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Activist Shareholders

Freedom of Action and Limits

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In the last season of shareholders' meetings, activist shareholders such as hedge funds attracted attention in connection with stock-exchange-listed companies. Such shareholders are often accused of putting the future of the company at risk in favour of short-term profits and of acting against the will of the less active majority. Though activist shareholders focus selectively on details of the strategic orientation of the company or on excessively weak development of the share price as central themes. The current situation of crisis in the financial markets, with sinking sales and falling share prices, may further encourage the phenomenon of shareholder activism.

Activist shareholders typically acquire minority holdings beneath the 30% threshold from which they would have to make a compulsory offer to the other shareholders. But even with these minority holdings, the German Stock Corporation Act (Aktiengesetz (AktG)) gives activist shareholders generous room for manoeuvre. For example, they can – especially from a holding of 5% – demand from the company's board of directors that an extraordinary shareholders' meeting be called with their own

resolution subjects. In addition to this, they can have their own items placed on the agenda for resolution at a shareholders' meeting that has already been called, not only from a holding share of 5% but even from a share of as little as 500t EUR of the capital stock (§ 122 para. 1 and 2 AktG).

Replacement of the Organs

In this way the activist shareholder can put forward a motion for withdrawal of confidence against the board of directors through the shareholders' meeting and thus prepare the removal of the board (§ 84 para. 3 S. 2 AktG). Or he can put forward motions for the de-selection of members of the supervisory board who have been chosen by the shareholders' meeting and suggest his own candidates for selection onto the supervisory board (§ 127 AktG). To de-select the members of the supervisory board, the activist shareholder frequently requires only the simple majority of the votes cast (§ 103 para. 1 AktG) instead of the legal 75%, due to corresponding provisions of the articles. Similarly, the activist shareholder requires a simple majority of the votes



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cast for the voting-in of candidates he has suggested (§§ 101 para. 1, 133 AktG). Furthermore, from a holding percentage or supporting of this motion of a total of 10% of the represented share capital, a vote is to be held on the activist shareholder's candidate for the supervisory board before the management's candidates (§ 137 AktG). In such a case, the influence of the voting representatives appointed by the company – with the votes for the administration's candidates – frequently proves ineffective and so the chances rise for the activist shareholder being able to push through his candidate.

Special Audits and Compensation Claims

Even if the activist shareholder at first fails to push through his candidate for the supervisory board, he still has legal room for manoeuvre. Recently, special audit motions for the examining of individual actions of the business management and motions for the appointment of a special representative for the enforcing of compensation claims against the executive board and supervisory board have become more important in the practice of shareholders' meetings. These motions can under certain circumstances also be asserted in court proceedings.

Importance of Blocking Minorities

Furthermore, according to the German Stock Corporation Act, important capital measures of the company, especially increases and decreases in capital or the creation of authorised capital or conditional capital, require a mandatory 75% majority of the basic capital represented at the shareholders' meeting (§§ 182 ff., 192 ff., 202 ff., 222 ff. AktG). In the case of smaller attendances at shareholders' meetings the holding amount of the activist shareholder gains proportionally in influence. If other shareholders then agree with the arguments of the activist shareholder and vote

with him, such resolutions can fail due to a blocking minority of more than 25%. This can have severe consequences for a company. In particular, the company can thereby lose the basis for capital increases with exclusion of subscription rights, which would lead to a dilution of the holding share of activist shareholders.

Limits and Restrictions

Activist shareholders must observe the legal regulations on share-trading, e.g. disclosing voting rights upon reaching, exceeding or falling beneath certain voting-rights thresholds in accordance with §§ 21 ff. WpHG (Wertpapierhandelsgesetz – German Securities Trading Act), the ban on market manipulation according to § 20a WpHG and the regulations on insider trading according to §§ 12 ff. WpHG. From the 31st May 2009, activist shareholders, upon reaching a voting-rights threshold of 10%, must provide information about their goals and the origins of the capital used for acquiring the shares unless the articles of the company provide for an exception (§ 27a WpHG). If activist shareholders do not want to run the risk of submitting a takeover bid they must also respect the rules on acting in concert (§§ 35, 29 para. 2, 30 para. 2 WpÜG, Wertpapierübernahme-Gesetz – German Securities Acquisition and Takeover Act). In addition to this, activist shareholders may neither act in misuse of the law nor violate their fiduciary duties stemming from company law. In practice, however, such legal violations can seldom be proven. Decisive here are the limits that the company sets for activist shareholders. By switching to registered securities, a better overview can often be obtained of the shareholders, and the importance of the holdings of activist shareholders can be lessened with measures increasing the presence. Overlapping tenures of members of the supervisory board can furthermore prevent a situation in which all representatives of the shareholders on the supervisory board are replaced in an election.

Outlook

The German Stock Corporation Act offers affected companies and their activist shareholders a versatile set of legal instruments. Nevertheless, it is at least just as important as the legal side to keep a sense of proportion. Affected companies should examine the concerns of activist shareholders thoroughly seriously and first of all seek discussion. Early preparation for a legal conflict is indispensable. But the extent to which this course of conflict should successfully be embarked upon cannot in the end be decided across-the-board, but only after in-depth consultation with the people playing a part in the individual case.

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