Shareholder litigation in M&A — what you should watch out for

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We've put lawyers from our offices in Spain, France, Germany, the Netherlands, and the U.S. on the spot. Having got them thinking about when they've been up against shareholders in M&A litigation, we asked for pointers you should keep in mind. Jurisdictions differ widely, so we'll step through them one by one.

In general, what are the shareholders' rights to be kept informed?

Bas Keizers, Netherlands: The right of individual shareholders to be informed is quite limited under Dutch law. The general meeting of shareholders is entitled to information it asks for, unless there are compelling reasons for the board or supervisory board not to comply with such a request.

Manon Cordewener, Netherlands: Yes, and that's because there's a clear distinction between the shareholder and the company itself. So, the information you give to a shareholder is often based on the shareholders' agreement. If this is not done properly, it could lead to a breach and then possibly to litigation.

Jon Aurrecoechea, Spain: Shareholders' information rights are quite limited. Generally, they are limited to the topics included in the agenda of the shareholders' meetings, except if they hold more than 25% of the share capital.

Ryan Philp, U.S.: Shareholders in the U.S. have a right to all material information necessary to their consideration of a deal. Lack of adequate disclosure is a basis to enjoin a transaction, at least temporarily. This adds weight to the need for full disclosure, to avoid a potential preliminary injunction that delays a deal. Recent precedent makes proper disclosure even more important because it can protect against post-closing damages claims.

What affects shareholders' chances of success in a claim? And how can companies minimise this risk? Give us an insider's view.

Pauline Faron, France: A lot of the claims we see have to do with lack of information about deals before they take place. Get the balance right and you cut the risk of litigation. Other issues include companies not complying with the rules on mergers and disagreements about valuations. First off, shareholders will try to prove they

weren't given enough information to vote wisely; second, that the rules haven't been followed, creating a risk the deal could be invalid. But courts rarely grant these types of claims. In claims for an independent expert to be appointed, shareholders will try to show they don't have the information so need an independent expert to get it.

Christine Gateau, France: After a deal has been approved at a shareholders' general meeting, minority shareholders can still dispute its validity. To have the deal annulled, they could try to prove the formal requirements of the meeting weren't met. In practice, this is hard to win. They could also try to prove the decision goes against the company's interests: that it's solely for the majority shareholders. If proved, abuse of a majority position can lead to annulment or damages.

To bring a claim for damages against a director, shareholders have to prove fault, personal loss, and a link between the two. The director's behavior is then compared with that of a reasonable person acting prudently and diligently.

Carla Wiedeck, Germany: To claim for lack of information, shareholders must show the board didn't share information, which it should have, that directly affects the company. A claim can also be considered if the company published a wrong ad hoc announcement. But all of that is a long shot. Loss due to lack of information is hard to prove because, typically, the stock price rises after a deal.

Olaf Gärtner, Germany: In a claim for breach of statutes, shareholders would need to show the statutes were broken. They can then try to block the deal or claim damages. And to claim damages, they must of course prove their losses. Shareholders may hold a tortious claim for damages if they have been intentionally injured, contrary to good faith. However, again, this is all pretty difficult for shareholders.

Jon Aurrecoechea, Spain: In claims for breach of contract they'd need to prove the breach, the loss, and how the two are linked. For claims against directors, they'd need to prove the directors acted willfully or negligently and against the law, by-laws, or legal duties of their position. As above, they must also prove how the loss and the cause relate, as is the case in France as well.

For claims in tenders and initial public offerings, shareholders must show the false information or omissions and again, of course, the cause-and-effect relationship.

Carlijn van Rest, Netherlands: In inquiry proceedings brought by the shareholders, they need to show why they believe the company has been mismanaged. Whether the company or a corporate body is liable can't be established in the inquiry proceedings. The liability can only be assessed in separate civil legal proceedings.

Bas Keizers, Netherlands: If the shareholders ask the court to declare a decision by the board invalid, the decision needs to have been against the law. A management decision could be, subject to annulment, non-binding for one of the following three reasons: the decision violates the company's articles of association about how decisions must be made; it is contrary to the principles of reasonableness and fairness in the Dutch Civil Code; or it breaks any of the company's by-laws.

Bill Regan, U.S.: To prove breach of the duty of care, shareholders need to show that the board approved a transaction on an uninformed basis, or, in certain circumstances, that the board failed to take appropriate steps to maximize the value obtained for the shareholders. For breach of the duty of loyalty, shareholders must show that directors pursued their own personal employment, financial, or other interests, and not the interests of the company and its shareholders. For disclosure claims, shareholders must show that directors failed to provide all material facts necessary for the shareholders to make an informed decision.

Shareholder activism is on the rise. How do you see this developing?

Bas Keizers, Netherlands: The last two decades show that shareholders want more and more say in the company and its direction. That's even though, in principle, the board decides the direction of the company.

Manon Cordewener, Netherlands: A number of accounting scandals in large group companies plus the relative ease with which shareholders, especially listed companies, can join forces to bring a collective action — comparable to class action in the U.S. — has led to a rise in shareholder activism in the Netherlands. And it's a big risk for companies. Collective action is easily accessible. It's relatively cheap to bring a claim, even though the loser pays. The costs are limited to court fees and some procedural costs, for example, and exclude the full lawyer's fee of the winning party. The success of hedge fund activists in the U.S. has also stirred this move toward more shareholder activism in Europe, due to corporate governance reforms.

Ryan Philp, U.S.: Companies today often have well-developed plans for shareholder engagement. There's more emphasis on disclosure and allowing shareholder input. More transparency and communication are ways to potentially head off activist challenges. It's a delicate balance, though, because the board must be able to maintain confidentiality in certain circumstances.

Jon Aurrecoechea, Spain: Discussions and agreements of the board are kept secret. When it comes to capital markets transactions (initial public offers or tender offers), there's a higher degree of shareholder activism. Different types of claims, say, for misinformation in a tender offer, are built up; and once a determined claim is found to be successful, other shareholders will replicate that one. As in the U.S., more or better disclosure and communication is a way to limit activism.

Olaf Gärtner, Germany: Germany has seen a strong rise in shareholder activism over the last two-and-a-half years. For many years, that has been a rather theoretical feature with about five to eight cases a year all over Germany. Now this has become a relevant point clients have to be aware of.

What conditions do courts look for to award some sort of interim relief?

Christine Gateau, France: Interim or injunctive relief can be sought in the summary proceedings or in ex parte proceedings, meaning the opposing party will not be

called.

Carla Wiedeck, Germany: In theory, a court can block a deal if, for instance, a shareholder resolution was needed and wasn't sought. Shareholders must prove they have certain rights and claim that without interim relief their right or claim would be made much harder. I say in theory because courts are very reluctant to grant such interim relief.

Jon Aurrecoechea, Spain: The claim must be justifiable on the essential facts of the case. There must be a real risk that enforcing the claim would be blocked if the petition weren't guaranteed in the proceedings. And the claimant may need to give security to cover potential damages to the defendant.

Bas Keizers, Netherlands: In the Enterprise Court's assessment, it will consider whether the company has been mismanaged by the board of directors, the supervisory board, the shareholders, or a combination of these bodies. All circumstances of the case are relevant for this assessment. The Enterprise Court of the Amsterdam Court of Appeal, which hears inquiry proceedings, can order interim measures at any time. It can suspend board members, temporarily appoint new board members, and suspend shareholders' voting rights.

If a shareholder claims damages, the court will assess whether the standard of due care towards the shareholder has been breached, which could be a tortious act.

Ryan Philp, U.S.: Because it's usually impractical to unwind a deal after it has closed, courts can issue an injunction to prevent or delay a closing where the disclosure fails to provide enough information or where provisions in the deal preclude other potential bidders from coming forward. In some circumstances courts may strike objectionable deal terms.

What you should look out for

Companies come to us with a range of concerns involving their shareholders. When a shareholder vote is needed, the importance of disclosure is heightened. This is often a cause of M&A litigation in the U.S. (less so in Europe), where disclosure of material information is viewed as a fundamental shareholder right.

Recent precedent in the U.S., which aligns with laws in other jurisdictions, has seen increased emphasis placed on full disclosure to protect the company. It can help avoid a potential preliminary injunction and give continued protection after shareholders approve a deal.

To minimize litigation risk, companies should focus on disclosure of all material information in connection with a shareholder vote and should develop a clear plan for shareholder engagement. A clear and well-executed strategy for shareholder engagement is particularly important where activist hedge funds control large blocks of shares.

As you can imagine, we've only scratched the surface in this write-up. Getting the Deal Through: M&A Litigation 2018 goes much deeper. It covers 13 jurisdictions — Brazil to the U.S. It explores a wider range of the risks of M&A deals. And it brings home just how much getting your deal through matters.

We've recorded two podcasts as well. In these you'll hear about some common themes in global M&A litigation. You can listen to these at hoganlovells.com/malitigation.

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