

Shareholder activism in Australia

What you need to know

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Want to know more?

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Shareholder Activism in Australia

Introduction and background

The past decade has seen a dramatic rise in shareholder activism across Europe and the US. Activist hedge funds globally now hold over US\$ 130 billion in assets.¹ Most of these are in the US but the trend is spreading and becoming increasingly common in Australia. Activist Insight, an industry media and data firm, has identified Australia in particular as a new hot spot for activism. The first half of 2015 alone saw 70% more public campaigns in Australia than in the whole of the previous year.²

Activism at a glance: The good and the bad

Sometimes activism has been decried as controversial and disruptive. For example those who might oppose it have argued that it is driven by a dominant aim to merely create short term wealth for some shareholders to the broader disadvantage of the interests of all shareholders or the longer term interests of the target company. In the context of board spills, it is often argued that a wholesale change to the composition of the board has an equivalent effect of changing control of the target company without requiring bidders to follow the take-over requirements otherwise applicable under Australian law when control of a company is to change and offering shareholders a premium for such control.

Conversely, activism is also often seen as a legitimate, fair and appropriate exercise of rights by one or more shareholders to effect relevant change to a company. For example activists may be motivated to alter the composition of a target board in the interests of improved corporate governance or to influence a change in strategic direction of the target company for the broader benefit of all shareholders and in the longer term interests of the target company.

Irrespective of the motivations or arguments for and against activism the fact remains that it is on the rise globally and more recently in Australia. Properly understanding activism is therefore an increasingly important part of the corporate and investment landscape. This paper provides some key background information relevant to shareholder activism and issues that activists, boards and shareholders alike ought to know.

Activism on the rise

Whatever the drivers of activism may be, there is no denying that activist campaigns are on the rise both globally and in Australia. They are generally quite successful in achieving their objectives. In 2014 activists secured a board seat in about 73% of all proxy fights globally.⁴

Activists generally seek to achieve their aims by approaching the board and outlining their objectives. This is done either privately or through a combination of both a private approach and a public campaign. Strategically activists may also determine to by-pass the board altogether and simply appeal to shareholders through direct engagement or indirectly through a public campaign.

The publicly available figures showing the rise of activists and their success, of course, only reflect the public campaigns and do not capture campaigns waged behind the scenes. They are likely to significantly underestimate the true impact of shareholder activism as campaigns often only become public after more subtle approaches have been unsuccessful.

¹ <http://www.barrons.com/articles/activist-hedge-funds-draw-big-inflows-and-some-worries-1432350654>

² Activist Investing Half Year Review, July 2015

Recent examples of shareholder activism in Australia

Target	Activist	Strategic Objective	Outcome
AGL	GetUp! / ACCR / Asset Owner's Disclosure Project	The shareholder group moved a special resolution to amend AGL's constitution to impose certain obligations on the company in pursuit of climate change limitation goals.	The resolution was not passed but the chairman made a statement committing AGL to objectives broadly consistent with the resolution.
Alchemia	Sandon Capital	By requisitioning a shareholder meeting, Sandon Capital sought the removal of two directors and the appointment of two of its nominees.	One of the directors resigned and one of the Sandon Capital nominees was appointed. The requisition was withdrawn.
Harvey Norman	Australian Shareholders' Association (ASA)	The ASA urged shareholders to vote against the remuneration report. If more than 25% of the shareholders had done so that would have triggered a vote to spill the board.	ASA was unsuccessful and the remuneration report was passed.
Intrepid Mines	Quantum Pacific	By requisitioning a series of shareholder meetings, Quantum sought to oust the existing Intrepid Mines board, and return the company's cash balance (including a A\$88.7 million settlement received) to shareholders.	Three Quantum nominees were appointed to the board and a share buy back was implemented.
Antares Energy	Lone Star Value Investors	Lone Star sought to change the composition of the Antares Board by removing 2 existing directors and appointing 5 of its own nominees.	Campaign unsuccessful. Shareholders voted to retain the existing board.

The activist approach

In general terms, shareholder activists are focussed on using the positions they acquire in target companies as a basis for effecting change within that company. Activist funds target companies of varying size and performance. However, most often the targets are companies with perceived board weaknesses and/or that appear to be underperforming.

Activist shareholders will have a well-formulated approach to the objectives that they wish to achieve. Often they will look to influence or effect a change to the composition of a company's board; to its governance; or, more generally, to its strategic direction.

An activating motivation may include:

- furthering an environmental or social issue;
- a desire to achieve improved corporate governance, whether through greater transparency and accountability or better board skills, greater board competence and/or more effective management. For example, concerns may relate to excessive or poorly targeted or structured executive remuneration or, more generally, consistently deficient corporate governance practices. It is not just activist funds - institutional shareholders are also taking more of an interest in these issues;
- an improved share price or a better return on investment for shareholders; and
- changing the asset mix or strategic direction of the company.



The Australian legal framework and issues to note

No "poison pills"

The Australian legal framework is considered to be fairly favourable to activists. For example, it is common to see companies in the US avail themselves of a "poison pill" defence to dilute and negate the influence an activist might have. (A "poison pill" sees a target company undertake a non-pro-rata rights issue to, in this context, dilute the activist shareholder). The ability to adopt the same or similar response in Australia is far more restricted. In Australia, shareholder approval is required for a non-pro-rata issue of more than 15% of the company's issued capital. (ASX listing rule 7.1)

Directors are always vulnerable

Directors are arguably more vulnerable in Australia than they are, say, in the US. In Australia, shareholders with a 5% stake or more have rights to propose resolutions to remove directors and nominate candidates for appointment as directors even if that director's position is not up for re-election and even without cause – so all board members are vulnerable to challenge at any given time.³ In the US, for example, directors may only be removed by shareholders when they are up for re-election. As in Australia, boards may be "staggered": which means that each year only a third of that board is vulnerable to a contested election at the annual general meeting (**AGM**). However, unlike Australia, directors may only be removed during their term for cause (such as gross negligence or misconduct, fraud, breach of duties). Without being able to rely on the spill provisions available in Australia, in the US it would therefore take an activist two AGMs (i.e. two years) to take control of a board (unless they can otherwise show cause).

Disclosure obligations

Some commentators also suggest that the disclosure obligations that Australian listed companies need to comply with also give activists an advantage. In the case of companies listed on the Australian Stock Exchange (**ASX**), boards must, subject to limited exceptions, disclose publicly through the ASX all market sensitive information. Disclosures need to be factual, relevant and expressed in a clear and objective manner. The obligation is immediate and continuing.

Good corporate governance underpins the philosophy behind continuous disclosure. It does, of course, provide activist funds with access to real time

information to assist them to consider potential targets of interest, even though they may not be an existing shareholder or have exposure to a particular target company.

By contrast, activists have no disclosure obligations unless they reach a shareholding threshold of 5% or more and then the requirement is simply disclosure of that fact. Not surprisingly (unless caught by the take-over or other disclosure requirements of the Corporations Act 2001 (Cth) (**Corporations Act**), activists:

- are generally under no obligation to make any disclosures regarding their intentions, irrespective of whether this may have a material impact on the price of shares in the target company; and
- are also free to proceed as they consider best serves their objectives and aims, without constraints as to timing, disclosure and strategy. If a board spill is one of their aims and they trigger that process (as noted below) then timing does become relevant too.

Of course, irrespective of the strategy adopted, activists will always need to be mindful that the statements they make and tactics adopted or steps taken are not, and are not at risk of being considered, misleading and deceptive, defamatory, damaging or otherwise in breach of applicable law.

The response of the board to an activist campaign

Boards also need to be careful in the way they approach and respond to an activist's campaign. Their actions must be scrupulously motivated by a proper corporate purpose, and be influenced by what is in the interests of the company and shareholders generally – not themselves personally or any shareholder block or group. Importantly, in Australia, the case law also currently makes it clear that expenditure of company funds on responding to an activist (including electioneering and proxy solicitation) must be reasonable and incurred for a proper purpose.

The company's responses and statements and disclosures to the market, shareholders and generally must be neutral in tone.⁴ Boards also need to be careful not to take any corporate actions that are directed at simply defeating the activist and which are not necessarily for a proper purpose and in the best interests of the company and/or arguably not necessary as part of the ordinary business of the company.

³ S 203D of the Corporations Act permits the company to pass a resolution to remove a director

⁴ *Advance Bank v FAI* [1974] 9 NSWLR 464

Management of the company is under the control of the board

Importantly, in Australia shareholders cannot direct boards on how to conduct the management of the company – that is a matter for the board only. This means that, while shareholders have rights to propose resolutions, the board is not compelled to put resolutions forward that concern management matters (even in an advisory capacity).⁵ To have a binding vote on a management matter, activists need to frame a resolution as an amendment to the company's constitution.⁶

Collective action by shareholders

Activists also need to be careful with the manner in which they cooperate with other shareholders. Certain kinds of collective action, such as formulating joint proposals or agreeing to vote in a certain way, may result in the relevant shareholders being deemed to be "associates" or to have acquired a "relevant interest".⁷ This means that their interests will be counted together for the purposes of the takeover and substantial holding provisions in Chapter 6 of the Corporations Act. Depending on the aggregated voting power of "associates" they may be required to lodge substantial holding notices relating to the group, may be prohibited from acquiring further interests in the company or may even breach the takeover provisions. ASIC has provided guidance on this issue by releasing Regulatory Guide 128 in June this year. It clarifies what ASIC will consider to be collective action giving rise to an "association".

⁵ *NRMA v Parker* (1986) 11 ACLR 1; compare this with US Securities Exchange Act Rule 14a-8 which permits shareholders who have owned either at least \$2,000 in market value or 1 percent of the voting stock of a company for at least one year to submit a proposal that a company must include in its proxy statement.

⁶ For example:

- GetUp! put forward a resolution to amend the constitution of Woolworths Ltd to implement a maximum A\$1 bet on all gaming machines controlled by Woolworths.
- Coastal Capital International put forward a resolution to amend the constitution of Billabong International Ltd to require shareholder approval for debt or equity financing arrangements.

⁷ Section 12(2) of the Corporations Act; ASIC Regulatory Guide 128

The activist's toolkit: Tactics available to activists

The activist's tool kit might include:

- **Member requisitioned meetings** - shareholder(s) holding a 5% stake or more may request directors to call a general meeting and the directors must do so.⁸
- **Member convened meetings** - shareholder(s) holding a 5% stake or more may call and arrange to hold a general meeting.⁹
- **Member proposed resolutions** - shareholder(s) holding a 5% stake or more may give a company notice of a resolution they propose to move.¹⁰
- **Distribution of member statements** - shareholder(s) holding a 5% stake or more may give the company a statement to be distributed to all members.¹¹
- **Two strikes rules** - Members have a right to vote to spill the board if 25% or more of the votes cast at an annual general meeting are against adopting the company's remuneration report for two successive years.¹²
- **Non-legal strategies** - leveraging public perception against incumbent boards to exert influence and effect strategic or operational change, for example by:
 - preparing a detailed 'whitepaper' criticising the company's announced strategic initiatives and presenting an alternate business plan for the target;
 - engaging with individual directors, in particular the Chairman;
 - engaging with institutional shareholders who may be likely to prefer the activist's proposed strategy to that implemented by the incumbent board; and
 - identifying key management who can be brought in to run the target.

⁸ Section 249D of the Corporations Act

⁹ Section 249F of the Corporations Act

¹⁰ Section 249N of the Corporations Act

¹¹ Section 249P of the Corporations Act

¹² Sections 250U and 250V of the Corporations Act

How should boards prepare for an activists approach?

Shareholder activism is becoming more and more common in Australia and it is not only the underperformers and the mismanaged that are being targeted. Boards should be proactive and put in place processes and systems to make them less vulnerable to activism or equally have processes and systems in place that allow them to engage effectively with activists.

Boards can prepare by:

- Focussing on shareholder engagement.
- Implementing sound corporate governance policies and ensuring compliance with these policies.
- Demonstrating the benefits of the company's long term investment strategy and clearly explaining the company's financial performance.
- Being open to shareholder input, engaging with major institutional investors and responding promptly to shareholder inquiries.
- Considering the addition of an 'independent' board member who demonstrates a willingness to review proposals objectively and from a shareholder's perspective.
- Working closely with key advisors on appropriate planning and processes.

This kind of preparation is likely to be beneficial to the company and the functioning of a board in any event.

The growing importance of proxy advisors

Beware the proxy advisor! Proxy advisory firms can be highly influential on the outcome of public campaigns. Proxy advisors advise shareholders on how to exercise their voting rights. Most large institutional investors, including pension funds, endowments, and mutual funds, usually follow proxy advisor recommendations when voting their shares. The most influential proxy advisors in the Australian market are arguably ISS and Glass Lewis. For boards and activists cultivating a good relationship with these firms is something that will need to be considered as part of a company's or activist's strategy around engaging with shareholders.

Conclusion

Shareholder activism is not to be ignored. If international experience is anything to go by, the trend of growing activism is likely to continue. It is important for companies and their shareholders that boards have a proper understanding of activism and that both boards and activist funds are well advised on activism in the context of the Australian legal framework.

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