Activist Hedge Funds and Board Representation: A Comparative Analysis of the European and American Fiduciary Duties in the Context of Activist-Nominated Directors

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Recently, a new breed of representative director has featured European and American corporate boards: activist-nominated directors. Activist-nominated directors are sponsored by hedge funds in course of an activist campaign targeting a listed corporation in a bid to amplify hedge funds' direct influence in board deliberations. Constituency directors are deeply rooted in (Continental) European corporate governance and activist-nominated directors may find that the decision-making processes and deliberations of multi-stakeholder (two-tier) boards are markedly different from majority-independent (unitary) boards, commonly featured at British and American firms. This dynamic in the (Continental) European corporate governance may significantly curtail activist directors' influence in gaining support for their demands that are at odds with the interests of other (board-represented) stakeholder interests at (Continental) European firms.

Keywords: activist-nominated director, constituency director, nominee director, representative director

1. INTRODUCTION

Nominee, or representative directors i.e., directors that were sponsored by a specific constituency in the nomination and election process of public companies, are a common commercial practice in both, Europe and the United States. Major constituencies either specifically contract with the corporation for their right to have a nominee director on the board (venture capital funds, creditors), or derive their nomination rights from company law statutes,[1] corporate governance codes[2] (employees) or charter provisions[3] (major shareholders). For these constituencies, sponsoring a director nominee is synonymous with direct monitoring and decision-making rights in the firm – an attribute that does not normally flow to minority shareholders.

Recently, a new breed of representative director has featured European and American corporate boards: activist-nominated directors. Activist-nominated directors are sponsored by hedge funds in course of an activist campaign targeting a listed corporation in a bid to amplify hedge funds' direct influence in board deliberations.[4] Provided less aggressive tactics, such as private engagement with, or public criticism of, incumbent directors of the target firm fail to persuade target management to implement activists' demands for strategic, capital structure and/or governance

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1 *See* e.g., Code de Commerce [C.com.] [Commercial Code], Art. L. 225-27-1 (Fr.) (setting forth the conditions for employee board representation rights at qualifying French companies); *see also* Mitbestimmungsgesetz [MitBestG] [Co-determination Act], 4 May 1976 BGBl I at 1153, last amended by Gesetz, 24 Apr. 2015, BGBl I at 642 (Ger.), http://www.gesetze-im-internet.de/mitbestg/index.html (setting forth the conditions for employee board representation rights at qualifying German stock corporations).

2 *See* e.g., Financial Reporting Council, UK Corporate Governance Code 2018, 5 (July 2018), https://www.frc.org.uk/directors/corporate-governance-and-stewardship/uk-corporate-governance-code (providing companies with three options for employee participation in board governance, including direct board representation).

3 Aktiengesetz [AktG] [Stock Corporation Act], 6 Sept. 1965, BGBl I at 1089, last amended by Gesetz, 12 Dec. 2019 BGBl I at 2637, Art. 101, http://www.gesetze-im-internet.de/aktg/AktG.pdf.AktG (stipulating that the by-laws of German stock corporations can provide that qualifying shareholders can directly delegate members to the supervisory board).

4 This was one of the main arguments of the opponents of the US proxy access rule 14a-11 for director elections (initially adopted in 2010, but vacated in 2011), contending that shareholder-sponsored directors benefiting from the proxy access rule and elected to the board with the required majority of the shareholder votes, would be special interest directors representing the nominating party's views and balkanizing American corporate boards. *See* Martin Lipton & Stephen A. Rosenblum, *Election Contests in the Company's Proxy: An Idea Whose Time Has Not Come*, 59 Bus. L. 67, 82–83 (2003); for opposing views *see* Lucian A. Bebchuk, *The Case for Shareholder Access to the Ballot*, 59 Bus. L. 43, 54–55 (2003).

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changes, activist funds can take two routes to demanding (and gaining) board representation at the targeted firm: a proxy contest or a settlement with the target firm. A proxy contest is an adversarial path for hedge fund board representation and is initiated with the submission of a (minority or majority[5]) dissident director slate for election at a general meeting, triggering contested director elections.

Proxy contests, on the other hand, are a costly mechanism for revamping corporate boards and their outcome can be highly uncertain for both sides (activist hedge funds and sitting directors). For this reason, activist hedge funds and target management can find it mutually beneficial to avoid a proxy contest and settle their ongoing feud. Settlements between corporate boards and activist hedge funds typically centre on board composition changes, by directly adding to the board, or agreeing to include in the board-sponsored director slate at the next general meeting, one or more directorships.[6] In some cases no formal settlement agreement is executed and the two parties can strike a friendly tone since the outset of the campaign, by agreeing to bring a representative of the activist investor on the board in order to benefit from its expertise and viewpoint. Yet, granting board representation in these circumstances could as well be interpreted as a quick concession to the hedge fund activist due to its reputation of conducting highly confrontational, public activist campaigns, that the target firm wants to avoid. Targeted firms have also offered a seat on the board to activist investors in a bid to normalize investor relations.

The appointment of hedge fund founders or other high-ranking hedge fund officers to corporate boards, however, has important legal implications. Directors affiliated with activist hedge funds can have divided loyalties to the corporation on whose board they serve and to the nominating hedge funds wherefrom they receive compensation packages contingent on the profits that these funds realize throughout their interventions. This dynamic can raise conflict of interests for activist-affiliated directors and may lead to a breach of the fiduciary duty of loyalty that directors are expected to discharge while serving on corporate boards.

To be sure, activist hedge funds do not sponsor only their principals or high-ranking officers as director nominees as independent directors (unaffiliated with the activist or the target management) are regularly sponsored by activist hedge funds. Independent directors, generally, do not face the same conflict of interest as activist directors, although activist hedge funds typically search and nominate at director elections, candidates that are receptive to adopting and advocating the activist fund's strategy, once installed in the corporate boardroom. Nevertheless, independent directors generally have more discretion vis-à-vis nominating hedge funds and can be reflective of a compromise reached between the activist fund and target management (oftentimes in a mixed-slate of independent and activist-affiliated director nominees agreed under a settlement).

Yet, in recent years, activist hedge funds have invented a novel technique to align the incentives of their (independent) candidates nominated from outside the fund, by offering director nominees very lucrative compensation payments contingent on the target firm's share price performance in the near-term, in addition to payments for agreeing to be on the activist-sponsored slate at a proxy contest, and for winning a board seat at the proxy contest.[7] These third-party compensation agreements (also called 'golden-leash') are intended to induce activist-nonmined directors to prioritize the agenda of hedge fund activists, which (at times) may be at odds with directors' duties to act in the long-term interest of the corporation (traditional) institutional investors and/or other stakeholder groups.

Against this background, the goal of this article is to analyse whether activist-nominated directors' representation of the nominating hedge funds' interest in board deliberations (Section A *infra*), sharing of inside or confidential information with the nominating hedge funds (section 3 *infra*) and entering into third-party compensation arrangements with the nominating hedge funds (section 4 *infra*) are (in each case) consistent with their fiduciary duty of loyalty, as applicable in selected European jurisdictions and in the US state of Delaware. These three aspects of the fiduciary duty of loyalty as analysed in section 2, 3 and 4 *infra* can have a direct impact on the effectiveness of hedge funds in implementing their agenda at the targeted firm and can therefore, augment or chill the role of hedge fund activism in the governance of public companies.

2. ACTIVIST-NOMINATED DIRECTORS REPRESENTING HEDGE FUNDS' INTERESTS IN BOARD DELIBERATIONS

2.1. The Fiduciary Duty of Loyalty in European (and Delaware) Law

The fiduciary duty of loyalty is a central tenet of corporate law governing director conduct in conflict-of-interest situations. Principally, it requires directors – in their fiduciary capacity – to act in the interest of the corporation and to forgo personal benefits or actions that may be harmful or contrary to the interest of the corporation. Doctrinally rooted in the common law of trusts, the fiduciary duty of loyalty is highly developed in common law

5 *See* Lazard Shareholder Advisory Group, *2019 Review of Shareholder Activism* 15 (2020), https://www.lazard.com/perspective/lazards-2019-annual-review-of-shareholder-activism/ (showing that in 2019, activists submitted a record number of twenty (long) slates for the election of majority board seats globally, netting thirty-four director seats of the contested elections that were resolved by the end of 2019).

6 For a detailed account of settlements with activist hedge funds in Europe, *see* Ana Taleska, *Settlements with Activist Hedge Funds: A European Perspective on an American Phenomenon*, 45(1) Del. J. Corp L. 49 (2020).

7 *See generally* Sean J. Griffith, Matthew D. Cain, Jill E. Fisch & Steven D. Solomon, *How Corporate Governance Is Made: The Case of the Golden Leash*, 164 U. Pa. L. Rev. 649 (2016) (conducting empirical study on the share price effects to board-adopted anti-golden leash by-laws and shareholder vote on an anti-golden leash by laws).

jurisdictions (United Kingdom and the United States, and in the case of the former, codified to a substantial degree in the Companies Act 2006). In the Continental European jurisdictions, conflict-of-interest rules were developed much later in time, primarily through judicial opinions drawing from civil law fiduciary concepts and the law of agency. To date, there is limited codification of the duty of loyalty in Continental European statutes[8] and arguably, less than desirable coverage of conflicts-of-interest rules applicable to board members.[9]

To take Germany as an example, the Stock Corporations Act (*Aktiengezets*) has traditionally included only a handful of specific conflict-of-interest rules applicable to directors (e.g., restrictions on usurpation of corporate opportunities and a ban on disclosure of confidential information).[10] German courts have attempted to fill this gap by interpreting general civil law fiduciary principles (i.e., the law on agency)[11] in resolving conflict-of-interest situations. The definition of the corporate purpose is one example to this point. The *Aktiengezets* contains no provision stipulating in whose interest directors ought to discharge their duties – an issue that becomes particularly relevant in the context of multi-stakeholder corporate boards (labour, banks and/or the government). However, German courts, in a line of precedents involving labour representatives dating from mid-1970s to early 1980s, have clarified that directors are bound to act in the interest of the corporation (*Unternehmensinteress).*[12]

Soft-law instruments, such as the German Corporate Governance Code, are the latest pronouncements on directors' duty of loyalty, as the German Corporate Governance Commission (*Regierungskommission*, responsible for the adoption of the Code), made the regulation of directors' conflicts of interest one of its priorities back in 2012.[13] Under the Code, the two-tier supervisory and management board have an obligation to ensure the continued existence of the corporation and its sustainable value creation and act in accordance with the company's best interests. Consistent with prior German case-law, the Code further stipulates that this duty applies to shareholder-representatives and employee-representatives serving on German supervisory boards in *equal measure.*[14] The overly board 'best interest'-standard, however, is qualified (differently) in two different contexts. First, management board members, who have the sole prerogative and assume full responsibility for the management of the corporation, must act in the best interests of the corporation,[15] meaning that they consider 'the needs of shareholders, employees and other stakeholders, with the goal of sustainable value creation'.[16] In the context of a pending takeover bid, however, supervisory and management board members are expected to act in the best interest of the company and the shareholders.

The Code also provides that conflicts of interest should be promptly disclosed. Management board members should disclose conflicts to the chairman of the management and of the supervisory board, whereas supervisory directors should report any conflicts of interest to the chair of the supervisory board.[17] It has also been argued that the two-tiered board structure is conducive to less director conflicts compared to a unitary board structure, given the strict division of competences between the management and supervisory boards i.e., the directors entrusted with day-to-day management of the corporation operate via a separate board that is accountable only to the supervisory board, whereas the directors supervising the management board have a part-time, non-executive role and are responsible directly to the shareholders. The two-tier board structure can also be a barrier for activist hedge funds, who by gaining supervisory board representation cannot quickly implement their proposed strategy at the target firm, as day-to-day management of German firms is within the competence of the management board.

In summary, German board members are expected to discharge their fiduciary duties by acting in the interest of the company as whole (and also in the interest of the shareholders in the event of change of control), regardless of the interest of the specific nominating constituency. As Section B *infra* further elaborates, such interpretation of the director fiduciary duties can have important implications for the German multi-stakeholder boards, which can include directors nominated by different constituencies i.e.,

8 *See* Holger Fleischer, *Legal Transplants in European Company Law – The Case of Fiduciary Duties*, Eur. Corp. & Fin. L. Rev. 378, 384 (2005) (arguing that 'the German Stock Corporation Act (AktG) has codified the duty of loyalty only in a rudimentary fashion'); *see also* Carsten Gerner-Beuerle, Philipp Paech & Edmund Philip Schuster, *Study on Directors' Duties and Liability Prepared for the European Commission DG Market* 125 (Apr. 2013), http://eprints.lse.ac.uk/50438/1/__Libfile_repository_Content_Gerner-Beuerle%2C%20C_Study%20on%20directors%E2%80%99%20duties%20and%20liability%28lsero%29.pdf (providing a comparative overview of director duties (of care and loyalty) in the EU Member States).

9 *See* Klaus J. Hopt & Patrich C. Leyens, *Board Models in Europe – Recent Developments of Internal Corporate Governance Structures in Germany, the United Kingdom, France and Italy*, Eur. Corp. & Fin. L. Rev. 135, 142 (2004) (arguing that 'because fiduciary duties in Germany have their foundations in the law of mandate, the issues at the heart of directors' duties- self-dealing, competition with the company, and use of corporate opportunity – are not adequately covered').

10 *See* Gerner-Beuerle, Paech & Schuster, *supra* n. 8, at 125.

11 *See* Klaus J. Hopt, *Conflict of Interest, Secrecy and Insider Information of Directors, a Comparative Analysis*, Eur. Corp. & Fin. L. Rev. 167, 169 (2003) (arguing that the tradition of trust is unknown in civil law jurisdictions, which have in certain areas developed company law rules with reference to civil law agency principles).

12 Will Joachim, *The Liability of Supervisory Board Directors in Germany*, 25(1) Int'l L. 41, 56 (Spr. 1990) (discussing the German case-law on the definition of corporate purpose).

13 *See* Paul L. Davies & Klaus J. Hopt, *Corporate Boards in Europe – Accountability and Convergence*, 61 Am. J. Comp. L. 301 (2013) (also arguing that the European regulation on corporate boards is converging via the adoption and implementation of national corporate governance codes, rather than via statutory changes).

14 RegierungsKommission, Deutscher Corporate Governance Kodex [German Corporate Governance Code] 7 (16 Dec. 2019), https://www.dcgk.de/en/code/gcgc-2020.html.

15 AktG, Art. 913(1) (stipulating management board members' duties to act on the basis of adequate information and in the best interests of the corporation).

16 German Corporate Governance Code, *supra* n. 14, at 2.

17 *Ibid.*, at 13.

employees, controlling shareholders and minority shareholders such as hedge funds).

In France, the *Code de Commerce* provides no doctrinal foundation for the fiduciary duty of loyalty,[18] and the '*devoir de loyauté*' of French directors was for the first time recognized in a line of precedents by the Court of Cassation (*Cour de Cassation*) dating back to 1996 and 1998.[19] The 1995 Viénot I Report (which was commissioned to clarify the role, duties and functioning of the board of directors of French listed firms amid their increasingly foreign shareholder base) also stated that 'management and directors must consider the company first and put the general interest ahead of their own at all times'.[20] French case-law, however, is not equivocal as to the beneficiaries of directors' duties, and under different judicial opinions, directors' duties are owed to the corporation (*obligation de loyauté envers l'entreprise)*, or to the shareholders directly (*obligation de loyauté envers l'entreprise).*[21] In the same vein, and depending on the context, the interests of the company have been interpreted as equal to (*conception contractuelle*) or separate from (*conception institutionnelle*) the shareholders' interests.[22]

Code de Commerce, presently includes only a fragmented set of conflict-of-interest rules[23] (primarily in reference to interlocking directorates (limited to five concurrent board seats)[24] and self-interested transactions with the company[25]), and as a result, French courts have played pivotal role in the development of conflict-of-interest rules in the last two decades, primarily by drawing from fiduciary principles and the law on agency.[26] Similarly to Germany, this lack of comprehensive (and codified) conflict-of-interest rules applicable to board members was taken up in the French Corporate Governance Code. Under the Code, directors have a mandate from all shareholders to act in all circumstances in the best interests of the corporation.[27] Further, directors have a duty to disclose conflicts of interests to the board and recuse themselves from board deliberations and voting on the particular issue.[28] Employee board representatives have the same rights and obligations as shareholder-elected directors and are expected to act in all circumstances in the best interest of the corporation.[29] The Code also provides (in a wording closely resembling the findings of the Viénot I Report) that controlling shareholders are vested with a special responsibility towards minority shareholders that is direct and separate from that of the board of directors, and are specifically required to take into consideration the interests of all shareholders.[30]

Interestingly, the Code discourages firms from having many different special interest directors represented on the board, except in the statutorily defined cases.[31] On this point, and responding to investor criticism about the lack of impartiality and independence of French directors, the Viénot I Report clarified that consistent with the traditional principles of French law and practice 'the board of directors collectively represents all company shareholders, and is not the sum of conflicting interests'.[32] To the contrary '[i]t must carry out its duties in the interests of the company and if it fails to do so, its members are jointly and severally liable'.[33] This position comes close to the arguments advocated by the proponents of board independence in the US (as opposed to the proponents of shareholder primacy), that proxy access i.e., allowing shareholder-sponsored board nominees on the corporate ballot at general meetings

18 *See* Gerner-Beuerle, Paech & Schuster, *supra* n. 8, at 120 (also showing that there seems to be a difference of opinion among French commentators as to whether the legal foundation for directors' duty of loyalty is better placed in their fiduciary role or in the principle of good faith); *see also* Andre Tunc, *A French Lawyer Looks at British Company Law*, 45 Mod. L. Rev. 1, 13 (1982) [hereinafter Tunc, French Lawyer British Law] (arguing that no comparable doctrine to the common law doctrine of fiduciary duties exists under French law); *see also* Andre Tunc, *French Lawyer Looks at American Corporation Law and Securities Regulation*, 130 U. Pa. L. Rev. 757, 767 (1981–1982) [hereinafter Tunc, French Lawyer, American Corporate Law] (arguing that the fact that the absence of a doctrine on directors' fiduciary duties leaves French law 'with serious loopholes').

19 *See* Fleischer, *supra* n. 8, at 383.

20 Conseil National du Patronat Français [French employers' association] & Association Française des Entreprises Privées [The Private-Sector Business Association], *The Boards of Directors of Listed Companies in France* 7 (10 July 1995), https://ecgi.global/code/vienot-i-report [hereinafter Viénot I Report].

21 *See* Fleischer, *supra* n. 8, at 395.

22 Gerner-Beuerle, Paech & Schuster, *supra* n. 8, at 68.

23 *See* James A. Fanto, *The Role of Corporate Law in French Corporate Governance*, 31 Cornell Int'l L.J. 31, 58–62 (1998) (providing a detailed analysis of these rules, including shareholder approval requirements for self-interested transactions but arguing that disclosure standards for managerial conflict-of-interest at publicly-held corporations are insufficiently developed).

24 C.com. Art. L. 225-77.

25 *See* Fanto, *supra* n. 23, at 58–62 (providing an overview of rules pertaining to director self-dealing transactions under French law); *see also* Tunc, *French Lawyer Looks at American*, *supra* n. 18, at 757, 767.

26 *See* Carste Gerner-Beuerle & Edmund-Philipp Schuster, *The Evolving Structure of Director Duties in Europe*, 15 Eur. Bus. Org. L. Rev. 191, 207 (2014).

27 Association française des entreprises privée [AFEP] & Mouvement des entreprises de France [MEDEF] (Fr.), *2018 French Corporate Governance Code for Listed Firms* 6 (July 2018), http://www.afep.com/wp-content/uploads/2018/06/Afep-Medef-Code-revision-June-2018-ENG.pdf [hereinafter French Corporate Governance Code]. *See also* Martin Gelter & Genevieve Helleringer, *Lift Not the Painted Veil: To Whom Are Directors Duties Really Owed*, 2015 U. Ill. L. Rev. 1069 (2015) (providing a comprehensive overview of the on the evolution of the debate on corporate purpose in France and arguing that a current influential interpretation of the *intérêt social* in the French scholarly debate is that directors should maximize shareholder value).

28 French Corporate Governance Code, *supra* n. 27, at 16–17.

29 *Ibid.*, at 7.

30 *Ibid.*, at 4. *See also* Tunc, *A French Lawyer Looks*, *supra* n. 18, at 1, 12–13 [hereinafter Tunc, French Lawyer British Law] (discussing a number of mechanisms that minority shareholders in French public firms may invoke whenever potential abuses by controlling shareholders are suspected to have occurred, including court-appointed expert to conduct an investigation, or temporary manager to run the company affairs, or monitor to observe the conduct of business operations).

31 *Ibid.*

32 *See* Viénot I Report, *supra* n. 20, at 12.

33 *Ibid.*

and the election of special interest directors (such as the activist directors) would lead to disruption and balkanization of American corporate boards.

In the United Kingdom, the extensively developed fiduciary duty of loyalty is comprehensively codified in the Companies Act 2006 and is embedded in the duty to promote the success of the company,[34] duty to exercise independent judgment,[35] duty to avoid conflicts of interests,[36] duty not to accept benefits from third parties[37] and the duty to declare interest in a proposed transaction.[38] In the context of the first of these five duties, which is of central importance for the definition of the fiduciary duty of loyalty, directors are required to promote the success of the company for the benefit of its shareholders as a whole, and in the pursuit of this objective to have regard to the long-term effects of directors' decisions, the interest of employees, the relationship with suppliers and customers, the impact on the environment and company's reputation for adhering to high standards of business conduct. This so-called 'enlightened shareholder value' principle, does not require directors to balance all the enumerated stakeholder interests; instead, directors are expected to run the company solely for the benefit of the shareholders (as a whole) and to take other constituencies' interest into account if this would be beneficial to shareholders.[39]

Further, the separate duty to exercise independent judgment is of direct relevance for nominee directors, who cannot blindly follow instructions from the nominating party. However, in recognition of nominee directors being a commercial reality in the corporate governance of many public and private corporations, the Companies Act 2006 allows the nominee director-status to be enshrined in the company's articles of association, in which case the respective nominee director shall not violate the duty to exercise independent judgment when aligning its position with the nominating constituency.[40] This provision can be particularly useful in private companies or joint ventures, where shareholders with (direct) board representation rights can be allowed to give instructions to their nominees, in line with the articles of association.[41] Even in this case, however, nominee directors are expected to act in a manner consistent with promoting the success of the company for the benefit of its shareholders, as this duty is considered to go to the core of board membership and cannot be waived in the articles of association in relation to nominee directors.

The duty to exercise independent judgment cannot be invoked by (dissident) directors as a legal ground for criticizing the collective decisions of the board. In *Stobart Group v. Tinkler*, the High Court of England and Wales held that 'the duty to exercise independent judgment is one that operates upon each director in the context of him operating as a member of the board of directors', and that whenever a board member discusses with shareholders matters that are within board's discretion, 'any discussion by him on those matters with shareholders, should either be in the presence of the rest of the board or with the prior approval of the board'.[42] This holding has important implications for activist directors who, even if disagreeing with the board's position on a particular issue, may not vent their discontent to other shareholders in an effort to agitate for (governance-related) changes in the firm.[43]

Across the Atlantic, the definition of directors' fiduciary duties by the courts of the US state of Delaware has also oscillated between the singular interest of the corporation and the dual interest of the corporation *and* its shareholders.[44] In the recent case of *In re Trados Incorporated Shareholder Litigation*, the Delaware Court of Chancery citing earlier precedents held that directors seek 'to promote the value of the corporation for the benefit of its stockholders'[45] – a standard of conduct that ostensibly resonates with the British 'duty to promote the success of the company for the benefit of all its members'. This broad formulation is seemingly flexible enough to accommodate (activist-nominated) directors demands for change in corporate strategy or capital structure.[46] Yet, a recent Delaware-precedent demonstrates that activist directors (and their nominating funds) will be held liable for breach of directors' fiduciary duties when pursuing self-interested short-term agendas that are not in the best interest of the corporation and its long-term shareholders, and that the (short-term) investment

34 Companies Act 2006, c. 46, § 172.
35 *Ibid.*, § 173.
36 *Ibid.*, § 175.
37 *Ibid.*, § 176, *see infra* s. C (discussing in more detail the duty not to accept benefits from third party in the context of third-party compensation arrangements between hedge fund activists and activist-nominated directors).
38 *Ibid.*, § 177.
39 Companies Act 2006, c. 46, § 172; *see generally* Richard Williams, *Enlightened Shareholder Value in UK Company Law*, 35 U.N.S.W.L.J. 360 (2012); *see also* Virginia Harper Ho, *'Enlightened Shareholder Value': Corporate Governance Beyond the Shareholder-Stakeholder Divide*, 36 J. Corp. L. 61 (2010).
40 Companies Act 2006, c. 46, § 172, *see also* 11 July 2008, Parl Deb HC (2006) col. 603 (UK) (Solicitor-General (Mr Mike O'Brien).
41 *See* Philip D. Crutchfield, *Nominee Directors: The Law and Commercial Reality*, 20(2) Aus. Bus. L. Rev. 109, 119 (1992).
42 *Stobart Group Limited v. William Andrew Tinkler* [2019] EWHC 258 [413] (Comm).
43 *See* Sam Bagot, *UK Shareholder Activist and Battles for Corporate Control*, Harv. L. Sch. F. on Corp. Governance & Fin. Reg (24 May 2019), https://corpgov.law.harvard.edu/2019/05/24/uk-shareholder-activism-and-battles-for-corporate-control/ (on the implications of Stobart Group v. Tinkler on activist directors).
44 *See* J. Travis Lester & John Mark Zeberkiewicz, *The Rights and Duties of Blockholder Directors*, 70 Bus. L. 33, 49–50 (2015); *see also* E. Norman Veasey & Christine T. Di Guglielmo, *How Many Masters Can a Director Serve – A Look at the Tensions Facing Constituency Directors*, 63 Bus. L. 761, 763 (2008).
45 *In re* Trados Inc. S'holder Litig (Trados II), 73 A.3d 17, 36–37 (Del. Ch. 2013).
46 *See generally* Lucian A. Bebchuk, Alon Brav & Wei Jiang, *The Long Term Effects of Hedge Fund Activism*, 115(5) Colum. L. Rev. 1085 (2015) (providing empirical evidence that firms targeted by activists exhibit improved performance results, following the implementation of the activist intervention).

horizon of activist investors can be a source of conflict-of-interest for activist-nominated directors representing the interests of the nominating fund. In *In Re PLX Technology Inc. Stockholders Litigation*,[47] the Delaware Court of Chancery held that the activist hedge fund Potomac Capital Partners aided and abetted its co-managing member (Eric Singer) in breaching his fiduciary duties as a director of PLX Technology – a company that Potomac targeted with the goal of demanding a sale. Singer was installed on the board and appointed chair of the strategic alternatives committee of PLX after a proxy contest that Potomac had initiated (and won) for the purpose of orchestrating the sale of PLX. Subsequently, PLX entered into a merger agreement with Avago Technologies. Chancellor Lester, deciding upon the shareholder-plaintiff's clam for breach of fiduciary duties by PLX's board members when approving the terms of the merger, stated that 'liquidity is one "benefit that may lead directors to breach their fiduciary duties"[48] and that 'particular types of investors may espouse short-term investment strategies and structure their affairs to benefit economically from those strategies, thereby creating a divergent interest in pursuing short-term performance at the expense of long-term wealth. In particular, "[a] ctivist hedge funds … are impatient shareholders, who look for value and want it realized in the near or intermediate term".[49] On the facts of the case, the Delaware Court held that with the quick sale of PLX, Singer (whose knowledge and actions were attributed to Potomac) had a divergent interest from that of PLX and its shareholders, and breached his fiduciary duties (and induced the other board members to breach their fiduciary duties as well).[50]

2.2. Application of the Fiduciary Duty-Analysis to Activist-Nominated Directors

The foregoing analysis shows that each director is expected to discharge the same set of fiduciary duties and to avoid conflict of interests. Special interests-directors bear no recognition in the national jurisprudence of the European countries analysed in the foregoing section, nor in the US state of Delaware. Moreover, directors are expected to discharge their duties in the interest of the corporation and (for the benefit of) its shareholders (France, United Kingdom, Delaware) and other constituencies (Germany). On this point, judicial opinions, statutory provisions (where available) and corporate governance codes vary (also within the same jurisdiction) and continue to develop and change over time.[51]

Common law (British and American) commentators have argued that the duty to act in the interest of the corporation (or to promote the success of the company for the benefit of its members) is tested against a subjective standard, which in the context of investor activism would imply that to the extent an activist director believes *bona fide* that it is in the firm's best interests to advocate the implementation of a strategy proposed by the nominating hedge fund, no breach of fiduciary duties would occur by virtue of that director having adopted and advocated the interests of the activist hedge fund on the board. [52] Activist-nominated directors in this manner may reconcile their dual fiduciary duty of loyalty to the company and to the nominating investor, provided they do not pursue personal objectives that are in conflict with the best interests of the firm and its shareholders. Undoubtedly, the issue of when an actual conflict of interest exists is fact-sensitive and can only be determined by common law courts on a case-by-case basis. Nonetheless, this approach allows for greater flexibility in accommodating nominee directors as a commercial reality, compared to the Continental European approach where directors' are expected to act in the interest of the corporation as a whole without adopting or representing any specific constituency interests (even when nominated by a specific constituency in order to fill in the statutory quota for board representatives designated to that specific constituency such as employee representatives on German supervisory boards).

Yet, even if activist-nominated directors, due to the fluidly defined corporate purpose[53] or the subjective standard for assessing their behaviour, have some leeway in terms of adopting and advocating the activist hedge fund's agenda, one may wonder how effective activist-nominated directors are in the pursuit of these goals, when serving on the multi-constituency (Continental) European boards. As Gelter & Helleringer have argued, special interest directors 'are likely to steer the corporation on a different course than in a corporation with a more traditional board dominated by senior management' and 'the function of a heterogeneous group of directors may therefore be to create a process of board decision making that will define the specific corporation's objective depending on which groups are represented on the board and that

47 *In re* PLX Tech. Inc. S'holders Litig., No. 9880-VCL (Del. Ch. 7 Nov. 2014).

48 *Ibid.*, at 101.

49 *Ibid.*, at 101–102.

50 *Ibid.*, at 121.

51 *See* Paul L. Davies, *Principles of Modern Company Law* 507 (8th ed. 2008) (arguing that the common-law directors' duties to act in the interest of the corporation has becomes meaningless, and for that purpose the U.K. reformulated directors' duty in the current definition of s. 172 of the Companies Act 2006).

52 For British perspective on this point *see* Deirdre Ahern, *Nominee Director's Duty to Promote the Success of the Company: Commercial Pragmatism or Legal Orthodoxy*, L. Q. Rev. 118, 127 (2011); for an Australian perspective *see* Crutchfield, *supra* n. 42, at 109, 113–114 (discussing the difference between a blanket prohibition for any consideration of nominator's interests as opposed to a more accommodating approach where nominator's interests can be taken into account as long as an honest and reasonable director would still find these to be in the best interest of the company); for a Delaware perspective *see* Veasey & Guglielmo, *supra* n. 45, at 767–773; Kai Haakon E. Liekefett & Leonard Wood, *Help! I Settled with an Activist*, Harv. L. Sch. F. on Corp. Governance & Fin. Reg. (11 June 2019), https://corpgov.law.harvard.edu/2019/06/11/help-i-settled-with-an-activist/ (arguing that Delaware law fiduciary duties, in reality, would not prevent activist directors to pursue the agenda of the nominating activist fund as activist directors would simply have to reach a conclusion that the interests of the fund are aligned with the interests of all shareholders).

53 Gelter & Helleringer, *supra* n. 27, at 1088–1092, 1112–1115.

may, at times, look more like negotiation between different groups than deliberation for a common purpose'.[54]

Indeed, this dynamic seems to play out in Continental European boards where activist-nominated directors join co-determined boards or intervene at a firm with government representatives sitting on the board. For example, in Germany, where half of the board seats of qualifying large corporations are attributed to one constituency (employee-representatives), whereas the remaining (shareholder-)representatives directors can have heterogeneous (long-term v. short-term) interests, hedge funds are not nearly as successful in attaining their objectives, compared to their track record at American target firms. Empirical studies investigating the effects of German hedge fund activism unequivocally show that activist hedge funds produce negative (mean/median) buy-and-hold abnormal returns in the long-run.[55] Furthermore, German firms targeted by hedge fund activists do not experience any fundamental changes in terms of profitability or capital market structure and apart from board turnover, activist investors are unable to implement any value-enhancing strategy at German targets.[56]

Government board representatives are also a common feature of German and French corporate boards in firms with state ownership and have reportedly stood in the way of major restructurings in these firms. For example, in the 2019 merger negotiations between Renault and Fiat Chrysler, the French government, which held 15% of the French automobile-maker and a seat on Renault's board, demanded a seat on the board of the merged Renault-Fiat entity, along with membership on the four-person nomination committee and veto rights over prospective chief executive appointments. Simultaneously, the French merger arbitrage hedge fund CIAM criticized the terms of the merger as unfavourable to Renault's shareholders (among which was CIAM).[57] The merger negotiations ultimately failed in June 2019 and the French government's demands relating to job security for Renault's employees, headquarters located in Paris and the corporate governance of the merged firm were blamed for this turn of events.[58]

These examples only briefly illustrate the complexities that activist-nominated directors are faced with, when serving on multi-stakeholder European boards. In contrast to American and British boards, where majority of directors are independent and corporate ownership is widely dispersed, European boards (may concurrently) feature employee representatives, government representatives, bank representatives and blockholder representatives, in addition to independent directors.

In more general terms, there are a number of board-related/governance factors that can inversely affect European hedge fund activism. For example, in both Germany and France, there is no fixed proportion of independent directors that boards should comply with. In Germany, the optimal number of independent members (from the sitting shareholder representatives) is left for each supervisory board to decide,[59] whereas in France the minimum requirements vary between one-half for widely held firms, and only one-third for firms with a controlling shareholder (excluding employee board representatives in each case).[60] Further, annual board elections are not a standard practice at many European listed firms. In Germany, directors are elected for a five-year (non-staggered) term, whereas in France, directors are elected for a four-year term and staggered boards are commonly implemented, allowing for at least some director turnover each year.[61] Moreover, the submission of a majority-or-full dissident director slate at general meetings is substantially curtailed under the national takeover law provisions, as collectively submitted dissident director slates by investors holding qualifying share-ownership (of typically 30% of the outstanding shares) may trigger an obligation for the shareholder proponents to launch a mandatory takeover bid for all outstanding shares (United Kingdom, Germany and Italy).[62]

In light of the foregoing, activist investors and their board representatives at European firms are less likely to successfully

54 *Ibid.*, at 1117–1118.

55 *See generally* Mark Mietzner & Denis Schweizer, *Hedge Funds Versus Private Equity Funds as Shareholder Activists in Germany – Differences in Value Creation*, 38(2) J. Econ. & Fin. 181 (2014), *see also generally* Tilman Drerup, *Long-Term Effects of Hedge Fund Activism in Germany* (2015), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1718365.

56 Drerup, *supra* n. 56, at 28.

57 *See* CIAM (Catherine Berjal), *Lettre aux administrateurs de Renault* [*Letter to Renault's Directors*] (3 June 2019), https://www.ci-am.com/news/2019/6/4/communiqu-de-presse-lettre-aux-administrateurs-de-renault.

58 Julia Kollewe, *Renault-Fiat Chrysler Merger Collapses, French Government Blamed as €33bn Deal to Create World's Third-Largest Carmaker Stalls*, Guardian (6 June 2019), https://www.theguardian.com/business/2019/jun/06/renault-fiat-chrysler-merger-collapses. Similarly, in 2017, the then-CEO of Renault publicly stated that the continued share-ownership of the French government in Renault is a barrier to implementing capital structure changes in the cross-shareholding structure of the Renault-Nissan alliance, *see* Peter Campbell, Arash Massoudi, Harriet Agnew & David Keohane, *French Government to Sell Down Stake in Carmaker Renault*, Fin. Times (2 Nov. 2017), https://www.ft.com/content/09bb0859-4c7f-319b-ad0d-4c908c0b82a3.

59 German Corporate Governance Code, *supra* n. 14, at 8.

60 French Corporate Governance Code, *supra* n. 27, at 7.

61 *See* State Street Global Advisors, *Board Accountability in Europe: A Review of Director Election Practices Across the Region* 2 (May 2018), https://www.ssga.com/investment-topics/environmental-social-governance/2018/05/board-accountability-in-europe-2018.pdf. *See also generally* State Street Global Advisors, *State Street Global Advisors' Response to the Proposed Amendments to the German Corporate Governance Codex (Kodex)* (31 Jan. 2019), https://www.ssga.com/investment-topics/general-investing/2019/01/ssga-response-to-german-corporate-governance.pdf (criticizing the lack of independent director requirements and the five-year supervisory board member's terms and calling for annual director elections).

62 *See* Ana Taleska, *Shareholder Proponents as Control Acquirers: A British, German and Italian Perspective on the Regulation of Collective Shareholder Activism via Takeover Rules*, 19 Eur. Bus. Org. L. Rev. 797 (2018) (discussing the impact of British, German and Italian takeover rules on the submission of majority-or-full dissident director slate at general meetings).

implement one-sided corporate strategies whose only objective is to maximize short-term shareholder value, while creating externalities for long-term shareholders, blockholders, creditors, employees and more generally, adversely affecting environmental, social and governance factors. To be sure, activist strategies can be instrumental in remedying underperforming companies and activist funds deploying inclusive, value-creating strategies that are cognizant of the multi-stakeholder nature of corporate entities can go a long way in the context of the consensus-based approach that underlies European corporate governance.[63] This is also reflected in the stark difference in the buy-and-hold returns that non-aggressive hedge funds are able to realize at German target firms, relative to aggressive hedge funds tactics (of 27.06% for non-aggressive as opposed to 3.12% for aggressive hedge funds during the time window of forty days before and 720 days after announcement of the activist intervention[64]).

3. INFORMATION-SHARING BETWEEN ACTIVIST DIRECTORS AND NOMINATING HEDGE FUNDS

An important facet of the fiduciary duty of loyalty is directors' duty of confidentiality. In the subsequent two sections, I analyse directors' non-disclosure duties as they relate to inside and confidential information (respectively), with a comparative (European and American) focus on how the duty of confidentiality plays out in the context of activist-nominated directors.

3.1. Inside Information

In course of their tenure, directors are regularly briefed on non-public (share) price-sensitive information relating to different aspects of corporate operations, governance or strategy. As corporate fiduciaries, directors are typically restricted under insider trading laws from directly trading on this information. However, recent empirical evidence from the US indicates that inside information is regularly disclosed from activist directors to nominating hedge funds (or hedge funds' employees). The nominating hedge fund typically cannot trade on this information due to US insider trading restrictions and standstill provisions under the settlements entered with target boards, but is not legally precluded from onward tipping this information to other activist funds and/or employees of other activist funds.[65] This information exchange is premised on an understanding that the tippees will financially benefit from trading on leaked insider information and in return, will support the tipper (i.e., the lead activist hedge fund sitting on the board of the target firm) throughout the activist intervention until its goals vis-à-vis target management are achieved.[66]

For these externalities to occur, however, the legal framework governing insider trading has to be permissive of such exchanges of inside information between activist directors and nominating investors, and of the onward disclosure of this information from the lead activist fund (or its employees) to other funds (or the employees of the recipient funds). In the US, tipping violations are assessed against the 'personal benefit test' developed by the Supreme Court in *Dirks v. SEC*, requiring that the tipper receives a personal benefit from the tippee before insider trading liability can be imposed.[67] This test may be initially easy to enforce against an activist-affiliated director tipping its nominator, but becomes increasingly more challenging to satisfy with every subsequent onward disclosure to the next tippee.[68]

In contrast, under the EU Market Abuse Regulation (MAR) any disclosure of material non-public (inside) information is illegal, unless made in the 'normal exercise of an employment, profession and duties'.[69] This exception from the general tipping restriction under EU law was tested before the European Court of Justice (ECJ) in the context of representative directors sharing inside information to their constituency – a scenario that was likely to appear on the ECJ's docket given the multi-stakeholder composition of corporate boards. In the *Grøngaard/Bang*-case,[70] an employee-elected board member (Mr Grøngaard) of a Danish listed financial institution disclosed inside information about a prospective merger of the financial institution to the general secretary (Mr Bang) of the trade union organizing the employees that appointed Mr Grøngaard to the board of the financial institution. Mr Bang subsequently disclosed this information to his colleagues at the trade union, and the latter traded on the inside information. In a preliminary ruling procedure, the ECJ ruled that the issue of which course of action falls within the 'normal exercise of an employment, profession and duties' is a matter of national law.[71] By extension, the question of

63 *Ibid.*, at 107–108 (discussing the German stakeholder system of corporate governance and arguing that 'politicians, unions, and many corporate managers uniformly agree that investors with limited stakes should not be allowed to control or eve influence key strategic and financial decisions').

64 *Ibid.*, at 132.

65 *See* John C. Jr. Coffee, Robert J. Jr. Jackson, Joshua R. Mitts & Robert E. Bishop, *Activist Directors and Agency Costs: What Happens When an Activist Director Goes on the Board*, 104 Cornell L. Rev. 381, 397 (2019) (discussing the potential recipients (and potential onward disclosure) of inside information leaked by activist directors in conjunction with US insider trading rules).

66 *Ibid.*, at 401–434 (in support of this argument about activist directors' information leakages, the authors present evidence of increased buy/ask spread of target firm shares, and abnormal trading activity following the appointment of activist director on target firm's board).

67 *Dirks v. SEC* 463 U.S. (1983), *see also* United States v. Newman 773 F.3d 438 (2d Cir. 2014), *Salman v. United States* 137 S. Ct. 420 (2016), United States v. Blaszczak No. 18-2811 (2d Cir. 2019) (subsequent opinions interpreting the 'personal benefit'-test).

68 *See* Coffee, Jackson, Mitts & Bishop, *supra* n. 66, at 437 (arguing that as the disclosure chain continues, the tippees may not know whether the tipper received a personal benefit for leaking the information or had a legitimate reason for sharing this information with the appointing hedge fund).

69 Council Regulation (EU) 596/2014, Art. 10, 2014 O.J. (L 173).

70 C-384/02 Criminal proceedings against Knud Grøngaard & Allan Bang, 2005 E.C.R I-09939.

71 *Ibid.*, para. 51.

whether an employee representative of the board may disclose inside information to the general secretary of the trade union representing the employees and electing the respective director to the board can only be answered by reference to national company law provisions, provided a close link exists between the disclosure and the exercise of the disclosing parties' employment, profession or duties, and that the disclosure is strictly necessary for the exercise of that employment, profession or duties.[72]

National courts deciding on the lawfulness on this type of disclosure – as per the ECJ's *Grøngaard/Bang*-opinion – must adhere to a strict interpretation of this test and give weigh to the fact that every subsequent onward disclosure increases the risk of violating the insider trading and tipping prohibitions set out market abuse rules, in particular if the information is sensitive such as a planned merger involving the company.[73]

In the aftermath of ECJ's preliminary ruling, the Danish courts held that disclosures of sensitive information from board members to trade union officials fell within the normal exercise of employee-elected board representatives' duties under Danish company law, and acquitted Mr Grøngaard and Mr Bang on the insider trading charges.[74] However, given MAR's reference to national rules for interpreting when information disclosure fall within the 'normal exercise of an employment, profession and duties', the facts of the *Grøngaard/Bang*-case may turn differently in another EU Member State, leading to a fragmented and inconsistent application of the EU insider trading rules in the context of information-sharing by nominee directors with the nominating constituency. Germany, is one example to this point, where employee-representatives on German boards (unlike in Denmark) are prevented from sharing confidential information with work councils or trade unions.[75] Also in France, directors representing employees (and/or employee shareholders), have the same rights and duties as all other board members, in particular in relation to confidentiality obligations.[76]

All else being equal, an activist-nominated director, arguably, can have a harder time showing that disclosure of inside information to the nominating hedge fund is conducted within the normal exercise of that director's duties, compared to other constituencies with statutory board representation rights in European listed firms. In the latter case, access to corporate boardrooms is adopted as a matter of public policy and societal consensus (e.g., co-determination, representation rights to major (family) shareholders, creditors (banks) or the government), whereas hedge fund activism has been fiercely opposed by the European business elites and political establishment, leading to a number of recent regulatory initiatives in a number of European jurisdictions (e.g., France, The Netherlands, Belgium) aimed at empowering long-term (traditional) shareholders, curtailing the rights of activist investors and demanding more disclosure in course of their conduct vis-à-vis European target firms.[77]

3.2. Confidential Information

In addition to inside information, which is statutorily defined as 'price-sensitive' non-public information of 'precise nature' relating to issuers of securities, directors regularly come across information that may not qualify as material, price-sensitive or imprecise (within the meaning of the EU insider trading rules), but is nonetheless in the best interest of the firm to be kept confidential. Corporate statues typically have no specific definition delineating the scope of confidential information and companies endeavour in their policy statement on confidentiality or through contractual arrangements with directors and/or constituencies, to define the scope of confidential information as broadly as possible.[78] As the below jurisdictional overview illustrates, European corporate statutes have uniformly adopted a strict non-disclosure policy for board members, whereas the courts in the US state of Delaware, have developed a more accommodating approach on informational exchanges between nominee directors and their constituencies.

In Germany, members of the supervisory and executive board have a duty to keep secret any confidential information, including confidential deliberations of the board, and are personally liable to

72 *Ibid.*, para. 48.

73 *Ibid.*

74 *See generally* Jasper Lau Jansen, *A Stricter Duty to Disclose Information to the Market in Denmark? The Dilemma Faced by Danish Companies, and Their Options Under the Decision by the Danish Securities Council in the TDC Case*, 5(2) Eur. Comp. L. 47 (2008).

75 *See generally* Martin Gelter & Genevieve Helleringer, *Constituency Directors and Corporate Fiduciary Duties*, in *The Philosophical Foundations of Fiduciary Law* (Andrew Gold & Paul Miller eds 2014).

76 French Corporate Governance Code, *supra* n. 27, at 7.

77 For recent French initiatives calling for tightened disclosure obligations for hedge fund activists and lowering the beneficial ownership disclosure threshold, *see* Club des Juristes Report, *Shareholder Activism* (Nov. 2018), http://www.leclubdesjuristes.com/wp-content/uploads/2019/11/Shareholder-Activism-Le-Club-des-juristes-nov.2019.pdf; *see also* Assemblée Nationale [National Assembly], *Activisme actionnarial: Examen d'un rapport d'information* (2 Oct. 2019), http://www2.assemblee-nationale.fr/15/commissions-permanentes/commission-des-finances/secretariat/a-la-une/activisme-actionnarial-examen-d-un-rapport-d-information; *see also* Davies & Hopt, *supra* n. 13, at 370 (discussing the changes in Dutch law with respect to minority (activist) shareholders).

78 *See* American Bar Association's Corporate Directors Guidebook, *Corporate Director's Guidebook* (5th ed. 2007), reprinted in 62 Bus. L. 1479, 1500 (2007) (stating that 'a director must keep confidential all matters involving the corporation that have not been disclosed to the public'); *see also* Cyril Moscow, *Director Confidentiality*, 74 L. Contemp. Probs. 197, 204–205 (2011) (arguing that only material information whose disclosure has not been (explicitly nor implicitly) consented by the corporation should qualify as confidential information); *see also* David A. Katz & Laura A. McIntosh, *Boardroom Confidentiality Under Focus*, N. Y. L.J. 2 (23 Jan. 2014) (categorizing confidential, non-public information into proprietary information (including trade secrets), inside information (regarding firm finances, operations and strategy), and sensitive information regarding board proceedings and deliberations, but arguing that for the purposes of drafting a firm confidentiality policy, confidential information should comprise 'all non-public information entrusted to or obtained by the directors due to their position on the board').

the corporation for any damages occurring as a result of the breach of the duty to keep information confidential.[79]

In France, directors of public companies have the right to be informed at all times and can require the chairman of the board to supply all information necessary for the effective discharge of director's duties at board meeting.[80] Relatedly, directors have an obligation under the French Commercial Code to keep secret any confidential information, designated as such by the president of the board directors.[81] The French Corporate Governance Code goes a step further by stipulating that directors have a strict duty of confidentiality with respect to any non-public information acquired in the performance of director's duties.[82] This duty to maintain confidentiality is equally applicable to employee-representatives on the board.[83]

In the United Kingdom, there is no statutory duty of confidentiality applicable to directors under the Companies Act 2006, but directors' confidentiality is considered an important aspect of their fiduciary duty of loyalty. However, in the spirit of the contractual nature of British company law, companies and shareholders can regulate the flow of confidential information in line with their preferences, either in their articles of association/by-laws, corporate policies or contractually.[84]

Interestingly, in *Stobart Group v. Tinkler*,[85] the High Court of England and Wales held that Mr Tinkler, as a director of Stobart Group, breached his duty of loyalty when selectively shared confidential information to some of Stobart Group's shareholders, without prior approval of the board, in a bid to steer change at the company and replace the chairman of the board. Relatedly, British directors have a general (statutory) duty to avoid conflicts of interest, which expressly includes the duty not to exploit any property, information or opportunity for personal benefit, regardless of whether the company could have taken advantage of the property, information or opportunity in question.[86]

Similarly to the U.K., where no separate statutorily defined duty to maintain confidentiality exists under the Companies Act 2006, the director's duty to maintain confidentiality in the US state of Delaware is deemed inherent to the fiduciary duty of loyalty.[87] Delaware courts, however, appear more cognizant of the practical reality of information-sharing between representative directors and their nominating investors and in *Körtum v. Webasto Sunroofs Inc.*,[88] the Delaware Court of Chancery found that the board cannot restrict constituency director's right to access corporate information on the ground that this director will subsequently disclose this information to the designating investor. The Court of Chancery further held that '[w]hen a director serves as the designee of a stockholder on the board, and when it is understood that the director acts as the stockholder's representative, then the stockholder is generally entitled to the same information as the director'.[89] Subsequently, in *Kalisman v. Friedman*, the Delaware Court of Chancery held that the director's right to information is 'essentially unfettered in nature' and that 'a corporation cannot assert a privilege and deny a director access to legal advice furnished to the board during the director's tenure', even though the director that was denied access to information was a founding member of the firm's largest shareholder that has waged a proxy fight and that director was included in the insurgent shareholder-sponsored director slate.

The Delaware-approach may serve as an example also for European jurisdictions, given that information-sharing between nominee directors and their designating constituencies is even more likely to occur in the context of the European multi-stakeholder boards. Without a sensible policy towards confidential information-sharing between nominee directors and their constituencies, corporate boards may use their claim for breach of fiduciary duties against disclosing directors in a selective manner.[90] However, in the absence of a statutory and ideally, EU-harmonized approach on this issue, a contractual approach may be in order. European firms, board members and their designating shareholders should consider executing confidentiality agreements governing sensitive information-sharing and ultimately, avoiding director (and investor)-liability as a result of undue leakage of sensitive information.[91] Activists and boards negotiating a settlement seem to have followed this contractual approach, as settlement agreements commonly include provisions regulating the flow of information between activist-

79 AktG, Arts 93 (on executive board's duty of confidentiality), 116 (on supervisory board's duty of confidentiality).

80 French Corporate Governance Code, *supra* 27, at 17.

81 C.com. Art. L. 225-37.

82 French Corporate Governance Code, *supra* 27, at 17.

83 *Ibid.*, at 7.

84 Summary of Key Terms in Relationship/Confidentiality Agreement between Rolls-Royce Holdings plc, the ValueAct Group and Bradley Singer dated 3 Mar. 2018, https://www.rolls-royce.com/~/media/Files/R/Rolls-Royce/documents/about/summary-of-key-terms-in-relationship-confidentiality-agreement.pdf (showing that the activist director was expressly authorized to share confidential information with the activist fund (ValueAct Capital)).

85 *See Stobart Group v. Tinkler*, *supra* n. 43.

86 Companies Act 2006, c. 46, § 175.

87 *See* Lester & Zeberkiewicz, *supra* n. 45, at 52 (pointing out that the first established the director's duty of confidentiality in *Henshaw v. American Cement Corporation*, 252 A.2d 125 (Del. Ch. 1969)); *see* Moscow, *supra* n. 79, at 200.

88 *Körtum v. Webasto Sunroofs Inc.* 769 A.2d 113 (Del. Ch. 2000).

89 *Kalisman v. Freidman*, C.A. No. 8447-VCL (Del. Ch. 2013). *See also* Moscow, *supra* n. 79, at 207 (arguing that there is an implied shareholders' consent for a shareholder-sponsored director elected at a proxy contest to share confidential information with the sponsor i.e., the shareholder that sponsored its nomination at the director elections).

90 Lester & Zeberkiewicz, *supra* n. 45, at 55.

91 *See* e.g., Catherine G. Deerlove & Jennifer J. Veet Barrett, *What to Do about Informational Conflicts Involving Designated Directors*, Prac. L. 45, 48–52 (2011) (proposing the execution of confidential agreements as a preferred course of action for avoiding undue disclosure of confidential information).

affiliated directors and designating investors, and/or have regulated the handling of confidential information under a separate confidentiality agreement concluded with the activist investor.[92]

Directors, however, may not always readily agree to execute restrictive confidentiality agreements with the firms on whose boards they serve. Under Delaware law, firms cannot compel directors to execute such agreements as the duty to maintain confidentiality already forms part of directors' fiduciary duties. Furthermore, strict confidentiality undertakings may contravene with the exercise of directors' fiduciary duties and may place directors in a position of conflict in choosing whether to comply with confidentiality restrictions or its fiduciary duties. Yet, even if directors do not enter into confidentiality agreements, designating investors may enter into confidentiality agreements with the firm as a matter of good governance practice, particularly in situations when directors obtain a seat on the board as a result of proxy contest and no agreement between the director and the firm was in place before the shareholder-sponsored director assumed board membership.

4. GOLDEN LEASH COMPENSATION ARRANGEMENTS

In course of the 2013 proxy season two US hedge funds, Elliott Management and JANA Partners filed dissident director slates for election at the general meetings of the New York-based oil producer, Hess Corp., and at the Canadian agricultural products-supplier Agrium, respectively. Each fund offered its director nominees compensation arrangements designed to reward activist-nominated directors relative to target firm's share price performance over a three-year time horizon. The compensation offered by Elliott was tied to each percentage point that Hess Corp.'s share price outperformed its peers, whereas JANA Partners offered activist-sponsored directors (collectively) 2.6% of its net investment gain from its intervention at Agrium, in addition to a fixed USD 50,000 fee for serving on Agrium's board of directors.[93]

The introduction of 'golden leash' compensation to activist-nominated directors was expectedly, controversial. Activist hedge funds argued that golden leash payments help them find and entice qualified candidates to agree being nominated on a dissident director slate and to improve target firms' performance while serving on the board. On the other hand, significant backlash ensued from the business community, arguing that golden leash arrangements lead to short-termism, destroy sustainable value creation by target firms and creates a special class of directors within corporate boards that has outsized monetary incentives to pursue strategic changes within a specific timeframe. Adhering to this line of argumentation, the prominent New York law firm Wachtel, Lipton, Rosen & Katz drafted and (publicly) distributed an anti-golden leash by-law that would disqualify director nominees with third-party compensation arrangements.[94] The bylaw was immediately adopted by (about thirty) corporate boards, but later abandoned as proxy advisors (i.e., ISS) criticized the adoption of anti-golden leash by-laws without shareholder approval and advised investors to withhold support from directors having discretionally adopted such by-laws.[95] On the regulatory side, NASDAQ adopted a disclosure rule in 2016, requiring listed companies to make public any third party payments to (nominees for) board directorship.[96]

Golden leash payments can be problematic from the perspective of the (European) conflict-of-interest regulations applicable to board members, even though no third-party compensation arrangements with respect to European activist-nominated directors have been reported thus far. Executive compensation is an important tool for aligning board members' incentives with the desired outcomes. The regulatory wave of say-on-pay reforms introduced in the aftermath of the financial crisis, including the 2017 Amendments to EU Shareholder Rights Directive,[97] had exactly the purpose of aligning directors' incentives with long-term value creation. Yet, third party compensation arrangements can interfere and possibly, distort the incentives that companies have intended to create for board members by virtue of their own compensation programs.

Several European jurisdictions already have in place rules that address the issue of directors' receipt of third-party payments/benefits, from the perspective of conflict-of-interest rules and/or from the perspective of executive remuneration regulations. First, the

92 For example, under the Cooperation Agreement by and among Microsoft Corp. and ValueAct Group that provided for the appointment of the President and CEO of ValueAct Capital, Mr G. Mason Morfit, the activist fund may be provided with confidential information in a manner governed by a separately executed Confidentiality Agreement; *see* Cooperation Agreement dated 28 Aug. 2013, by and among Microsoft Corporation and ValueAct Group, https://www.sec.gov/Archives/edgar/data/789019/000119312513354149/d592198dex991.htm.

93 *Ibid.*, at 652, *see also* Matteo Tonello, *Activist Hedge Funds, Golden Leashes, and Advance Notice Bylaws*, Harv. L. Sch. Blog on Corp. Governance & Fin. Reg. (7 Jan. 2016), https://corpgov.law.harvard.edu/2016/01/07/activist-hedge-funds-golden-leashes-and-advance-notice-bylaws/.

94 Wachtel, Lipton, Rosen & Katz, *Shareholder Activism Update: Bylaw Protection Against Dissident Director Conflict/Enrichment Schemes* (9 May 2013), https://clsbluesky.files.wordpress.com/2013/05/shareholder-activism-update-bylaw-protection-against-dissident-director-conflict-enrichment-schemes-1.pdf. For a critique of the Wachtell Bylaw from a Delaware corporate law perspective, *see* Brandon S. Gold, *Why the Wachtell Bylaw on Director Compensation by Shareholders Is Overbroad and May Fail Blasius Scrutiny*, Colum. L. Sch. Blog on Corp & Cap. Mkt. (31 May 2013), https://clsbluesky.law.columbia.edu/2013/05/31/why-the-wachtell-bylaw-on-director-compensation-by-shareholders-is-overbroad-and-may-fail-blasius-scrutiny/.

95 Institutional Shareholder Services, *Director Qualification/Compensation Bylaw FAQs* (13 Jan. 2014), https://www.issgovernance.com/file/files/directorqualificationcompensationbylaws.pdf.

96 *See* The Nasdaq Stock Market LLC; Notice of Filing of Amendment No. 2 and Order Granting Accelerated Approval of a Proposed Rule Change, as Modified by Amendment No. 2, to Require Listed Companies to Publicly Disclose Compensation or Other Payments by Third Parties to Board of Director's Members or Nominees, Securities and Exchange Commission, Release No. 34-78223 (1 July 2016), https://www.sec.gov/rules/sro/nasdaq/2016/34-78223.pdf.

97 Council Directive 2017/828, 2017 O.J. (L132) 1 (introducing say-on-pay obligations for European listed firms).

2017 German Corporate Governance Code had a general prohibition for board members to 'demand or accept inappropriate benefits from third parties for themselves or for any other person in connection with their work rendered for the company'.[98] To the extent they are allowed (i.e., are not inappropriate), the German Code (similarly to the NASADQ-rule) required companies to disclose directors' third party benefits by adding them to the fixed, one-year and multi-year variable remuneration components in the standardized (executive remuneration disclosure) format set forth in the Code.[99] Driven by the executive remuneration disclosure rules set out in the 2017 EU Shareholder Rights Directive and their mandatory transposition into the national laws of EU Member States, legislative changes ensued in Germany where the German Stock Corporations Act was amended in December 2019 in order to set out an obligation for German public companies to prepare a remuneration report on the executive compensation of supervisory and management board members, which report should also include information, inter alia, on services that a member of the management board has been promised by a third party with regard to his activity as a board member.[100]

Second, the British Companies Act 2006 regulates third party benefits in the context of directors' fiduciary ('no-conflict') duties, and provides that a director is prevented from accepting a benefit from a third party conferred by reason of his being a director, or by reason of doing anything in his capacity as a director, unless the receipt of the benefit cannot reasonably be regarded as likely to give rise to a conflict of interest.[101]

In conclusion both, the German and British rule show that third party benefits are not *per se* prohibited, as long as they do not create conflict-of-interests for the directors receiving the benefits, in which case directors would breach their fiduciary duty of loyalty. Yet, in the German multi-stakeholder system of corporate governance and under the British Companies Act 2006 (requiring directors to promote the success of the company for the benefit of *all* shareholders, and in so doing have regard to different stakeholders, including long-term effects), golden leash payments may well be interpreted by national courts as conflicting with the interests of (long-term) shareholders, in particular if intended to serve short-term activists' goals.

5. CONCLUSION

The purpose of this article is to analyse whether activist-nominated directors would act in a manner consistent with their fiduciary duty of loyalty when representing the interests of, sharing confidential information with, or accepting compensation from, the nominating hedge funds. To address the first of these three lines of analysis of the law of fiduciary duties, it starts by explaining the genesis of the fiduciary duty of loyalty in three European jurisdictions (Germany, France, and the United Kingdom) and shows that, in each case, directors' duties apply uniformly to directors regardless of whether they were nominated by an activist investor or by a constituency with statutory or contractual board representation rights. Each board member has a duty to act solely in the interest of the corporation (and possibly (for the benefit of) its shareholders, employees, creditors or other stakeholders, depending on the national law (and prevailing judicial interpretation)). Such broadly construed corporate purpose, in conjunction with a subjective standard for assessing the legality of directors' actions, may leave nominee directors ample opportunity to adopt and promote objectives that in their personal *bona fide* belief are in the interest of the corporation, while at the same time coinciding with the interests of the nominating constituency. In these settings, the interest of the corporation becomes endogenous to board composition and relatedly, the discharge of director's fiduciary duties which is typically assessed from the viewpoint of the interest of the corporation can and does, as this article in Part A *supra* shows, accommodate directors' representation of opinions that largely reflect the interests of a nominating constituency including, the interests of an activist investor.

Second, it shows that the Continental European fiduciary duty of loyalty assumes strict confidentiality on the side of board members and as a result thereof, the sharing of confidential information, including with a nominating constituency, would lead to direct violation of the statutory company law provisions (France, Germany). This article argues, however, that in light of the multi-stakeholder boards being a common practice in Continental Europe, the more flexible common law approach (UK, Delaware) to sharing confidential information with a nominating constituency would be more appropriate and can be developed in Europe in a manner consistent with the fiduciary duty of loyalty either via statutory rules or contractually, provided the confidential nature of the disclosed information is ensured.

Third, it outlines the main features of the golden-leash arrangements between activist-nominated directors and the nominating hedge funds as developed in the US and shows that even though these arrangements have not yet been reported to occur in the European context, the existing legal framework under the German and British company laws already provides a disclosure mechanism for third party compensation arrangements entered into by board members in connection with their service on the board, which would allow investors to be informed of such arrangements and take appropriate action, to the extent they are not aligned with the corporate interest.

98 German Corporate Governance Code, *supra* n. 14, at 8.
99 *Ibid*., at 16.
100 AktG, Art. 162, https://www.bgbl.de/xaver/bgbl/start.xav#__bgbl__%2F%2F*%5B%40attr_id%3D%27bgbl119s2637.pdf%27%5D__1613150294980.
101 Companies Act 2006, c. 46, § 176.

Constituency directors are deeply rooted in (Continental) European corporate governance and activist-nominated directors may find that the decision-making processes and deliberations of multi-stakeholder (two-tier) boards are markedly different from majority-independent (unitary) boards, commonly featured at British and American firms. This dynamic in the (Continental) European corporate governance may significantly curtail activist directors' influence in gaining support for their demands that are at odds with the interests of other (board-represented) stakeholder interests at (Continental) European firms. Consequently, activist-nominated directors may have to adapt to a more cooperative and inclusive style of governance, in order to have their voice heard in European boardrooms.