main principles. This is supported by guidance published by shareholder representative groups, including the Investment Association and NAPF, which recommend that dialogue take place at regular intervals throughout the year. Further, engagement efforts are often initiated by investors rather than by the company. Investor responsibility to improve engagement in this way is now enshrined in the Stewardship Code.

Over recent years there has been an increased focus on collective engagement by the UK government. In 2011, at the request of Vince Cable, Secretary of State for Business, Innovation and Skills, the government commissioned a review of UK equity markets to be undertaken by the economist John Kay. In July 2012, the Final Report of his independent review was published. It identified that traditional forms of shareholder engagement had focused disproportionately on corporate governance matters, leading to a vacuum in respect of companies' strategies for long-term, sustainable competitive advantage. It also highlighted impediments to engagement arising from increased international ownership, increasingly fragmented shareholding and the perceived regulatory barriers that inhibit collective engagement. The review recommended the formation of an independent 'investor forum', to be championed and developed by the asset management industry. In October 2014, the Investor Forum was constituted with a view to fostering better relationships between UK-listed companies and investors and encouraging shareholder engagement.

Despite an increased focus from policy makers and regulators on promoting better corporate governance, proxy fights and US-style legal threats remain relatively uncommon in the UK. Rather, activist investors typically prefer to engage with companies on an informal basis, for example, by lobbying shareholders behind closed doors and attempting to resolve issues on an amicable basis. UK companies tend to be less prone than their US counterparts to giving board positions to activists.

23 Are directors commonly involved in shareholder engagement efforts?

Best practice guidance recommends that directors be involved in shareholder engagement efforts. The Governance Code, for example, states that the directors of a company should be accessible to shareholders and should make themselves available to engage on any issues (whether or not related to a vote at a company's general meeting). While, in practice, most shareholder contact is with the chief executive and finance director, best practice guidance emphasises the role of the chairman and senior independent director for maintaining shareholder relations. Under the Governance Code, a company with a premium listing of equity securities must include details in its annual report of the steps taken by the board to develop an understanding of the views of major shareholders.

Fiduciary duties

24 Must directors consider an activist proposal under any different standard of care compared with other board decisions? Do shareholder activists, if they are a majority or significant shareholder or otherwise, owe fiduciary duties to the company?

Directors are not required to consider an activist proposal under any different standard of care as compared with other board decisions.

Equally, a director who is a majority or significant shareholder, or any director appointed or nominated to the board by that shareholder, would be subject to the same fiduciary duties as all other directors of the company. These include duties to act in a way that the director considers would most likely promote the success of the company for the benefit of its members as a whole, to exercise independent judgement and to avoid actual or potential conflicts of interest. In the event of a conflict, the courts have held that the nominee director's primary loyalty is to the company and the company's interest must ultimately prevail over those of the appointing shareholder.

However, an activist acting in its capacity as a shareholder of a UK-listed company will owe no fiduciary duties to the company regardless of the size of its shareholding.

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General

1 What are the primary sources of laws and regulations relating to shareholder activism and engagement? Who makes and enforces them?

The primary sources are state corporate law and federal law. In addition, publicly traded companies must comply with the listing rules of the exchange on which they are listed. Beyond laws and regulations, there is a developing consensus of best practices advocated by proxy advisory firms, institutional investors and others in the investment community that issue guidelines that may touch on shareholder activism and engagement issues.

State law

State corporate law establishes the fiduciary duties of directors of both privately held and publicly traded companies. Delaware is, by far, the most popular state of formation of legal entities in the United States. In addition, Delaware is often viewed as having a major influence on the corporate law of other states. For that reason, Delaware General Corporate Law (DGCL) will serve as a reference point in this chapter.

Federal law

Federal laws related to shareholder activism and engagement include the Securities Act of 1933 (the Securities Act), the Securities Exchange Act of 1934 (the Exchange Act), the Hart-Scott-Rodino Antitrust Improvements Act (the HSR Act), the Public Company Accounting Reform and Investor Protection Act of 2002 (the Sarbanes-Oxley Act) and the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the Dodd-Frank Act). For example, shareholder activists are required to comply with beneficial ownership reporting requirements under section 13 of the Exchange Act, which generally require a person or 'group' who has acquired direct or indirect beneficial ownership of more than 5 per cent of an outstanding class of equity securities to file a report with certain information with the Securities and Exchange Commission (SEC) within 10 calendar days of crossing the 5 per cent threshold. Companies must navigate the disclosure requirements of the Exchange Act in reporting on corporate governance matters in their periodic disclosure and their annual meeting proxy statement disclosures.

2 What are the other primary sources of practices relating to shareholder activism and engagement?

Other primary sources of practices relating to shareholder activism and engagement include the policy guidelines of proxy advisory firms (such as Institutional Shareholder Services (ISS) and Glass Lewis), of large institutional investors (such as BlackRock, T Rowe Price and Vanguard) and of others in the investment community (such as the Council of Institutional Investors, TIAA-CREF and CalPERS). These sources are viewed as very influential in practice (for example, an ISS recommendation is estimated by some to influence up to 20 per cent of the shareholder vote in certain situations) and, as a result, companies have a complex web of preferences for directors and management to wade through.

3 Are some industries more or less prone to shareholder activism? Why?

No company or industry is immune to shareholder activism. Even industry leaders that have outperformed their market peers have been recent targets of shareholder activism. In 2016, AbbVie, United Continental and Yahoo were targets of activist campaigns, while Apple, DuPont, eBay, Microsoft, PepsiCo and Sony, to name just a few, have been subject to similar campaigns since 2014. Companies in highly regulated industries, such as banks and insurance companies, were once seen as less likely targets for a shareholder activist campaign. Although this may still be true, the recent targeting of AIG (by Carl Icahn) and the Bank of New York Mellon (by Nelson Peltz) makes it clear that companies in highly regulated industries can also be subject to shareholder activism. In 2016, approximately 14 per cent of all companies targeted by activist shareholders were financial institutions and 12 per cent were in the healthcare industry, in each case an increase over the previous three-year average.

4 What are the typical characteristics of shareholder activists in your jurisdiction?

In discussing shareholder activism in the United States, it is helpful to separate shareholder activists into two separate categories:

- hedge fund activists: this category consists of professional investors who make sizeable (but still minority) investments in a target company and then publicly or privately advocate for change; and
- 14a-8 activists: this category consists of shareholders who submit proposals under Exchange Act Rule 14a-8, which requires a company to include a shareholder proposal in its proxy materials if certain requirements are met (for example, the shareholder owns the lesser of US$2,000 or 1 per cent of the securities entitled to vote on the proposal for at least one calendar year prior to submission of the proposal). 14a-8 proponents vary widely and include retail shareholders, social justice groups, religious organisations, labour pension funds and other coalitions.

Traditional long shareholders, including large institutional investors, have been known to support both types of activists, although a 2015 letter from the CEO of BlackRock, the world's largest asset manager, to the CEOs of every S&P 500 company, stressed that companies should 'resist the pressure of short-term shareholders to extract value from the company if it would compromise value creation for long-term owners.' Also, a 2015 open letter from the chairman and president of Vanguard, which has US$3.6 trillion of global assets under management, stressing that 'boards [should not] capitulate to things that aren't in the company's long term interest,' indicates that while institutional investors may be willing to support shareholder activists in some instances, institutional investors will carefully evaluate whether a shareholder activist's proposal is damaging to long-term value creation. This being said, large institutional investors have shown a willingness to consider activist campaigns when appropriate and consistent with their investment goals, with each of BlackRock and Vanguard, among others, issuing guidance on activist efforts and even launching activist campaigns.

5 What are the main operational, governance and sociopolitical areas that shareholder activism focuses on?

Shareholder activists have focused on a wide variety of capital structure changes, such as increasing leverage (Ethan Allen), share dividends and repurchases (Apple, eBay, Microsoft), and strategic changes such as a company sale or breakup (Xerox, DuPont, AIG) or other operational changes, including changes to boards of directors (Canadian Pacific, Mondelez). Often, shareholder activist campaigns will couple a call for capital structure changes and strategic changes with criticism of and suggested changes to corporate governance (eg, eliminating structural defences, board refreshment, management changes, criticism of executive compensation and other governance changes). Shareholder activists often stick to a similar playbook campaign-to-campaign with respect to governance changes. For example, some shareholder activists are known for criticising or suggesting an overhaul of management.

During the 2016 proxy season, about half of the 14a-8 proposals focused on corporate governance topics (relatively steady as compared to 2015), over 40 per cent focused on environmental and social issues (a slight increase from the year prior) and slightly less than 10 per cent focused on compensation matters (a decrease from the same category in 2015). It is important to note that a large percentage (approximately 25 per cent) of 14a-8 proposals never end up on ballots, either because they are withdrawn by the proponent (usually following negotiations with the target company, an increasing trend in recent years) or because they are excluded by the company on the basis of an SEC 'no action' position. In addition, the great majority of 14a-8 proposals that go to a shareholder vote do not receive majority support.

Shareholder activist strategies

6 Describe the general processes and guidelines for shareholders' proposals.

A shareholder may propose that business be brought before a meeting of shareholders by providing notice and complying with applicable provisions of state law and the company's by-laws and charter. The company's by-laws will generally set forth the time requirements for delivering the proposal (for example, that the proposal be received by the company's corporate secretary not more than 90 days and not less than 30 days before the meeting), other procedural requirements (such as a description of the ownership and voting interests of the proposing party) and limitations on the types of proposals that can be submitted (for example, that a proposal may not be submitted that is substantially the same as a proposal already to be voted on at the meeting). It is often costly to submit a proposal in this manner because the soliciting shareholder must develop its own proxy materials and conduct its own proxy solicitation.

Under Exchange Act Rule 14a-8, a shareholder may submit a proposal to be included in the company's proxy statement alongside management's proposals (avoiding the expense of developing independent proxy materials and conducting an independent proxy solicitation). Rule 14a-8 sets forth eligibility and procedural requirements, including:

- that the proposing shareholder have continuously held, for at least one year by the date the proposal is submitted to the company, the lesser of US$2,000 in market value or 1 per cent of the company's securities entitled to vote on the proposal and continue to hold those securities through the meeting date;
- that the proposal be no longer than 500 words; and
- that the proposal be received at least 120 calendar days prior to the anniversary of the date of release of the company's proxy statement for the previous year's annual meeting.

If the shareholder has complied with the procedural requirements of Rule 14a-8, then the company may only exclude the proposal if it falls within one of the 13 substantive bases for exclusion under Rule 14a-8 (eg, that the proposal would be improper under state law, relates to the redress of a personal claim or grievance, deals with a matter relating to the company's ordinary business operations, relates to director elections, has already been substantially implemented, is duplicative of another proposal that will be included in the company's proxy materials or relates to a specific amount of cash or stock dividends). A company will often seek 'no action relief' from the SEC staff to exclude a shareholder proposal from the company's proxy materials. If no action relief is not granted, a company could, but rarely does, seek a declaratory judgment from a court that the shareholder proposal may be excluded from the company's proxy statement.

Shareholder proposals are often precatory or non-binding, and do not require implementation even if the proposal receives majority support. Shareholder proposals may, however, be binding if the proposal is with respect to an action reserved for the shareholders (for example, a proposal to amend the by-laws may be binding depending on state law and the company's by-laws).

7 What common strategies do activist shareholders use to pursue their objectives?

Activist shareholders may use a number of different tactics to pursue their objectives. For example, an activist shareholder may:

- privately engage the target's management or directors in order to reach a settlement before raising issues in a more public forum;
- apply pressure through the media or investor communications, for example, by issuing 'white papers' or open letters to management, the board or shareholders;
- threaten or conduct a 'vote no' campaign (ie, an exempt solicitation);
- threaten or launch a proxy contest for director elections;
- demand a list of shareholders (either as a threat or precursor to formal action);
- make a shareholder proposal (either a precatory or binding resolution); or
- call a special meeting of shareholders.

The particular strategy pursued depends on the type of activist, the company's defensive measures and the activist's goals. Of course, within a single activist campaign multiple strategies may be employed.

8 May shareholders call a special shareholders' meeting? What are the requirements? May shareholders act by written consent in lieu of a meeting?

Whether a shareholder may call a special meeting depends on state corporate law. With respect to Delaware corporations, under DGCL section 211(d), a company's certificate of incorporation or by-laws may authorise shareholders to call a special meeting of shareholders. The certificate of incorporation or by-laws would then set forth the procedural requirements for calling a special meeting, including the minimum holding requirements for a shareholder to call a special meeting.

We note that ISS and Glass Lewis are both in favour of providing shareholders with the right to call a special meeting. ISS prefers a 10 per cent holding threshold; Glass Lewis prefers a 10–15 per cent holding threshold, depending on the size of the company. In practice, the threshold varies considerably from company to company, although 25 per cent is sometimes cited as the most common threshold.

Whether shareholders may act by written consent without a meeting depends on state corporate law. With respect to Delaware corporations, under DGCL section 228, shareholders may act by written consent in lieu of a shareholders' meeting, unless the company's charter provides otherwise.

9 May directors accept direct compensation from shareholders who nominate them?

Under federal securities law and Delaware corporate law, direct compensation from shareholders is generally permitted. This, however, is only part of the answer. Under Delaware corporate law, it would be important to analyse whether acceptance of the compensation is contrary to the directors' fiduciary duties to the corporation. Under federal securities laws, the compensation would also likely have to be disclosed. In addition, the corporation itself may have limitations in its by-laws or charter with respect to directors accepting direct compensation from shareholders who nominate them.

It is important to bifurcate compensation paid to a nominee prior to nomination and ongoing compensation paid to a director after the director is on the board. Although some in the corporate governance community have asserted that separate compensation can create dysfunctional boards with poisonous conflicts, it is important to recognise that reasonable compensation in exchange for agreeing to stand for re-election is often necessary to recruit high-quality independents to run in a proxy contest, and that this is distinguishable from ongoing compensation, which may create questions regarding alignment of economic incentives depending on the circumstances.

10 May shareholders nominate directors for election to the board and use the company's proxy or shareholder circular infrastructure, at the company's expense, to do so?

Companies are not required by state or federal law to permit shareholders to nominate directors for election to the board and use the company's proxy infrastructure, at the company's expense, to do so (ie, proxy access is not legally mandated). In 2011, the DC Circuit struck down Exchange Act Rule 14a-11, which would have granted proxy access (limited to 25 per cent of the board) to 3 per cent shareholders who have held their shares for at least three years.

In the past two years, proxy access was thrust back onto the agenda in large part through Exchange Act Rule 14a-8 proposals. In the 2016 proxy season, approximately 200 companies received proxy access proposals, nearly twice as many as the previous year. While proxy access proposals brought to a shareholder vote received on average less than 50 per cent support, a substantial majority of companies that adopted proxy access by-laws in 2016 did so voluntarily in advance of their 2016 annual meetings. At the time of writing, it is expected that more than half of the S&P 500 will have adopted a proxy access by-law with most allowing nominations for 20 per cent of the board seats by a shareholder or group of shareholders who have owned 3 per cent or more of the company's shares for three years or more. Given the relative infancy of proxy access by-laws, we have not yet observed a critical mass of shareholders utilising this new option to nominate directors, but it will be interesting to observe the existence and magnitude of such nominations in the 2017 proxy season and beyond.

Historically, shareholders wishing to nominate directors needed to submit their own competing proxy and stand-alone ballot, in each case a costly endeavour. On 26 October 2016, however, the SEC proposed changes to require the use of universal proxy cards in contested proxy elections. This universal ballot would ultimately allow shareholders that meet the requisite holding period and ownership threshold requirements to take advantage of the target's pre-existing proxy submission while nominating different candidates. While it remains an open question whether the proposed SEC rule requiring universal ballots will come to fruition in light of the outcome of the recent US presidential election, to the extent such rule is formalised, it will not likely take effect in time for the 2017 proxy season, but it will be important to track its impact in the seasons that follow.

11 May shareholders bring derivative actions on behalf of the corporation or class actions on behalf of all shareholders? What defences against, or policies regarding, strike suits are applicable?

Shareholders may bring derivative actions on behalf of a corporation, or class actions on behalf of a class of shareholders where there has been an alleged breach of the directors' or officers' fiduciary duty of care, fiduciary duty of loyalty or other wrongdoing. The purpose of a derivative suit is to remedy harm done to the corporation usually by directors and officers. In contrast, individual shareholder actions or class actions address harms to the shareholders in their capacity as shareholders. Whether a lawsuit should be brought as a derivative action or as a class action depends on the nature of the wrongdoing alleged, the type of relief sought and to whom the relief would go.

Derivative suits face a number of procedural hurdles, which depend in large part on the jurisdiction in which they are brought. Certain states require that, before a derivative lawsuit is filed, the shareholder make a 'demand' on the board of directors to bring the lawsuit on the corporation's behalf. The demand requirement implements the basic principle of corporate governance that the decisions of a corporation – including the decision to initiate litigation – should be made by the board of directors. If a shareholder makes such a demand, the board of directors may consider whether to form a special litigation committee of independent directors to evaluate the demand. If the board of directors refuses the demand, the shareholder may litigate whether the demand was 'wrongfully refused'. Certain jurisdictions recognise an exception to the demand requirement where demand would be 'futile'– namely, if a majority of the board of directors is conflicted or participated in the alleged wrongdoing. In such circumstances, it might be appropriate and permissible for the shareholder to skip the demand process and proceed directly to filing a complaint (in which he, she or it would need to demonstrate that a demand would have been futile).

While shareholder derivative suits are brought for the benefit of the corporation, shareholder direct and class actions address unique, direct harms to the particular shareholder plaintiffs. In such cases, a critical factor in determining the outcome of the litigation will be which standard of review is applicable to the board's conduct, in other words, the deferential 'business judgement rule' or a heightened standard of review (such as Revlon, Unocal or entire fairness). Many public companies have adopted 'exculpation' provisions in their governance documents, which provide that directors cannot be personally liable for damages arising out of breaches of the duty of care. However, a director generally cannot be indemnified or exculpated for breaches of the duty of loyalty, including the obligation to act in good faith.

Company response strategies

12 What advice do you give companies to prepare for shareholder activism? Is shareholder activism and engagement a matter of heightened concern in the boardroom?

Our advice is always situation-specific; that being said, a few good rules of thumb are:

- companies should 'think like an activist,' and the board and management should routinely have conversations about the company's strengths and vulnerabilities. Outlining potential arguments a shareholder activist may make for change can help facilitate tough conversations. Companies may wish to consider involving outside advisers in some of these conversations, as appropriate;
- it is also important for a company to critically evaluate its shareholder engagement efforts. Being aware of concerns before they reach a boiling point should be the ultimate goal. The company should spend time developing a consistent and coherent message outlining the company's key strengths and addressing potential concerns and vulnerabilities. The process of developing these materials often airs out additional issues;
- companies should periodically review their by-laws, governance guidelines and structural defences, and focus not just on evolving 'best practices,' but on whether the company's governance structure meets its current needs;
- companies should monitor their shareholder base and be aware of the corporate governance and other preferences of its shareholders. Institutional shareholders increasingly have bespoke policies. It is important to be aware of these policies; and
- companies should be thoughtful about whether and when to enter into settlements with activist shareholders.

13 What structural defences are available to companies to avoid being the target of shareholder activism or respond to shareholder activism?

There are a number of structural defences available to companies, including: staggered boards, poison pills, not permitting shareholders to call a special meeting, not permitting shareholder action by written consent and not permitting replacement of directors without cause (and permitting only directors to fill director vacancies because of removals). In addition, stringent advance notice and other requirements for shareholder proposals and director nominations and the voting standard for director elections (plurality versus majority) can serve as a structural defence. Some states, such as Delaware, have an anti-takeover statute that restricts a shareholder that has acquired 15 per cent or more (but less than 85 per cent in the same transaction) of the company's outstanding shares, without approval of the board, from engaging in certain business combination transactions with the company for a period of three years.

The effectiveness of structural defences varies depending on the situation, and none of the defences make a company immune to shareholder activism. We would also note that because proxy advisory firms and others will scrutinise a company for having defensive mechanisms in place, many companies have lost the appetite to maintain structural defences. For example, 53.2 per cent and 56 per cent of S&P 500 companies had a poison pill or staggered board, respectively, in place in 2004, compared to just 5.8 per cent and 11 per cent in 2014. Entering the 2016 proxy season, the number of S&P companies that had a poison pill had fallen even further, down to just 3.8 per cent. This reflects widespread acceptance that there is little advantage to having a poison pill in place (and generating negative attention from proxy advisory firms) since a poison pill can usually be quickly and effectively adopted when a threat emerges. Exceptions to this trend are newly IPO'd companies. Such companies often have the most structural defences in place because it is easiest to adopt these mechanisms before going public. However, even here the proxy advisory firms have recently warned that they will recommend withhold votes against directors if the defences are not dismantled early in the company's public life.

14 May shareholders have designees appointed to boards?

Shareholders may seek to nominate a director for election to the board in accordance with the company's charter and by-laws. As noted above, proxy access would allow the shareholder to nominate a director for election to the board and avoid the expense of developing independent proxy materials and conducting an independent proxy solicitation.

Often, when a shareholder activist and company have reached a settlement, they memorialise the agreement in a cooperation agreement. The form of cooperation agreements has become increasingly standard and typically includes a standstill agreement by the shareholder activist, a voting agreement by the shareholder activist to vote for the company's nominees, an agreement by the company to nominate the shareholder activist's nominees to the board (and to renominate them for election at the next annual meeting if certain conditions are met) and a mutual non-disparagement covenant. The appointment of a new director to the board requires public disclosure under Form 8-K, and many companies conclude that entry into the cooperation agreement itself requires public disclosure under Form 8-K as well. In any event, the shareholder activist and company generally issue a joint press release.

Disclosure and transparency

15 Are the corporate charter and by-laws of the company publicly available? Where?

Item 601 of Regulation S-K requires US public companies to file their charter and by-laws with the SEC. SEC filings can be accessed on the SEC's EDGAR database. In addition, many public companies include their charter and by-laws on their website. An amendment to a company's charter or by-laws triggers an 8-K filing requirement.

In addition, New York Stock Exchange listing rules require that a listed company include on its website the company's nominating and corporate governance committee charter, audit committee charter and compensation committee charter along with the company's corporate governance guidelines.

16 Must companies, generally or at a shareholder's request, provide a list of registered shareholders or a list of beneficial ownership? How may this request be resisted?

Under Exchange Act Rule 14a-7, if a company has made or intends to make a proxy solicitation in connection with a shareholder meeting, the company must, upon written request of a shareholder entitled to vote at the meeting, either give the requesting shareholder the shareholder list or mail the requesting shareholder's soliciting materials to the company's shareholders at the requesting shareholder's expense.

In addition, state corporate law and a company's charter and by-laws may provide for access to shareholder lists under additional circumstances. For example, Delaware corporate law allows shareholders to inspect the company's stock ledger and its other books and records so long as the shareholder submits a demand under oath and explains the 'proper purpose' of the request.

17 Must companies disclose shareholder engagement efforts or how shareholders may communicate directly with the board? Must companies avoid selective or unequal disclosure? When companies disclose shareholder engagement efforts, what form does the disclosure take?

Generally speaking, companies are not required to publicly disclose their shareholder engagement efforts, although companies often choose to disclose such efforts in their annual meeting proxy in order to show responsiveness to shareholder concerns. In their annual meeting proxy, companies are required to disclose how security holders may communicate with the board of directors.

Regulation FD is intended to ensure that companies do not engage in selective or unequal disclosure. Regulation FD applies when a company or a person acting on the company's behalf (ie, all senior officers and any other officer, employee or agent of the company who regularly communicates with the financial community) discloses material non-public information to investors or security market professionals. If such disclosure is intentional (ie, the person communicating the information either knows, or is reckless in not knowing, that the information is both material and non-public), then to cure the violation the information must be simultaneously disclosed to the public. If such disclosure is inadvertent (ie, the person communicating the information did not know, and should not have known, that the information is both material and non-public), then to cure the violation the information must be promptly disclosed to the public. Disclosures under Regulation FD often consist of furnishing the information on Form 8-K with the SEC but may also include other widely disseminated sources, including press releases.

It is important to note that disclosures to persons who expressly agree to maintain the disclosed information in confidence are expressly exempted from Regulation FD. For this reason, before discussing material non-public information with a shareholder activist, a company will insist on signing a confidentiality agreement. We note for completeness that the shareholder activist may not want the company to disclose material non-public information to it, because the shareholder's ability to trade in the stock may then be limited (because of insider trading concerns).

18 Do companies receive daily or periodic reports of proxy votes during the voting period?

During a contested situation, it is not unusual for companies to receive frequent updates on proxy vote tallies. Even in uncontested situations, for relatively routine annual shareholder meetings, companies will often choose to receive updated reports on proxy voting (if for no other reason than to confirm that they will have a quorum).

Historically, Broadridge, which is the single largest agent collecting vote tallies, would provide the vote tallies both to the shareholder proponent and the company. However, in May 2013, after certain brokers objected to the release of this information to shareholder proponents, Broadridge changed its policy to provide vote tallies to the shareholder proponent only if the company affirmatively consents. Proxy rules are currently silent on preliminary vote tallies, but SEC chair Mary Jo White has discussed either conditioning the broker's exemption from the proxy rules on a requirement to provide everyone with preliminary vote tallies, or to permit brokers to provide issuers with the total votes cast only in order to determine a quorum. At the same time, White noted that rulemaking may not be the only way to solve these concerns, and encouraged the corporate governance community to work together and achieve a compromise on this issue. We continue to watch this area going forward, although we do not expect changes to be imminent, especially given the upcoming change in presidential administration.

19 Must shareholders disclose significant shareholdings?

Accumulations of large blocks of equity securities trigger reporting under section 13 of the Exchange Act, which requires that any person or group that acquires beneficial ownership of more than 5 per cent of a class of a public company's registered voting equity securities must file a beneficial ownership report with the SEC disclosing its ownership and certain other information. For this purpose, beneficial ownership generally means direct or indirect voting or dispositive control over a security, including through any contract, arrangement, understanding, relationship or otherwise. A person is also deemed to be the beneficial owner of securities over which the person can acquire voting or dispositive power within 60 days. Thus, an option, warrant, right or conversion privilege that results in voting or dispositive power and that can be exercised within 60 days creates current beneficial ownership. Disclosure may also be triggered by membership in a 'group' that beneficially owns more than 5 per cent, as discussed below. Acquisitions or ownership of a class of non-voting securities does not trigger any filing obligations for these purposes.

Generally, an individual investor or group that beneficially owns more than 5 per cent of a class of equity securities of a public company must report its holdings on Schedule 13D within 10 days after its holding exceeds 5 per cent, unless it is eligible to report its holdings on a

Update and trends

We have been focused on the continued momentum of proxy access by-laws. At the time of writing, we anticipate that more than half of the S&P 500 will have adopted proxy access by the end of the year, and we expect companies that have not yet adopted proxy access to be under increasing pressure to do so. One question will be the impact, if any, these developments will have on board compositions and turnover.

We have additionally taken note of the expanding base of companies that have been subjected to activist campaigns in the past years. If 2016 has taught us anything it is that no company is safe. Activist shareholders have shown a growing tendency to broaden their scope of review, targeting companies at all points on the capitalisation spectrum. This trend, coupled with the toppling of previously customary structural defences and the increased engagement of institutional investors, the largest shareholders in target companies, should lead all public companies to be proactive when evaluating susceptibility to activist campaigns. This is perhaps a driving force behind the increase in settlements with activist shareholders, though we caution companies that consider such rapid settlements to be mindful of its long-term strategy as well.

Finally, we are paying close attention to the impact that the US election of November 2016 has on this area of practice. While the results of the presidential election received the lion's share of media attention, perhaps the bigger driver of change in the activist space is the fact that each chamber of Congress and the presidency will be held by a single party, a rare phenomenon in American politics. As these branches of government begin to shape their policy goals for the next two to four years, we will keep an eye on the impact on activist engagement.

short-form Schedule 13G. Importantly, a Schedule 13D requires detailed disclosures regarding the filer's control persons, source of funds and the purpose of the acquisition of the securities, including any plans for further acquisitions or intention to influence or cause changes in the management or business of the issuer. Material changes in the previously reported facts require prompt amendment of a Schedule 13D.

Certain investors can satisfy their section 13 beneficial ownership reporting obligations by filing the simpler and less detailed Schedule 13G. These include specified institutional investors (eg, banks, broker-dealers, investment companies and registered investment advisers) acting in the ordinary course and without a control purpose or effect, and passive investors acting without a control purpose or effect. There are also other exceptions that may allow an investor to report beneficial ownership on a Schedule 13G instead of a Schedule 13D.

As 'beneficial ownership' is based on the power to vote or dispose of a security, whether ownership of a significant derivative position in the equity securities of a public company will trigger a Schedule 13D or Schedule 13G filing requirement depends on the type of the particular derivative. Cash-settled derivatives generally do not give rise to beneficial ownership because they do not create a contractual right to acquire voting or dispositive control, but other types of derivatives may constitute beneficial ownership of the underlying securities.

An investor may generally talk with other investors and management about its investment in a company (see question 21). However, if the investors coordinate activities or agree to act together with other investors in connection with acquiring, holding, voting or disposing of the company's securities, the investors may be deemed to have formed a 'group' for purposes of sections 13 and 16 of the Exchange Act. An investor group will have its holdings aggregated for purposes of determining whether the relevant reporting thresholds have been crossed. For example, if three investors, each with 4.9 per cent of a company's voting shares, form a group, they will have to file a Schedule 13D or Schedule 13G because their shares collectively exceed the 5 per cent threshold. And, because the group's ownership exceeds 10 per cent, each member will have to report beneficial ownership of his, her or its shares under section 16(a) of the Exchange Act and, more importantly, be subject to section 16(b)'s short-swing profit disgorgement rules (even though each investor, by itself, owns less than 10 per cent of the public company).

The HSR Act may also impose a filing obligation with the Federal Trade Commission and the Department of Justice on certain investors that acquire more than $78.2 million of a company's voting securities or assets (this dollar amount is adjusted annually) as well as a 30-day waiting period, during which the transaction cannot close. These filings are not public but either party may choose to make the fact of the filing public. In addition, if either party requests and is granted early termination of the waiting period, the fact of the grant of early termination will be made public. Finally, there are certain structures that can be used (involving put-call options or the use of multiple funds as acquisition vehicles) that may effectively allow an investor to accumulate the right to stock well in excess of the HSR Act threshold. Counsel should be consulted regarding the use of such methods as the risks are highly technical.

20 Are shareholders acting in concert subject to any mandatory bid requirements in your jurisdiction?

There is no 'mandatory bid' requirement under US federal tender offer rules or Delaware corporate law.

We would note for completeness that at least three states have statutory 'control share cash-out' provisions (of which, in some cases, companies may opt out), providing that if a bidder gains voting power of a certain percentage of shares (for example, 20 per cent in Pennsylvania, 25 per cent in Maine and 50 per cent in South Dakota), other shareholders can demand that the controlling shareholder purchase their shares at a 'fair price' (effectively providing the equivalent of dissenters' rights applicable to the acquiror rather than the issuer).

21 What are the primary rules relating to communications to obtain support from other shareholders? How do companies solicit votes from shareholders?

The federal proxy rules are the primary rules relating to communications to solicit support from shareholders. In addition, companies that choose to hold private discussions with certain shareholders must be mindful of Regulation FD (see question 17). Companies solicit formal votes from shareholders at both annual and special meetings, each of which are subject to federal proxy rules and certain notice requirements under the DGCL and/or a company's by-laws. Shareholders may cast absentee ballots or designate a proxy to vote either at such proxy's discretion or with specific and binding guidance.

In March 2014, the SEC staff provided guidance on applying the proxy and tender offer rules when statements are made through certain social media channels. The guidance permits the use of a hyperlink to information required by certain rules when a character-limited or text-limited social media channel, such as Twitter, is used for regulated communication. Since the guidance has been issued, we have seen shareholder activists and companies use Twitter and other social media outlets in a proxy solicitation context.

22 Is it common to have organised shareholder engagement efforts as a matter of course? What do outreach efforts typically entail?

See question 12. Proactively engaging with shareholders has become crucial to earning the trust (and voting support) of shareholders. It is not unusual for companies to plan tours to meet with large shareholders and discuss their concerns, and to prepare presentations outlining not just the company's performance but also the company's governance structure. At the same time, engagement has, in some instances, become so pervasive that it has actually overwhelmed proxy advisory firms and institutional shareholders. Shareholder engagement without a clear purpose can be counterproductive.

23 Are directors commonly involved in shareholder engagement efforts?

There is no requirement for directors to be involved in shareholder engagement efforts. Senior management is usually at the forefront of these efforts, but there has been a continued push by investors (including Vanguard) and corporate governance groups (such as SDX) for independent directors to have greater involvement in shareholder engagement.

Fiduciary duties

24 Must directors consider an activist proposal under any different standard of care compared with other board decisions? Do shareholder activists, if they are a majority or significant shareholder or otherwise, owe fiduciary duties to the company?

Directors owe a duty of care to the corporation. That is, directors must make decisions regarding the corporation with due care, which entails acting in a fully informed and deliberate manner and with the care of a prudent person in a similar situation. Directors have the same duty of care when considering an activist proposal as they do with any other board decision. It is important to note that director actions are generally entitled to the business judgement rule presumption. This is the presumption that directors act in a non-negligent manner, in good faith and in the best interest of the corporation. When the business judgement rule applies, courts will not second-guess the judgement of the board if the board arrives at such judgement through reasonable procedures and without conflicts of interest. Under certain circumstances (for example in the context of a sale of the company, when the board of directors has a conflict of interest and with respect to defensive measures), enhanced scrutiny of the board action may apply.

Generally, fiduciary duties of a controlling or a significant shareholder are most relevant in the context of a self-dealing transaction (where the controlling shareholder is effectively on both sides of the transaction). This set of facts is not normally present in a shareholder activist campaign.

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