The Shareholder Rights and Activism Review

Fourth Edition

Editor
Francis J Aquila

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THE SHAREHOLDER RIGHTS AND ACTIVISM REVIEW

FOURTH EDITION

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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, almost half of the publicly announced activism campaigns in 2018 targeted non-US companies. This movement is being driven by, among other things, a search by hedge funds for new investment opportunities and a cultural shift toward increased shareholder engagement in Europe, Australia and Asia.

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 fourth 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 2019

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Chapter 14

UNITED KINGDOM

Gavin Davies, Greg Mulley and Mark Bardell[1]

I OVERVIEW

Shareholder activism continues to grow in prevalence and significance in the United Kingdom, in common with global trends. Although shareholder activism is not a new concept in the UK market, the types of investors undertaking activism, the companies that they are targeting and the outcomes that they are seeking to achieve have continued to evolve over recent years, influenced in large part by the development of such activity in the United States.

'Shareholder activism' is a generic term that is usually used to describe an approach by a shareholder or shareholder group to a company's board, and if necessary to its fellow shareholders, seeking to effect change within a company. Although shareholder activism in the United Kingdom has historically been focused on obtaining board representation, activist investors have begun to utilise the legal and regulatory tools available to them to achieve a more diverse range of outcomes, short of a full control transaction.

Shareholder activism campaigns in the United Kingdom can be categorised in many different ways. One simple approach is to distinguish between: (1) event-driven activism, where an activist shareholder will seek to assert its influence on a company's current corporate activity, particularly in relation to a takeover or other M&A situation; and (2) strategic or operational activism, where outside a company's current corporate activity, a shareholder activist seeks to address operational performance, the balance sheet or other strategic issues, or some other longer-term concern at a company, such as governance or remuneration. Although strategic or operational activism is often associated with management or leadership changes, achieving control in the strict company law sense is not usually an objective and paying a control premium is something activists will seek to avoid.

Just as the type of shareholder activism can vary broadly, there is no one type of shareholder activist in the United Kingdom, and the term can cover a wide range of investors. Some activists are specific investment funds with activism as their business model, and it is these investors that are generally classed as 'activist' shareholders. Equally, existing shareholders may become 'active' shareholders; for example, where they consider that the company is underperforming or they disagree with the decisions being made by the company's board. Traditionally, institutional investors in the United Kingdom have refrained from voicing their concerns or criticisms of management in the public domain, and the vocal activist community has historically been composed of hedge funds, specific investment funds and other alternative investors. Increasingly, however, institutional investors and other shareholders are becoming more prepared to air their concerns in the open, or to lend

1 Gavin Davies, Greg Mulley and Mark Bardell are partners at Herbert Smith Freehills LLP.

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their support (publicly or privately) to those who are more willing or able to do so, when they feel that their concerns are not being registered by management. Activist shareholders are sometimes described as performing a 'lightning rod' role for such dissent in the public market; they can sometimes provide a useful channel for the dissatisfaction felt by a wider group of shareholders and potentially gain their support.

The established shareholder activist funds operating in the United Kingdom are generally well researched, tactically astute and determined, and come armed with the access to funds needed to support their campaigns. These activists will be prepared for a hostile response (and will not shy away from public disagreement) but may prefer to reach a consensual agreement with a board if they can. They are persistent (some with multi-year time horizons on their investment) and relatively resistant in the face of an initial knock-back (with a number of examples of activists willingly reiterating arguments and returning to shareholders for a second shareholder vote).

II LEGAL AND REGULATORY FRAMEWORK

The global focal point of shareholder activism over the past decade has been and remains the US market, where activist investors have been ready and willing to employ the legal means available to them to achieve their objectives. In the United Kingdom, corporate law has always provided a strong basis of shareholder rights from which to challenge directors. This, together with concerted efforts over many years by UK regulators and policymakers to encourage more active shareholder engagement (particularly following the failures identified in the global financial crisis), has resulted in a legal and regulatory framework in the United Kingdom that is arguably the most benign framework for possible activist activities in Europe. This position is likely to increase in a post-Brexit environment.

The most important legal tools available to an activist shareholder are enshrined in English company law (the Companies Act 2006), which provides an activist shareholder with the means of amplifying its influence beyond the size of its shareholding (which in some cases may be quite small) and becoming the lightning rod for the shareholder voice of change referred to in Section I. The most powerful tool in an activist shareholder's toolkit is the ability to call for a general meeting of a company. Provided that a shareholder holds at least 5 per cent of a company's issued share capital, it may requisition a general meeting of its fellow shareholders and propose one or more resolutions to be considered at that meeting (Section 303). Alternatively, shareholders holding at least 5 per cent, or a group numbering at least 100 shareholders, may requisition specific resolutions to be considered at a company's annual general meeting (AGM) (Section 338). It is this ability to introduce a resolution, taken with the ability of a simple majority of those voting at the relevant meeting to remove or appoint a new director, that gives the shareholder its most potent threat. Accordingly, in strategic and operational as well as governance and pay situations, the requisition will be to remove existing directors from the board or appoint new directors nominated by the activist investor, to ensure new voices on the board to help achieve the desired outcome. However, provided that it relates to a matter that is not defamatory or vexatious and, if passed, would be effective, there is no limit to the type of wording of a resolution that an activist may propose. 'Directive' resolutions by shareholders to the board, which are not very prevalent and are most frequently used by action groups, and issue-focused activists, are not generally regarded as being effective, unless the resolution is passed by a special resolution.

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Ordinary resolutions of a company may be passed by a simple majority (50 per cent plus one share), whereas special resolutions require a majority of 75 per cent. This means that a group of shareholders holding 50 per cent of the shares voted at a meeting have the power to pass ordinary resolutions or, conversely, a minority bloc of 25 per cent may block special resolutions. These thresholds refer to percentages of shareholders present and voting at the meeting, so a much smaller overall bloc of shareholders may be able to pass or block resolutions, depending on turnout. It is generally thought that FTSE 350 shareholder turnout is around the 70 per cent mark. For a UK-listed company, in particular, one with a premium listing, certain significant corporate transactions will require shareholder approval (e.g., a class 1 major transaction under the UK Listing Rules or where non-preemptive issuances of consideration shares are required). Therefore, significant corporate activity will often present a voting opportunity for a shareholder to intervene (and likewise on a takeover, by exercising votes on a scheme of arrangement, or accepting or not a contractual takeover offer).

The Companies Act 2006 contains a number of other ancillary rights that may also assist a shareholder in conducting its activist campaign. Under Sections 116, 809 and 811, shareholders have the right to inspect and copy a company's register of members and any register of beneficial interests, which can allow other shareholders to be identified and subsequently communicated with, or (if the directors of a company have failed to comply with a shareholder's requisition) allow the activist shareholder to call the general meeting itself at the company's expense (Section 305).

In addition, any shareholder has the right to attend and speak at a general meeting of a company (whether that meeting has been requisitioned or is being held in the ordinary course of business), giving that shareholder the opportunity to state a view or ask difficult questions to the directors. This right may be exercised by a representative of the shareholder or via a proxy.

Listed companies in the United Kingdom are required to hold an AGM each year, which will include re-election of directors by rotation and, in the case of FTSE 350 companies, will typically propose resolutions to reappoint each of their directors to comply with the UK Corporate Governance Code. This can provide shareholders with an annual opportunity to effect change. Another common means of activist shareholders voicing their discontent has been to vote against the annual directors' remuneration report, the subject of an annual advisory vote at each AGM (high-profile examples include AstraZeneca, Drax Group, London Stock Exchange and BT in 2018). In the United Kingdom, across the FTSE 100, the number of remuneration reports to have faced at least 10 per cent shareholder opposition in 2018 has increased by 39 per cent, and the number of contested (20 per cent or greater opposition) remuneration report resolutions has increased by 63 per cent relative to the 2017 AGM season.[2] The introduction in 2013 of a binding AGM vote every three years on the directors' remuneration policy provides another more significant opportunity for shareholder 'say-on-pay' intervention.

In extreme cases, an activist shareholder may decide to exercise its right under the Companies Act 2006 to take legal action in the form of a derivative claim against a company's directors (which is a claim on behalf of the company) (Section 260) or an unfair prejudice petition (Section 994). Such shareholder litigation is very rare in the United Kingdom in relation to listed companies.

2 Georgeson's 2018 Proxy Season Review, p. 7.

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Although the legal and regulatory framework in the United Kingdom is generally favourable to activist shareholders, the United Kingdom has tended to see a higher level of cooperation between activists and boards of directors when compared with the United States. In a substantial majority of cases, a disgruntled investor in a UK company will begin by contacting the board of that company and attempting to persuade the directors of its view, or to take certain actions, through informal engagement in the first instance. A host of other soft or 'non-legal' options are open to activists, including private discussions with other shareholders and public press, or social media campaigns. The shareholder activist will gauge support for certain resolutions that a group of investors may come together to require the board to propose at a general meeting (as discussed above), or cooperate in opposing certain resolutions proposed by the board.

Although shareholders are generally free and indeed encouraged by policy (such as the Stewardship Code) to talk to one another, it is important to take account of the regulatory context for any such discussions. As discussed below, investors will need to be careful that they do not unlawfully disclose any inside information (as defined in the EU Market Abuse Regulation (EU 596/2014) (MAR)) in relation to their intentions, or (if they have such information) the company, which could amount to market abuse under MAR.

A strategy often employed by activist funds, acting individually, is to build up a stake in a company to increase its leverage to call for change. Such stake-building exercises require particular care. Under the City Code on Takeovers and Mergers (the Code), a person will be required to make an offer for all of the remaining shares of a company subject to the Code for a price not less than the price paid for any shares by the potential controller during the previous 12 months if he or she (together with any persons 'acting in concert' with him or her) becomes interested in shares carrying 30 per cent or more of voting rights. Although shareholders will not generally be deemed to be acting in concert as a result of agreeing to vote on resolutions in a certain way, the Code states that where a group of shareholders requisition a 'board control-seeking' resolution (or threaten to do so), and subsequently acquire shares taking the aggregate interest of the group above 30 per cent, a mandatory offer will be required (Note 2 on Rule 9.1; see also Practice Statement No. 26 for further guidance). The ruling of the Takeover Panel in respect of Petropavlovsk Plc in June 2017[3] confirms that if the resolutions requisitioned by activists propose the appointment of directors who are truly independent of the activists, the resolutions will not be board control-seeking for the purposes of Note 2 on Rule 9.1 and so the acting in concert provisions of the Code will not apply.

Activist investors building a stake will, in the usual way, need to consider their disclosure obligations under the Financial Conduct Authority's (FCA) Transparency Rules. Where a shareholder's interests in shares in a listed UK issuer reach or fall below 3 per cent, and every 1 per cent increment thereafter, he or she must notify the issuer, who is then required to announce to the market. For these purposes, indirect and derivative interests will both be counted as well as direct holdings. This prevents an activist from building up a significant stake in secret. Limited exemptions may apply (e.g., investment firms will only be required to disclose from 5 per cent). Disclosure thresholds are slightly less onerous for companies that are listed in the United Kingdom but incorporated in another country.

The activist wishing to deal in shares will also need to be well advised on the restriction contained in MAR on dealing on the basis of inside information, and the criminal offence of insider dealing under the Criminal Justice Act 1993. If the only inside information in a

3 Takeover Panel Statement 2017/10.

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stakebuilder's possession is its own intentions, a safe harbour is available under MAR (and the FCA's Market Watch 20 publication has also generally been regarded as clear that this will not amount to market abuse). However, care needs to be taken where information is obtained from the target or from other shareholders.

Institutional investors in UK-listed companies should have regard to the Stewardship Code, which sets out good practice for their duties to engage as shareholders, and is applied on a 'comply or explain' basis. It recommends that institutional investors establish clear guidelines on when and how they will escalate stewardship activities. It says engagement is likely to begin with confidential discussions but may be escalated where a company does not respond constructively. The Stewardship Code recognises the role that activism may play in improving corporate governance.

The board of a company facing an approach from activist shareholders is unlikely to sit idly by, but may select from various strategies to defend its position. Some of these are 'legal' defences. For example, a company may refuse to allow a resolution to be requisitioned on the grounds that it is 'frivolous or vexatious' or defamatory, or it may challenge a requisitioned resolution on technical grounds. Careful consideration needs to be given before adopting such an approach since it may well give the impression that the board is unwilling to openly engage with shareholder concerns. An engagement on the substantive issues of concern and a demonstration that directors are open to measured and thoughtful challenge is generally regarded as an approach more likely to dissipate activist pressure.

III KEY TRENDS IN SHAREHOLDER ACTIVISM

Globally, shareholder activism has seen a substantial increase over recent years, with particularly strong growth in 2018 in terms of both numbers of activists engaged in activism and companies that were publicly targeted by activist shareholders. Globally, a record 131 activists engaged in activism against companies with market capitalisations greater than US$500 million at the time of the campaign.[4] In 2018, the number of companies targeted by activists worldwide was 922, compared with 856 in 2017. Shareholder activism has been a long-term feature of US markets; however, it is increasingly being exported overseas as funds look for new markets that have not yet been fully explored. In 2018, 433 companies outside the United States were publicly subjected to activist campaigns, compared with 344 in 2017. Of these 433 companies, 78 were in Australia and 57 were in Canada.[5] The European and UK markets are also at the forefront of this global trend: between 2010 and 2015, the number of shareholder activist campaigns in Europe (including the United Kingdom) was thought to have increased by 126 per cent, while in 2018, only 53 per cent of campaigns against UK companies were led by UK activists. This is evidenced in the increased activities of US funds such as Elliott Management, Third Point and ValueAct in continental Europe. It seems that this US–Europe activism has increased in recent times: see, for example, Elliott Management's campaign against the AkzoNobel board in respect of the latter's stance on the proposed takeover by rival PPG; and Third Point's campaign against the board of Nestlé, which resulted in the board announcing a US$21 billion share buy-back.

Both historically, and reinforced by the introduction of 'say-on-pay' legislation, shareholder intervention in the United Kingdom has been focused on board-related matters

4 Lazard – *2018 Review of Shareholder Activism*, p. 1.

5 Activist Insight – *The Activist Investing Annual Review* (2019), p. 6.

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such as executive remuneration and requests for board representation. In January 2017, BlackRock issued its chair and CEO Larry Fink's annual letter to the CEOs of more than 300 UK companies stating that pay rises for executives should not go beyond the level of such rises in respect of other employees without a strong rationale. Given that BlackRock owns a stake in every company in the FTSE 100, this represented a potential catalyst for further shareholder intervention in remuneration issues.

Shareholder intervention has also recently focused on environmental, social and governance (ESG) matters. In January 2018, BlackRock issued Larry Fink's annual letter to CEOs stating that a company's management of ESG matters demonstrates leadership and good governance that is essential to sustainable growth and is therefore increasingly being integrated into BlackRock's investment process.

The number of activist matters relating to company M&A and other corporate activities is, however, also increasing (as outlined in Section III.i).

i Event-driven activism

As outlined above, shareholder activism in the UK market has been traditionally focused on the performance and remuneration of executive directors and requests for board representation by activists. Over the past decade, however, the types and objectives of shareholder activists have evolved and an increasing number of activist campaigns have been event-driven, involving company M&A (both private and public) or other corporate activity (including the return of value to shareholders by means of dividends or share buy-backs). In 2018, 216 activist campaigns launched worldwide related to company M&A. Event-driven activism has been marked in the United Kingdom this year, particularly around high-profile M&A, such as the takeover bids made by Comcast and 21st Century Fox for Sky.[6]

Whenever a company is required to obtain prior shareholder approval to acquire or dispose of a company or business (e.g., if the transaction is a class 1 or related party transaction for the purposes of the UK Listing Rules), shareholders are given the ability to reject a deal after it has been conditionally agreed by the company's board. In M&A situations that are dependent on shareholder approval, activists may seek to influence a particular outcome through public criticism, proxy solicitation, lobbying of institutional investors or proposing alternative transactions.

Activists may also seek to instigate or put pressure on a company to undertake an acquisition or disposal, or otherwise return value to its shareholders, particularly if a company is perceived to be sitting on too much cash or shareholders would prefer a return of cash to an M&A transaction that has been proposed by the board.

In public takeover situations, where the ultimate decision as to whether to proceed with the transaction rests with the shareholders of the target company (by shareholder vote on a takeover by scheme, or acceptance of the offer on a takeover by contractual offer), activist investors can have a significant influence. This is the case even at the early stages of a potential bid, by encouraging a target board to negotiate with the bidder or indicating that they, as shareholders, will not accept an offer below a certain minimum level to attempt to encourage an increase in the bidder's offer price.

6 ibid, pp. 10–11.

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ii Activism as a more acceptable activity and name-calling

Shareholder activism has historically had pejorative connotations in the United Kingdom, with activists being stereotypically cast as opportunistic and aggressive 'corporate raiders' concerned with realising short-term returns at the expense of long-term shareholder interests and value creation.

The rise of an activism advisory community and the terminology being used suggest that, as in the United States, in the United Kingdom, there is increasing acceptance of activism as a valid and indeed desirable public market business model, as evidenced by the more neutral language used.

In the United Kingdom, in addition to the traditional broker role for the company, financial advisers have been establishing specialist teams to advise listed companies on activist situations. Specialist proxy solicitation agents have moved across from the United States to support the hunt for shareholder votes on behalf of both boards and activists. The Big Four accountancy firms have built up teams to support their listed clients and, like financial advisers, PR consultancies are increasingly seeing activism as a specialist area of advice. Interestingly, the terminology has changed; a few years ago, terms such as 'corporate defence' were prevalent among this type of advisory work. Now 'corporate preparedness', 'shareholder engagement' and 'valuation solutions' are terms in widespread use.

Similarly, in the United States, a new nomenclature shows a change in attitudes. 'White hat' has been introduced in recent years to identify a less contentious form of 'constructive activism' with a focus on medium to long-term value creation. White hat activists are characterised as typically favouring more collaborative measures conducted in private (usually on a consensual basis) and as only instigating a public activist campaign as a last resort.

More generally, the term 'activist shareholder' is increasingly being moderated to terms such as 'active' or 'engaged' shareholder, to disassociate from historic negative connotations associated with the term 'activist'.

iii US-style tactics and developments – the adoption of the settlement agreement

The global focal point of shareholder activism over the past decade has been and remains the US market, with activist investors such as Carl Icahn, Pershing Square, ValueAct and Elliott Management playing prominent and well-publicised roles in the US activist community.

Although some of the tactics and approaches developed by US activist investors have been adopted in the UK market, regulatory and legal limitations on the type of influence activists can have on UK boardrooms has meant that many of the bolder forms of US activism have not translated across the Atlantic. However, one US trend that is beginning to be implemented in the United Kingdom is the use of settlement agreements or 'activist relationship agreements'. These are an evolution of UK-style relationship agreements that have, for many years, been used to regulate relationships between listed companies and their controlling or significant shareholders.

Settlement agreements have been in use in the United States over the past decade and provide a means of settling a potential contest between an activist investor and a company, while avoiding the significant drain on resources that a protracted proxy battle may entail. US-style settlement agreements typically include the following basic components:

a an agreed set of actions to be taken by the company, which may include the appointment of board representatives for the activist investor;

b a standstill agreement in relation to the activist's share ownership in the company;

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c a standstill agreement in relation to certain corporate governance matters (e.g., a restriction on the activist from taking certain actions designed to gain additional board representation); and
d other material provisions, which may include non-disparagement clauses, remedy provisions and the term of the agreement.

An example of a US-style settlement agreement with an activist investor being adopted by a UK company was announced by Rolls-Royce in March 2016, considered further below, even though the company labelled it a 'relationship agreement', which is more familiar and more neutral sounding to a UK audience familiar with such agreements. These agreements are required under the UK Listing Rules for shareholders with interests of 30 per cent or more of voting rights, a level of shareholding ValueAct had not reached.

In February 2019, Hammerson disclosed that in 2018 it had entered into a similar relationship agreement with Elliott Management, which will remain in force for a maximum of 12 months, subject to certain conditions.

iv Use of dedicated websites and microsites

A practice that has become more common among activist shareholders in the United Kingdom is the use of dedicated websites or microsites as a platform to promote their message more widely. These sites provide activists with the means of collating their arguments (generally from Regulatory News Service press releases, shareholder circulars, etc.) with other supporting data and third-party resources in a public forum that is easily accessible for other shareholders, journalists and the public in general.

Well-advised activist shareholders will carefully evaluate the legal and regulatory basis on which this information is made available. They will consider financial services and market abuse law and regulations, as well as defamation issues, just as they would with any public release or circular. They will also consider the full range of legal challenges as they would for contents of any website or microsite before it is launched to avoid breaching any copyright, third-party confidentiality or data protection laws.

v Board diversity

A topic that is not yet widely raised specifically in relation to activist campaigns, but may become more important and is becoming increasingly challenged by institutional investors, is the role of gender diversity on the boards of listed companies.

According to a study conducted by Bloomberg, between 2011 and 2016, the five biggest US activist funds only nominated women for a board seat in seven out of 174 occasions.[7] In the United Kingdom, the charge of 'male, pale and stale' has been levelled in the context of a proposed board slate, and the Equality and Human Rights Commission has published a good practice guide on 'how to improve board diversity'.[8]

Furthermore, according to the Investment Association, 42 per cent of UK asset managers made a voting decision based on a company's gender diversity in 2018, while 56 per cent had engaged with companies on the subject. Legal & General Investment Management, for example, resolved to vote against the re-election of any chair whose board consists of fewer

7 Carol Hymowitz, 'Icahn, Loeb and other Activists Overlook Women for Board Seats', Bloomberg, 8 March 2016.

8 The Equality and Human Rights Commission, 'How to improve board diversity', 2016.

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than 25 per cent women and cast over 100 votes against the election of UK chairs in 2018, up from 31 in 2017 and 13 in 2016.[9] The United Kingdom's largest private pension scheme (the Universities Superannuation Scheme) and the Church Investors Group have declared similar voting policies. This is illustrative of a growing trend of investors' expectations of companies to disclose policies, procedures and targets in response to the Hampton-Alexander review (2018) and the Parker review (2017) focusing on gender and ethnicity respectively on FTSE 350 boards.

With increasing focus being given to the diversity of company boards by regulators, policymakers and investors, the question of diversity, of both existing boards and whether nominees of activist shareholders improve or worsen that position, may be raised more often.

vi Focus on the consumer sector

Activists seek out value in listed companies, whether by balance sheet restructuring, encouraging corporate events or through business turn-around, wherever they see the most valuable opportunity. But, there can be phases of the economic cycle where certain sectors become a particular focus for funds (e.g., historically, opco/propco separation or conglomerate break-ups). Activism in the consumer sector is not new: in 2007, Cadbury Schweppes announced a demerger of its confectionery and soft drinks business at a stage when Trian was holding 3 per cent of the company's shares and leading calls for such a change. Large international consumer companies currently face challenges around focuses and efficiencies, against a background of slowing sales growth and thinning margins. Activists are currently looking at opportunities for value to be created in such consumer companies, through cost-cutting, the use of leverage and other tools. This has seen campaigns led by Trian (in relation to Procter & Gamble) and, in Europe, by Third Point (in relation to Nestlé) and by Elliott Management (in relation to Whitbread's divestment of Costa Coffee). Consumer companies in the United Kingdom will be watching this trend carefully.

vii Focus on larger cap companies

Activists are increasingly targeting larger cap companies with the view increasingly appearing to be that 'no one is too big' if they present a valuable opportunity, and even household names and 'national champions' are the subject of activist intervention. Reasons that shareholder activism at larger cap companies appears to be becoming more common include: (1) larger cap companies are thought to be more prone to inefficiency and poor corporate governance than smaller companies and there may be inefficiencies created by the 'conglomerate effect'; and (2) activist funds are of an increasingly large size and are able to take advantage of the increasing support for activism from fellow shareholders and their ideas and input becoming more widely accepted. Some of the more notable activist situations involving large-cap companies in recent years include Elliott at AkzoNobel and Telecom Italia, Hudson Executive Capital at Deutsche Bank, Trian in relation to Procter & Gamble and Third Point in relation to Nestlé. In the United Kingdom, large-cap companies in focus recently include Unilever, Barclays and Whitbread.

9 Legal & General Investment Management, 'Active Ownership Corporate Governance report', 2018, p. 16.

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viii Focus on 'proxy plumbing'

Though UK shareholder votes are generally passed on comfortable margins, there have been some close votes recently on high-profile matters (e.g., bids by Melrose for GKN, and CVC and Blackstone for Paysafe), increased focus on 'proxy plumbing' and the role of proxy solicitation agents in helping to get votes through the back office to ensure that they are taken into account. Where the result of the vote will be or is likely to be close, there is also the right that exists under the Companies Act for a shareholder who holds at least 5 per cent of a company's issued share capital to require the directors of a company to obtain an independent report on any poll taken or to be taken at a general meeting of the company (Section 342).

IV RECENT SHAREHOLDER ACTIVISM CAMPAIGNS

i Rolls-Royce

ValueAct Capital Partner's investment into Rolls-Royce Holdings Plc provides an example of white hat activism and the adoption of a US-style settlement agreement.

Following several months of stakebuilding, in July 2015, ValueAct became Rolls-Royce's largest shareholder with a shareholding of 5 per cent. ValueAct positioned itself as an engaged investor, not an activist, and began to exert pressure on Rolls-Royce privately. Following an initial rejection of board representation in November 2015, on 2 March 2016, Rolls-Royce announced that it had entered into a 'bespoke relationship agreement' with ValueAct, which contained the following key terms:

a ValueAct was to be granted one representative on the Rolls-Royce board, subject to certain conditions relating to ValueAct's shareholding;

b a standstill in relation to ValueAct's share ownership (ValueAct cannot acquire more than a 12.5 per cent shareholding);

c a standstill on certain corporate governance matters, including restrictions on ValueAct requisitioning general meetings, soliciting proxies, proposing mergers or other change of control transactions, proposing changes to Rolls-Royce's strategy or publicly criticising or disparaging Rolls-Royce; and

d a commitment from ValueAct to vote in accordance with the board's recommendation on 'customary resolutions' at general meetings.

The relationship agreement expired on 3 May 2018, and it was replaced with an agreement relating to confidentiality, the board representative's compliance with applicable law, Rolls-Royce's codes, policies and guidelines, and the right of the representative to attend committee meetings.

ValueAct now holds an approximate 9.5 per cent shareholding and has one seat on the board.

ii Electra Private Equity

Sherborne Investors' activist campaign in relation to Electra Private Equity Plc is a high-profile example of a contentious proxy battle for board representation, in furtherance of a call for an operational turnaround.

Following a period of stakebuilding and a public rebuttal of its request for board representation, in October 2014 Sherborne requisitioned a general meeting for shareholders to vote for the appointment of two Sherborne nominee directors to the board of Electra and the removal of one existing director. Sherborne's campaign was centred on the belief

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that it had identified significant value in the Electra portfolio that the existing board had failed to realise and that could be unlocked by certain changes to the company's strategy. The proposals were defeated at the general meeting, and Electra's board subsequently announced its own strategic review.

Following the release by the company of its strategic review and a further period of stakebuilding in Electra, Sherborne requisitioned a second general meeting in November 2015. At that meeting, Electra shareholders voted in favour of the appointment of two Sherborne nominee directors to the board of the company.

iii Premier Foods

The campaign by Hong Kong-based activist Oasis Management in relation to Premier Foods is an example of how M&A events can create opportunities for operational-focused activists.

In May 2016, Premier Food's board rejected a takeover approach from McCormick at 65p per share; however, in the following months, its shares generally traded at between 40p and 45p per share (bar a rise in the summer of 2016), with a profit warning subsequently issued in January 2017. Following the rejection of the McCormick approach, and in an atmosphere of shareholder discontent, Oasis Management began to build its stake and the pressure on the board: it reached a 5 per cent holding in October 2016 and increased this to 8 per cent by March 2017. Subsequently, Premier Foods agreed to appoint an Oasis Management representative as a non-executive director on its board, pursuant to a relationship agreement whereby Oasis Management agreed to further raise its shareholding in Premier Foods to 10 per cent by 30 June 2018 (but no higher than 15 per cent).

The relationship agreement between Oasis Management and Premier Foods was terminated in April 2018 with the Oasis Management representative stepping down from the board. Oasis Management voted against the re-election of Premier Foods' then CEO at its AGM held in July 2018. Despite shareholders voting in favour of re-electing Premier Food's CEO, he later stepped down in November 2018. More recently, Oasis Management's representative joined the Premier Foods board as a representative and Oasis continues to hold a 12 per cent stake.

iv Bowleven

The Monaco-based fund Crown Ocean Capital's successful campaign against African oil explorer Bowleven, is an example of activists focusing on operational and strategic changes within a company.

In early 2017, Crown Ocean Capital made repeated calls for Bowleven to be restructured from an exploration company to a holding company, to return just under £100 million in cash to shareholders. Crown Ocean Capital also raised concerns over the independence of the Bowleven board. Throughout its campaign, Crown Ocean Capital grew its shareholding, from 13 per cent in November 2016 to 22 per cent in March 2017. Crown Ocean Capital subsequently requisitioned a general meeting resulting in five directors and the CEO of Bowleven being removed. The narrow majority in favour of each of their respective removals ranged from approximately 51 per cent to 54 per cent. At the same time, two Crown Ocean Capital representatives were appointed to the Bowleven board, having captured approximately 55 per cent and 52 per cent of the vote.

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v AB InBev/SABMiller

Elliott Management's involvement in the *AB InBev/SABMiller* takeover is an example of a 'hold-out' approach through which activists seek to profit during live takeover situations. It is particularly noteworthy given the size of the transaction.

In November 2015, AB InBev made a formal £71 billion offer for SABMiller. However, after a sharp fall in the value of sterling following the result of the referendum in the United Kingdom on whether to leave the European Union in June 2016, the value of the cash offer fell below the value of the alternative offer consisting primarily of shares in AB InBev's new holding company, which appeared to have been designed for the benefit of SABMiller's two largest shareholders. Elliott Management, in July 2016, acquired (through derivative contracts) an interest in SABMiller and argued for AB InBev to make an offer on improved terms. As a result of Elliott Management's campaign, AB InBev increased its cash offer by 100p per share to 4,500p per share valuing SABMiller at £79 billion.

vi Johnston Press

Two activist shareholders in Johnston Press, Crystal Amber and Custos Group, engaged the board in 2017 with various demands, including removal of its chair and CEO, reform of executive pay and moving its headquarters from London to Scotland. Custos Group proceeded to serve a requisition in November 2017 proposing removal of the chair and one other director, and the appointment of two non-executive directors of the company. The requisition was subsequently determined by the company to be invalid. In May 2018, the CEO resigned and was replaced by the CFO.

vii Whitbread

Whitbread is an example of activists attempting to unlock value at a company by pushing for a break-up or demerger.

After disclosing an interest in Whitbread in December 2017, Sachem Head publicly urged Whitbread in January 2018 to spin off its Costa Coffee chain from its hotels and restaurants business. On 16 April 2018, Elliott Management disclosed an approximate 5 per cent holding in Whitbread. On 25 April 2018, Whitbread announced that it was committed to a demerger of its hotel and coffee chain businesses and that the demerger of Costa Coffee would be pursued as quickly as practical and appropriate to optimise value for shareholders. On 31 August 2018, Whitbread announced that it had agreed to sell Costa Coffee to Coca-Cola for an enterprise value of £3.9 billion, the net proceeds of which were to be used to repay debts, return value to shareholders and pursue its international expansion into Germany.

viii London Stock Exchange

The London Stock Exchange is an example of an activist using a directive resolution to attempt to force the board to take certain actions.

In October 2017, the London Stock Exchange announced that its CEO would leave the group by the end of December 2018 and that the board had initiated a process to find a successor. In November 2017, TCI Management Limited sent the London Stock Exchange a letter questioning the announcement regarding the CEO's departure and subsequently requisitioned a general meeting of the London Stock Exchange to consider: (1) an ordinary resolution to remove the chair; and (2) a special resolution to direct the board to terminate

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the search for a new CEO and permit the current CEO to remain in office as a director and CEO until 2021 on no less favourable terms than his existing arrangements. Subsequently, in November 2017, the London Stock Exchange announced that the CEO would step down with immediate effect (having been asked to do so at the board's request) and that he would not be returning under any circumstances and also that the chair would not stand for re-election at the 2019 AGM. In light of those events, TCI withdrew the requisition relating to the CEO at the London Stock Exchange's request, but not the resolution to remove the chair. Some 79 per cent of shareholders present and voting at the general meeting voted against the resolution to remove the chair that had been requisitioned by TCI.

ix Sky

Comcast and 21st Century Fox's competing bids to acquire Sky plc prompted an example of event-driven activism and how activists can attempt to engage with regulators on a live takeover situation.

In December 2016, Fox made a firm offer for the 61 per cent stake in Sky that it did not already own at a price of £10.75 per share. Comcast then made a competing bid in April 2018 by offering £12.50 per share in Sky, which resulted in an increased competing bid by Fox at a price of £14 in July 2018. In December 2017, Walt Disney Company had announced the terms of a definitive agreement to acquire Fox.

The UK Takeover Panel confirmed that, pursuant to its 'chain principle', The Walt Disney Company would be compelled to make a mandatory offer of £14 per share to Sky shareholders if the company was not acquired by another bidder. However, Elliott Management, which had built a 2.8 per cent stake in Sky, as well as other investors, including Davidson Kempner, contested that the Panel's approach to the application of the chain principle had produced an inadequate price. Elliott Management argued that Walt Disney should make a mandatory offer of at least £15.01 per share and other activist investors made similar arguments.

Although the Panel did not rule in favour of Elliott Management or other shareholders' representations for a higher offer price, the transaction ultimately culminated in an auction process resulting in Comcast's acquisition of Sky for £17.28 per share (totalling US$38.8 billion), a 71 per cent increase in Sky's share price.

x Unilever

Aviva Investors' activist campaign in relation to Unilever Plc is a high-profile example of an activist influencing a company's business decisions, in particular its restructuring plans.

On 15 March 2018, Unilever announced plans to unify its dual parent company structure (dual-incorporated and dual-listed in the United Kingdom and the Netherlands) under a new holding company, incorporated and tax domiciled in the Netherlands. The new parent company would have had a premium listing in London, with shares traded on the Main Market of the London Stock Exchange as well as on Euronext in Amsterdam. It would not, however, have been eligible for admission to the FTSE UK index series.

A range of institutional shareholders, including Aviva Investors and Lindsell Train who each respectively held 1.4 per cent and 2.5 per cent, announced their intention to oppose the move because some would have been forced to sell their shares when Unilever dropped out of the FTSE UK index, leading shareholders to perceive the move as having no discernible benefit for UK public shareholders.

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The shareholder response led to the company announcing on 5 October 2018 that they 'recognise that the proposal has not received support from a significant group of shareholders and therefore consider it appropriate to withdraw'.[10]

xi The Investor Forum

The Investor Forum was launched in 2014 as an investment industry body of institutional investors to facilitate shareholder engagement. Since then, it has steadily increased its activity: in 2018, it was asked to review 12 UK companies, with five reviews resulting in comprehensive collective engagement.[11] Recent examples include Unilever, Imperial Brands and Victrex. Given that the Investor Forum's 43 members represent approximately 30 per cent of the FTSE All-Share market capitalisation, the next 12 months will likely see it continue its efforts to foster collective engagement.

V REGULATORY DEVELOPMENTS

Perhaps the most significant recent change in the regulatory landscape as far as shareholder activism is concerned was the coming into force of MAR on 3 July 2016. MAR, as an EU Regulation, has direct effect in each Member State without the need for any implementing measures by national legislatures. It aims to impose a more uniform market abuse regime across the European Union than that possible under its predecessor, the Market Abuse Directive, and is also broader in scope. It governs, among other things, market abuse and the obligation on issuers to disclose inside information regarding themselves or their financial instruments to the market. There are some detailed changes with potential relevance to shareholder activism, in particular, the introduction of formal provisions regarding market sounding, which sit alongside pre-existing provisions relating to wall crossing and selective disclosure.

Market sounding is defined for the purposes of MAR as the communication of information (whether or not inside information) prior to the announcement of a transaction to gauge the interest of one or more potential investors in the transaction or by a bidder to sound out target shareholders on a takeover. Detailed requirements apply to all persons who disclose information in a market sounding. These include requirements for an assessment of whether the information is inside information, the use of scripts, recorded telephone lines (if available), sounding lists, cleansing and recorded keeping. Although the market sounding regime will be most relevant to a company being targeted by an activist, it will be important for all parties to an activist campaign to ensure continued compliance with MAR.

The aspects of the regime that are most important to shareholder activism (i.e., market abuse and disclosure of inside information by issuers) have not been altered materially by MAR from the previous regime applicable in the United Kingdom (and indeed much of the case law is likely to remain informative for interpretation). However, there are areas that active shareholders, and companies targeted by them, will focus on. These include questions of inside information (including inside information of the shareholder itself), and the applicability of the new investment recommendation regime to shareholder activist situations.

Another development is the formal adoption of certain amendments to the Shareholder Rights Directive (2007/36/EC). The Shareholder Rights Directive is the source of many of

10 Unilever, RNS announcement, 'Statement from the Board of Unilever', 5 October 2018.

11 The Investor Forum – 2018 Annual Review.

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the shareholder rights discussed above that have been given effect in English company law through amendments to the Companies Act (including shareholders' rights to requisition meetings and resolutions). The amendments adopted in April 2017 pursuant to the Shareholder Rights Directive (EU/2017/828) were implemented on 10 June 2019 through a patchwork of legislation and regulation, including the Proxy Advisors (Shareholders' Rights) Regulations 2019 (SI 2019/926) which introduced new rules for proxy advisers who will now be subject to transparency requirements and a code of conduct.

A further more recent development is the introduction of the Investment Association's Public Register, which is an aggregate list of publicly available information regarding meetings of companies in the FTSE All-Share that have received significant shareholder opposition to proposed resolutions (votes of 20 per cent or more against any resolution) or withdrew a resolution prior to their AGM. The Investment Association introduced the Public Register in response to the UK government's green paper on corporate governance reform with the aim of highlighting those companies that receive a high vote against, or withdraw, a resolution, and to understand the process used by those companies to identify and address the concerns of their shareholders. The Investment Association announced[12] that the analysis of the data from the AGMs and general meetings held in 2018 revealed that 120 companies (over 20 per cent) were added to the Public Register compared with 110 companies over the same period in 2017.

VI OUTLOOK

The legal and regulatory framework in the United Kingdom relating to shareholder rights and engagement has continued to evolve to encourage active shareholder engagement, and will continue to provide a benign framework for shareholder activists. The market will continue to develop, as activists increasingly seek to distinguish themselves, and as institutional shareholders, listed companies, advisers, commentators and the investment community become more widely accepting of this activity, seek to understand the nuances between its various protagonists and, in the case of some institutional investors, become active themselves.

For a number of market structural reasons, shareholder activism in the UK market is unlikely to reach the prevalence currently seen in the United States. But, the United Kingdom remains a fertile ground for activists to continue to seek targets for strategic campaigns, as well as companies with a range of corporate events in which they will choose to intervene, and sectors that come into focus. As more players become involved, the possibilities of situations involving more than one shareholder leading on engagement, or multi-year or multi-approach campaigns, and the possibility of shareholders speaking out in defence of a company, will increase. Although the extent of the change to the United Kingdom's legal and regulatory framework resulting from Brexit is impossible to judge at this stage, it will certainly provide activists with new opportunities, as some listed company boards seek to address their own business strategies in an economically turbulent post-Brexit environment.

It does seem clear that any company that is party to an M&A proposal, whether on the buy-side or sell-side, or as a public bidder or a target itself, can expect its shareholders to focus not only on that M&A proposal but also on any fallout from that M&A, particularly if it is unsuccessful.

12 Investment Association, 15 February 2019, 'FTSE 100 pay and director re-election spark renewed shareholder rebellion at 2018 AGM season'.

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Concerns over high-profile corporate issues mean that there is now an increasing focus in the United Kingdom on corporate governance and the ESG standards of companies, and anticipation that shareholders will become more involved in these issues going forwards. The new UK Corporate Governance Code was published in July 2018 and applies to all premium listed companies for financial years beginning on or after 1 January 2019. The FRC has also published a detailed consultation on a new UK Stewardship Code and intends to publish the final-form Stewardship Code in October 2019. The direction of travel of institutional shareholders is to an ever-increasing and more meaningful focus by their investee companies on ESG issues, and the effect of this is expected to be seen in engagement by active shareholders with their investee companies.

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