THE SHAREHOLDER RIGHTS AND ACTIVISM REVIEW

Fifth Edition

Editor
Francis J Aquila

THE LAWREVIEWS

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For further information please contact Nick.Barette@thelawreviews.co.uk

Editor
Francis J Aquila

THE LAWREVIEWS

PUBLISHER
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BUSINESS DEVELOPMENT MANAGER
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PREFACE

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

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

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

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

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

My sincere thanks to all of the authors who contributed their expertise, time and labour to this fifth edition of *The Shareholder Rights and Activism Review*. As shareholder activism

continues to diversify and increase its global footprint, this review will continue to serve as an invaluable resource for legal and corporate practitioners worldwide.

Francis J Aquila
Sullivan & Cromwell LLP
New York
August 2020

Chapter 5

GERMANY

Michael J Ulmer[1]

I OVERVIEW

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

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

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

An invitation like this could not be ignored by activists, often US hedge funds, that are on the lookout for new opportunities. Low interest rates and past successes allow these funds to raise even more capital. In the United States, however, activist campaigns no longer lead to the same level of return as they once did. There, companies are now much better prepared, have turned into sophisticated communicators of their strategies and often preemptively take measures activists would usually press for.[2] However, the less aggressive approach of active ownership recently followed by many activists resonates well with German corporate culture,

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

2 For current developments in the United States, refer to the Cleary M&A and Corporate Governance Watch (Mergers and Acquisitions, Corporate, Shareholder Activism), available at www.clearymawatch.com.

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

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

II LEGAL AND REGULATORY FRAMEWORK

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

i Corporate constitution

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

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

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

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

4 In the case of a company that is subject to co-determination, the employees' representatives on the supervisory board are determined by means of special procedures.

circumstances, the supervisory board could agree with a shareholder to suggest a specific candidate to be voted for by the shareholders' meeting. Depending on the number of the company's employees, one-third or even half of the members of the supervisory board are determined by the company's employees.[5]

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

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

ii Minority rights

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

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

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

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

5 Having more than 500 employees leads to one-third of the supervisory board members being determined by the company's employees, whereas more than 2,000 employees results in half of the board members being employees' representatives.

Finally, minimum pricing rules under German takeover law also need to be understood in the context of the protection of minorities. In a takeover scenario for a publicly traded company, the bidder must offer all shareholders a price per share at least equal to the highest price the bidder paid for shares of the company in the six months prior to the offer.[6] In the event of a squeeze-out, a merger, or conclusion of a domination and profit and loss transfer agreement, all shareholders are entitled to trade in their shares for what the law describes as 'adequate' compensation.

iii Disclosure requirements

When building a stake in a publicly traded company, activists face a tight regime of disclosure obligations. Acquiring shares and reaching the thresholds of 3, 5, 10, 15, 20, 25, 30, 50 and 75 per cent of the total voting rights within a company requires the shareholder to immediately notify the Federal Financial Supervisory Authority (BaFin) as well as the respective company, which in turn must inform the market about such transactions.[7] In the context of a 10 per cent notification, the acquiring shareholder must inform the company about the underlying objectives behind the acquisition: classification of the investment as strategic or financial, intention to increase the stake within the next year or influence the composition of the company's boards or to significantly change the company's financing structure. Acquiring shares representing 30 per cent or more of voting rights is deemed to be taking over control of the company. A shareholder reaching this 30 per cent threshold is required to submit a public takeover offer for all shares in the company pursuant to the WpÜG (the Takeover Act).

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

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

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

7 The BaFin and the company need to be informed without undue delay and no later than within four trading days. The company, in turn, must inform the market without undue delay and no later than within three trading days.

Besides voting rights, short positions in a company's shares are also subject to disclosure obligations. Starting with 0.2 per cent of the issued share capital of a company, covered net-short positions must be notified to the BaFin. Thereafter, each 0.1 per cent increase triggers further notification requirements. As of 0.5 per cent of the issued share capital, notifications of covered net-short positions must also be made to the public.[8] Taking uncovered short positions in shares of a publicly traded company is prohibited.

iv Shareholder obligations

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

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

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

III KEY TRENDS IN SHAREHOLDER ACTIVISM

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

i Short sellers

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

The short seller then bets on a falling share price, using financial instruments. Often the activist, with the help of financial institutions, borrows shares in the target company and sells them immediately with the intention of repurchasing the shareholding at a lower price once the campaign has its effect. Following the sale of the lent shares, the activist publishes a report on the target company, sharing the analysis of the company's potential weaknesses

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

and making the case that the company is overvalued and its share price inflated. Usually, these reports are accompanied by managed media coverage. Short selling campaigns gain additional momentum once the falling share price triggers stop-loss orders. Further, if the target's share price rose quickly in the past, shareholders that bought cheap are generally willing to exit quickly once they observe the first signs of a downward trend. Sometimes, several activists proceed together right from the beginning of an attack. More often though, the short seller will already have repurchased the shareholding for a then lower price and transferred it back to the lender when other activists join the campaign, waiting for a second wave or just hoping to benefit from the momentum created by the attack.

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

ii Value-driven activists

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

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

While activist shareholders following this approach take minority stakes in the target company, they use several tools to increase their influence. Media campaigns that denounce inefficiencies and demand measures with an alleged direct impact on the share price help to win over other shareholders. More passive investors, such as asset managers, and pension and mutual funds are more and more often backing such campaigns, either in full or at least those elements that are within the focus of their investment guidelines, such as good governance or executive compensation. An increasing number of institutional investors announced their intention to more actively pursue such goals in the future, and have now begun to act accordingly.[9] With most shareholders' interest in increasing the value of their

9 *Handelsblatt*, 'Der neue Druck der Investoren', 13 April 2018, p. 24; *Frankfurter Allgemeine Zeitung*, 'Fondsgesellschaften werden aktivistischer', 14 May 2019, p. 22.

investment being aligned with this main objective of the activists, even a campaign based on a small shareholding can find majorities at shareholders' meetings, especially given that proxy advisory services are now regularly seen in the German market.

iii Special situation activists

For years now, special situation activists have achieved a certain notoriety in Germany. They make use of scenarios where the votes resulting from their shareholding are required to either allow a takeover to succeed or to implement specific corporate measures.

The qualified majorities required to take a company private by way of a squeeze-out (95 per cent or 90 per cent in the event of a merger-related squeeze-out), to merge or to reorganise a company (75 per cent), or to enter into a domination and profit and loss transfer agreement with the company (75 per cent), provide the platform for their campaigns. The latter threshold is of utmost significance, especially in takeover scenarios. Without a domination and profit and loss transfer agreement being in place with the target company after a takeover, the major shareholder cannot instruct the management of a publicly traded company on how to run its business. Measures required to realise synergies could not, therefore, be implemented. In addition, the company's cash flows could not be used to refinance the acquisition. This is one reason most public takeover offers are subject to the condition that 75 per cent of the company's shares are tendered.[10] Given that a significant number of shareholders usually ignore a takeover offer or deliberately keep all or parts of their shareholdings, even a stake well below 25 per cent could lead to a takeover offer failing. Special situation activists build such stakes when a takeover is announced or once corresponding rumours become more reliable. In the course of the takeover process, they agree a price with the bidder for which they would tender their shares, thereby significantly increasing the likelihood of the takeover offer being successful. Pursuant to the pricing rules under German takeover law, the price, on a per share basis, would also need to be offered to all other shareholders.

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

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

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

IV RECENT SHAREHOLDER ACTIVISM CAMPAIGNS

In recent years, the number of campaigns run by activist shareholders in Germany increased significantly and shareholder activism is now perceived as one of the key trends in the market. The following recent campaigns are of particular interest.

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

Advertising company Ströer, financial investor AURELIUS and media group ProSiebenSat.1 all recently came under attack from short sellers.

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

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

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

ii ThyssenKrupp/Cevian and Elliott

As previously with Bilfinger – where Cevian some years ago became the biggest shareholder, took two seats on the supervisory board and transformed the struggling building conglomerate into a more focused industrial service provider – the Swedish activist, now with Elliott, is pressing for radical change at industrial giant ThyssenKrupp (2017–2020).

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

Against the background of financial results that persistently failed to meet Cevian's expectations, the activist was demanding a break-up of the group, arguing that overall valuation could be increased significantly by creating more focused and efficient, independently managed enterprises. Management resisted these demands. This was when Elliott acquired a stake in ThyssenKrupp that, together with the shareholding of Cevian, equals that of Krupp Stiftung. Together, the activists initially pressed for adjustment of the terms of a steel joint venture that had been agreed with Tata Steel and that did not ultimately

obtain antitrust clearance. Shortly thereafter, the CEO of ThyssenKrupp as well as the chair of the supervisory board resigned from their offices. The new CEO presented a plan to split the group, ultimately resulting in two listed entities. Krupp Stiftung, which had originally opposed a break-up, signalled it would back this plan. Cevian obtained a second seat on the company's supervisory board, whose new chair is also well known to the activist from past cooperation. Owing to adverse market conditions, the new CEO's plan was finally renounced and the CEO was replaced by the chair of the supervisory board. Under her lead the precious elevator business was sold. The search for partners or even buyers interested in the steel, ship building and certain other businesses has now started.

iii GEA, SAP, Uniper and Scout24/Elliott and others

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

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

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

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

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

iv STADA/AOC and Elliott

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

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

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

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

v Commerzbank/Cerberus

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

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

V REGULATORY DEVELOPMENTS

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

At the end of 2018, the Federal Court of Justice (BGH) clarified that shareholders of a listed entity do not act in concert if, based on a one-time agreement, they vote to replace the members of the supervisory board with the aim of shifting the company's strategy. A singular agreement would not qualify as acting in concert even if it had a long-term impact on the company.[11] In consequence, the voting rights held by these shareholders are not attributed to the respective others, the 30 per cent threshold is not reached by way of attribution and no public takeover offer for all shares in the company is triggered by the agreement. This clarification will have a comforting effect on activist shareholders teaming up to change a target's strategy.

11 BGH, judgment of 25 September 2018, II ZR 190/17 – Stuttgart.

One year earlier, the BGH held that the price paid by a bidder for bonds convertible into shares in the target in the context of a public takeover offer must be taken into account when determining the minimum offer price, at least if the bonds are convertible into shares in the target at short notice.[12] McKesson, when taking over pharma wholesaler Celesio, bought bonds convertible into Celesio shares from Elliott, which had built that stake to finally be bought out by the bidder. The prices paid by the bidder for both shares and convertible bonds of the target were held to be relevant with regard to the minimum pricing rules. This judgment will thus influence the tactics of activist shareholders focusing on special situations when building a stake in the respective target.

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

VI OUTLOOK

Not least because of the considerable success of recent campaigns and, most recently, low valuations caused by the covid-19 crisis, market participants agree that shareholder activism in Germany will play an even bigger role in the future. Its legal framework and corporate culture as well as factual circumstances led to Germany being identified as a new playground for activists. Many of their goals resonate well with other shareholders that, therefore, support their campaigns. Even formerly passive institutional investors announced their intention to become more actively engaged with the management of the companies they invest in and have now begun to act accordingly.

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

Besides these general developments within corporate culture, many companies are seriously considering preemptively taking defensive measures that have proven effective in the US market. These measures include white paper exercises with the company's management taking the position of an activist shareholder. Based on benchmark studies, risks for sustainable growth are identified and addressed. Further, early warning systems are being implemented. They focus on changes in the shareholder structure, trading volumes of the company's shares

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

and related financial instruments, changes in the investment and voting policies of major shareholders, as well as analysts' reports or critical statements by stakeholders. Finally, defence manuals are being compiled that set out in detail which internal departments and which external advisers are to be involved in the event of an imminent attack, which steps need to be taken at a specific phase of a campaign and which approaches should be followed with respect to the activist, the key shareholders and the media.

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

Appendix 1

ABOUT THE AUTHORS

MICHAEL J ULMER

Cleary Gottlieb Steen & Hamilton LLP

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

His work extends to a broad range of industries and clients, including leading German corporates, *Mittelstand* companies, and domestic and international financial and strategic investors. He has vast experience in assisting clients from the Middle East with outbound investments.

Dr Ulmer is widely published. Among others, he is the author of the quarterly released *Cleary Gottlieb M&A Telegram* and co-author of Cleary Gottlieb's *Public Bids and Squeeze-Outs in Germany, a Statistical Survey* (2002–2016).

JUVE, the leading publication on German law firms, distinguishes Dr Ulmer as an 'M&A Heavyweight' and frequently recommended lawyer for M&A and corporate, and *Chambers Europe* recommends him as a notable practitioner for 'Corporate/M&A: High-end Capability', describing him as 'really good at finding and labelling risks and knows how to translate the legal aspects into business language'.

Dr Ulmer joined Cleary Gottlieb as a partner in 2016. He started his career at Hengeler Mueller and joined Allen & Overy as a partner in 2006.

CLEARY GOTTLIEB STEEN & HAMILTON LLP

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

an LBR business

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