SHAREHOLDER ACTIVISM IN AUSTRALIA: BACK BIGGER AND BOLDER AS ESG AND TRANSACTIONAL ACTIVISM LOOK TO CONVERGE

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Legal Briefings – By **Rebecca Maslen-Stannage and Lauren Selby**

Following a pandemic dip, shareholder activism is back. And it's bigger and bolder than ever, as the ESG activism corporate Australia has grown accustomed to looks like converging with transactional activism.

At the same time, the lines are blurring as to who even is an "activist"? NGOs and hedge funds are being joined by long term investors and major institutions in the quest to influence corporate behaviour and business decisions.

Pre-pandemic, super funds and other fund managers had already moved from perceived passive investors to instigators of transactions. AusSuper was seen as a core player in the Healthscope deal. Fund managers have done everything from gentle prompting through to voting intention statements to promote deals.

In the United States, ESG-branded fund managers Trillium Asset Management has used its investment holdings to successfully exercise shareholder rights to file proposals asking Starbucks to commit to reducing waste sent to landfill and shift away from single-use packaging, and Marathon Petroleum Corporation to establish intensity reduction targets and link achievement of those targets to executive compensation.

Now, as institutional investors increasingly look to highlight their ESG credentials to appeal to their own investor bases, it is a logical step for them to seek to exert their influence on transactions which have ESG implications, particularly if they can present this as leading to improved financial as well as ESG returns. This trend has already started, albeit not in the form of a classic institution, through Grok Ventures acquiring an interest in AGL and using it to oppose AGL's demerger.

Meanwhile in the Australian election, the extent of support for the "teals" – a cross between liberals and greens - and a major shift to greens in Queensland surprised many. This is likely to encourage ESG activists in their efforts to persuade retail investors to support ESG campaigns, whether in the governance or transactional space. It will likely further incentivise fund managers to up their profile on ESG issues, including positioning in relation to transactions they see as having ESG impacts – although of course superannuation funds also need to be mindful of recent legislative changes requiring them to act in the "financial" best interest of their members.

Particularly in transactions with an ESG component, scenario planning for potential activist activity is now more important than ever.

"CLASSIC" ESG SHAREHOLDER ACTIVISM PLAYBOOK

For ESG activists, the starting point is usually discussions with management and the board where "recommendations" are canvassed with the purpose of reaching a mutually agreeable resolution.

Where an investor feels that their suggestions aren't being well received by the company, they will progress to increasingly aggressive tools to achieve their goals. For example, taking their grievances to the media or releasing a 'white paper' which outlines that position or publicly releasing and promoting the investor's voting intentions ahead of a general meeting.

The last resort (or the 'nuclear' option) is where an activist threatens to requisition a general meeting and resolutions to remove directors. It is the proliferation of activity at this end of the spectrum which has caught our attention. In Australia, active investment managers are no longer satisfied using only the more passive tools and will more readily escalate the aggressiveness of their campaigns. In particular, we have noted a marked increase in the use of the following powers enshrined in the *Corporations Act 2001* (Cth):

- Section 249D – a company must call and arrange to hold a general meeting where requested by members with at least 5% of the votes;
- Section 249N – members with at least 5% of votes, or at least 100 members may give a company notice of a resolution they propose to move at a general meeting;

- Section 203D – members of a public company may, by resolution, remove a director from office.

It is not a big leap from “mainstream” investment managers using their shareholdings in this way to opposing, or seeking to modify the terms of, transactions – to oppose transactions which they may see as having negative ESG effects or to extract an ESG “price” for their support for a deal.

THE US STYLE HEDGE FUND PLAYBOOK

The playbook for a US hedge fund is to buy a meaningful stake in a company and look to maximise the value of the investment by instigating change. Initially, the hedge fund will look to do this through engagement with management and the board. However, if they do not see change occurring at the pace they require, these hedge funds have shown an increased appetite to escalate their campaigns by employing more aggressive activist tools.

It appears that increasingly some Australian investment managers are building activism into the core of their business model. For example, Sandon Capital is a self-described ‘activist fund manager’. It seeks to buy shares in undervalued and underperforming companies where there is potential for change. Similarly, Tanarra Capital, an Australian based funds manager, invests in publicly listed companies where it sees opportunity for growth. In practice, this means Tanarra will buy a 5-10% shareholding in order to obtain “significant influence over the company”.

Both of these investment managers have recently mounted campaigns against companies which are Australian household names. They have demanded changes to management and sought to influence company strategy. Interestingly, Tanarra has tried to distinguish itself from US hedge funds which have been criticised for chasing short term outcomes to the detriment of a company’s longer term strategy and stability. Tanarra says that it sees itself differently because it uses strategies that “leave companies strategically enhanced over the long term”.

With the global success of some activist investors achieving superior returns their activity shows no sign of slowing. In the UK, Elliott Investment Management recently demanded a split of multinational SSE’s energy business, a move it believes would restore shareholder confidence and unlock significant value. Meanwhile, Third Point, a large US-based investment advisor, has called for Royal Dutch Shell to split into multiple standalone companies.

CONVERGENCE OF THE ESG AND HEDGE FUND PLAYBOOKS

The two, previously separate playbooks are now converging. We have seen this in:

- Grok Ventures' campaign with respect to AGL;
- Wilson (WAR)'s public statements in relation to that campaign, and
- The Trillium examples above and participation in campaigns by other funds such as Blackrock.

FORWARD PLANNING

Companies that may once have considered themselves "safe" from activist investor pressure tactics should appreciate that it is often just a question of time before they will be targeted. No ASX company is immune and the range of issues which attract ESG attention is ever-widening.

And undertaking a transaction – particularly one that requires a shareholder vote – may prove too appealing an opportunity for activists to miss, whether in terms of changing outcomes or securing publicity, or both.

Forward planning is important, including advance consideration of how the company would initially respond to an activist approach and what pre-emptive steps should be taken. As with classic shareholder activism, the Board and Management dynamic can be key here and activists will often look to adopt a divide and conquer approach to achieve their outcome.

It's important to recognise that things are moving incredibly quickly in this space. Public perceptions in ESG and the approach of activists are evolving. Today's "safe" institutional investors may change and feel like foes. Companies need to stay engaged with their shareholder base and scenario plan on that basis.

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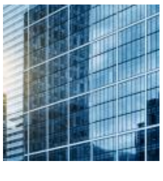

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KEY CONTACTS

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REBECCA MASLEN-STANNAGE
CHAIR AND SENIOR PARTNER, SYDNEY
+61 2 9225 5500
Rebecca.Maslen-Stannage@hsf.com

LAUREN SELBY
EXECUTIVE COUNSEL, SYDNEY
+61 2 9322 4859
Lauren.Selby@hsf.com