



The Professionalization of Shareholder Activism in France

by Carine Girard and Stephen Gates

Shareholder activism in France is increasingly influenced by networks of hedge fund investors and other specialized players (including proxy advisory firms and investor associations). In the last few years, these networks have professionalized the way shareholder activism is conducted in the country. This report summarizes notable activism developments in France and examines the phenomenon of professionalization with two recent examples: the Suez-Gaz de France and the Atos Origin cases.

The Increasing Complexity of Shareholder Activism in France

This report contributes to a specific understanding of shareholder activism influence on French companies. In France, the need for financial capital drove the government and the business community to adopt select legal

and institutional modifications¹ imposed by Anglo-Saxon institutional investors.² Changes in French legislation, accompanied by the rise of proxy-voting advisory firms and the search for innovative investment strategies by hedge funds, have strengthened the impact of institutional investor networks and led to increased professionalization of shareholder activism.



Evolution in French shareholder rights legislation Only a few years ago, a report demonstrated that an activist shareholder's announcement registered only a low level of public reaction (as measured by cumulative abnormal returns).³ This finding could be explained by the passive role of institutional investors, which in turn was due to the following three constraints in French corporate law:

- 1 Prior to the 2001 New Economic Regulation Law, institutional investors needed to gather 10 percent of voting rights to be able to put forward a shareholder proposal. The 2001 New Economic Regulation reduced the threshold to between 1 and 5 percent of voting rights, depending on the company's market capitalization level.⁴
- 2 Until 2003, institutional investors were not required to report on the exercise of their voting rights attached to shares held by collective pension schemes. The 2003 Financial Security Act established the principle that investment management companies must exercise the voting rights held by their funds "in the exclusive interest of [...] shareholders and unitholders." For any decision contrary to this general principle, asset managers are required to explain why they have not exercised those rights and "report their practices."⁵
- 3 Before the publication of the 2005 Mansion Report, institutional investors had to suspend the public trading of their shares five days prior to the annual general meeting (AGM) of shareholders. The report included the recommendation, which then became law, that a record date system be established. Under the new system, shareholders wishing to vote in general meetings have to produce a certificate proving that their shares have been blocked or recorded. Today, under the law, shareholders wishing to attend the meeting in person and who have not received their admission card before midnight Central European Time (CET) on the third business day before the meeting shall also be provided with a certificate.⁶

Before these three legislative changes, institutional investors preferred that investor associations improve the chances of shareholder activism success.⁷

Role and tactics of French investor associations French investor associations generally initiate a legal action at an early stage in the activism process. The lawsuit may either replace or accompany other, more traditional, activism-related activities. Immediately launching a lawsuit presents a number of advantages,⁸ including:

- making use of legal loopholes;
- threatening that an AGM be convened by a representative appointed by the court;
- putting a halt to proceedings to gain time to undertake public engagement practices (such as seeking media coverage) and convince passive shareholders to coordinate their proxy voting actions; or
- negotiating a higher exit premium during a takeover attempt.

The 2001 New Economic Regulation Law made an effort to close certain legal loopholes. However, research shows that the number of French investor associations has since continued to increase:⁹ currently, there are more than 20, each specializing in specific legal actions such as civil, criminal, or class actions. Prior to 2001, it was noted that 63 percent of activist activities took the form of a lawsuit and that subsequently this rate has fallen to less than one-third.¹⁰

More recently, investor associations such as *l'Association Des Actionnaires Minoritaires* (ADAM), have been collaborating regularly with hedge fund activists. As stated by Colette Neuville, the association's leader, collaboration is offered "as long as [activists'] objectives go beyond the short term and help to create value for all the shareholders."¹¹

Role and tactics of activist hedge funds The recent growth of the hedge fund industry in many countries has been fueled by the portfolio diversification strategies of pension funds. (Pension funds are heavily invested in alternative instruments, including hedge funds).¹² To limit their capital investment and risk exposure, activist hedge funds enlist the outside support of institutional investors as well as fellow hedge funds.¹³

Activist hedge funds can leverage their relatively small stake in a target company through one or more tactics.¹⁴ First, they can federate like-minded hedge funds. (In the United States a Schedule 13D disclosure form is filed as one "person" acting as a group for the purpose of acquiring, holding or disposing of securities of an issuer).¹⁵

Second, activist hedge funds can act in so-called “wolf packs” of like-minded investors, avoiding disclosure under conditions in which their discussions or brainstorming are not deemed to constitute a “plan or proposal.”¹⁶ Without disclosure, the activists also avoid triggering a “poison pill” the company might have in place for defense.

Finally, studies have documented how activist hedge funds have learned to abuse the stock-lending market through a process called “empty voting.”¹⁷ With this technique, activist hedge funds borrow large blocks of shares just prior to the shareholder meeting record date for the sole purpose of influencing the outcome of a particular shareholder vote. Empty voting refers to the separation between voting rights and underlying economic interest in the corporation that results from deploying this technique.

Techniques like those mentioned above can reduce the costs (communication and share accumulation costs, in particular) incurred by an activist in reaching the threshold of voting rights necessary to put forward a shareholder proposal or to resist a management proposal. On this point, it is worth noting that in France, only 5 percent of voting rights are required to put a shareholder resolution on the agenda¹⁸ or to call an AGM.¹⁹ While this requirement might seem low, in practice it is not: more than half of AGMs in French companies occur only after they have been called a second time.²⁰ The low level of shareholder participation in the AGM serves the interests of activist hedge funds, which often represent more than 20 percent of the capital at the meeting.²¹ From 2005-2008, shareholder resolutions proposed by hedge funds received an average 45 percent approval rate at the AGMs of companies registered in the SBF 250 (*Société des Bourses Françaises 250 Index*).²² Additional analysis of this data demonstrated that the higher the rate of participation from shareholders (other than the resolution sponsor), the lower the average rate of resolution approval at the AGM.²³

Role and tactics of proxy advisory professionals In the last decade, the French market has also witnessed the rise of a new category of professionals that includes RiskMetrics/Deminor, Proxinvest, and the France-based asset management association *Association Française de Gestion* (AFG). They offer proxy advisory and solicitation services that may enhance the effectiveness of the activist coalition’s campaign. Active investors are clearly influenced by the recommendations issued by such advisors to vote for or against a proposal: in particular, AFG recommendations encourage passive shareholders to vote in favor of proposals put forward by an activist coalition.²⁴

These activist professionals play a dual informational role in the shareholder activism process.²⁵ They certify the relative quality of competing management teams and corporate governance systems as well as predict activism outcomes by conveying new information to the market.

In conclusion, the emergence of activist hedge funds and proxy professionals has profoundly affected the French shareholder activism process, changing the way shareholder activism is conducted. To date, activist hedge funds and proxy professionals have targeted large French firms such as Vivarte, Alstom, Arcelor, Suez, Atos Origin, Carrefour, Valéo, Accor, and Saint-Gobain. See Table 1 (“Notable Cases of Shareholder Activism in France,” on page 5.)

The French Shareholder Activism Process

In general, shareholder activism is a multi-stage process, which only in certain circumstances is escalated to the most hostile stage.²⁶

Target selection The first stage involves target selection from a portfolio of firms. The choice of a target could be driven by a number of considerations relating to underperformance, governance, or social and environmental issues.²⁷

Private engagement The second stage—known as “behind-the-scenes” or “private-engagement” activism—consists of collaborative informal communication activities (e.g., private meetings with the CEO and the chairman or meetings with board members).

Public engagement In contrast, the third stage becomes confrontational as a result of the refusal by the target management to accommodate the changes sought by the activists. Known as “public engagement,” this stage refers to the proxy voting process to support a shareholder proposal or to contest a management proposal at the shareholder meeting. It may also be characterized by activities such as media coverage, lobbying initiatives, and a proxy battle.

In France, shareholder resolutions are rare. In its 2009 European voting results report, RiskMetrics observed that only 21 shareholder proposals were submitted at French AGMs (among them, 15 were rejected) and out of 194 management proposals relating to share incentive plans, only four were subsequently withdrawn in response to objections from shareholders.

Hostility Finally, the fourth stage is characterized by the most hostile degree of activism and can take the form of

a publicized exit by a dissatisfied shareholder, a takeover attempt, and/or a lawsuit.²⁸

In the 2001-2004 period, a gradual increase in activist shareholder tactics has been observed among 71 French firms listed in the SBF index.²⁹ Unlike the dynamic in the U.S. and the UK, in France, the proxy battle remains “the main vector of direct dialogue between the CEO and shareholders.”³⁰

Similarly, there are documented positive correlations between legal actions and calls for extraordinary general meetings (EGM) of shareholders.³¹ In particular, when executive remuneration is the issue, shareholder activism appears to be most expressed through AGMs, through the courts, or by filing a complaint with the *Autorité des Marchés Financiers* (AMF).

However, as indicated earlier, the emergence of activist hedge funds and proxy voting professionals is exercising a profound influence on the French shareholder activism process. The next section describes the modus operandi of these new players.

The Modus Operandi of Three Professional Shareholder Activism Groups in France

This section examines the modus operandi of three shareholder activism professionals that mobilize international investor networks and operate in the French market:

- **RiskMetrics/Deminor:** a proxy analysis, voting recommendation and solicitation firm
- **Hermes EOS:** a voting and private engagement network
- **CalPERS and Knight Vinke:** an institutional investor/activist hedge fund network

RiskMetrics/Deminor In 2005, RiskMetrics (which owns Institutional Shareholder Services) acquired European shareholder-advocacy firm Deminor, becoming the world’s largest provider of proxy analysis and voting guidance, with a global client base of more than 1,700 investment institutions. RiskMetrics/Deminor operates in two ways: first, it helps clients create their own customized voting policies, which it subsequently executes on their behalf; second, it analyzes companies’ proxies and provides voting recommendations to clients who may follow them or use them as a baseline for their own voting decisions.

Since many institutional investors do not have the internal capability to collect, translate, and analyze company proxy voting materials in time to vote, RiskMetrics’ recommendations have become very influential, even in France.

Hermes Equity Ownership Services (EOS) As of the fourth quarter of 2010, Hermes EOS has over £60 billion of assets (approximately €71 billion or \$93 billion) under stewardship for its network of institutional investor clients. Even when it is not responsible for investing its clients’ assets, the firm fulfills the fiduciary duty of its network of investors by voting their shares and engaging with companies to improve performance. Specifically, it executes voting in 6,000 companies and represents its clients’ interests in engagements with 450 companies in nearly 50 countries annually.

EOS leverages its engagement impact with companies through its extensive network of formal and informal contacts with other fund managers whether or not they are clients of EOS. Discussions are kept private while they are proving constructive, or until the engagement is complete; in France, in particular, Hermes EOS recently decided not to disclose any information about its engagements with French companies other than to confirm that they engaged with Alcatel-Lucent, Galeries Lafayette and Vinci, and that they publicly engaged in specific networks to increase environmental, social, and governance standards in French listed corporations.³²

CalPERS and Knight Vinke (KV) In 2007, the California Public Employees’ Retirement System (CalPERS) increased the fund’s corporate governance target to 5 percent of its total global equity portfolio (up from 3 percent).³³ At the time of this re-allocation, that represented a maximum target level of \$12.5 billion. Mainly through its fund dedicated to corporate governance, CalPERS invests in 10 hedge funds specialized in corporate governance activism, including Knight Vinke (KV) in Europe. While KV takes the lead in initiating and coordinating an institutional investor network and related activism initiatives, CalPERS publicly supports KV and votes its shares with KV.

Table 1 on page 5 illustrates the professional players involved in France’s most notable cases of shareholder activism.

Table 1

Notable Cases of Shareholder Activism in France

Targeted firm	Year	Issues	Activism stages	Type of activists (percentage of shareholding, when available)
Vivarte	2000	Alter business strategy: achieve operational efficiency Improve governance: oust CEO	Public	<i>Raider</i> : Guy Wyser Pratt and Atticus (33%)
Alstom	2004	Improve governance: lawsuit against excessive executive remuneration	Public and penal action	<i>Investor association</i> : APPAC
	2008	Environmental, Social and Ethical issues	Public	UNPRI Sudan Engagement Group Hermes EOS
Arcelor	2006	Alter business strategy: carry out M&A Improve governance: rescind takeover defenses	Private	<i>Investor associations</i> : ADAM APPAC Goldman Sachs Several hedge funds
	2007	Other policies: stop unequal treatment of shareholders	Threat of legal action	SRM
Suez	2006	Alter business strategy: opposed to the merger between Suez and Gaz de France (spin-off)	Public and judicial	ADAM <i>Raider</i> : Albert Frère Knight Vinke (1%)
	2008	Alter business strategy: obtain focus (spin-offs, dismantle)	NA	NA Centaurus Pardus
Atos Origin	2007	Alter business strategy: obtain focus (spin-offs, dismantle) Improve governance: oust CEO and nominate independent board members	Public	ADAM Pardus (10.04%) Centaurus (12.3%)
Carrefour	2008	Alter business strategy: obtain focus (spin-offs, dismantle)	Public	<i>Raider</i> : Arnault Group Blue Capital (12.9%)
Valéo	2007	Improve governance: nominate board members	Public	Guy Wyser Pratt Pardus (19.7%)
	2008	Alter business strategy: obtain focus (business restructuring)	Private	Pardus (18.54%)
Accor	2008	Improve governance: oust CEO and nominate board members Alter business strategy: obtain focus (spin-offs, dismantle)	Public	Arnault Group <i>Private equity fund</i> : Eurazeo Blue Capital (10.7%)
Saint-Gobain	2008	Improve governance: change board members	Private	Wendel Investment (18%)

Two Case Studies of Shareholder Activism Networks in France

To illustrate how hedge funds and proxy-voting professionals in France mobilize investor networks in highly coordinated activism campaigns, this report examines their role in the Suez-Gaz de France merger and a board restructuring at ATOS Origin. Both cases are also indicative of the influence that the public sector still exercises in industrial and business relations in the country.

The role of hedge funds in activist networks: the Suez-Gaz de France case³⁴ As mentioned earlier, Knight Vinke (KV) is an activist hedge fund that typically targets large European companies, buying about 1 percent of their outstanding shares and then persuading other investors to join its campaign to affect corporate strategy. Its flagship fund, which receives a significant investment from institutional investors like CalPERS, has more than \$1.5 billion under management.

On July 22, 2004, the French government partially privatized Gaz de France (GDF), while guaranteeing that it would not lower the number of publicly held shares below 70 percent. On February 25, 2006, Dominique de Villepin, then Prime Minister of France, announced the merger of GDF and Suez, which effectively would lower the government's ownership stake in the merged entity to 34 percent. GDF's unions and opposition political parties (communist and socialists) objected firmly to the transaction. The European regulatory authorities opened a lengthy antitrust investigation concerning the impact on competition in France and Belgium and imposed several divestments of Suez's assets.

On September 3, 2006, Gaz de France and Suez announced their agreed terms of merger, which were based on the exchange of 21 Gaz de France shares for every 22 Suez shares via the absorption of Suez by Gaz de France. On September 7, 2006, an extremely contentious debate about the merger opened in the Assemblée Nationale, and by November 30, 2006, both the Sénat and Conseil Constitutionnel approved the merger, but it was stipulated that it could not take effect until July 1, 2007.

During September and October 2006, KV published 13 full-page newspaper advertisements advocating that the two companies should strategically agree to a spin-off and publicly list Suez Environnement, a division of Suez.

On November 16, 2006, the French investor association ADAM publicly criticized the banks involved in the merger, notably HSBC, for their lack of independence in determining the share exchange ratio between GDF and Suez.

Suez owned Electrabel, the Belgian electricity company, whose significant shareholder, Albert Frère, demanded on November 21, 2006 a special dividend of €4 per share to compensate for the share exchange ratio. The same day, KV demanded a special dividend of €6.5 to €7 per share. The press speculated that KV was acting as a stalking horse for savvy Frère, who was vice-chairman of Suez and controlled 7.2 percent of its stock through Groupe Bruxelles Lambert (GBL.) In fact, Eric Knight had once worked for Frère's Pargesa Group.

On December 22, 2006, KV published an open letter in the French newspaper, *Le Figaro*, stating that the valuation of Suez's shares under the merger proposal was insufficient, and recommended that Suez's board suspend the merger. In the letter, KV reported that 18 of 20 major institutional investors, including CalPERS, had strong reservations about the merger.

On December 29, 2006, market rumors surfaced that François Pinault, another prominent French investor, might launch a takeover of Suez. As a result of these speculations, which continued throughout January 2007, the company's share price rose. On January 4, 2007, President Jacques Chirac announced that the GDF Suez merger was a "strategic project for France and for Europe." On January 12, Albert Frère increased his shareholding in Suez to 9.5 percent of capital.

Over the course of 10 days—ending on January 15, 2007, in the midst of this market speculation about Suez's eventual ownership—KV sold its nearly 1 percent of Suez's shares. At the same time, another group of professional activists invested in Suez's equity. In the end, Suez's environmental division was listed separately on the French stock exchange, and the valuation for the remaining Suez stock improved in the merger. GDF Suez eventually merged on July 22, 2008.

The role of proxy advisors in activist networks: the Atos Origin case The activism process in Atos Origin, a French IT services company, began with private negotiations between Centaurus, an activist hedge fund and the management of the target company. On October 23, 2006, Centaurus was the principle shareholder with 5.49 percent of shares. After the failure of negotiations, Centaurus joined with Pardus, (another hedge fund), and publicly announced a joint action “to put pressure on the board... to explore all strategic alternatives” including “a dismantling.”³⁵ Additional demands included board seats and the dismissal of Atos’ CEO, Philippe Germon. Two days before the public announcement, Pardus bought 7.32 percent of the shares and the voting rights of Atos Origin.

What makes this case particularly interesting is that the two funds also enlisted the services of local activist professionals, namely French investor association ADAM to support their proposals.³⁶ The Atos Origin management convinced Investor Sight and Deminor, proxy-voting advisors to large networks of international investors, to support their position; in particular, Deminor maintained that Colette Neuville, ADAM CEO, lacked independence in the matter because of her business relations with Centaurus and Pardus.

On the basis of paper votes, Centaurus and Colette Neuville should have been elected to the board at the AGM, and the chairman, Didier Cherpitel, should have been dismissed.³⁷ However, CEO Philippe Germon reacted by adjourning the meeting when, unexpectedly, the chairman of the board of the Employee Stock Option Plan (ESOP) fund stated publicly that he would use ESOP’s 3 percent voting rights in favor of the activist coalition.

Eventually, on May 27, 2008, the two coalitions announced the end of their confrontation in the newspaper *Les Echos*. The activist coalition elected its members to the board, but agreed to sell its shares to PAI Partners, a European private equity firm.

In November 2008, Thierry Breton, the former French Minister of the Economy, replaced Philippe Germon at the helm of Atos Origin.

Atos Origin is an interesting case because of the direct intervention of the French government. Five days before the AGM, Senator Philippe Marini publicly expressed his concern and stated that Atos Origin risked being dismantled if the two funds, Centaurus and Pardus, were to succeed in taking control of it. This cultural context “...can create a strong support to managers’ entrenchment despite the relevance of strategic changes required by activists”³⁸ and may explain the limited success of the activist coalition.

Conclusion

Specialized networks of dedicated investors and proxy-voting professionals are expected to continue to exercise growing influence in French companies as these networks increase their ownership in French companies. The voice of professional shareholder activists in French corporate governance will be magnified further by recent changes to corporate law and shareholder rights.

The two studies discussed in this report suggest that shareholder activism is a learning process that, in the future, may become the domain of dedicated professional services. In fact, with time, all players involved in the process—including management, employee shareholders, the French government, investor associations, and activist sponsors themselves—are acquiring increasing levels of sophistication in their tactics.

On the other hand, compared to the U.S. context, the number of French corporations targeted by activist hedge funds remains low. As underlined by the two examples, French public authorities continue to lobby and exert their influence to retain their control of critical industrial and business sectors. These authorities can deter activism by increasing its cost—for hedge funds, and other players—thereby undermining the probability of its success.

Endnotes

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