

PAPER

Shareholder Activism in Austria and Germany

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1. HISTORY AND DEVELOPMENT OF SHAREHOLDER ACTIVISM

1.1. Germany

Shareholder activism has dramatically increased in Germany in the last few years, culminating most recently in a number of prominent cases. For the first time, such cases also involved globally active shareholder activists such as, for example, Elliott. One of the main reasons for Germany's becoming such an attractive jurisdiction for activist shareholders is that it is a country with a significant number of public medium-size companies (so-called Mittelstand companies) as well as very large corporations.

Activists are no longer just smaller local or medium-size regional players, but also include large international activists that operate on a global level. Such activists are generally carefully selecting particular jurisdictions favorable for their type of activities, and while German target companies for activists have previously been rather small corporations, recently also very large German companies represented in the DAX segment of the Frankfurt Stock Exchange have been targeted by activists.

With activists becoming more familiar with the German legal framework and continuing to explore and test out the opportunities provided by the German legal regime, more aggressive strategies have evolved in the recent past. Such strategies are not limited to legal opportunities available under German law, but also include all forms of aggressive PR and media (as well as social media) campaigns.

In their campaigns, activists tend to select German target companies, which are generally seen critically by at least some of its shareholders, potentially having a negative press and media coverage or image problems in the public view, which are often resulting, inter alia, from governance topics or problematic or unsuccessful transactional activities such as, for example, acquisitions, mergers or spinoffs.

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In such an environment, activists could—generally speaking—lately gain a higher level of acceptance for their activities in Germany, managing thereby to convince—at least partially—national and international institutional shareholders, long-term investors, pension funds and proxy agents to support their campaigns. Support by these groups is often driven by their hope that the actions proposed by shareholder activists will improve the overall governance or business—and stock price performance—of the target company.

With regard to long-term investors, it could lately be observed that proposals made by shareholder activists have been supported by such long-term—orientated investors, either by their voting with the activists on particular items on the agenda of shareholder meetings or by proposing modified alternatives that are still following the general direction initially proposal by activists.

Due to these recent developments in Germany, activists are no longer only seen as greedy or predatory, but rather also as beneficial when initiating change in targeted companies. Overall, it can be observed that activist campaigns in Germany are getting more professional with the involvement of experienced financial, legal and media advisors. This may also be part of the reason activists are also winning approval, in particular from proxy advisors, which are playing a significant role in many German shareholder meetings. This, in turn, typically increases the success rates of activist campaigns in Germany.

In response to the general surge of shareholder activism, German target companies and/or their boards are currently in the process of developing modified strategies on how to respond to attacks by shareholder activists.

The overall situation certainly contributes to a lively debate about the role of a corporation in Germany and its role in society. Such debate includes the question of whether improvement of short-term performance typically focused on by shareholder activists would be the premier and/or only aspect looked at, or whether long-term goals related to corporations and society in general should also be taken into account.

1.2. Austria

As in Germany, shareholder activism has most recently become a highly debated topic in Austria. Historically, shareholder activism has not played a significant role in Austria, inter alia, because in the past the typical shareholder structure of listed Austrian companies could be characterized as predominantly controlled by either a single (often controlling or majority) shareholder or by a group of shareholders acting in concert and jointly controlling companies. Obviously, such shareholder base gave little room for potential success of shareholder activities. However, over the past decade, Austrian shareholder structures started to change so that nowadays an increasing number of Austrian companies either have a higher percentage of free float or generally a more diversified shareholder structure. Both cases provide better opportunities for shareholder activists and contribute to the rise of shareholder activism in Austria.

Additionally, European discussions and legislation related to corporate governance and compliance of listed companies provided a fruitful ground for shareholder activists to

influence Austrian as well as other international investors and proxy agents to follow the requests and recommendations of activists. Therefore, shareholder activism is currently potentially affecting quite a number of companies in Austria.

The majority of the recent campaigns in Austria have mainly focused on the legal and governance structure of companies; the composition of their supervisory and management boards; related party transactions; board compensation with a particular focus on variable compensation elements; the profitability, divestiture, M&A scenarios; and the investigation of the management by a so-called special auditor (*Sonderprüfer*).

Also, in Austria, proxy advisors play a significant role as they are increasingly joining proposals by shareholder activists. In recent campaigns, activists were almost exclusively hedge funds or special situations funds and the targeted companies were quite often Austrian real estate companies or public real estate funds. All target companies had in common that their stock price was below the expected level, often due to governance- or compliance-related topics or uncertainties related to the strategic positioning of such companies, failed acquisition activity or impairment items connected to previous acquisitions.

Another remarkable fact is that in Austria, shareholder activity is quite often centered around shareholder meetings, although lately media campaigns also started to increase. Historically, the attendance at such shareholder meetings in Austria was comparatively low. This led to the rather strange situation that, on the one hand, shareholders with less than 30 percent of the voting rights could in fact control shareholder meetings, and on the other hand, this low attendance could also increase the activist shareholder's influence in the respective shareholder meetings.

2. RECENT CASES

2.1. Germany

2.1.1. ThyssenKrupp / Cevian / Elliott

The German ThyssenKrupp case is very significant as it signaled a shift in the style of shareholder activism in Germany. The campaign was much more aggressive than previous ones, and it led to a drastic change in the company's overall structure and management, making it a very successful campaign from the perspective of the shareholder activist.

Cevian started its engagement in ThyssenKrupp with a minor stake of approximately 5 percent in 2013 and extended such shareholding over the coming years to approximately 18 percent in 2018. Cevian was concerned with the underperformance of ThyssenKrupp when comparing the company to its peers and constantly criticized the company's overly complex legal and corporate structure. The first phase of the campaign started in 2015, when Cevian managed to install one of their partners in the company's supervisory board after an intense campaign that primarily focused on public interviews.

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In May 2018, Elliott came into play by acquiring a stake of less than 3 percent in ThyssenKrupp, and Elliott was also unsatisfied with the company's management. Facing this pressure, ThyssenKrupp formed a steel venture with Tata Steel to please the shareholders and to improve the performance of the company. Cevian and Elliott, however, were not satisfied with the deal and pressured management of ThyssenKrupp to a renegotiation. This unsatisfactory situation led to support from other nonactivist long-term-oriented shareholders of ThyssenKrupp and increased pressure, especially from Elliott. The situation climaxed when the CEO of ThyssenKrupp and, shortly after, the chairman of the supervisory board stepped down.

In September 2018, it was announced that ThyssenKrupp would split into two independently traded public companies. It was planned to split the industrial goods business from the steel and marine divisions, thereby creating ThyssenKrupp industrials and ThyssenKrupp materials. However, in May 2019, ThyssenKrupp announced that the planned split of the divisions would be canceled. According to ThyssenKrupp, the reason behind the cancellation was the economic slowdown and the overall business performance of the company.

2.1.2. STADA / Elliott

The case of STADA / Elliott is a typical example for M&A-related activism. In April 2017, Bain and Cinven announced a public tender offer and wanted to take STADA private. After this announcement, Elliott acquired a substantial stake in STADA to tender a portion of its shares in order to help it succeed.

After lowering the initial acceptance threshold from 75 percent to 63 percent, Bain and Cinven acquired the majority of STADA shares in August 2017 for EUR 66.25 per share and, finally, held approximately 65 percent of the shares. After that, Elliot increased its stake in STADA, anticipating that the next step would be a so-called DPLA—a domination, profit and loss agreement, which enables the buyer to control the target's strategy and business decision-making and to access its cash flow. For such a DPLA, a stake of at least 75 percent was required.

Bain and Cinven therefore needed Elliott's support for implementing this DPLA. Elliott, knowing the importance of its shares, then demanded EUR 74.40 per share.

While Bain and Cinven ultimately proposed to offer this demanded amount to all the minority shareholders, the share price of STADA shares had increased well above EUR 80 per share at that point in time and Elliott was finally able to sell its shares for EUR 81.73 per share in October 2018 to Bain and Cinven.

2.2. Austria

2.2.1. Petrus Advisers AG / Wienerberger AG

In 2018, the terms of two members of the supervisory board of Wienerberger were about to be extended. Petrus, a special situations fund, focusing, inter alia, on Austrian

companies, held approximately 3 percent of Wienerberger's shares, and was generally dissatisfied with the development of the company's share price. Therefore, Petrus proposed the expansion of the supervisory board to nine members, suggesting two experts of its choice to the supervisory board. In order to create pressure, Petrus submitted two applications for a so-called special audit. Such application for special audit is a shareholder right under Austrian law, which gives shareholders of an Austrian company the opportunity to have particular predefined activities of a company reviewed by an independent expert. Due to this pressure, Wienerberger undertook to carry out a professional process with external help in order to define suitable requirement profiles and select suitable candidates for the supervisory board, as well as looking for ways to increase efficiency within the company. For this purpose, Wienerberger also undertook to consult with its main shareholders, including Petrus Advisors. In turn, Petrus Advisors withdrew the proposed expansion of the supervisory board to nine members and two special audit requests.

This case is an example for using the threat of a special audit as leverage to achieve a satisfying compromise as a minority shareholder.

2.2.2. Petrus / Immofinanz AG / CA Immo

In 2017, Immofinanz AG and CA Immo, two listed real estate funds, were considering a merger. Petrus, as a minority shareholder in both companies, was strictly against the merger and was generally disappointed with the price development of Immofinanz AG. Petrus, therefore, published an open letter to the managing board of Immofinanz AG in which they demanded the sale of Immofinanz's Russian business and other noncore assets as well as a share buyback and a cash offer for the shareholders. With this, Petrus aimed to double the price per share of Immofinanz and made the aforementioned measures conditional for its approval of the merger. While the sale of the Russian business did indeed happen, probably to some extent also due to the pressure from Petrus, the price development of Immofinanz remained unchanged at merely 2 percent per year. Petrus blamed this, at least in part, on the bad deal concerning the Russian business and alleged that Immofinanz negotiated it badly.

Due to this further disappointment, Petrus remained against the merger and demanded a change of management in 2018. Shortly after this demand, however, the terms of the members of the management board were extended for another five years. Following this, Petrus then proposed two managers as independent members of the supervisory board for the election in the next general meeting coming up.

2.2.3. BWT / group of minority shareholders

In 2018, minority shareholders of Austrian Best Water Technology AG (BWT) successfully challenged a merger resolution that would have led to a so-called "cold delisting" of BWT in court.

The majority shareholder planned to merge BWT into the unlisted 100 percent subsidiary. Shareholder activists argued that the sole reason of such merger was the creation of a cold delisting with the attempt to delist the shares of BWT from the Vienna Stock Exchange

without the majority shareholder/company paying compensation to minority shareholders. The Supreme Court argued in its decision that the resolution of the merger in the general assembly was an abuse of law and therefore annulled the resolution. As a result, BWT had to pay the shareholders compensation for the stock market exit.

3. Relevant Features in Local Law Facilitating or Discouraging Activism

3.1. Germany

3.1.1. Minority Shareholder Rights

The German legal framework provides a number of rights to minority shareholders, dependent on their overall stake in the company. The most notable ones and the ones most commonly exercised are listed below:

- Holding a single share entitles a shareholder to (i) attend, speak at and vote at shareholder meetings and (ii) file countermotions before and at the shareholder meeting and file proposals regarding the election of supervisory board members or auditors.
- Holding shares representing 1 percent or EUR 100.000 of the registered capital, additionally entitles a shareholder to request a special audit by a court-appointed auditor.
- Holding shares representing 5 percent or EUR 500.000 of the registered capital entitles a shareholder to (i) convene a shareholders' meeting and (ii) request the amendment of the agenda of the general meeting.
- Holding shares representing 10 percent or EUR 1 million of the registered capital entitles a shareholder to request an individual vote on the discharge of management and/or supervisory board members.
- Holding shares representing 25 percent and one share of the registered capital entitles a shareholder to block all resolutions that by German law must be passed by a three-quarters majority (for example, changes in the object of the company, certain types of capital reduction and conversion or the dissolution and merger of the company, and any amendment to the Articles of Association).

3.1.2. Notification Requirements and the Schaeffler KG/Continental AG Case

When building a position in a listed company, certain notification obligations have to be fulfilled. Previously, so-called cash-settled options have been used to secretly build up a position in a listed company. When building up a stake in a listed company, for shareholder activists the German Schaeffler/Continental case has been of relevance.

Basically speaking, so-called cash-settled equity swaps have been used for a hostile takeover when, Schaeffler announced its voluntary takeover of Continental AG, a German

DAX 30 company in 2008. At the time of the offer, Schaeffler already held approximately 8 percent of Continental through shares and physically settled call options. However, Schaeffler had also entered into cash-settled equity swaps with several investment banks, the majority of which held 2.999 percent of Continental's shares, in order to avoid German notification requirements (3 percent being the threshold for a notification requirement). In total, Schaeffler held such cash-settled equity swaps for approximately 28 percent of Continental's shares. German courts held that cash-settled options can no more be used to secretly build up a stake in a listed company. Therefore, it became much more difficult for shareholder activists to secretly build up a larger shareholder position.

3.1.3. Corporate Governance Code

In addition to the German Stock Corporation Act, the German Corporate Governance Code presents essential statutory regulations for the management and supervision of German listed companies and contains, in the form of recommendations and suggestions, internationally and nationally acknowledged standards for good and responsible corporate governance. Companies often follow such recommendations and suggestions voluntarily as they are obliged to disclose deviations annually and to explain such deviations. The corporate governance code therefore works on a "comply or explain" basis.

A specifically significant recommendation concerns the composition of the supervisory board. Namely, the supervisory board shall determine how many of its members shall appropriately be independent while considering the shareholder structure. A member is deemed independent if it has no personal or business relationship with the company, its governing bodies, a controlling shareholder or a company affiliated with it that may give rise to a material and not merely temporary conflict of interest.

Including an independent member in the supervisory board prevents, to a certain extent, orchestrated acts of majority shareholders or the management and therefore provides a certain level of protection for minority shareholders and activists.

3.2. Austria

3.2.1. Minority Shareholder Rights

Apart from typical activist strategies, which include open letters to the management or public campaigning over the media, shareholder activists are also taking advantage of the possibilities provided under Austrian corporate law.

The main law providing provisions to be used by shareholder activists to boost their campaigns is the Austrian Joint Stock Corporation Act. Particularly, it provides minority shareholders with a wide range of possibilities to request information from a company and to influence a company. The rights provided by law mostly allow a minority shareholder to force a company to engage constructively with the shareholder. However, certain measures, as for instance the so-called special audit, allow shareholders to apply pressure to a company by exposing them to the threat of an examination by an independent auditor. The items listed below are the most notable ones and the ones most commonly exercised.

- Holding shares in an Austrian corporation, regardless of the number of shares actually held, entitles a shareholder to attend and speak at the shareholders' meeting and to ask questions with regard to the agenda of such meeting, exercise voting rights and ultimately to challenge a shareholder's resolution in court within a one-month contestation period after having objected to a shareholder resolution in a shareholder meeting.
- Holding shares representing 1 percent of the registered capital entitles a shareholder to (i) submit proposals for resolutions on each item of the agenda of a planned shareholder meeting and request that these be published on the website and (ii) request the review of the amount of consideration for a mandatory offer aimed at gaining control with the Austrian Takeover Commission.
- Holding shares representing 5 percent of the registered capital entitles a shareholder to (i) demand the convening of the general meeting or the inclusion of certain items of the agenda (if necessary by court) and (ii) request amendment of items on the agenda.
- Holding shares representing 10 percent of the registered capital entitles a shareholder to (i) request the dismissal of a member of the supervisory board for good cause, (ii) demand a special audit appointment of a statutory auditor by court and (iii) request the assertion of damage claims by the company against shareholder, members of the management or supervisory board or third parties, if these claims are not unfounded.
- Holding shares representing 25 percent and one share of the registered capital entitles a shareholder to block all resolutions that by Austrian law must be passed by a three-quarters majority (for example, changes in the object of the company, certain types of capital reduction and conversion, the dissolution and merger of the company and any amendment to the Articles of Association).

3.2.2. Legal Restrictions on the Establishment of Participations

3.2.2.1. Notification of Participation

The Austrian Stock Exchange Act stipulates that a person acquiring shares, financial instruments or other comparable instruments in relation to issuers that are admitted to trading on a regulated market must make a notification of shareholding to the company, the financial authority and the stock exchange when reaching certain percentage thresholds. This obligation aims to ensure that the market is informed about changes in ownership structure and shall prevent a quiet and creeping building of a large participation. For shareholder activists, this regulation is a double-edged sword as it prevents them from quietly building up a larger stake but also ensures that they are at all times informed about the participation of other shareholders.

3.2.2.2. Austrian Takeover Act

Pursuant to the Austrian Takeover Act, a shareholder is obliged to make an offer for all shares of the target company on obtaining a controlling participation of 30 percent (companies can lower the threshold in their articles of incorporation). While it may generally not be the goal of a shareholder activist to obtain such controlling participation, the regulation also applies for shareholders acting in concert. This means that the shareholdings of shareholders are to be attributed to each other if they are acting in concert. If the combined shares of such shareholders reach the threshold of a “controlling participation,” they are obliged to make an offer for the remaining shares of the company. Such provision has particular relevance in Austria when shareholder activists are trying to influence other (long-term) shareholders to follow their initiatives and jointly vote in shareholder meetings. This provision of the Austrian Takeover Act de facto prevents activists from exercising factual control over a company together with other shareholders, as they otherwise would be required to make a mandatory takeover offer to all the remaining shareholders.

3.2.3. Corporate Governance Code

In addition to the Austrian Joint Stock Corporation Act, the Austrian Code of Corporate Governance (the Code) sets voluntary rules for companies to help them establish good corporate governance and control systems. For more than a decade now, Austrian laws on stock markets and capital markets have been supplemented by a self-regulatory standard based on the principle of “comply or explain.” The Code has initiated many positive changes and has helped strengthen the confidence of international and national investors in the market. It serves as a benchmark in the Austrian capital market for good governance and controls and has become an essential component of the Austrian system of corporate governance.

While the rules set out in the Code are very extensive and would go beyond the scope of this article, it contains one particularly important regulation. It sets out rules for the composition of the supervisory board of listed companies and stipulates that the majority of the supervisory board elected by the general meeting or delegated by the shareholders must be independent of the company and its management board.

Additionally, in case a company has a free float of more than 20 percent, at least one of those independent members of the supervisory board has to meet the additional criteria of not being a shareholder of the company with more than 10 percent or a representative of such shareholder. In case a company has a free float of more than 50 percent, at least two members have to fulfil the criteria set out above.

Considering the extensive rights of the supervisory board members, this regulation ensures a certain objectivity of the board and may, therefore, protect minority shareholders and activists from the supremacy of a majority shareholder or a group of shareholders.

3.2.4. Duty of Care

The Austrian Joint Stock Corporation Act contains an extensive “duty of care” for the management. In a nutshell, such duty stipulates that management is obliged to protect

and represent the interests of shareholders. In addition, the Austrian Takeover Act provides that management of a target company has to maintain objectivity and stay neutral during a takeover offer period. Among many others, one of the outcomes of this regulation is the so-called “prohibition of prevention” under the Austrian Takeover Act. The prohibition of prevention aims to mitigate the conflict of interest of management in the event of a takeover bid and shall ensure that management (and also the supervisory board) cannot prevent a takeover that would be advantageous for the target company. In takeover scenarios, such provision can be helpful for shareholder activists as it limits the possible action of the management of a target company.

4. Thoughts About Future Developments

4.1. Germany

Considering the recent success of several campaigns in Germany, it seems very likely that activism will surge in the years to come. Many of the recent campaigns have been supported by proxy advisors, institutional investors and long-term investors, which are increasingly welcoming activists trying to reorganize stagnant companies or to increase profit. Due to this recent success, the German legal framework and the overall current circumstances in Germany, Germany turned out to be a new playground for activists.

Companies are starting to become aware of this increase in activist campaigns and are increasingly preparing themselves. While good corporate governance has been on the agenda for a while, strategies of activists have recently become more aggressive and public. The media plays an ever-increasing role in activist campaigns and, therefore, companies will have to improve their communication with the press and with shareholders and will have to ensure being well prepared for such campaigns.

Overall, the surge in shareholder activism could have a very positive effect on the German market as companies will be forced to more transparency and efficiency in the long run.

4.2. Austria

Following the European and global trend, a further increase in shareholder activism is to be expected in Austria. The implementation of the European Shareholder Rights Directive II (2017/828) will also contribute to this. Such directive will give shareholders a say in the remuneration of management of a listed company. In Austria, the directive will be implemented by giving the shareholders a vote on the general remuneration policy every four years and an annual vote on the remuneration report. Although this vote will be nonbinding for the supervisory board, the mandatory publication of the documents and the outcome of the respective votes open up another pressure point for ambitious activists.