The Shareholder Rights and Activism Review

Second Edition

Editor
Francis J Aquila

The LawReviews

THE SHAREHOLDER RIGHTS AND ACTIVISM REVIEW

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Chapter 2

AUSTRALIA

Quentin Digby and Timothy Stutt[1]

I OVERVIEW

Shareholder activism has long been a feature of the Australian corporate landscape. From corporate 'raiders' in the 1980s and 1990s to retail shareholder activists throughout the 2000s, Australia's shareholder-friendly regulatory regime has supported a robust level of engagement between the country's listed companies and their shareholders over economic, social and governance issues.

However, even in the context of this long-standing tradition of activist engagement, 2017 was a standout year for shareholder activism in Australia. It was the year the nation saw the American hedge fund activist playbook in action, with Elliott Associates and Elliott International (the Elliott Funds) launching an activist campaign against 'the Big Australian', global miner BHP. Because of the prominence of the target – BHP is one of the country's largest companies and its most recognisable brands – the ongoing campaign by the Elliott Funds has elevated the topic of hedge fund activism to become a mainstream area of focus for boardrooms across Australia.

II LEGAL AND REGULATORY FRAMEWORK

The Australian regulatory framework is conducive to activist campaigns with clear statutory rights afforded to shareholders in respect of accessing the company's register of shareholders and contacting its shareholders, nominating and removing directors, and requisitioning resolutions and calling shareholders' meetings. Further, Australian listed companies are not permitted to have 'poison pills' and almost universally have a single class of ordinary voting shares, as required by the Australian Securities Exchange (ASX). However, in spite of this, there are certain defences and structural advantages available to boards and management of listed companies in Australia when responding to activist campaigns.

i Contacting shareholders

Under the Corporations Act 2001 (Cth) (the Corporations Act), companies are required to allow anyone to inspect their register of shareholders. The Corporations Act also provides a process for people to request copies of the register of shareholders. This statutory right is commonly used by shareholder activists for the purposes of gathering shareholders' contact details to write to them regarding activist proposals or to solicit votes in respect of upcoming shareholders' meetings.

1 Quentin Digby is a partner and Timothy Stutt is a senior associate at Herbert Smith Freehills.

By accessing the register (or obtaining a copy of the register), a person would obtain each shareholder's name and address, as well as details regarding their holding in the company (Section 169 of the Corporations Act). At present, the information does not include e-mail addresses as these are not prescribed details for inclusion in the register under Section 169. However, there is currently a proposal for reform in this area, discussed below in Section V.

It is an offence to use information about a person listed in the register to contact or send material to them, unless the use or disclosure of that information is relevant to the shareholding of that person or to the rights attaching to the shareholding (Sections 177(1) and (1A) of the Corporations Act). However, in most cases, activist proposals will comply with this requirement as they would typically be relevant to the exercise of votes by shareholders. Where shareholder activists send material to shareholders that is inaccurate or that the company's board considers is misleading, there are a number of avenues open to the board, including taking action against the activists for engaging in misleading or deceptive conduct or, potentially, defamation.

In Australia, the register of shareholders only contains the names and details of the legal holders of shares (i.e., not the underlying beneficial holders). This can create a significant barrier to shareholder activists contacting shareholders, as it means that they are reliant on the timely relay of information by intermediaries and custodians. A separate register of relevant interests held in the company's shares, including beneficial interests, is also required to be kept by the company under the Corporations Act. However, such registers only contain information regarding shareholders' beneficial interests where it has been specifically requested by the company pursuant to a 'tracing' notice and the data is often not helpful to shareholder activists and other users (as companies are only required to share the 'raw data' and not their internal analysis of underlying beneficial interests, which provides a greater insight into the company's ownership).

Of course, as a substitute for corresponding with each shareholder, activists typically limit their direct engagement to the key underlying institutional shareholders and then rely on print and social media for indirect engagement with the balance of the register, including retail shareholders (as well as to exert pressure on the board).

ii Calling shareholders' meetings

It is relatively straightforward for shareholder activists to call or requisition a meeting of shareholders under the Corporations Act for the purposes of formally considering and voting on activist proposals. The Corporations Act also includes a process for shareholders to requisition additional resolutions for consideration at an upcoming scheduled shareholders' meeting.

Shareholders holding 5 per cent of the votes in a company can requisition a shareholders' meeting under Section 249D of the Corporations Act. Where a meeting is duly requisitioned according to this process, the company's directors are compulsorily required to convene the meeting within two months of the requisition and the company must meet the relevant costs of holding it. A shareholder request for these purposes must be in writing, state any resolution to be proposed at the meeting, be signed by the members making the request and be properly given to the company. Failure to follow these procedural requirements can invalidate the requisition and companies can, and commonly do, refuse to convene meetings where they are not complied with. The directors may also refuse to convene the requisitioned meeting where the subject of the meeting is a matter that is not validly within the power of shareholders, as discussed further below in Section V.

Where a meeting is requisitioned using the process in Section 249D, decisions regarding the content of the notice of meeting will be determined by the board of the company (as in the normal course). The shareholder is entitled to request that a statement be included with the notice of meeting setting out its views (Section 249P) and there are limited grounds on which companies may refuse to comply with this requirement. Companies may refuse the request where the statement is more than 1,000 words long or defamatory. Although the shareholder would be requisitioning the meeting, almost without exception the company's chairman would have the right to chair the meeting under the company's constitution. Accordingly, companies are able to control the conduct of proceedings of the meeting including any debate on an item of business, subject to the usual rules regarding the conduct of meetings and duties of the chair.

The Corporations Act also includes an alternative process for shareholders to convene a meeting, in which case they would be in a position to determine the time and venue of the meeting and the content of the initial notice of meeting but also be liable to pay the expenses of calling and holding the meeting themselves (e.g., printing, postage, venue costs, etc). Under Section 249F, shareholders with at least 5 per cent of the votes that may be cast at a general meeting of the company may call, and arrange to hold, a meeting. Calling a shareholders' meeting according to this process provides activists with a strategic advantage in that they can control the timing and location of the meeting (subject to the overriding requirement that it be held at a reasonable time and place), as well as the content of meeting materials, including the notice of meeting. Again, the chairman of the company is likely to be able to chair the meeting under the company's constitution and control the conduct of the meeting. Despite its advantages for shareholder activists, this alternative process is infrequently used in Australia given the considerable costs it can entail for the convening shareholder.

iii Requisitioning additional resolutions for scheduled shareholders' meetings

Where there is already a shareholders' meeting in contemplation (e.g., the company's annual general meeting), an alternative process, commonly used by retail shareholder activists, is to requisition additional resolutions for consideration at that upcoming meeting. Under Section 249N of the Corporations Act, 100 shareholders or shareholders with 5 per cent of the company's votes may give a company notice of a resolution that they propose to move at a general meeting.

Similar to requisitioned meetings, the notice must be in writing, set out the wording of the proposed resolution and be signed by the members proposing to move the resolution. The company need not give notice of the resolution if it is more than 1,000 words long or defamatory. However, it is otherwise required give notice to shareholders that the resolution will be considered at the next general meeting that occurs more than two months after the notice is given and, provided it is received in time, the company must meet the costs of giving shareholders notice of the requisitioned resolution.

Because this process allows for 100 shareholders (with shareholdings of any size) to requisition resolutions, it is the preferred mechanism for social and environmental shareholder activists to agitate for changes in company's operations and policies. With the power of social media continuing to increase, what was once a significant logistical hurdle has become a far simpler requirement for social and environmental activists to meet. As a result, campaigns from groups such as the Wilderness Society and the Australasian Centre for Corporate Responsibility have become relatively common for ASX-listed companies.

As a matter of procedure (though it can also be relevant to strategy), where a requisition is received from a shareholder, irrespective of whether it is valid, the company is required to make an ASX release within two business days. This creates significant timing pressure for companies in developing their response strategy to a requisition.

Under Australian law, the board can dismiss a requisitioned resolution if it purports to direct the board how to exercise its powers of management (as set out in its constitution). Generally, in order to supplant the powers vested in the board, such 'directions' would be required to be enshrined in the constitution (with a special resolution requisitioned to amend the constitution for that purpose). This position has recently been confirmed by the Full Court of the Federal Court of Australia and is discussed further below in Section V.

iv Nominating and removing directors

Australian companies typically have very low thresholds in their constitutions for shareholders to nominate a person for election to the board of the company. Unlike other comparable jurisdictions, Australian law does not mandate a threshold level of shareholder support for an external candidate to be nominated to the board of a listed company. In most cases, a single shareholder (with a holding of any size) will be able to nominate a person for election to the board of a company and need only comply with the specific timing requirements in the relevant company's constitution.

Because of the simplicity of this nomination process (which requires no minimum baseline level of support), it has occasionally been used by shareholder activists in place of requisitioning resolutions as a platform to advance criticisms of the company or agitate for changes to the company's processes or operations. For the company, an external nomination can involve additional expense and distraction beyond that which would be otherwise required with a requisitioned resolution or statement. In particular, additional care and attention is required, from a governance perspective, in dealing with any director nomination.

The external candidate will typically be elected if they secure a simple majority of votes cast at the shareholders' meeting, unless the company is at its constitutionally mandated maximum board size. Where the company is at its maximum number of directors, the candidate will need to outpoll one of the incumbent directors standing for re-election at the meeting.

The Corporations Act also sets out a specific process for shareholders that wish to remove a director from the board of a public company. This process applies regardless of anything in the company's constitution, though in some cases the constitution may provide additional avenues for removing directors.[2]

In order to validly requisition a resolution to remove one or more directors, the shareholder must give notice of its intention to move the resolutions and comply with the process for requisitioning a resolution (outlined above). The notice of intention must be given to the company at least two months before the meeting is to be held (Section 203D(2) of the Corporations Act). The company must give the relevant director or directors a copy of the notice as soon as practicable after it is received and the director is entitled to put their case to shareholders by giving the company a written statement for circulation to members and speaking to the motion at the meeting.

2 See, for example, the recent case of *State Street Australia Ltd in its capacity as Custodian for Retail Employees Superannuation Pty Ltd (Trustee) v. Retirement Villages Group Management Pty Ltd* [2016] FCA 675.

v Other avenues available to activist shareholders

Public listed companies in Australia are required under the ASX Listing Rules to hold an election of directors each year at their annual general meeting and this provides an opportunity for activist shareholders to lodge a 'protest' vote against particular directors or block the re-election of incumbent directors to agitate for board succession.

Australian listed companies are also required to put an advisory resolution to their shareholders for adoption of the remuneration report at each annual general meeting and, in recent years, this mechanism has been co-opted by some activist shareholders as a 'protest' against the company's current management or operations (i.e., for issues outside of executive remuneration). Additionally, where a company receives an 'against' vote of at least 25 per cent of the votes cast in two consecutive years (better known in Australia as receiving 'two strikes'), a board spill resolution must be put to shareholders that, if passed, will require that the non-executive directors of the company stand for re-election at a special 'board spill meeting' of the company if they wish to continue in office. Although intended to address issues related to the remuneration practices of companies, this mechanism is open to abuse by shareholder activists as an indirect means of suggesting a spill of the board and placing pressure on the company's directors. The 'two strikes' rule can also be practically difficult for directors from a duties perspective, given that it essentially relies on directors being influenced by factors extraneous to the core principle of what is in best interests of the company.

In extreme circumstances, shareholder activists may bring derivative proceedings against the company's directors under Section 236 of the Corporations Act (being a claim brought on behalf of the company) or seek court orders to address conduct that is oppressive to shareholders under Section 233 of the Corporations Act.[3] Although these types of proceeding rarely proceed to trial in Australia, hostile shareholder activists will occasionally put the company on the notice they are contemplating such proceedings as a means of 'encouraging' the swift resolution of issues under negotiation. In some cases, proceedings may be instituted, however, this is a 'high-stakes' manoeuvre for activist shareholders as the courts have the power to award costs against the party bringing the action (including full costs indemnification, where appropriate). The Corporations Act includes a process for shareholders or persons bringing derivative actions to apply to the court for access to the company's documents. Although any such application must be made in good faith and for a proper purpose, it can be used by shareholder activists to help them build a case against the incumbent board or management, including as a way to build their case for instituting a derivative action.

vi Considerations for boards in responding to activist campaigns

In responding to any activist campaign, the board of the relevant company must have regard to their duty to act in the best interests of the company and for proper purposes. Relevantly, under the principles set out in the *Advance Bank* case,[4] limitations are placed on the board's use of company funds to 'campaign' in relation to contested director elections.

3 See, for example, the recent case of *RBC Investor Services Australia Nominees Pty Limited v. Brickworks Limited* [2017 FCA 756] (discussed below in Section IV).

4 *Advance Bank Australia Ltd v. FAI Insurances Ltd* (1987) 9 NSWLR 464; 12 ACLR 118.

It is relatively unusual in Australia for high-profile companies to be subject to contested director elections involving shareholder mail-outs and extensive lobbying by activist investors. For that reason, the legal limits on how companies can respond to such campaigns are not well defined. However, case law in Australia (including the *Advance Bank* case) does allow for:

a directors to make recommendations to shareholders where they genuinely believe that it is desirable for shareholders to know their views on matters before the meeting; and

b the communication to shareholders of information that is material to their decision on how to vote on the external nomination or shareholder requisitioned resolutions.

Directors have a duty to provide shareholders with any material information they have in relation to a shareholder activist proposal to ensure that voting proceeds on an informed basis. This permits the directors to rebut inaccurate aspects of activist proposals or present counter arguments for consideration by shareholders (i.e., 'informing' shareholders). It will not, however, extend to the board telling shareholders how to vote on proposals (i.e., 'urging shareholders') or engaging in debates over issues of personality.

The board's 'toolkit' for responding to a contested director election scenario or other activist proposal would typically include:

a formulation of a board recommendation in relation to the external nomination or shareholder requisition;

b high-level meetings between directors and substantial shareholders;

c sending specific hard copy or e-mail communications to shareholders; and

d establishment of a shareholder hotline to receive inbound calls from shareholders to answer questions regarding the external nomination or shareholder requisitioned resolutions.

In some cases, companies may also engage a proxy solicitation firm for the purposes of making outbound calls to shareholders. This involves a higher level of risk from an *Advance Bank* perspective, unless it is strictly limited in scope to ensuring that shareholders are aware of the issue (and the relevance of their vote) and the costs involved are reasonable. However, depending on the intensity of the activist campaign, the company may be justified in taking more assertive steps to ensure that shareholders are receiving balanced and accurate information, including the use of proxy solicitation firms.

III KEY TRENDS IN SHAREHOLDER ACTIVISM

i Increased prominence of 'hedge fund' shareholder activism

Traditionally, the Australian experience with shareholder activism has been marked by strong activism at the retail level – in particular, small shareholders relying on mechanisms in the Corporations Act to provide them with a platform to agitate for social or environmental change. Even against a backdrop of falling attendances at annual general meetings in Australia, this form of small shareholder activism has continued to thrive and indeed grow, with many of the country's most prominent companies receiving director nominations from external candidates (e.g., Macquarie, BHP, Fairfax, Woolworths, Commonwealth Bank of Australia and Ten Network Holdings) or requisitioned resolutions from retail shareholders (e.g., Santos and Commonwealth Bank of Australia).

However, in a break with tradition, hedge fund activism has clearly taken centre stage in 2017 with what Credit Suisse has described an 'eruption of activism in Australia'.[5] While the most prominent example of hedge fund activism in Australia was the Elliott Funds' very public campaign against BHP launched in April 2017, there are a number of other activists in the region that have been generating significant media attention – including onshore funds, such as Sandon Capital (in relation to Iluka Resources and BlueScope Steel), as well as offshore funds, such as Janchor Partners (in relation to Bellamy's Australia and, reputedly, Medibank Private).

Despite their recent increased prominence, hedge fund activism and other forms of 'economic' activism are not new phenomena in Australia. Activist Insight data suggests that at least 50 Australian listed companies each year have received a public demand from investors during the period from 2013 to 2016.[6] Activist shareholders, such as Sir Ron Brierly and Dr Gary Weiss, have been in the market for decades through various investment vehicles and prominent local activist shareholders include Allan Gray, Mercantile Investment (which is Brierly-linked), Ariadne Australia (which is Weiss-linked), MH Carnegie, Sandon Capital, Thorney Opportunities, and the local branches of Lazard Asset Management and Aberdeen Asset Management. Activist campaigns by offshore investors have been rare in Australia until fairly recently, however, it appears momentum is increasingly in this respect with campaigns targeting Australian firms launched by Lone Star Value Management, Janchor Partners, Coliseum Capital Management and the Elliott Funds.

The emergence of offshore shareholder activists with access to larger pools of capital has resulted in a broader range of targets for activist campaigns. During the period from 2013 to 2016, the vast majority of activist campaigns against Australian companies were waged against small-cap companies, with as few as 9 per cent of targets being large or mid-cap companies.[7] However, recent campaigns have targeted much larger companies, such as BHP (BHP Billiton Limited market cap: A$80.7 billion; BHP Billiton Plc market cap: £27.5 billion), Bluescope Steel (market cap: A$7.9 billion), Iluka Resources (market cap: A$3.8 billion), and Brickworks (market cap: A$2 billion).[8] This trend is expected to increase as offshore investors gain confidence and become more active in the region.

ii Characteristics of shareholder activist campaigns in Australia

Similar to the United States and United Kingdom, hedge fund or 'economic' activists operating in Australia typically seek to make an economic gain on an investment (usually in the short term) through means that are not aligned with the current strategy of the company. Common activist goals include:

a persuading companies to make a capital return or pay a special dividend;

b changes in business strategy (which the activist may seek to effect through a change in management or board composition);

c a restructure or sale of a significant asset; or

d putting the company 'in play' or seeking to extract a higher price in a change of control situation.

5 Credit Suisse, 'Australian Investment Strategy: Activist Alpha' (13 June 2017).

6 Activist Insight (in collaboration with Arnold Bloch Leibler), 'Shareholder activism in Australia: a review of trends in activist investing' (30 June 2016).

7 Activist Insight; see footnote 6.

8 Market capitalisations presented as at 15 July 2017.

Some activists may also 'bet against' companies that they perceive to be overvalued, looking to encourage a downward correction in the share price so they can close out a short position at a profit.

While opportunities are most often identified by shareholder activists based on their own investment theses and research, in some cases they may be the result of institutional shareholders making a 'request for intervention'. Requests for intervention are most often made in respect of Australian companies' with high levels of passive ownership through superannuation and pension funds, given those investors are often prevented from effecting changes at their portfolio companies themselves due to resourcing and reputational considerations.

Until recently, the vast majority of activist campaigns in Australia have been conducted 'behind closed doors', with private approaches made by shareholder activists to companies' boards. Where the activist holds a significant stake, or is aligned with the board and management on a particular issue, then it is common for the board to reach an understanding or negotiated outcome with the shareholder, in which case the matter would not usually become public. Often, at this stage, the activist would privately engage with members of the investment community (institutional shareholders, other significant investors and analysts) for the purpose of building momentum for change and increasing pressure on the company's board.

In Australia, it has historically been rare for shareholder activists to take the next step of publicly advocating for their proposed course of action (e.g., through 'white papers', open letters to the board, their own website and the media). However, recent activist campaigns have borrowed more heavily from the American hedge fund activist playbook, with tactics including:

a public criticism of the board, individual directors and management;
b formation of informal investor alliances and voting blocs;
c proposing or supporting candidates for appointment to the board;
d advocating for (or formally proposing) removal of existing directors;
e requisitioning shareholder resolutions and members' statements;
f requisitioning extraordinary general meetings of shareholders; and
g encouraging unsolicited offers for the company or its assets.

iii Limitations on collaboration by shareholder activists

Under the Corporations Act, investors may become 'associates' for takeover and substantial holding notice purposes where they act together in relation to a common portfolio company. This provides an important protection for Australian companies in respect of the 'wolf pack' type tactics sometimes seen in the United States, as it prevents shareholder activists from taking control of a company in circumstances where other shareholders are uninformed about this passing of control and are not given any opportunity to obtain a control premium (or other benefits that would be paid if control were to pass legitimately).

Under the Corporations Act, an investor can become an associate of another investor if they propose to:

a enter into, or have already entered into, a relevant agreement with the other investor for the purpose of controlling or influencing the composition of the entity's board or the conduct of the entity's affairs; or
b act, or are acting, in concert in relation to the entity's affairs.

As stated by the Australian Securities and Investments Commission (ASIC), investors concerned about common issues may become 'associates' or be regarded as having entered into a 'relevant agreement' for the purposes of the takeover or substantial holding provisions. This is because these provisions are not only concerned with the power of individual investors in relation to the voting and disposal of shares in companies, but also the aggregated voting power of groups of investors who are either related or associated with each other in relation to some aspect of the entity's affairs. Depending on the aggregated voting power of the group, investors acting collectively in this way may be required to lodge substantial holding notices relating to the group, may be prohibited from acquiring further interests in the entity under the takeover prohibition in Section 606 of the Corporations Act or may even breach the takeover provisions.[9]

In June 2015, ASIC released a regulatory guide to clarify the circumstances in which investors acting collectively will and will not be taken to be 'associates' for the purposes of the takeover and substantial holding notice provisions of the Corporations Act.[10] Conduct with is 'permissible' and unlikely to cause issues includes holding discussions with other investors, making recommendations to other investors in relation to voting, and making individual or joint representations to the company's board. Conduct that is likely to raise issues with associateship includes jointly signing requisitions for shareholders' meetings or resolutions, formulation of joint proposals in relation to board appointments or strategic issues, accepting inducements to vote or act in a specific way, agreeing on a plan concerning voting or limiting their freedom to vote (e.g., by granting another investor their irrevocable proxy).

Another aspect that is unique to Australian law, especially relative to the United States, that renders 'wolf pack' tactics high risk are the country's broad insider trading rules that apply in relation to trading while in receipt of any material information in respect of a company (irrespective of whether it was sourced from a company insider or not). Prohibitions on 'tipping' similarly apply in relation to any material information regardless of its source. Knowledge of an activist hedge fund's intent to target a company on 'governance' grounds could, in the context of a clear track record of being able to force a significant corporate transaction, constitute materially price sensitive information.

IV RECENT SHAREHOLDER ACTIVISM CAMPAIGNS

i BHP and the Elliott Funds

The Elliott Funds' 'value unlock plan' in relation to BHP is the highest profile example of hedge fund activism in Australia and has generated an enormous amount of public interest, both in Australia and overseas.

BHP became the subject of intense media attention when the Elliott Funds published a letter to the company outlining their 'value unlock plan' that proposed a number of changes to BHP's structure and operations, including:

a collapsing the group's dual listed structure;

b demerging the group's onshore United States and Gulf of Mexico deepwater assets into a separate New York Stock Exchange-listed vehicle; and

9 Australian Securities and Investments Commission, Regulatory Guide 128: Collective action by investors (June 2015), [7]–[8].

10 Australian Securities and Investments Commission; see footnote 9.

c proposing an off-market buy-back of at least US$6 billion, followed by a series of subsequent buy-backs.

The Elliott Funds publicly argued that the changes would unlock US$46 billion for BHP shareholders and sought to capitalise on the media following the release of their plan by criticising the board and management of BHP.

BHP responded to the Elliott Funds' proposals by issuing its own detailed 28-page response, outlining the costs and associated risks of the Elliott Funds' proposals and suggesting that they would significantly outweigh any potential benefit. The proposals also attracted the ire and attention of the Australian government with the Australian Treasurer issuing a public statement that 'should BHP Billiton implement the Elliott Associates proposal… it may commit a criminal offence and could be subject to civil penalties under the Foreign Acquisitions and Takeovers Act 1975'.

The Elliott Funds have since issued a revised proposal and continue to make further public comment in the media, however it is clear that they are still coming to grips with some of the relatively unique aspects of an Australian activist campaign with such a high-profile 'local champion' as the target.

ii Brickworks and Perpetual Investment Management

Perpetual Investment Management's (Perpetual) six-year campaign to dissolve the cross-shareholding structure between Brickworks and Washington H Soul Pattinson (WHSP) is one of the highest profile examples of a shareholder activist seeking recourse to Australian courts.

Perpetual has long contended that the cross-shareholding between Brickworks and WHSP is unfairly oppressive towards minority shareholders because:

a the directors of each company prioritise the maintenance of the cross-shareholding over the interests of shareholders; and

b the Millner family (members of which are directors and shareholders of both companies) are using the structure to entrench control over the companies.

In 2013, Perpetual, which has traditionally been a relatively passive long-term fund manager, agreed to act in concert with a well-known activist, MH Carnegie, with a view to requisitioning meetings of shareholders of both companies to vote on a proposal to dissolve the cross-shareholding structure and elect a new independent director of Brickworks (the Proposal). The Proposal failed due to a failure to obtain a favourable tax ruling on the restructure and a shareholder vote against the election of the independent director.

Ultimately, Perpetual took the matter to the Federal Court of Australia,[11] with Jagot J finding against Perpetual in July 2017 on the grounds it failed to establish that the cross-shareholding structure was unfair or oppressive for minority shareholders. Jagot J also confirmed the court's reluctance to second guess the judgement of directors in relation to commercial matters in the absence of clear evidence that they had acted unreasonably.

11 *RBC Investor Services Australia Nominees Pty Limited v. Brickworks Limited* [2017 FCA 756].

iii Praemium and former CEO

Praemium is an example of shareholder activism successfully orchestrating a board spill and the return of a removed CEO back into office.

In February 2017, the board of Praemium terminated the employment of the company's CEO (which had the effect of removing him from the board as well), publicly stating that someone with a 'different skill set' was needed in the role. The removed CEO responded by entering into a cooperation deed with a number of Praemium's institutional shareholders, creating a bloc with approximately 17.3 per cent of the company's shares. The voting bloc requisitioned an extraordinary general meeting and put forward a resolution to remove all of the company's directors and replace them with nominees of the voting bloc. A highly public and hostile campaign ensued, with the voting bloc writing to all shareholders publicly, and both the removed CEO and the board of Praemium making public statements.

The extraordinary general meeting of Praemium shareholders was held in May 2017, with the incumbent directors being removed and the voting bloc nominees being elected as directors. The new directors have since re-appointed the CEO. Institutional shareholders who provided support for the spill included Paradice Investment Management, Australian Ethical and the Abercrombie Group.

iv Spark Infrastructure and James Dunphy

James Dunphy's campaign for a seat on the board of Spark Infrastructure is an example of a small shareholder taking advantage of topical issues, like investment decisions or remuneration, to seek support of key stakeholders and proxy advisers.

Mr Dunphy nominated himself for election as a director of Spark Infrastructure on a platform that was critical of Spark Infrastructure's A$734 million equity investment for a 15 per cent stake in the New South Wales electricity transmission business, TransGrid. He argued that with his experience in investment banking and as a company director, he would be better placed to bring change to the board's 'acquisition-driven' strategy, which in his opinion would improve Spark Infrastructure's securities price.

Through a dedicated website 'MakeThemAccountable.com.au' and considerable media coverage, Mr Dunphy was initially able to garner support from some institutional shareholders and proxy advisers and managed to secure 21.23 per cent of securityholders' votes at the 2016 annual general meeting (AGM).

Mr Dunphy continued his campaign into 2017 and again nominated himself for election to the board at the 2017 AGM. However, the board's engagement with securityholders in the intervening period had clearly been effective, with support for Mr Dunphy's campaign to join Spark Infrastructure's board dropping significantly. Mr Dunphy secured less than 1 per cent of votes in favour of his election at the 2017 AGM.

v Bellamy's Australia and Black Prince, Delta Partners and Janchor Partners

Black Prince Private Foundation's (Black Prince) campaign to spill the board of Bellamy's Australia Limited and elect new directors is another recent example of a dissident shareholder successfully executing an overhaul of a company's board due to performance concerns.

On 2 December 2016, Bellamy's' share price dropped 42.7 per cent after the board released an unexpected profit downgrade citing a 'temporary dislocation' of sales due to Chinese regulatory reform. This prompted Black Prince, a substantial shareholder with a

14.48 per cent interest in Bellamy's, to requisition an extraordinary general meeting of the company to spill the board (except for the chairman) and elect new directors including its own nominee.

The requisition from Black Prince generated a lot of media coverage in Australia as it was not initially clear who was behind the Black Prince investment vehicle. After Bellamy's issued a directive under the Corporations Act requiring Black Prince to disclose the holders of relevant interests in its Bellamy's shares, Black Prince revealed its relationship to charitable investment vehicles linked to one of the Black Prince nominations for director, Jan Cameron.

During the two months preceding the general meeting Black Prince and Jan Cameron increased their combined holding to 17.67 per cent. In the same period, investment firm Delta Partners built an interest in the company of 8.79 per cent and Hong Kong-based Janchor Partners built an interest of 5.4 per cent. These shareholders were all reported in the media as being involved in discussions regarding changes to the board in the lead up to the general meeting.

All but one of Bellamy's existing directors departed the board (including the chairman): some by resignation before the meeting and the others as a result of the removal resolutions receiving more than 50 per cent of the vote in favour. At the meeting, shareholders elected a nominee director for Black Prince, Rodd Peters, and a further independent non-executive director, although Jan Cameron's nomination did not succeed. Rodd Peters was subsequently appointed chairman of the board. Janchor Partners' chief investment officer, John Ho, was also appointed to the board one month after the general meeting and later assumed the chairman role from Rodd Peters.

V REGULATORY DEVELOPMENTS

i Confirmation of board's ability to reject requisitions usurping board powers

In June 2016, the Full Court of the Federal Court of Australia in *Australasian Centre for Corporate Responsibility v. Commonwealth Bank of Australia*[12] (*ACCR v. CBA*) confirmed existing case law that companies' boards can reject shareholder requisitioned resolutions that purport to 'direct' the board and management on matters that are properly within their powers, such as operational or management decisions.

In *ACCR v. CBA*, the Australasian Centre for Corporate Responsibility used social media to gather 100 CBA shareholders to requisition a resolution for inclusion in CBA's 2014 notice of AGM. In its letter to CBA, ACCR presented three alternative resolutions (in order of ACCR's preference):

a the first two (ACCR preferred) resolutions were 'advisory' resolutions. Both were expressed as statements of shareholder opinion or concern regarding the level of disclosure by CBA in relation to 'greenhouse gas emissions that the bank is responsible for financing'; and

b the third resolution sought to amend CBA's constitution to require it to include information on greenhouse gas emissions in its yearly directors' report.

12 [2016] FCAFC 80.

CBA included the third resolution in its 2014 notice of annual general meeting, explaining to ACCR that the first and second proposed resolutions were 'matters within the purview of the board and management of the Bank', and accordingly the resolutions were 'not valid and capable of being legally effective'.

ACCR sought to challenge this view and applied to the Federal Court for relief in the form of declarations that the first two resolutions were valid (as well as the third resolution, which was not in contention), an injunction to compel CBA to put the first two resolutions at its next annual general meeting and a declaration that the board or management of CBA acted outside its powers in publicly commenting on the third proposed resolution and recommending that members vote against it.

In the first instance, ACCR's case failed on all grounds and Davies J declined to grant the relief sought. Davies J found that the first and second proposed resolutions were not referrable to any power other than to the power of management vested exclusively in the CBA board and that it followed that the CBA board was not required to put those resolutions to the annual general meeting. Importantly, in respect of ACCR's claim that the board or management of CBA acted outside its powers in publicly commenting on the third resolution, Davies J found that (to the extent the claim was pleaded), she accepted CBA's submissions that the power of the directors to make such statements is derived from its constitution and the duty to inform shareholders.

ACCR appealed the decision to the Full Court of the Federal Court of Australia but lost the appeal and had costs awarded against them. The Full Court clearly confirmed that boards are not required to submit shareholder requisitioned resolutions to an annual general meeting if the resolution would not be legally effective and binding if it was passed.

In bringing its claim and subsequent appeal, ACCR was clearly intending to create a precedent for Australian shareholders to be able to requisition 'advisory' shareholder resolutions on matters relating to management. If successful, this would have brought Australia in line with North America, where the practice is well established. Although Australia has, to a large extent, been insulated from a proliferation of shareholder requisitioned resolutions thus far, the *ACCR v. CBA* case was a timely endorsement of the principle that shareholders cannot by resolution express an opinion as to how a power vested by the company's constitution in the directors should be exercised.

ii Introduction of a bill providing access to shareholders' e-mail addresses

On 14 June 2017, Senator Nick Xenophon introduced a Bill into Parliament to amend the Corporations Act to require companies' registers of shareholders to include e-mail addresses for each shareholder. At present, only shareholders' names, physical addresses and shareholding information form part of the register.

The proposed Bill would provide persons requesting access to the register of shareholders, including activist shareholders, the means to electronically contact shareholders using their e-mail addresses. Given the printing and postage costs involved in doing physical mail-outs to shareholders, the ability to contact shareholders by e-mail is expected to provide shareholder activists with a significantly more cost-effective communications channel for activist campaigns.

The Bill was introduced following a members' campaign against the leadership of Australia's professional body for certified practising accountants, CPA Australia Limited. The

dissident members were critical of CPA Australia for not providing members' e-mail addresses to them, given that it was going to be cost prohibitive for them to send physical mail-outs to its 160,000 members worldwide. In the media, Senator Xenophon was quoted as saying:

> *…the Corporations Act needs to be brought into the 21st century by allowing members to access e-mail addresses of other members. Right now a lot of entities know that they are insulated from member or shareholder action by virtue of the prohibitive cost of contacting them all by mail.*[13]

Debate on the Bill was adjourned following its second reading in the Senate and it has been referred to the Economics Legislation Committee that will report on the Bill by 11 September 2017.

VI OUTLOOK

As outlined above, the Australian regulatory regime is facilitative to shareholder activism and an increasing number of companies, and increasingly larger companies, are being targeted by activist campaigns. We expect that these trends will continue in the future, with more campaigns from offshore hedge funds and 'economic' activists bringing additional pools of capital into the relatively uncrowded Australian market.

We expect that offshore activists will disrupt the traditional practice of 'behind closed doors' activism in Australia and that where there is a lack of responsive reaction by boards to private approaches this will be met with more overt aggression and publicly hostile campaigns. This trend is likely to be supported by the proposed reforms to provide access to shareholders' e-mail addresses, which will open up more cost-effective communications channels for shareholder activists and result in 'hard-fought' campaigns with escalating rounds of criticism and counter-criticism.

Longer term, we expect that traditionally passive investors will become increasingly activist themselves – both by making requests for intervention and by taking action in their own right. BlackRock, Vanguard and State Street are active participants in the global governance conversation and have high levels of ownership of Australian companies. With the growth in passive assets under management, we expect that their views will increasingly inform Australian activism trends, though we expect that an increasing recognition of the importance of long-term value creation will temper their support for overtly activist tactics or campaigns marked by short-termism. As public campaigns become 'normalised', we expect that other traditionally passive investors, such as the Australian superannuation and pension funds, will also become increasingly prominent in shareholder activist campaigns as an extension of their stewardship responsibilities.

Finally, we also anticipate an increase in the use of shorting by shareholder activists, including public 'short' campaigns against specific companies. Shareholder activists are increasingly employing short strategies and this is expected to continue given the prevailing low growth environment. With the aid of new tools, such as the forensic accounting services now offered by some proxy advisory firms, we expect that past corporate disclosures will be combed through for points of leverage and shareholder activists will publish progressively sophisticated research on short campaign targets.

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13 *Australian Financial Review*, 'Xenophon intervenes in CPA Australia CEO Alex Malley dispute' (2 June 2017).

Appendix 1

ABOUT THE AUTHORS

QUENTIN DIGBY

Herbert Smith Freehills

Quentin is a partner in Herbert Smith Freehills' Sydney corporate practice and established the firm's head office advisory team (HOAT) in 1998. HOAT specialises in strategic corporate governance issues including board reporting and advice, market disclosure (both continuous and periodic), director and executive appointments, remuneration and disclosure, and shareholder communications and relations.

HOAT has established an unparalleled reputation for providing focused advice and guidance on not only legal and regulatory requirements but also market practice and emerging trends. HOAT now advises 60 per cent of the ASX 20 companies on corporate governance issues and approximately 40 per cent of ASX 100 companies.

Quentin acts as a trusted adviser for the corporate secretariat and general counsel teams and boards of a number of the firm's significant ASX-listed clients and is the delegate for the Law Council of Australia on the ASX Corporate Governance Council.

TIMOTHY STUTT

Herbert Smith Freehills

Timothy is a senior associate in Herbert Smith Freehills' head office advisory team (HOAT), where he advises publicly listed companies on corporations law, governance, executive remuneration, and shareholder engagement and activism matters. Timothy also has previous experience in the financial industry, having worked as an analyst for an investment manager based in the San Francisco Bay Area.

As a senior member of HOAT, Timothy advises ASX-listed companies on market disclosure and shareholder engagement issues, including in relation to sales downgrades, contentious general meetings, ESG and economic shareholder activism and proxy adviser engagement. Timothy is a regular presenter on governance and remuneration matters for clients and at industry seminars (including at the Governance Institute of Australia).

In 2010, Timothy was one of two Australians to receive a Young Leaders Program scholarship from the Japanese Ministry of Education to study for his master's in business administration (MBA) in Tokyo. He also holds a Bachelor of Laws (honours) and Bachelor of Commerce from Monash University, Melbourne.

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