european corporate governance institute

ecgi

Shareholder activism in Germany

Law Working Paper N° 470/2019
August 2019

Andreas Engert
Freie Universität Berlin and ECGI

© Andreas Engert 2019. All rights reserved. Short sections of text, not to exceed two paragraphs, may be quoted without explicit permission provided that full credit, including © notice, is given to the source.

This paper can be downloaded without charge from:
https://doi.org/10.67929/ecgi-law-470-2019

european corporate governance institute

ECGI Working Paper Series in Law

Shareholder activism in Germany

Working Paper N° 470/2019

August 2019

Andreas Engert

© Andreas Engert 2019. All rights reserved. Short sections of text, not to exceed two paragraphs, may be quoted without explicit permission provided that full credit, including © notice, is given to the source.

Abstract

Shareholder activism by hedge funds has taken hold in Germany in spite of large ownership concentration. This essay uses the example of Stada Arzneimittel AG to highlight features of activism, German style. It goes on to discuss the legal issues raised by activist campaigns at the two stages of acquiring a shareholding in the target company and, subsequently, of interacting with its management and pressuring for strategic or corporate governance changes. In light of the theory and evidence on the short-term and long-term effects of shareholder activism, the essay concludes that German and European law has rightly refrained from intervening in this most recent corporate governance development. The law lacks a reliable filter to sort desirable from undesirable forms of activism.

Keywords: shareholder activism, hedge fund activism, major shareholdings disclosure, insider trading, company secrets

JEL Classifications: G34, K22

Andreas Engert*
Professor
Freie Universität Berlin, Department of Law
Vant-Hoff-Straße 8
14195 Berlin, Germany
phone: +49 30 838 50018
e-mail: andreas.engert@fu-berlin.de

*Corresponding Author

Andreas Engert

Shareholder activism in Germany

Shareholder activism by hedge funds has taken hold in Germany in spite of large ownership concentration. This essay uses the example of Stada Arzneimittel AG to highlight features of activism, German style. It goes on to discuss the legal issues raised by activist campaigns at the two stages of acquiring a shareholding in the target company and, subsequently, of interacting with its management and pressuring for strategic or corporate governance changes. In light of the theory and evidence on the short-term and long-term effects of shareholder activism, the essay concludes that German and European law has rightly refrained from intervening in this most recent corporate governance development. The law lacks a reliable filter to sort desirable from undesirable forms of activism.

The essay is forthcoming in Holger Fleischer, Hideki Kanda, Kon Sik Kim, and Peter O. Mülbert (eds.), German and East Asian Perspectives on Corporate and Capital Market Law: Investors versus Companies.

Keywords: shareholder activism, hedge fund activism, major shareholdings disclosure, insider trading, company secrets

JEL Classifications: G34, K22

Andreas Engert

Shareholder activism in Germany

I. Introduction

Shareholder activism has become a lasting force in corporate governance around the globe.[1] Hailed by some as a cure for shareholder apathy,[2] others perceive it as a threat to the long-term thriving of corporations and their stakeholders.[3] In Germany, shareholder activism arrived most visibly with the campaign of several UK and US hedge funds led by The Children's Investment Fund (TCI) against the attempted takeover of London Stock Exchange by Deutsche Börse in 2005.[4] The clash between Deutsche Börse's management and the activists culminated in the crushing defeat and ouster of the company's CEO Werner Seifert. This very prominent occurrence has been preceded and—even more so—followed by many activist campaigns,[5] prompting many contributions in the legal literature, especially by legal advisers of potential target corporations.[6]

---

1 See M. BECHT/J. FRANKS/J. GRANT/H. WAGNER, Returns to Hedge Fund Activism: An International Study, Rev. Fin. Stud. 30 (2017), 2933, 2953 (documenting the rise in numbers of activist campaigns in a broad international sample 2000–2010).

2 Vocal proponents in the U.S. literature include: R. GILSON/J. GORDON, The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights, Colum. L. Rev. 113 (2013), 863, 896–902 (characterizing activists as filling the gap left by more diversified institutional investors); L. BEBCHUK/A. COHEN/S. HIRST, The Agency Problems of Institutional Investors, J. Econ. Persp. 31 (2017), 89, 104–107 (likewise).

3 See L. STRINE, Who Bleeds When the Wolves Bite?, Yale L.J. 126 (2017), 1870; J. COFFEE, The Agency Costs of Activism: Information Leakage, Thwarted Majorities, and the Public Morality, ECGI Law Working Paper 373, 2017.

4 BECHT/FRANKS/GRANT/WAGNER (n. 1), 2941–2944 (providing a sketch of the incident); one of the first contributions to the legal debate in Germany was motivated by the Deutsche Börse case, see A. ENGERT, Hedgefonds als aktivistische Aktionäre, ZIP 2006, 2105.

5 See the studies cited in n. 41 *infra*.

6 See, e.g., M. SCHOCKENHOFF, Vorstände im Visier aktivistischer Aktionäre. Auswechslung und Vergütungsreduzierung auf Verlangen von Aktionären und Investoren?, ZIP 2017, 1785; M. SCHOCKENHOFF/J. CULMANN, Shareholder Activism in Deutschland, ZIP 2015, 297 (citing three cases, including the 1990s "Girmes" case); B. GRAßL/T. NIKOLEYCZIK, Shareholder Activism und Investor Activism, AG 2017, 49; M. SCHIESSL, Empfehlungen an Publikumsgesellschaften für den Umgang mit Hedgefonds, ZIP 2009, 689, 690–691 (recounting prominent cases and citing Hermann Krages as an German shareholder activist of the 1950s).

Without giving away too much, shareholder activism is now a firmly established part of the corporate governance landscape of German stock corporations.[7] As understood in this essay, it reflects a coherent and specific investment strategy. Briefly put, activism consists of taking significant minority positions in publicly traded firms, effecting changes in corporate management, and selling at a profit. While this is a straightforward description, it fails to cover behaviors that occasionally are also referred to as "activism." Sometimes any sustained exercise of voice by shareholders in the corporation is referred to as "activist." The assertive and short-run campaigns considered in this essay could then be characterized—based on their typical promotors—as "hedge fund activism" to distinguish them from the continuous and more temperate engagement of mutual funds, pension funds, and other traditional institutional investors with corporate management.[8] Hedge funds are also targeting corporations with short selling positions to benefit from alleged—and often real—managerial misbehavior, especially relating to questionable accounting.[9] Likely because of their public attacks on firms, these hedge funds are also often labeled as "activist."[10] But short sellers only seek to persuade the market of the perceived wrongdoing and to gain from the resulting fall in the stock price. Their strategy does not involve active intervention in the management of the corporation.

The following section II casts more light at German-style shareholder activism using the recent example of the successful campaign against the incumbent management of Stada AG. It also reviews the empirical evidence on the scope and effects of activism, putting the focus on Germany. Sections III and IV then considers in more depth the issues raised by shareholder activism under German law, separately for the

---

7 See the illuminating comparison between activism in the U.S. and in Germany by K. LANGENBUCHER, Hedge Fund Activism in Germany and the US – on Convergence, Differences and Normative Reasoning, in H. Siekmann (ed.), Festschrift für Theodor Baums, 2017, 743.

8 See, e.g., M. DENES/J. KARPOFF/V. MCWILLIAMS, Thirty years of shareholder activism: A survey of empirical research, J. Corp. Fin. 44 (2017), 405, 407–408 (distinguishing hedge fund activism from other types).

9 For examples from Germany, see M. SCHOCKENHOFF/J. CULMANN, Rechtsschutz gegen Leerverkäufer, AG 2016, 517, 518–519; see also J. WENTZ, Shortseller-Attacken – ökonomische und juristische Bewertung eines ambivalenten Geschäftsmodelles, WM 2019, 196. For the U.S., see I. APPEL/J. BULKA/V. FOS, Active Short Selling by Hedge Funds**,** ECGI Finance Working Paper 609/2019.

10 See, e.g., WENTZ (n. 9), 196 ("Sortseller-Aktivisten").

two stages of building a shareholding in the target corporation and then of using the resulting power to influence management. Section V briefly concludes.

II. Shareholder activism in Germany: state of play

In this essay, activism is seen as an investment strategy aiming at returns from accomplishing major changes in the management of individual corporations. Dedicated activists specialize in this strategy. Rather than holding a broad portfolio of shares and earning the market return, plus perhaps a minor extra reward for stock picking, activists seek to identify target firms where they believe that implementing far-reaching changes—such as replacing existing leadership or a sale of the business—would substantially increase the market value of the corporate stock. Having found a suitable target, they make concentrated investments at the current price and use the acquired shareholding to pressure for the desired measures. If the campaign succeeds, they liquidate their stake and realize the resulting price increase. The returns of activists reflect mostly their ability to discover worthwhile targets and to pressure their management; the general market return from holding risky stock is only an accidental complement. In the jargon of financial investment, the expected returns consist of much "alpha" (asset manager ability) and only little "beta" (market risk premium). This return composition makes activism the natural domain of hedge funds.[11]

1. Activism as an investment strategy: The case of Stada Arzneimittel AG

The recent activist campaign targeted at the German drug maker Stada Arzneimittel AG ("Stada") serves to illustrate the three steps of buying low, intervening, and selling high. Founded in 1895 as an association of German pharmacists, Stada became a stock corporation in 1970 and went public in 1997/1998.[12] Since 1993, the dominant figure in the firm's management had been Hartmut Retzlaff as chairman of

---

11 See *infra*, n. 40.

12 Until 1997, share ownership had been restricted to pharmacists and physicians. See Stada Arzneimittel AG, Eine Zeitreise: Die Geschichte von STADA 1895–2015, available at https://www.stada.de/konzern/unternehmensgeschichte.html (last visited 1 November 2018); Hoppenstedt Aktienführer 1976–2015, database available at https://digi.bib.uni-mannheim.de/aktienf%c3%bchrer/data/index.php (last visited 1 November 2018).

the executive board (*Vorstand*). Mr. Retzlaff in 2014 boasted an annual compensation of seven million Euros, a rather large paycheck for a firm with both sales and a market capitalization of around two billion Euros.[13] There were also allegations of Mr. Retzlaff improperly promoting the career of his son within Stada.[14] Perhaps more importantly, the generic pharmaceutical industry had seen much consolidation in previous years. Stada was seen as a potential takeover candidate,[15] except for the fact that the transferability of its shares was restricted, meaning that acquiring them required approval by the executive board.[16]

On 1 April 2016, the investment fund Active Ownership Capital, based in Luxembourg and managed in Frankfurt by two finance professionals,[17] reported having acquired a 5.05% shareholding in Stada.[18] Only as late as 28 June 2016, already deep into the battle, the U.S.-based activist investor Guy Wyser-Pratt announced that he had also acquired slightly less than 3% of the voting rights.[19] Other than these two investors, no further changes in Stada's ownership structure became publicly observable.[20] Active Ownership Capital seems to have reached out

---

13 See Stada, Annual Report 2014, pp. 2, 96. In fairness, Mr. Retzlaff in the same year agreed to forego 17 million Euros of his previous 35 million Euros net worth of pension benefits, see Stada, Annual Report 2013, p. 97. Mr. Retzlaff's compensation for 2015, his last full year in office, halved to 3.6 million Euros, Stada, Annual Report 2015, p. 108.

14 P. HOLLSTEIN, System Retzlaff: Family Business, apotheke adhoc, available at https://www.apotheke-adhoc.de/nachrichten/detail/markt/stada-family-business-generika-apotheke-retzlaff/ (last visited 1 November 2018).

15 See E. HENNING, Activist Investor to Pressure Stada AG to Explore Potential Sale, Wall Street Journal, 3 May 2016, available at https://www.wsj.com (last visited 2 November 2018); E. HENNING, Stada Arzneimittel Holds Buyout Talks With CVC Capital, Wall Street Journal, 25 May 2016, available at https://www.wsj.com (last visited 2 November 2018) (pointing to estimates of a potential takeover valuation of 60 Euros per share).

16 § 8 of Stada's articles of incorporation as of 2015, accessible at https://www.unternehmensregister.de (last visited 1 November 2018); Stada, Annual Report 2015, p. 142. Since 1990, stock exchanges no longer require that listed firms commit to granting approval, see W. BAYER, in: Münchener Kommentar zum AktG, 4th ed. 2016, § 68 AktG marg. nos. 78–80.

17 See http://activeownershipcapital.com (last visited 19 March 2019). One of the founders, Klaus Röhrig, formerly worked for Elliott, the famous U.S.-based activist hedge fund manager.

18 Major shareholding disclosures by Stada, accessible at https://www.unternehmensregister.de (last visited 19 March 2019). In addition to the shares, Active Ownership Management also acquired call and put options, each for .96% of Stada's shares.

19 See S. IWERSEN/M. TEIGHEDER, Activist Investor Buys Stake in Stada, 28 June 2016, available at https://www.handelsblatt.com/ (last visited 19 March 2019).

20 A shareholding disclosure by BNY Mellon Service Kapitalanlage-Gesellschaft dated 25 February 2016, accessible at https://www.unternehmensregister.de (last visited 19 March 2019)

to other activists as potential allies but without tangible results.[21] Nonetheless, the fund proved capable of launching an ultimately successful campaign against the incumbent management. From the beginning, it appears that Active Ownership sought not so much to mend Stada's strategy or corporate governance but rather to accomplish a sale of the company.[22] Stada's management at one point agreed to nominate five directors suggested by the fund for election to the supervisory board but then reneged on its promise and postponed the general meeting.[23] Mr. Retzlaff appears to have held talks with CVC Capital Partners, a private equity fund manager, as a potential friendly acquirer.[24] When the attempt failed, Mr. Retzlaff cited health reasons for taking an indefinite leave of absence on 5 June 2016.[25]

The shareholders meeting was finally held on 26 August 2016 and turned into a showdown between management and the activist fund. Interestingly, the two leading proxy advisors were split in their support for either camp.[26] Active Ownership Capital received support from Deutsche Bank's DWS fund family and other shareholders.[27] After heated debates, not all of the activist's candidates for the supervisory board were elected but it succeeded in replacing Martin Abend, the long-time chairman, along with all but one shareholder representatives on the supervisory board. Importantly, the shareholders meeting also voted to remove the restriction on

---

likely served the stake building effort of Active Ownership Capital as indicated by the congruence of the derivative positions.

21 See HENNING (n. 15), 3 May 2016 (reporting that large hedge funds in London and New York had shown skepticism about the potential for a sale of the firm). But see Börsen-Zeitung, BaFin nimmt sich Stada-Investor vor, 29 July 2016 (referring to an investigation by the market supervisor BaFin into a possible failure to disclose shareholdings based on coordination with other investors).

22 See references in n. 15. But see IWERSEN/TEIGHEDER (n. 19) (citing Active Ownership Capital's criticism of the supervisory board's failure "to embrace reform"); HENNING (n. 15), 25 May 2016 (citing a claim by the fund's managers that they were interested in improving performance). See also S. WADEWITZ, Stada-Aktionäre machen ihrem Ärger Luft, Börsen-Zeitung, 27 August 2016, 7 (reporting divergent characterizations of the fund's goals).

23 HENNING (n. 15), 25 May 2016.

24 HENNING (n. 15), 25 May 2016.

25 IWERSEN/TEIGHEDER (n. 19).

26 S. WADEWITZ, Rückendeckung für Stada Aufsichtsrat, Börsen-Zeitung, 13 August 2016, 1; S. WADEWITZ, Stada schafft klare Verhältnisse, Börsen-Zeitung, 16 August 2016, 9.

27 On DWS' early support, see HENNING (n. 15), 25 May 2016.

share transferability from the articles.[28] Half a year after the shareholders meeting, the executive board of Stada disclosed that it considered overtures from three competing private equity firms.[29] After what it described as a "structured bidding process", the board on 10 April 2017 announced its support of a takeover bid by the private equity investors Bain Capital and Cinven, which had increased its offer from 58 to about 65 Euros at the last minute.[30]

But it went even better for the shareholders of Stada: In their first attempt, Bain and Cinven failed to reach their acceptance threshold of 67.5%.[31] A second, slightly improved bid with a lower acceptance threshold of 63% finally succeeded on 17 August 2017.[32] Yet in the meantime, another activist arrived on the scene: Paul Singer and its Elliott fund group notified a first stake of 8.7% in early July 2017 and till the end of August expanded it to 15.2%.[33] The new advance belongs to another activist strategy with a peculiar German flavor: interventions in ongoing acquisitions with the goal of squeezing a more attractive price from the acquirer. Elliott, in fact, has pioneered this approach that relies on at least three levers offered by the German institutional environment:[34] accumulating a share block in the takeover phase to

---

28 S. WADEWITZ, Stada droht juristisches Nachspiel, Börsen-Zeitung, 30 August 2016, 7.

29 Inside information disclosures by Stada of 12, 13, 16, and 23 February 2017, accessible at https://www.unternehmensregister.de (last visited 19 March 2019) (naming only Advent International and Cinven).

30 Inside information disclosure by Stada of 10 April 2017, accessible at https://www.unternehmensregister.de (last visited 19 March 2019). L. BURGER/A. HÜBNER, Bain, Cinven pay up to win backing for Stada deal, Reuters, 10 April 2017, available at https://uk.reuters.com/article/uk-stada-m-a-idUKKBN17C0CT (last visited 19 March 2019).

31 Inside information disclosure by Stada of 26 June 2017, accessible at https://www.unternehmensregister.de (last visited 19 March 2019) (noting that the threshold had already been lowered from 75%).

32 S. CLAUSEN, Bain und Cinven gelingt Kauf von Stada – Aktie steigt stark, Manager-Magazin, 18 August 2017, available at http://www.manager-magazin.de/unternehmen/artikel/stada-bain-capital-und-cinven-gelingt-kauf-a-1163470.html (last visited 19 March 2019). See also inside information disclosure by Stada of 10 July 2017, accessible at https://www.unternehmensregister.de (last visited 19 March 2019) (disclosing Stada's consent to exemption from one-year exclusion period for renewed public takeover bid).

33 Major shareholding disclosures by Stada of 12 July 2017 and 31 August 2017, accessible at https://www.unternehmensregister.de (last visited 19 March 2019).

34 See the opinion piece by two Elliott managers S. WAXLEY/F. TUIL, Rechte für alle – Kampf um Wella als Blick in die Zukunft, Börsen-Zeitung, 2 April 2005, B12 (characterizing Elliott's intervention in Procter & Gamble's acquisition of Wella AG as a model); B. GRAßL/T. NIKOLEYCZIK, Shareholder Activism und Investor Activism, AG 2017, 49, 51 (describing a more recent intervention by Elliott).

prevent the acceptance threshold to be met, preventing in the same manner the acquirer's ability to conclude a domination agreement after the takeover, or—failing this—challenging the compensation offered in the domination agreement. In acquisitions of German stock corporations, domination agreements—a special institution under the German *Konzernrecht* (group law)—are the necessary condition for an acquirer to avail itself of the target's assets to pay for the acquisition price.[35] Concluding a domination agreement requires a 75% qualified majority in the shareholders meeting, giving activists a realistic prospect of snatching up a veto position. As many transactions rely on the target's assets for funding, blocking the domination agreement gives activists a strong bargaining position at a point in time when the acquirer can no longer back out of the transaction. Even if the agreement goes through without additional concessions, the activist can still challenge the terms of the pay-out offer in appraisal proceedings. In the case of Stada, Elliott seems to have reached an understanding with Bain and Cinven: The profit transfer and domination agreement was approved by a 99% majority of the shareholders on 2 February 2018. It contained a pay-out offer at Euro 74.40, a sizable premium on the takeover price, which nonetheless virtually no outside shareholder accepted.[36] The last step consisted of another offer by Bain and Cinven in October 2018, as a precondition for delisting the stock, to purchase all outstanding shares at Euro 81.73, bringing their shareholding eventually to 93.6%.[37] This offer finally was to sweet to reject for Elliott.[38] Active Ownership Capital had sold out already in June 2017 at a stock price of around Euro 65. Compared to the stock price of Euros 30–35 upon acquiring its stake, it had doubled its investment within a year.

---

35 For an overview of the German law of corporate groups, see K. LANGENBUCHER, Do We Need a Law of Corporate Groups?, in: Fleischer/Kanda/Kim/Mülbert (eds.), German and Asian Perspectives on Company Law, (Mohr Siebeck 2016), 353, 359 ff.; A. SCHEUCH, Konzernrecht: An Overview of the German Regulation of Corporate Groups and Resulting Liability Issues, European Company Law 13 (2016) 191; T. TRÖGER, Corporate Groups, in Fleischer/Hansen/Ringe (eds.), German and Nordic Perspectives on Company Law and Capital Markets Law (Mohr Siebeck 2015), 157, 162 ff.

36 Major shareholding disclosure by Stada of 22 October 2018, accessible at https://www.unternehmensregister.de (last visited 19 March 2019) (showing Cinven and Bain shareholding of 65.3% and an additional derivative position of 7% in October 2018).

37 Stada, Annual Report 2018, 12.

38 Major shareholding disclosure by Stada of 4 December 2018, accessible at https://www.unternehmensregister.de (last visited 19 March 2019) (reporting complete disposal of Elliott's stake).

The following stock price chart presents the timeline of events.

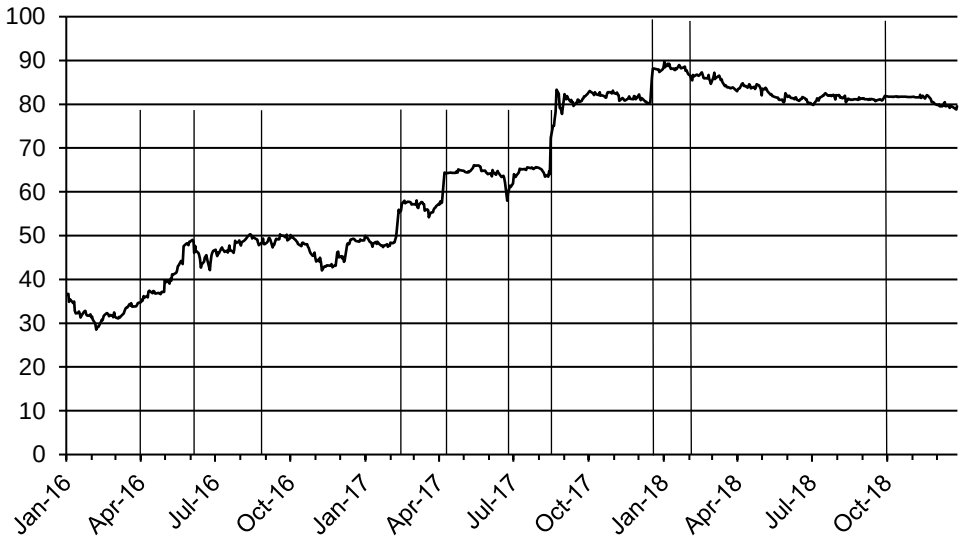


Figure 1: Stock price of Stada AG[39] and timeline of events. From left to right: disclosure of acquisition of 5% stake by Active Ownership Capital (1 April 2016); chairman of executive board Hartmut Retzlaff takes indefinite leave of absence (5 June 2016); chairman of supervisory board Martin Abend dismissed in shareholders meeting (26 August 2016); competing indications of interest from three competing bidders acknowledged (12–23 February); offer of Euro 65 from Bain and Cinven approved by executive board (10 April 2017); first takeover bid fails (16 June 2017); second bid succeeds (17 August 2017); conclusion of domination agreement (19 December 2017); approval of domination agreement by shareholders meeting (2 February 2018); announcement of acquisition offer in preparation of delisting (1 October 2018).

2. The larger picture

The Stada case encapsulates the main features of shareholder activism: Instead of broadly investing in a diversified portfolio and perhaps attempting to overweight undervalued securities, activists take concentrated positions in the stock of firms that they believe have a large potential for appreciation.[40] They then cajole and often

---

39 The data was downloaded from the Stada website.

40 Put differently, the business model of an activist investor is to reap returns from the asset manager's superior investment skills ("alpha", "arbitrage profits") rather than from taking market risk and earning a risk premium ("beta"). This explains why hedge funds are the epitomic activist investors, see BEBCHUK/COHEN/HIRST (n. 2), 104–106; J.P.Morgan, The activist revolution, 2015, 3–4. On the nature of hedge funds, see A. ENGERT, Transnational Hedge Fund Regulation, EBOR 11 (2010), 329, 333–335.

pressure management and their fellow shareholders to bring about the changes they deem necessary to realize the potential. When their views align with those of more traditional investors, they have a fair chance of enlisting their support and of giving their cause greater voting power than they themselves possess; the Stada management's partial defeat in the shareholders meeting of 26 August 2016 came at the hands of conventional institutions like Deutsche's asset manager DWS. If the measures are adopted, the stock price is likely to rise either because the activists' views mirror market beliefs or because the change consists of a control transaction that boosts the stock price, such as a takeover as in the case of Stada. The last step in the activist playbook is to sell at the new, elevated price. The event-driven activism practiced by Elliott can be seen as a variation of the more general theme of buying low, effecting change, and selling high.

The standard game plan of activism and its increasing use in the U.S. and around the world—including Germany—have been amply documented.[41] Empirical studies tend to confirm that activists take only minority positions[42] and hold them for one to two years on average.[43] With their campaigns, activists seek and often achieve changes in board composition, the divestiture of business units, or a takeover of the company.[44] They target predominantly smaller firms with apparently undervalued but relatively liquid stock, facilitating the build-up and eventual sale of stakes by activists.[45] Target

---

41 See C. THAMM/D. SCHIERECK, Shareholder Activism in Deutschland, Corp. Fin. 2014, 17, 18–19 (providing an overview of existing studies on activism in Germany); 21–27 (reporting incidence, characteristics, and outcomes for 253 activist events in Germany 1999–2011); BECHT/FRANKS/GRANT/WAGNER (n. 1), 2938–2943 (documenting the incidence, characteristics, and international distribution of activism 2000–2010); A. BRAV/W. JIANG/H. KIM, Recent Advances in Research on Hedge Fund Activism, Ann. Rev. Fin. Econ. 7 (2015), 579, 580–583 (summarizing the incidence and characteristics of activism in the U.S., 1994–2011). See also the broader survey on the full range of shareholder activities in corporate governance by DENES/KARPOFF/MCWILLIAMS (n. 8).

42 See, e.g., BECHT/FRANKS/GRANT/WAGNER (n. 1), 2939.

43 See BRAV/JIANG/KIM (n. 41), 583.

44 See THAMM/SCHIERECK (n. 41), 17, 27 (Germany); STADLER/ZU KNYPHAUSEN-AUFSEß, Shareholder activism by hedge funds in a concentrated ownership environment: an empirical study for Germany, Int. J. Fin. Services Mgmt. 8 (2015), 58, 67–68 (Germany); BECHT/FRANKS/GRANT/WAGNER (n. 1), 2952–2953 (international sample); BRAV/JIANG/KIM (n. 41), 582 (USA).

45 See BECHT/FRANKS/GRANT/WAGNER (n. 1), 2939; BRAV/JIANG/KIM (n. 41), 583–584; but see W. BESSLER/W. DROBETZ/J. HOLLER, The Returns of Hedge Fund Activism in Germany, Eur. Fin. Mgmt. 21 (2015), 106, 120–122 (finding that German targets exhibit significantly lower returns to assets but seem not to differ in their market-to-book ratio).

firms also tend to have a higher level of institutional ownership before the campaign;[46] the latter observation could reflect the support that institutional investors lend to activists.[47] Lastly, one would believe activists to shun companies with controlling shareholders as it is difficult or impossible to win a vote against such insiders.[48] In fact, Stada was widely owned when it became the target of Active Ownership Capital.[49] The ownership structure of German listed corporations is generally less conducive to shareholder activism; Figure 2 shows that 40% of public companies have a majority shareholder and more than 55% have at least a 30% blockholder. Nonetheless, a considerable number of activist interventions have been recorded in Germany. A recent study for the relatively early period of 2000–2006 counts no less 217 engagements but with a focus on companies with a comparatively less concentrated ownership.[50]

---

46 See BECHT/FRANKS/GRANT/WAGNER (n. 1), 2939; BRAV/JIANG/KIM (n. 41), 583–584.

47 Specifically on the reinforcing role of passive index funds, see I. APPEL/T. GORMLEY/D. KEIM, Standing on the Shoulders of Giants: The Effect of Passive Investors on Activists, Rev. Fin. Stud. 32 (2019), 2721; for the importance of proxy advisers in Germany and other European countries, see J.-M. Hitz/N. Lehmann, Empirical Evidence on the Role of Proxy Advisors in European Capital Markets, Eur. Acct. Rev. 27 (2018), 713, 720 (documenting that 46.8% of German listed firms were covered by the largest proxy advisor ISS in 2008–2010).

48 But see K. KASTIEL, Against All Odds: Hedge Fund Activism in Controlled Companies, Columbia Bus. L. Rev. 60 (2016), 60 (analyzing activist engagements in corporations with controlling shareholders).

49 As of 1 April 2016, the only major holdings in the Bafin database were DWS (5.04%), BNY Mellon Service Kapitalanlage-Gesellschaft (3.21%), and LSV Asset Management (3.07%).

50 BESSLER/DROBETZ/HOLLER (n. 45), 115, 124 (reporting a lower median maximum shareholding than the greater than 30% value depicted in Figure 2). But see M. MIETZNER/D. SCHWEIZER, Hedge funds versus private equity funds as shareholder activists in Germany—differences in value creation, J. Econ. & Fin. 38 (2014), 181, 186 (finding only 67 instances for 2001–2007 with a much more restrictive data gathering procedure); similarly T. H. DRERUP, Long-Term Effects of Hedge Fund Activism in Germany, 2014, available at SSRN: https://ssrn.com/abstract=1718365 (last visited 12 July 2019), 9–11 (142 activist blockholdings and 136 passive investments by hedge funds 1999–2010).

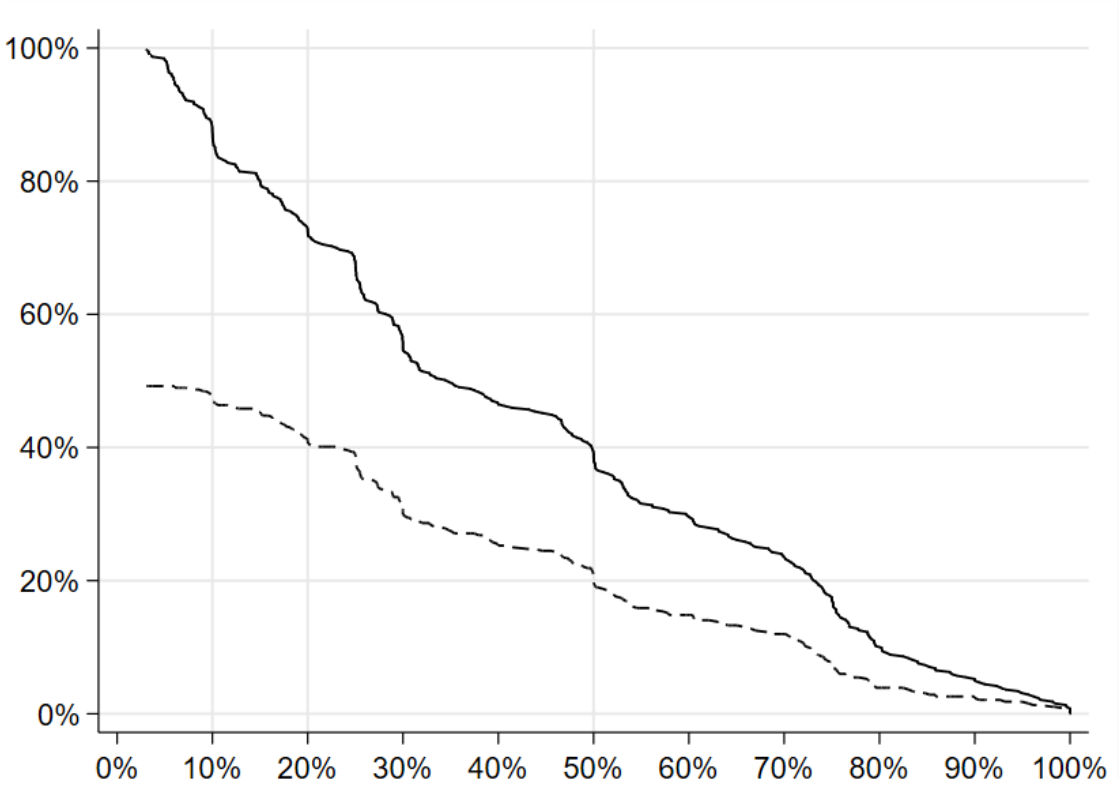


Figure 2: Reverse cumulative distribution of the largest shareholding in a sample of 384 listed German stock corporations as of December 2017.[51] *The straight line shows the percentage of companies (vertical axis) with a largest shareholder directly or indirectly holding at least as many voting rights as shown on the horizontal axis. The dashed line represents the corresponding percentage of natural persons as largest shareholders.*

The most interesting question from a policy perspective concerns the evaluation of shareholder activism. A simple and rather compelling argument suggests that activists perform a valuable service to other shareholders: To produce a positive risk-adjusted return from their investments, activists must be able, on average, to "buy low and sell high." For this, the market valuation of the firm needs to increase from the activists' taking a position to exiting it. Unless activists systematically lose money or the market systematically mistakes actual value losses for gains, it follows that activist interventions on average benefit stock value and shareholders. The empirical evidence tends to support this view. As Figure 3 documents for Germany, the stock market reacts favorably when it learns that a company has become the

---

51 The figure is adopted from A. ENGERT/T. FLORSTEDT, Which Related Party Transactions Should Be Subject to Ex Ante Review?, ECGI Law Working Paper 440, 2019.

target of one or more activists.[52] Stock appreciation widens when activists obtain concessions or otherwise accomplish their goals.[53] Also, activists appear to be far more effective than conventional institutional shareholders at implementing value-enhancing changes.[54] The evidence is more mixed when it comes to the effects of activism on real operating performance, on long-run stock returns as well as on other stakeholders.[55] It could well be the case that much or even all of the gains to shareholders result from a costly redistribution of firm value at the expense of creditors and employees. This possibility entails a task description for the law in regulating shareholder activism. The legal framework should seek to encourage activism when it is valuable and minimize the destructive occurrences. Unfortunately, the law seems not well equipped to accomplish this. Most of the rules in place, at least in Germany, seem to either facilitate or restrain activism but without much regard to the consequences in the particular case.

---

52 See the overview by BRAV/JIANG/KIM (n. 41), 584–586. For Germany, see MIETZNER/SCHWEIZER (n. 50), 192–195; BESSLER/DROBETZ/HOLLER (n. 45), 124–130. For an in international sample, see BECHT/FRANKS/GRANT/WAGNER (n. 1), 2948–2950.

53 BECHT/FRANKS/GRANT/WAGNER (n. 1).

54 See the overview of empirical results on valuation effects of different types of shareholder activities in DENES/KARPOFF/MCWILLIAMS (n. 8), 417.

55 See A. BRAV/W. JIANG/H. KIM, The Real Effects of Hedge Fund Activism: Productivity, Asset Allocation, and Labor Outcomes, Rev. Fin. Stud. 28 (2015), 2723 (arguing that activism enhances labor and capital productivity); L. BEBCHUK/A. BRAV/W. JIANG, The Long-Term Effects of Hedge Fund Activism, Col. L. Rev. 115 (2015), 1085, 1123–1130 (finding no significant reversal of initial price increases over subsequent three years); E. DEHAAN/D. LARCKER/C. MCCLURE, Long-Term Economic Consequences of Hedge Fund Activist Interventions, ECGI Finance Working Paper 577, 2018 (finding no significant long-term price effects of activism and no improvements in operating performance). As to the effects on other stakeholders, see BRAV/JIANG/KIM (n. 41), 589–590.

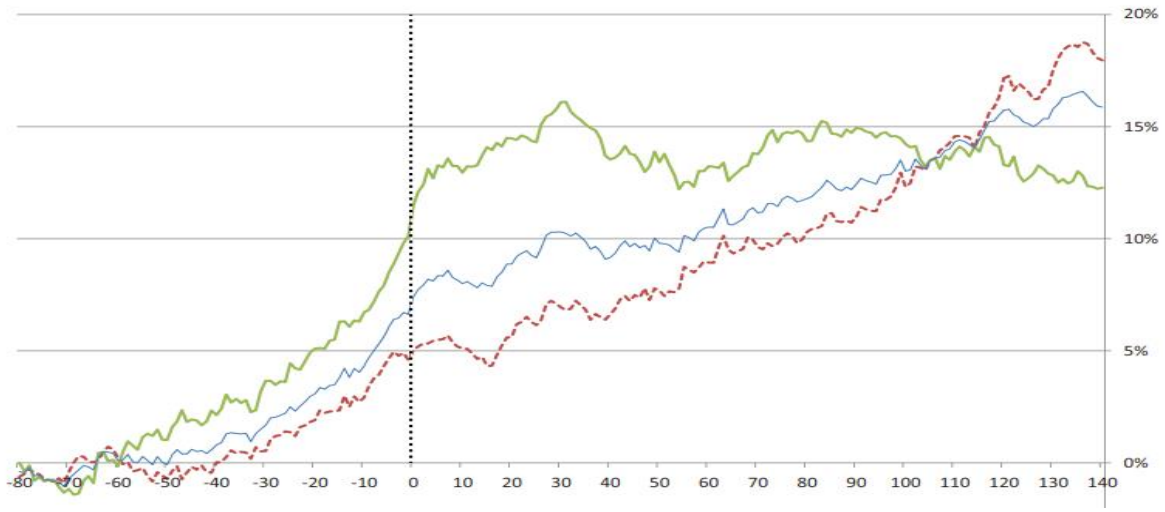


Figure 3: Cumulative abnormal returns of German stock starting 80 days before until 140 days after the release of information about an activist engagement with the respective company. The blue line represents the full sample of 231 activist events studied by Bessler/Drobetz/Holler.[56] *The green and red lines show the returns of subsamples of more (green) or less (red) activists.*

III. Activist stake building under German law

Activists use shares in the target corporation in two respects: They leverage the rights of shareholders to pressure management and they seek to benefit from a resulting increase in the share price. Acquiring a substantial shareholding in the corporation's stock before and during a campaign therefore is an essential piece of their game plan. In the course of building a stake, a critical legal issue for activists is the requirement to disclose their identities and shareholdings upon crossing specific thresholds (subsection 1). In addition, one may wonder whether activists could run afoul of insider trading rules (subsection 2).[57]

---

56 BESSLER/DROBETZ/HOLLER (n. 45), 127.

57 Recently, the power to prohibit acquisitions of German firms by foreign investors under §§ 55–62 Foreign Trade and Payments Ordinance (*Außenwirtschaftsverordnung*, *AWV*) has received heightened attention, especially in relation to investors from China. Because the regime applies almost exclusively to non-EU investors and is triggered at a rather high 25% shareholding (see § 56 of the Ordinance), it has little effect on activists.

1. Major holdings and related disclosures

The contribution by BACHMANN in this volume covers the disclosure requirements for major holdings of listed corporations under German law and also discusses their rationale.[58] To avoid duplication, the following focuses on aspects of particular relevance for activists. Especially in the early stages of their campaign, having to disclose their identity and the size of their shareholding clearly is not in their interest. Since activists build a reputation on their repeated success, their arrival signals to other investors that a change in the corporate strategy or governance is becoming more likely and that it could ultimately boost firm value. Anticipating this outcome, the stock price increases and impedes the further expansion of the activist stake needed to influence management and to profit from it.[59] Activists, therefore, will be very mindful especially of the lowest voting rights threshold—which the German legislature in 2007 lowered from 5% to 3%, arguably in response to the successful activist campaign against the management of Deutsche Börse in 2005.[60] Further thresholds are at 5%, 10%, 15%, 20%, 25%, 30%, 50%, and 75%.[61] Crossing any of these limits, either by increasing or reducing one's shareholding, triggers a duty to report one's identity and the resulting voting rights share (but without a duty to update the share subsequently, absent a new threshold contact). The report has to be publicized without undue delay, at most within seven trading days of crossing the threshold,[62] affording activists additional time to accumulate more shares at the lower pre-announcement price.

Importantly, attribution rules seek to capture indirect economic ownership of voting rights, such as through subsidiaries or fiduciaries. A particularly complex and

---

58 See §§ 33–47 STA (Securities Trading Act, *Wertpapierhandelsgesetz*, *WpHG*). Note that the STA has been renumbered as of 2018; before then, the provisions were contained in §§ 21–30 STA. An English translation of the STA, unfortunately only as of June 2011, is available at https://www.bafin.de/SharedDocs/Veroeffentlichungen/EN/Aufsichtsrecht/Gesetz/WpHG_en.html (last visited 27 October 2018).

59 The standard economics reference for this problem in the takeover context is S. J. GROSSMAN/O. HART, Takeover bids, the free-rider problem and the theory of the corporation, Bell J. Econ. 11 (1980), 42, 42–47.

60 The draft mentions "experiences in the very recent past", Bundesrat, printed paper 579/06, p. 74.

61 § 33(1) STA (formerly § 22(1) STA).

62 See §§ 33(1), 40(1) STA. Trading days exclude weekends and certain public holidays, see § 47(1) STA.

consequential rule for activists is that voting rights are imputed to each of two or several (direct or indirect) shareholders who "coordinate [… their …] conduct in respect of the issuer".[63] If multiple activists simultaneously approach a target, they will be wary not to be "acting in concert" under this provision to avoid having to aggregate their holdings and hitting the disclosure threshold much earlier.[64] It is the German version of the art of walking the fine line between a "wolf pack" (no aggregation) and a "group" (triggering aggregation).[65] What constitutes acting in concert has raised a number of thorny issues, especially regarding the nature and intensity of the influence on which members of the group have to coordinate.[66]

Also in response to the Deutsche Börse incident, the German legislature introduced the duty of a shareholder crossing the 10% threshold (or a higher threshold) to provide information on his intentions and the financing of the acquisition within 20 trading days.[67] The investor is required to disclose, among other things, whether he intends to acquire additional voting rights, to influence the election of corporate directors, or to change the corporation's capital structure. As regards the financing of

---

63 § 33(2) STA (formerly §22(2) STA).

64 In addition, mutual attribution based on "acting in concert" is virtually the only way in which activists ever risk triggering the duty to extend a takeover offer for all target shares under §§ 35(1), 29(2), 30 Takeover Act (*Wertpapiererwerbs- und Übernahmegesetz*, *WpÜG*). An English translation of the Takeover Act, unfortunately only as of December 2011, is available at https://www.bafin.de/SharedDocs/Veroeffentlichungen/EN/Aufsichtsrecht/Gesetz/WpUEG_en.html (last visited 27 October 2018).

65 For the U.S., see J. C. COFFEE/D. PALIA, The Wolf at the Door: The Impact of Hedge Fund Activism on Corporate Governance, Annals of Corporate Governance 1 (2016), 1, 24–36 (defining "wolf packs" and explaining the workings of the tactic under U.S. law). For important differences in insider trading regulation between the U.S. and Germany, see LANGENBUCHER (n. 7), 749–750. See also BECHT/FRANKS/GRANT/WAGNER (n. 1), 2940–2943 (tallying the frequency of observable engagements by more than one hedge fund at 21.7%); BESSLER/DROBETZ/HOLLER (n. 45), 116–117 (around 23% of visible wolf packs in a German sample).

66 For excellent overviews of the legal analysis in Germany in English, see D. A. VERSE, Acting in Concert in German Company and Takeover Law, in: H. Fleischer/J. L. Hansen/W.-G. Ringe (eds.), German and Nordic Perspectives on Company Law and Capital Markets Law (Tübingen 2015), 215; A. TALESKA, Shareholder Proponents as Control Acquirers: A British, German and Italian Perspective on the Regulation of Collective Shareholder Activism via Takeover Rules, EBOR 19 (2018), 797, 819–822; see also the recent judgment BGH, 25 September 2018, II ZR 190/17, NJW 2019, 219 (excluding voting agreements in "single instances" even if the vote has far-reaching strategic implications and rejecting the opposite view of BaFin, the market supervisor).

67 § 43(1) STA (formerly § 27a STA).

the transaction, the shareholder only needs to state the debt ratio.[68] In contrast to holdings disclosure, failure to provide the additional information about intentions and funding carries no specific sanction.[69]

A last element of the disclosure regime for major shareholders concerns derivative positions. After a meandering development, the current rules comprehensively cover the use of derivatives to create economic ownership—a "long" position—in vote-bearing stock of a listed corporation. The most significant recent change was the inclusion of cash-settled derivatives.[70] The compelling reason behind counting even purely financial long positions is that they hedge their holder against a rise in the stock price; because she can always acquire shares in the open market, this is the equivalent of a call option with physical delivery. Disclosure duties for derivatives attach separately to the voting rights embodied in derivatives and to the sum of voting rights from shares and derivatives; only the lowest 3% threshold is excluded.[71] For the purpose of calculating long positions, short positions are not subtracted.[72] Still, the market as well as the corporation's management can be interested in whether an activist holds a countervailing short position in the stock of the target corporation.[73] Yet a disclosure duty arises only for *net* short positions, that is, only in the extreme case that the activist would stand to benefit overall from a decline in the stock price.[74]

---

68 See the legislative reasoning, Bundestag, printed paper 16/7438, p. 12.

69 Other than the issuer having to publicize non-compliance, § 43(2) STA. For a potential liability for market manipulation, see U. H. SCHNEIDER, in: Assmann/Schneider/Mülbert, Wertpapierhandelsrecht, 7th ed. 2019, § 43 WpHG, marg. no. 30. For the rather severe implications of not disclosing major holdings see BACHMANN in this volume.

70 See § 38(1)(b) STA (formerly § 25 STA) and again BACHMANN in this volume.

71 See §§ 38(1), 39(1) STA.

72 See § 38(4) sentence 2 STA.

73 In the mid-2000s, there was a concern about potential conflicts of interest caused by "empty voting," that is a voting rights share with an incongruous economic interest in the firm, see A. BRAV/M. D. RICHMOND, Empty voting and the efficiency of corporate governance, Journal of Financial Economics 99 (2011), 289, 289–90 (summarizing the policy debate); from a German perspective ENGERT (n. 4), 2107–2108; C. OSTERLOH-KONRAD, Gefährdet "Empty Voting" die Willensbildung in der Aktiengesellschaft?, ZGR 2012, 35.

74 See art. 6(1), (2) Short Selling Regulation (EU) No 236/2012 (imposing a disclosure duty for net short positions in excess of .5% of an issuer's share capital). See also art. 3(1) and recital 5 Delegated Regulation (EU) No 918/2012 (defining ownership in terms of the "ultimate beneficial owner" to prevent avoidance of the disclosure duty).

2. Activists' intentions as inside information

In addition to disclosure duties regarding shareholdings and intentions, insider trading regulation could pose another problem. National laws on insider trading have been harmonized in the EU since the 1990s. They are now governed by the EU's Market Abuse Regulation[75] (MAR) that in 2016 supplanted member state rules. Unsurprisingly, activists must not "use" inside information in their decision to acquire stock in the corporation.[76] This effectively precludes them from building or extending a stake if they have, for instance, obtained relevant non-public information from directors of the corporation.[77] The more interesting question is whether the activists' own intentions constitute inside information and are "used" when activists trade to carry out their plans. The BGH at some point ruled out this possibility by excluding a person's own mental states from the notion of "information."[78] This view is less than compelling.[79] It would imply that, for instance, the individual manager of an activist hedge fund could exploit, for her own private account, her intention to acquire a substantial shareholding in a new target on behalf of the fund. Contrary to the court's contention, the literal meaning of "information" quite naturally encompasses a mental state such as a self-devised strategy or plan.[80] An activist's decision to build a major stake in a corporation also often satisfies the further elements of inside information: it will usually be non-public, sufficiently precise, and

---

75 Market Abuse Regulation (EU) No 596/2014.

76 Art. 14(a), 8(1) MAR.

77 Recitals 24, 25 MAR create a presumption that possession of inside information implies its use in the transaction. The recitals follow ECJ, 23 December 2009, C-45/08, *Spector Photo Group*, ECLI:EU:C:2009:806, marg. nos. 38, 45–62.

78 BGH, 6 November 2003, 1 StR 24/03, *Sascha Opel*, BGHSt 48, 373, 378–79 (arguing that the literal meaning of "information" presupposes an external reference because one can hardly become "informed" of one's own thoughts).

79 H.-D. ASSMANN, in: Assmann/Schneider/Mülbert (eds.), Wertpapierhandelsrecht, 7th ed. 2019, art. 7 MAR marg. no. 17; L. KLÖHN, "Selbst geschaffene innere Tatsachen", Scalping und Stakebuilding im neuen Marktmissbrauchsrecht, supplement to ZIP issue 22, 2016, 44 (each also citing the substantial following of the judgment).

80 Recital 31 sentence 2 and art. 9(5) MAR may be read as treating an intention as information (but dismissing that its execution constitutes "use" of that information). The ECJ has so far only stated that a common decision of several individuals—which goes beyond a mental state—constitutes "information," see ECJ, 10 May 2007, C-391/04, *Georgakis*, ECLI:EU:C:2007:272, marg. nos. 32–34. See also KLÖHN, *supra* note 79, 46 (dismissing recital 54 sentence 3 MAR).

capable of significantly affecting the stock price if publicized.[81] Nonetheless, art. 9(5) MAR makes it plain that carrying out one's intention to trade does not come under the insider trading prohibition. The proper reason is that the decision to trade, though "information," is not being "used" in the transaction in the sense implied by the insider trading prohibition. In *Spector Photo Group*, the ECJ has established the principle that inside information is only "used" if the informed trader takes "unfair advantage" from the information.[82] Art. 9(5) MAR essentially implies that executing one's own trading decision should not be viewed as obtaining an "unfair advantage" lest any major transaction require previous public announcement.

While art. 9(5) MAR contents itself with addressing a rather simple case, a more difficult issue is whether activists' further intention of mending the management or strategy of the target corporation is information that confers an "unfair advantage."[83] In this regard, activists have privileged information not just about their own trading but about their potential effect on the corporation and its business. Exploiting this foreknowledge is critical to the activists' investment strategy of buying low, effecting change, and selling high. Whether this informational advantage is fair decides the fate of shareholder activism. The problem has received scant attention, perhaps because many find the solution obvious. There is a close analogy to the more well-known problem of stake building in the preparation of a takeover. Such acquisitions before a public bid are common practice and widely accepted, and yet they would violate insider trading laws if the undisclosed intention to seize control were judged to confer an unfair advantage.[84] A justification is that the takeover as a business opportunity is a creation of the bidder's own effort and ingenuity. It is not unfair for the bidder to claim the value of this productive discovery for himself,

---

81 Art. 7(1)(a) MAR contains the definition of inside information. On the requirement that information be precise, see *infra*, IV.2.a).

82 ECJ, 23 December 2009, C-45/08, *Spector Photo Group*, ECLI:EU:C:2009:806, marg. nos. 52–53, 61–62. The principle has been endorsed in recitals 23, 24 sentence 3 MAR.

83 Cf. H. SCHÄFER, Shareholder Activism und Corporate Governance, NZG 2007, 900, 901 (discussions with target management as inside information).

84 Art. 9(4) MAR could be (mis)read to this effect: If the plan to pursue a takeover were regarded as "inside information [obtained] in the conduct of a public takeover" the provision legitimizes its use in the public takeover but not in a prior stake building, see the second subparagraph and art. 3(31) MAR.

except to the extent shareholding disclosure rules force him to reveal information.[85] This same line of reasoning extends to shareholder activists and their strategy of increasing the market value of a corporation by pressuring its leadership.[86] The argument also suggests that an activist can selectively share his investment idea to attract likeminded other investors—form a "wolf pack"—without committing illegal "tipping."[87]

IV. Interaction between activists and managers under German law

Having acquired a sizable stake, activists will invariably approach the firm's management to advance their agenda. The arrival of assertive new investors is unlikely to please the directors on the two boards of a German stock corporation, the *Aufsichtsrat* (supervisory board) and the *Vorstand* (executive board). But directors have good reason to enter into a conversation with the firm's new vocal minority. Their inclination to listen to activists reflects the powers of shareholders in a German stock corporation, which subsection 1 briefly summarizes. The following two subsections consider in more depth two important aspects of management's dealings with activists: firstly, the disclosure of information as part of the dialogue with activists (subsection 2), and secondly the ability of supervisory and executive directors to concede to their demands (subsection 3).

1. Shareholders' powers in the German stock corporation

As a general rule, the powers of the shareholders over the corporate affairs are to be exercised in the *Hauptversammlung* (shareholders meeting).[88] These powers are

---

85 ENGERT (n. 4), 2109. See also H.-D. ASSMANN, in: Assmann/Schneider/Mülbert (eds.), Wertpapierhandelsrecht, 7th ed. 2019, art. 8 MAR marg. no. 47, 59 (contending that the implementation of business decisions as such does not constitute use of inside information).

86 ENGERT (n. 4), 2109–10 (but arguing for an exception if activists predominantly take a short position with a view to harming the corporation).

87 Such selective disclosure is made "in the normal exercise of an employment, profession or duties" under art. 10(1) MAR. But see LANGENBUCHER (n. 7), 749–50 (maintaining that informing others of the crossing of a relevant threshold under holdings disclosure rules before publication could constitute illegal tipping).

88 See, explicitly, § 118(1) SCA (Stock Corporation Act, *Aktiengesetz*, *AktG*). The Federal Ministry of Justice provides an English translation of the statute as of 2017 at http://www.gesetze-im-internet.de/englisch_aktg/index.html (last visited 10 July 2019).

narrowly confined. Shareholders are precluded from directly determining the firm's business strategy, which falls primarily under the domain of the executive board.[89] Shareholders can neither instruct nor elect the executive directors. Their only lever on corporate management is the right to elect and—with a 75% majority—to terminate directors on the supervisory board.[90] The supervisory board in turn elects the executive directors for a maximum period of five years; dismissing executive directors before the end of their term requires an additional shareholder vote of no confidence.[91] Overall, management enjoys a surprising degree of insulation from shareholder pressure compared to other jurisdictions, especially at the earlier stages of a supervisory board's tenure. Nonetheless, the position of management is far from comfortable. It remains a vital concern for managers to ensure majority support in the shareholders meeting, not least because clinging to one's office against a shareholder majority likely diminishes the career prospect in other public firms. An indication of this is the great importance managers attribute to winning the mandatory discharge vote in the annual shareholders meeting, in spite of it having no legal consequences.[92]

On their own, activists hardly ever command a majority of the votes in the shareholders meeting. Their power derives from offering their fellow shareholders an alternative to the strategy of management and perhaps also to the incumbent managers themselves. To garner support from institutional investors and proxy advisors,[93] activists need to create the perception that they are advocating the interests and views of shareholders. Other investors find themselves in the convenient position of an audience to which two rival camps appeal for approval. The contest forces managers to attend better to shareholder concerns. Because of this

---

89 On the division of labor between the executive and the supervisory board, see *infra*, IV.3.a).

90 Supervisory board directors are often elected for the statutory maximum term of five years, see § 102(1) SCA. The articles of incorporation can—but rarely do—relax the 75% majority requirement, see § 103(1) SCA.

91 See § 84(1), (3) SCA.

92 See § 120(1), (2) SCA.

93 For the relevance of institutional investors for activism, see *supra*, n. 45, 46, and accompanying text.

welcome disciplinary effect, other investors will be cautious not to discourage activists and will penalize management for not engaging with their demands.

In addition to enlisting the support of other shareholders, activists occasionally can invoke certain rights granted to a minority or to individual shareholders. Most of them relate to the shareholders meeting, such as the rights to request a shareholders meeting or to add items to the agenda (5% minority), to have countermotions disseminated to other shareholders (individual shareholders), to a vote on shareholder nominees prior to candidates proposed by the supervisory board (10% minority), and to demand a separate vote on the discharge of individual directors (10% minority).[94] Executive directors have to respond to questions of individual shareholders during the shareholders meeting.[95] After the shareholders meeting, individual shareholders can challenge any resolution for violation of procedural or substantive law, including of other shareholders' fiduciary duties and the articles of incorporation.[96] To scrutinize the conduct of directors and pursue claims against them, a 1%-minority can petition the court to appoint a special investigator if facts suggest dishonest behavior or gross violations of the law or the articles; the investigator provides a written report of which any shareholder can receive a copy.[97] Furthermore, a 1%-minority can petition the court to grant them standing to bring claims on behalf of the corporation against directors if, again, there is reason to believe in dishonest behavior or gross violations and if certain other conditions are met.[98]

---

94 § 122 SCA (shareholders meeting or item requests), §§ 126, 127 SCA (dissemination of counterproposals), § 120(1) SCA (discharge vote), § 137 SCA (prior vote on shareholder nominees).

95 § 131 SCA. On § 131(4) SCA, see *infra*, text following n. 123.

96 *Anfechtungsklage* (annulment action), §§ 243, 245, 246 SCA. For certain structural changes such as mergers or domination agreements, shareholders can initiate appraisal proceedings to claim compensation, see, e.g., § 305(5) SCA. For the use of this right by activists, see *supra*, text following n. 33.

97 §§ 142(2), 145(6) SCA.

98 See § 148(1) SCA. Important further restrictions are a demand requirement and that the minority must have learned of the conduct after acquiring its shareholding. The minority right under § 147(2) SCA to institute a special corporate representatives for an action against directors has not gained importance because it presupposes a prior resolution by a simple majority in the shareholders meeting to bring claims under § 147(1) SCA.

2. Sharing information

Even if shareholders may be somewhat less powerful in German stock corporations than elsewhere, there is still ample reason for managers to take an activist advance seriously. A first condition for meaningful interaction is the ability to exchange information. For instance, objections against proposals by activists often rely on inside knowledge of the particular circumstances, such as accounting intricacies or unrevealed business opportunities.[99] Management may also want to disclose its own strategies and intentions to avert an unnecessary and costly conflict with activists. Yet sharing information is subject to restrictions under securities regulation and general corporate law.

a) Insider trading regulation

Insider trading rules impose a first constraint. Among other types of behavior, the MAR proscribes not only using inside information in transactions but also the "unlawful disclosure" of it.[100] "Inside information" is defined as non-public, precise information relating to the corporation, its shares, other issuers, or financial instruments when it is likely to have a significant effect on prices if publicized.[101] The significant price effect hinges on whether a reasonable investor would take the information into account in her investment decisions[102]—whether she has an incentive to use the information.[103] Activists will often be interested in corporate strategy, a possible restructuring, or major transactions. Even discussing such fundamental changes leads management to share its own views and intentions. The

---

99 See, e.g., SCHIESSL (n. 6), 693 (arguing that a discussion of specific proposals often involves a presentation of accounting and tax implications).

100 Art. 14(c), 10(1) MAR. Recital 19 MAR expresses that "[t]his Regulation is not intended to prohibit discussions of a general nature regarding the business and market developments between shareholders and management concerning an issuer."

101 Art. 7(1)(a) MAR.

102 Art. 7(4) MAR.

103 If the effect is uncertain, a reasonable investor would rely on the *expected* price change, i.e., the sum of possible changes weighted by their probabilities. If the information affects the probability of an event (or fact) only little, the event's (or fact's) impact on value must be correspondingly larger (probability-magnitude formula). Cf. ECJ, 28 June 2012, C-19/11, *Geltl v Daimler*, ECLI:EU:C:2012:397, marg. no. 55; BGH, 23 April 2013, II ZB 7/09, NJW 2013, 2114, marg. no. 25; L. KLÖHN, Das deutsche und europäische Insiderrecht nach dem Geltl-Urteil des EuGH, ZIP 2012, 1885, 1891.

fact that management is actively contemplating a spin-off may well move stock prices.

In spite of the potential price effect, such information could still fail to be "precise." This additional element poses considerable difficulty in determining when exactly a process of corporate decision-making creates an inside information. The MAR clarifies that intermediate steps can themselves constitute "inside information."[104] In the *Geltl* case concerning the resignation of a CEO, the ECJ held that information about uncertain facts or events—such as the potential demise of the CEO—is "precise" only if the fact or event is not "implausible" but has a "realistic prospect" of existing or occurring. The Court explicitly ruled out that the probability should be linked to the magnitude of the possible effect on prices in the sense that a more consequential fact or event implied a lower probability threshold.[105] In the Court's view, the additional requirement of "precise" information serves to enhance legal certainty,[106] especially with regard to an issuer's duty to publicize promptly inside information that "directly concerns" them.[107] This rationale suggests that even a significant price effect should be disregarded if it is caused by the anticipation of a future event—the demise of the CEO—for which there is not (yet) a "realistic prospect." In fact, there could well be more agreement about when an important event has a "realistic prospect" of occurring than about when probabilities have changed sufficiently to induce a reasonable investor to trade on the information. The flip side, of course, is that insiders are allowed to exploit an informational advantage for personal gain so long as the "realistic prospect" threshold is not met.[108] Such

---

104 Art. 7(3) MAR.

105 ECJ, 28 June 2012, C-19/11, *Geltl v Daimler*, ECLI:EU:C:2012:397, marg. no. 48–55. Recital 16 MAR incorporates the "realistic prospect" language (in German: "realistische Wahrscheinlichkeit", instead of "tatsächlich erwartet" in the ECJ's judgment) as well as the ECJ's dismissal of the magnitude of the possible price impact.

106 ECJ, 28 June 2012, C-19/11, *Geltl v Daimler*, ECLI:EU:C:2012:397, marg. no. 48. Practitioners likewise articulate a need for certainty, see D. KOCHER/S. WIDDER, Die Bedeutung von Zwischenschritten bei der Definition von Insiderinformationen, BB 2012, 2837, 2839.

107 Art. 17(1) MAR. Issuers can defer disclosure if they have a legitimate interest in doing so and further conditions are met, art. 17(4) MAR. In this case, they are required to record when they became aware of the inside information and decided to delay disclosure, along with other information, art. 4(1) Implementing Regulation (EU) 2016/1055. After publication, the information has to be passed to the market supervisor, art. 17(4) subpara. 3 MAR.

108 This point is rightly and forcefully made by L. KLÖHN, in: Klöhn, Marktmissbrauchsverordnung, 2018, art. 7 marg. no. 109.

profit opportunities exist whenever non-public information is capable of having a significant effect on prices.

To avoid this consequence, it has been argued that knowledge of the intermediate step—the CEO discussing her resignation with a confidant—constitutes information in its own right and as such is clearly "precise."[109] To qualify as inside information, it only remains to show that it affects the stock price when published. This view renders the ECJ's jurisprudence in *Geltl* obsolete because early indications of important events are typically themselves "precise" information (such as the fact that a discussion of the matter took place).[110] If the ECJ intends to promote predictability for issuers, it will need to abstract from price effects of intermediate events due to potential later events that do not yet meet the realistic prospect test.[111]

Taking the ECJ's ruling in Geltl seriously, management only conveys inside information if its statements create a "realistic prospect" of a later transaction or other price-relevant event of which the investing public is unaware. German commentators tend to equate the "realistic prospect" with a more-likely-than-not standard.[112] Instead of a purely probabilistic threshold,[113] it seems more attuned to the decision-making context to demand that a potential transaction or measure has been sufficiently elaborated to receive extensive consideration from decision-makers

---

109 See L. KLÖHN, in: Klöhn, Marktmissbrauchsverordnung, 2018, art. 7 marg. nos. 100–103.

110 See L. KLÖHN, in: Klöhn, Marktmissbrauchsverordnung, 2018, art. 7 marg. nos. 110–111 (admitting that the realistic prospect test retains little importance other than precluding a duty to disclose the potential future event rather than just the past indicator event); H. KRAUSE/M. BRELLOCHS, Insider trading and the disclosure of inside information after Geltl v Daimler—A comparative analysis of the ECJ decision in the Geltl v Daimler case with a view to the future European Market Abuse Regulation, Cap. Markets L. J. 8 (2013) 283, 290.

111 See G. BACHMANN, Ad-hoc-Publizität nach "Geltl", DB 2012, 2206, 2209–10; D. KOCHER/S. WIDDER, Die Bedeutung von Zwischenschritten bei der Definition von Insiderinformationen, BB 2012, 2837, 2840–41. This operation has been called a "blocking effect" of the realistic-prospect test in relation the preceding event's price effect, L. KLÖHN, in: Klöhn, Marktmissbrauchsverordnung, 2018, art. 7 marg. nos. 104–110.

112 H. KRAUSE/M. BRELLOCHS, Insider trading and the disclosure of inside information after Geltl v Daimler—A comparative analysis of the ECJ decision in the Geltl v Daimler case with a view to the future European Market Abuse Regulation, Cap. Markets L. J. 8 (2013) 283, 288–289; A. SCHALL, ZIP 2012, 1286, 1288; D. POELZIG, Insider-und Marktmanipulationsverbot im neuen Marktmissbrauchsrecht, NZG 2016, 528, 532.

113 The German and Spanish versions of recital 16 sentence 2 MAR refer to a "reasonable" or "realistic" probability, while the English, French, and Dutch versions speak of a realistic "prospect," "perspective," or "assumption," respectively.

and, in this sense, has become a serious option. Even thorough discussions with activists—who remain outside management—hardly suffice to produce such an inside information.

When, perhaps as a result of activists' pressure, a major transaction or strategy change has become a realistic possibility, this triggers the general duty to publicize such inside information.[114] Management can delay disclosure in order to safeguard a legitimate interest of the issuer, provided the public is not misled and confidentiality is kept. Ensuring an orderly decision-making process and avoiding a commitment effect from premature disclosure can justify a delay.[115] It is conceivable that management, while delaying publication, might want to assuage activists by privately revealing and discussing its emerging plans. Yet non-public disclosure of inside information is prohibited except if made "in the normal exercise of an employment, a profession or duties."[116] The ECJ has emphasized that conveying the information must be "strictly necessary" for the exercise of management's responsibilities.[117] This is an exacting standard. Nonetheless, one can imagine a situation where activists threaten to wage an all-out battle to press for changes that management is already about to devise and implement, thereby detracting much time and attention from the actual task. Under circumstances like these, it could be "strictly necessary" for the interest of the company to appease activists by confidentially disclosing management's intentions. As the strictly-necessary test demands that the information leakage be kept to a minimum,[118] management must make it explicit that inside information is being shared, thereby subjecting the activists to the insider trading restrictions with regard to the information.[119]

---

114 See n. 107 above.

115 See art. 17(4) subpara. 2 MAR (multi-stage decision process as potential reason for legitimate delay); recital 50(b) MAR and ESMA, MAR Guidelines, Delay in the disclosure of inside information, ESMA/2016/1478, para. 8(a), (c) (ongoing negotiations and pending approval by another corporate body as examples of legitimate interests).

116 Art. 10(1) MAR.

117 ECJ, 22 November 2005, C-384/02, *Grøngaard and Bang*, ECLI:EU:C:2005:708, marg. nos. 34–38, 48.

118 This is also a precondition for continued delay of public disclosure, see art. 17(4)(c) MAR.

119 While not directly applicable, the market sounding provisions in art. 11(5) MAR give a good indication of what is required. In the absence of a proper confidentiality obligation by the recipient, the issuer is required to immediately publicize the information, art. 17(8) MAR.

b) Corporate law duties of confidentiality and equal treatment

Besides securities regulation, information disclosure also raises issues under corporate law. Fiduciary duties prevent the directors of a German stock corporation to share company secrets and other confidential information with outsiders.[120] As a matter of course, an exception applies where disclosing the information is needed to comply with a legal mandate or otherwise serves the corporation's best interest. A case in point is allowing a due diligence review by a potential acquirer or major investor, provided that the corporation has an interest in being acquired or attracting a new shareholder.[121] It is the responsibility of the executive board to define the corporation's best interest and, therefore, to decide whether the information should be revealed, and to whom.[122] Letting management be ensnared in a battle with activist shareholders only because the latter lack certain key information hardly benefits the corporation. As a consequence, fiduciary duties—like insider trading laws—permit the executive board to disclose relevant information to allow activists to evaluate the corporate position and strategy under exceptional circumstances and provided that a proper confidentiality agreement is in place.

Giving activists privileged access to company secrets also raises an issue of equal treatment because other, less powerful shareholders are foreclosed from receiving the same information. In addition to a general equal treatment requirement on behalf of shareholders,[123] German law contains a special—and somewhat curious—regime for equal access to information: The Stock Corporation Act compels management to disclose, upon request, in the shareholders meeting any information that has previously been given to a shareholder in this capacity. The statute expressly precludes the objection that divulging the information would harm the company.[124]

---

120 § 93(1) sentence 3, § 116 SCA.

121 See J. KOCH, in: Hüffer/Koch, Aktiengesetz, 13th ed. 2018, § 93 marg. no. 32. But see M. LUTTER, Due diligence des Erwerbers beim Kauf einer Beteiligung, ZIP 1997 613, 617 (requiring an overwhelming interest in taking advantage of a unique business opportunity).

122 See BGH, 16 April 2016, XI ZR 108/15, NJW 2016 2569 marg. no. 35 (referring to the executive board as the "master of company secrets"); BGH, 5 June 1975, II ZR 156/73, *Bayer AG*, BGHZ 64, 325, 329 (considering the executive board's authority but confining it to actual confidentiality needs).

123 § 53a SCA. See also § 48(1) no. 1 STA (formerly § 30a(1) no. 1 STA).

124 § 131(4) sentences 1, 2 SCA.

The relevance of the provision is limited because the request has to identify the information that was given to the other shareholder; management cannot be asked to substantiate whether such revelation took place.[125] Leaving aside the practical difficulty of asserting the right, it seems inconsistent to allow selective disclosure to individual shareholders under a confidentiality agreement and then, as a consequence of this release, to require full disclosure to all shareholders. To avoid this unfortunate result, a better reading of the statutory duty is that it attaches only if making the information available outside the shareholders meeting was unjustifiable under the equal treatment principle.[126] The duty is better seen as a remedy for a violation of equal treatment. Sharing information with activists in the best interest of the corporation should not imply spilling the beans.

3. Activists' influence on management

Beside information leakage to activists, a second major concern is to which degree management can open itself to pressure from activists without surrendering its responsibility under the corporate constitution and compromising its fiduciary obligation towards the corporation and all of its shareholders.

a) Role of the supervisory board

With regard to shareholder involvement, a vivid recent debate concerns the role of the supervisory board and specifically whether it can—and perhaps should—engage in a conversation with investors.[127] The German two-tier system necessitates a

---

125 D. KUBIS, in: Goette/Habersack/Kalss, Münchener Kommentar zum AktG, 4th ed. 2018, § 131 marg. no. 158. But see BayObLG, 17 July 2002, 3Z BR 394/01, NZG 2002 1020 1021 (enforcing a request to state "which information and details" about the company's valuation were provided to a particular major shareholder).

126 D. VERSE, Der Gleichbehandlungsgrundsatz im Recht der Kapitalgesellschaften, 2006, 510–512; H. FLEISCHER, Investor Relations und informationelle Gleichbehandlung im Aktien-, Konzern- und Kapitalmarktrecht, ZGR 2009, 905, 520. Contra G. BACHMANN, Kapitalmarktpublizität und informationelle Gleichbehandlung, in: Grundmann et al. (eds.), Festschrift für Eberhard Schwark (Munich 2009), 331, 332.

127 See K. HOPT, The Dialogue between the Chairman of the Board and Investors: The Practice in the UK, the Netherlands and Germany and the Future of the German Corporate Governance Code Under the New Chairman, ECGI Law Working Paper No. 365/2017, available at SSRN: https://ssrn.com/abstract=3030693 (providing an overview of the German debate in English).

separation of powers between the supervisory and the executive board.[128] At first blush, the executive board figures as the supreme corporate organ: The Stock Corporation Act's very first provision on the corporate constitution vests it with the power to "govern" or "direct" the corporation under its own responsibility, distinguishing this strategic leadership from the more routine "management" of the corporation that is also entrusted to the executive board.[129] The supervisory board, on the other hand, is excluded from corporate management.[130] Its main powers consist in appointing or—on rare occasions—dismissing managing directors, setting their compensation, and supervising their conduct.[131] Yet as a matter of course, there is no bright line between management and monitoring the managers. The responsibility for retaining the most able managers and overseeing the exercise of their duties inevitably requires a judgment on managerial decision-making. German law further blurs the distinction by charging the supervisory board with not only a hindsight evaluation of management performance but also a forward-looking monitoring and advisory role.[132] Emphasizing the active involvement of the supervisory board has been a long-run trend in German corporate law in the decades past.[133] In

---

128 On the German two-tier system, see generally K. HOPT, The German Law of and Experience with the Supervisory Board, in Veil/Gao, Foreign Investments on Chinese Capital Markets, 2017, 121. See also section 3 German Corporate Governance Code (2017), available at https://www.dcgk.de/en/home.html (last visited 2 March 2019).

129 Compare § 76(1) SCA ("governance" or "Leitung" of the corporation) to § 77(1) SCA ("management" or "Geschäftsführung"). The English translation furnished by the Federal Ministry of Justice (n. 88) misses this difference.

130 § 111(4) sentence 1 SCA.

131 § 84(1), (3) SCA (appointment of managing directors and dismissal for cause); §§ 87, 112 SCA (compensation and service contract); § 111(1) (supervision of executive board). The drafters of § 84(3) SCA consciously introduced the for-cause requirement to prevent the supervisory board from wresting control from the executive board, see H. FLEISCHER, Zur Abberufung von Vorstandsmitgliedern auf Druck Dritter, DStR 2006, 1507, 1508.

132 § 90(2) no. 4 SCA (duty of executive board to inform the supervisory board of significant transactions ahead of time to give the latter an opportunity to comment on the transaction); § 111(4) sentences 2–5 SCA (mandatory list of transactions that require supervisory board approval).

133 See, e.g., BGH, 25 March 1991, II ZR 188/89, *Deutscher Herold*, BGHZ 114, 127, 129–130 (recognizing for the first time an advisory duty of the supervisory board); BGH, 6 November 2012, II ZR 111/12, *Piëch/Porsche*, ZIP 2012, 2438, 2439 (duty of supervisory directors to assess independently the risks involved in major transactions); section 5.1.1 German Corporate Governance Code (n. 128) ("regularly advise and supervise the Management Board"). The requirement to subject certain transaction to supervisory board approval (n. 132) has been introduced only in 2002. See generally J. LIEDER, The German Supervisory Board on Its Way to Professionalism, Germ. L.J. 11 (2010), 115.

consequence of this development, many now consider both boards to be entrusted with determining the strategy and "governing" the stock corporation.[134]

The supervisory board's rise to leadership forms the background for the narrower debate whether it has the right to interact directly with activist investors. The more conservative commentators insist on the prerogative of the executive board in shaping the corporate strategy. Although the supervisory board may have become more active and more involved in strategy development over time, it need not follow that it has authority to speak with outsiders about these matters.[135] Others claim that the power of a corporate organ to decide—or to participate in decision-making—entails a right to explain and discuss one's position with the relevant stakeholders and the public.[136] When the supervisory board is involved in shaping and implementing the corporate strategy, the argument goes, it should be able to explain it to major investors and to learn their views.[137] Yet even those advocating direct exchanges between the supervisory board and the shareholders respect the executive board's prerogative over strategy, notably the exclusive right to initiate strategy changes. As it is in the interest of the corporation to speak "with one voice", the supervisory board must exercise caution to not undercut the executive board's communication with investors and the market.[138]

---

134 See J. KOCH, Der Vorstand im Kompetenzgefüge der Aktiengesellschaft, in Fleischer/Koch/Kropff/Lutter, 50 Jahre Aktiengesetz, ZGR-Sonderheft 19, 2016, 65, 77–81 (summarizing the positions).

135 See the nuanced argument made by J. KOCH, Investorengespräche des Aufsichtsrats, AG 2017, 129, 131–133 (external communication only where executive board lacks ability to provide the information demanded by investors, especially the appointment and compensation of managing directors). See also M. HABERSACK, in: Goette/Habersack/Kalss, Münchener Kommentar zum AktG, 5th ed. 2019, § 111 AktG marg. no. 67 (likewise); B. GRUNEWALD, Der Einfluss des Aufsichtsrats auf die Geschäftsführung – was ist erwünscht, was ist erlaubt?, ZIP 2016, 2009, 2010–11 (reserving all matters of strategic leadership to the executive board).

136 H.-C. HIRT/K. HOPT/D. MATTHEUS, Dialog zwischen dem Aufsichtsrat und Investoren, AG 2016, 725, 733–734; H. FLEISCHER/L. BAUER/T. WANSLEBEN, Investorenkontakte des Aufsichtsrats: Zulässigkeit und Grenzen, DB 2015, 360, 363–365. See also BGH, 5 June 1975, II ZR 156/73, *Bayer AG*, BGHZ 64, 325, 331 (recognizing a corporate interest, in the context of employee representative on the supervisory board, in allowing directors to dispell misunderstandings or rumors and to improve public perceptions of the corporation).

137 HIRT/HOPT/MATTHEUS, supra n. 136, 734; FLEISCHER/BAUER/WANSLEBEN, supra n. 136, 364 (but emphasizing the monitoring, as opposed to strategy-shaping, role of the supervisory board).

138 HIRT/HOPT/MATTHEUS, supra n. 136, 735; FLEISCHER/BAUER/WANSLEBEN, supra n. 136, 365–366.

For practical matters, it appears that the more expansive reading of supervisory board authority is being adopted in corporate Germany. Since 2017, the German Corporate Governance Code contains a "suggestion" that the chairperson of the supervisory board "should be available – within reasonable limits – to discuss Supervisory Board-related issues with investors."[139] A working group composed of academics, corporate directors, investors, and advisers has drawn up "Guiding principles for the dialogue between investors and German supervisory boards" to advise on the appropriate scope of such conversations.[140] By promoting a "stewardship" responsibility of institutional investors, the 2017 recast of the EU's shareholder rights directive and its ongoing implementation further strengthens the legal basis for direct shareholder engagement with the supervisory board.[141]

Institutional investors seem to demand more access to the supervisory board.[142] Direct interactions make the supervisory board more accountable to the other party: The ability to ask questions, advance preliminary views, and learn from responses ultimately allows one to make fine-tuned requests that are harder to reject because valid objections should have come up during the conversation. Such pointed demands come from significant shareholders with much sway in corporate elections. If only the executive board were to talk with them, investors would wield less power over the supervisory board and, as a consequence, over the managing directors themselves. Viewed from this angle, denying investors access to the supervisory board is a legal strategy to strengthen management independence towards shareholders. The German debate seems not to have addressed this underlying policy issue—likely because accountability to the stock market continues to be seen as highly desirable.

---

139 Section 5.2 para. 2 The German Corporate Governance Code, supra n. 128.

140 Not accidentally, the authors of HIRT/HOPT/MATTHEUS, supra n. 136, also participated in the working group.

141 The current draft of the implementation bill requires institutional investors and asset managers to describe their engagement policy with portfolio companies, including on exchanges with "corporate organs" (plural!), see § 134b(1) no. 3 SCA as introduced by the draft, Bundestag, printed paper 19/9739.

142 Without exception, all contributions to the debate admit that the driving force have been (foreign) investors. On the resulting convergence towards the more common one-tier model see only G. BACHMANN, Dialog zwischen Investor und Aufsichtsrat, in Gesellschaftsrecht in der Diskussion 2016, 2017, 135, 154–155 (also for another balanced assessment of the debate).

b) Management autonomy

When activists have built a stake and secured sufficient support from other investors to pose a plausible threat, both sides will want to avoid a costly and risky battle for control. Time has come to negotiate and perhaps to agree on changes in corporate policies and the management team. Research from the U.S. records a considerable number of "settlements" between activists and management.[143] Side-deals to appease vociferous investors can be suspicious for various reasons. An obvious concern is "greenmailing"—management paying off activists from the corporate coffers, typically by acquiring their shares at a premium. The latter technique is almost certainly illegal for a German corporation,[144] as would be any disbursement of wealth to individual shareholders outside an officially declared dividend, which would have to be paid equally to all shareholders.[145] Subtler forms of value transfers can be harder to spot and to deter.

Apart from greenmailing of all stripes, it could seem questionable to allow a subset of shareholders to obtain a sustained and possibly concealed grip on the corporation. This relates to another contemporary debate in German corporate law about the abdication of managerial authority. As mentioned before, the power to "govern" the corporation "on its own responsibility" is vested in the executive board.[146] Neither the supervisory board nor the shareholders meeting must interfere with the executive board's prerogative.[147] The doctrine of "prohibition of precommitment" (*Verbot der Vorwegbindung*) also precludes the executive board from surrendering its

---

143 L. BEBCHUK/A. BRAV/W. JIANG/T. KEUSCH, Dancing with Activists, Working Paper, 2017, available at SSRN: https://ssrn.com/abstract=2948869, Table 1 and Table 5 (documenting agreements in 17–20% of activist engagements in 2008–2011, typically over changes in the composition of the board). For Germany, see M. SCHOCKENHOFF/J. CULMANN, Shareholder Activism in Deutschland, ZIP 2015, 297, 300–305 (discussing possible agreements with activists under German law).

144 See the restrictions on the acquisition of own stock in § 71 SCA. Buying off activists can hardly be justified by averting "serious and imminent harm" from the corporation, as § 71(1) no. 1 SCA would require. Even based on authorization by the shareholders meeting, management would have to offer a premium equally to all shareholders, see § 71(1) no. 8 sentences 3 and 4 SCA.

145 See the principle of preservation of corporate resources (*Prinzip der Vermögensbindung*) enshrined in § 57(1), (3) SCA.

146 See again § 76(1) SCA

147 For the shareholders meeting, see § 119(2) SCA (no resolution on management matters other than at the initiative of the executive board).

constitutional power by voluntary agreement.[148] The traditional prohibition has been tested in certain control transactions, including the acquisition of minority positions. In such instances, investors often request, and corporations accede to, "business combination agreements" or similar agreements in order to ensure the execution of complex transactions. In the course of such arrangements, management may commit to abstaining from soliciting competing offers or issuing new shares, to compensating the investor's expenses if the deal fails, to pursuing a certain business strategy, or to proposing investor nominees for election to the supervisory board.[149] Because the ability to commit to a course of action can benefit the corporation or its shareholders, such as by attracting higher bids in control transactions, many commentators are prepared to soften the ban on obligations regarding the executive board's power to "govern"—as opposed to "manage"—the corporation.[150] One prominent view proposes to retain the prohibition but to narrow its scope. A commitment over a moderate timespan is said to be the exercise, rather than abdication, of discretion.[151] An alternative position considers only encroachments on shareholders' rights, specifically the ultimate control over who governs the corporation.[152] A more radical proposal is to abolish the prohibition altogether and to invoke only directors' fiduciary duties against excessive commitments.[153]

---

148 A seminal reference is M. LUTTER, Zur Vorbereitung und Durchführung von Grundlagenbeschlüssen in Aktiengesellschaften, in Festschrift Hans-Joachim Fleck, 1988, 169, 184–185 (arguing against a binding abdication of the executive board's responsibility but excluding commitments to third parties). Related doctrines in common law jurisdictions are referred to as the "no-fettering rule" (UK) and the prohibition of "abdication of authority" (US), see H. FLEISCHER, Zur Unveräußerlichkeit der Leitungsmacht im deutschen, englischen und US-amerikanischen Aktienrecht, in Festschrift für Eberhard Schwark (2009), 137, 139, 144.

149 See D. WEBER-REY/M. REPS, Ankerbeteiligungen: Chancen für die Corporate Governance, Rechtsrahmen und Investorenvereinbarungen, ZGR 2013, 597, 619–626 (summarizing possible undertakings in investment agreements); J. REICHERT, Business Combination Agreements, ZGR 2015, 1, 6–9 (likewise for business combination agreements).

150 Compare again § 76(1) SCA and § 77(1) SCA and see n. 129 above. Under the conventional analysis, the prohibition attaches only to the strategic "governance" of the corporation.

151 FLEISCHER (n. 148), 151; REICHERT (n. 149), 23.

152 T. KUNTZ, Grundlagen und Grenzen der aktienrechtlichen Leitungsautonomie, AG 2016, 101, 107–109, 112–113 (including also the power to delegate decisions to management such as in the case of authorized capital).

153 KOCH (n. 134), 95–100 (but listing specific statutory restrictions of management powers that, if exceeded by a commitment, result not only in a breach of fiduciary duty but also render the agreement invalid).

Management need not enter into legally binding agreements with activist shareholders.[154] A truce can—and likely often will—take the form of an informal understanding. Therefore, the relevant question is whether the "prohibition of precommitment" or equivalent restrictions from fiduciary duties extend to promises made to placate shareholders who threaten to wage war against management. It is often argued that directors must resist any act that they themselves consider contrary to the best interest of the company.[155] Announcing this principle is one matter, effectuating it a different one. Directors will strongly perceive it in their own private interest to avoid a battle with activists that could result in a resounding defeat and their individual displacement from a lucrative position of power. In choosing between their own judgment and the demands of activists they face a pronounced conflict of interest. At the same time, addressing the conflict poses insurmountable difficulty. The only viable option would consist of withdrawing the protection of the business judgment rule and to expose directors to liability under a substantive fairness review. Such a strategy would be forbiddingly unattractive: In determining fairness, courts would have to pit their own judgment against that of activists.[156] If activists are a force for the better at least on average, one is hard pressed to believe that courts are well positioned to compare the business strategies of incumbent management with that of the activists. Also, fairness review would create significant uncertainty for managers. The threat of personal liability would become a credible argument for managers to reject changes to their own original plans, shielding them against activist influence generally—which is unlikely to strike the best balance.

---

154 But see SCHOCKENHOFF/CULMANN (n. 143) (suggesting that binding agreements occur).

155 See, e.g., for the supervisory board's decision to dismiss a managing director after a no-confidence vote of the shareholders meeting, FLEISCHER (n. 131), 1513; for its right to nominate supervisory directors WEBER-REY/REPS (n. 149), 625.

156 The Delaware courts have famously developed an "intermediate" standard of review in hostile takeovers where management is likewise conflicted because it is at risk of losing its position, see Unocal v. Mesa Petroleum, 493 A.2d 946, 954–956 (Del. 1985); Revlon v. MacAndrews & Forbes Holdings, 506 A.2d 173, 180 (Del. 1986). In the present context, directors could be too inclined to accommodate activists, rather than opposing them.

V. Conclusion

Shareholder activists have become major players in the contemporary landscape of corporate governance. Germany is no exception. Its financial and legal environment has proved amenable to activism and allowed a considerable number of campaigns to succeed. This accords well with the available economic theory and evidence that suggests greater accountability to shareholders can yield benefits—but this same evidence cannot rule out potential adverse effects on the long-run performance of certain firms as well as on stakeholders other than equity investors. The law would have little difficulty to suppress or restrict shareholder activism across the board if this were considered desirable. It is a far more challenging task to tell value-enhancing, beneficial instances of activism from destructive ones that sacrifice long-term corporate success and stakeholder welfare. Law and regulation seem poorly equipped to draw such a distinction with any degree of confidence. The most promising strategy seems to be to leave the decision to shareholders. As is often the case in corporate governance, the appropriate role of the law may be a limited one.

european corporate governance institute

about ECGI

The European Corporate Governance Institute has been established to improve *corporate governance through fostering independent scientific research and related activities.*

The ECGI will produce and disseminate high quality research while remaining close to the concerns and interests of corporate, financial and public policy makers. It will draw on the expertise of scholars from numerous countries and bring together a critical mass of expertise and interest to bear on this important subject.

The views expressed in this working paper are those of the authors, not those of the ECGI or its members.

www.ecgi.global

european corporate governance institute

ECGI Working Paper Series in Law

Editorial Board

Editor	Amir Licht, Professor of Law, Radzyner Law School, Interdisciplinary Center Herzliya
Consulting Editors	John Coates, John F. Cogan, Jr. Professor of Law and Economics, Harvard Law School
	Horst Eidenmüller, Freshfields Professor of Commercial Law, University of Oxford
	Curtis Milhaupt, Professor of Law, Stanford Law School
	Niamh Moloney, Professor of Law, Department of Law, London School of Economics and Political Science
Editorial Assistants	Alison Schultz, University of Mannheim
	Julian Hanf, University of Mannheim

www.ecgi.global/content/working-papers

european corporate governance institute

Electronic Access to the Working Paper Series

The full set of ECGI working papers can be accessed through the Institute's Web-site (www.ecgi.global/content/working-papers) or SSRN:

Finance Paper Series	http://www.ssrn.com/link/ECGI-Fin.html
Law Paper Series	http://www.ssrn.com/link/ECGI-Law.html

www.ecgi.global/content/working-papers