

Summer 2022

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Recommended Citation

Giovanni Strampelli, *Private Meetings Between Firm Managers and Outside Investors: The European Paradigm*, 18 *Hastings Bus. L.J.* 237 (2022).

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Private Meetings Between Firm Managers and Outside Investors: The European Paradigm

GIOVANNI STRAMPELLI*

ABSTRACT

Institutional ownership of listed companies has grown significantly, leading to an increase in ownership concentration in the European Union. Under the current context of re-concentrated ownership, institutional shareholders are expected, also in Europe, to play a more active role in corporate governance and to exert influence on the company's strategies. Within such a corporate governance landscape institutional investor engagement is becoming a distinctive feature of corporate governance of European listed companies. In particular, board-shareholder dialogue is a key engagement tool and is essential in order to enable institutional investors to fulfil their stewardship functions. Board-shareholder dialogue is also core to listed companies' communication strategies, since the growing demand for engagement by institutional investors has rendered traditional investor relations insufficient. Nevertheless, private meetings between directors and institutional investors raise concerns with respect to the financial markets law framework in the EU. In particular, the EU market abuse regime and the related principle of equal treatment for shareholders seem to hinder dialogue between directors and key shareholders. Against this background this Article shows that legal constraints deriving from EU financial markets law do not hamper institutional investor engagement. Furthermore, based on recommendations from corporate governance and stewardship codes as well as good practice standards drafted by corporate governance experts and institutions, it outlines an innovative practical framework that reduces the risk of violating disclosure rules and fosters board-shareholder engagement. In doing so, the Article provides theoretical and practical insights that can help to make institutional investor engagement more effective also in non-European countries.

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I. INTRODUCTION

Starting from the 1990s in the United States, and more recently in Europe, institutional ownership of listed companies has grown significantly, leading to an increase in ownership concentration.¹ Under the current context of re-concentrated ownership in Europe, institutional shareholders are expected to play a more active role in corporate governance and to exert influence on the company's strategies.² According to the SRD II:

Effective and sustainable shareholder engagement is one of the cornerstones of the corporate governance model of listed companies, which depends on checks and balances between the different organs and different stakeholders. Greater involvement of shareholders in corporate governance is one of the levers that can help improve the financial and non-financial performance of companies, including as regards environmental, social and governance factors, in particular as referred to in the Principles for Responsible Investment, supported by the United Nations.³

In particular, as far as the role of the institutional investors is concerned, although it recognizes that “the experience of the last years has shown that institutional investors and asset managers often do not engage with companies in which they hold shares”,⁴ the SRD II emphasizes that “[i]nstitutional investors and asset managers are often important shareholders of listed companies in the Union and can therefore play an important role in the corporate governance of those companies, but also more generally with regard to their strategy and long-term performance”.⁵

Within such a context, institutional investors are expected to actively monitor their investee companies. For example, according to the EFAMA

1. See A. DE LA CRUZ ET AL., OWNERS OF THE WORLD'S LISTED COMPANIES 9-13 (2019), www.oecd.org/corporate/Owners-of-the-Worlds-Listed-Companies.htm. See also Ronald J. Gilson & Jeffrey N. Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights*, 113 COLUM. L. REV. 863, 864-68 (2013); Edward Rock, *Institutional Investors in Corporate Governance*, in THE OXFORD HANDBOOK OF CORPORATE LAW AND GOVERNANCE 365 (Jeffrey Gordon & Wolf-Georg Ringe eds., 2015).

2. See, e.g., Randall S. Thomas, *The Evolving Role of Institutional Investors in Corporate Governance and Corporate Litigation*, 61 VAND. L. REV. 299, 300 (2008) (highlighting that “[t]he theory was simple: if shareholder monitoring could limit managers' divergence from the goal of shareholder wealth maximization, then institutional shareholders were well positioned to act as effective monitors. Institutions held larger blocks of stock than most other investors and collectively held well over fifty percent of the stock of most large public companies. Acting together, these shareholders would have the power and the incentives to push for good corporate governance and to nudge managers to pursue wealth-maximizing strategies”).

3. Directive 2017/828, of the European Parliament and of the Council of 17 May 2017 Amending Directive 2007/36/EC as Regards the Encouragement of Long-Term Shareholder Engagement, 2017 O.J. (L 132/1) 3 [*hereinafter* SRD II], recital 14.

4. *Id.*, recital 15.

5. *Id.*

Stewardship code,⁶ “asset managers may seek to preserve and enhance value in the companies they invest in, through exercise of voting rights and engagement”. Indeed, even though broader definitions are accepted,⁷ institutional investors’ stewardship activities encompass both voting and engagement. Namely, according to the EFAMA Code, Stewardship is defined as

engagement, i.e. the monitoring of and interaction, with investee companies, as well as exercising voting rights attached to shares. Engagement can be on matters such as: business strategy and its execution; risk management; environmental and social concerns; corporate governance issues such as board composition and the election of independent directors, together with executive remuneration; compliance, culture and ethics; and performance and capital structure.⁸

Against this background, the following analysis will focus on interactions between issuers and institutional investors, that is the so-called board-institutional investors engagement. As stated by the EFAMA Code, contacts with a single or several board members of investee companies can consist in unilateral communication from institutional investors to board members (one-way engagement), or in bilateral dialogue (two-way engagement). Namely, “[i]n a one-way engagement, asset managers present their perspective regarding specific issues to board members of investee companies, who in turn do not communicate any information”. Differently, during a bi-way engagement, “an exchange of information should take place between asset managers and board members of investee companies”.⁹

Calls from institutional investors for engagement with the board have grown. Private dialogue (“behind the scenes”) with directors is an important

6. Eur. Fund & Asset Mgmt. Ass’n, EFAMA Stewardship Code (2018) [hereinafter EFAMA Code], <https://www.efama.org/newsroom/news/efama-stewardship-code-principles-asset-managers-monitoring-voting-engagement>. The EFAMA Code played a major role in developing board-shareholder engagement at the EU level by inspiring some stewardship codes adopted at national level. See, e.g., Assogestioni, Italian Stewardship Principles (2016) [hereinafter Italian Stewardship Principles], <https://ecgi.global/code/italian-stewardship-principles-2016> (recognizing that “[t]he adopted Principles are inspired by those contained in the EFAMA Code for External Governance, approved by the European Fund and Asset Management Association, of which Assogestioni is a member”).

7. See Eur. Sec Mkt. Auth., Undue short-term pressure on corporations 55 (ESMA30-22-762) (Dec. 18, 2019), <https://www.esma.europa.eu/document/report-undue-short-term-pressure-corporations-financial-sector> (noting that “[e]ngagement strategies can be classified according to three broad categories, namely (i) engaging in private conversations with management and the board; (ii) exercising voting rights at companies’ shareholder meetings and (iii) proposing resolutions at companies’ shareholder meetings (so-called shareholder proposals). Yet, there is some fluidity around the term. Some consider engagement to be limited to behind-the-scene interactions, while others have a broader interpretation and consider that for example exit, takeover and publicly voicing displeasure constitute engagement strategies”).

8. *Id.* at 8.

9. EFAMA CODE, *supra* note 6, at 7.

instrument of institutional investor activism¹⁰ As recognised also by the ESMA,¹¹ whilst due to their informal nature the precise extent of private meetings between institutional investors and directors is not easy to estimate,¹² available empirical analysis shows that private discussions with directors have become one of the most popular measures of shareholder engagement by institutional investors,¹³ and that other public mechanisms (such as shareholder proposals or public criticism) are used only if interventions behind the scenes fail¹⁴ This is because, as further studies suggest, private meetings with a company's directors and its management (and, more generally, activism behind the scenes) can create value and have an effective impact on issuers' decisions.¹⁵

10. See ESMA, *supra* note 7, at 55 (stating that “individual or collective dialogue between shareholders and management is an increasingly important form of engagement. Attempts by institutional investors to engage with the board have grown over time and private dialogue with directors is now an important instrument of institutional investor activism”). See also Klaus J. Hopt, *The Dialogue Between the Chairman of the Board and Investors: The Practice in the UK, the Netherlands and Germany and the Future of the German Corporate Governance Code Under the New Chairman* (European Corp. Governance Inst., Law Working Paper No. 365/2017, 2017), <https://ssrn.com/abstract=3030693>; Wolf-Georg Ringe, *Shareholder Activism: A Renaissance*, in *THE OXFORD HANDBOOK OF CORPORATE LAW AND GOVERNANCE* 407 (Jeffrey Gordon & Wolf-Georg Ringe eds., 2015); Doron Levit, *Soft Shareholder Activism* 2 (May 31, 2017), <https://ssrn.com/abstract=1969475>; Matteo Tonello and Matteo Gatti, *Board-Shareholder Engagement Practices*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Dec. 30, 2019), <https://corpgov.law.harvard.edu/2019/12/30/board-shareholder-engagement-practices/>.

11. ESMA, *supra* note 7, at 55 (noting that “empirical analysis shows that private discussions with directors have become one of the most popular measures of shareholder engagement by institutional investors”).

12. Lucian A. Bebchuk & Michael S. Weisbach, *The State of Corporate Governance Research*, 23 REV. FIN. STUD. 939, 942 (2010); Matthew J. Mallow & Jasmin Sethi, *Engagement: The Missing Middle Approach in the Bebchuk-Strine Debate*, 12 N.Y.U. J.L. & BUS. 385, 396 (2016) (arguing that “[e]ngagement often occurs privately-away from the scrutiny of the public and the media-and it is less measurable than a shareholder vote. Consequently, empirical research on the effectiveness of engagement is lacking”).

13. See Joseph A. McCahery et al., *Behind the Scenes: The Corporate Governance Preferences of Institutional Investors*, 71 J. FIN. 2905, 2911–12 (2016) (showing that 63% of the institutional investors surveyed have engaged in direct discussions with management); Elroy Dimson et al., *Active Ownership*, 28 REV. FIN. STUD. 3225, 3226 (2015); David Solomon & Eugene Soltes, *What Are We Meeting for? The Consequences of Private Meetings with Investors*, 58 J.L. & ECON. 325, 326–28 (2015); Stefano Cascino and al., *Who Uses Financial Reports and for What Purpose? Evidence from Capital Providers*, [2014] 11 ACC. EUR. 185. See also the evidence provided by ESMA, *supra* note 7, at 61 (showing that private engagements are considered to be an important stewardship tool by a large number of institutional investors).

14. See McCahery et al., *supra* note 13, at 2912; ESMA, *supra* note 7, at 56 (noting that, given the negative signalling mechanism that the use of shareholder proposals or other “public” initiatives may have, “investors typically try to engage with firms behind the scenes and prefer not to take public measures, which may also explain why a high number of shareholder proposals are withdrawn before the shareholder meeting”).

15. See Marco Becht et al., *Returns to Shareholder Activism: Evidence from a Clinical Study of the Hermes UK Focus Fund*, 22 REV. FIN. STUD. 3093, 3097, 3108–18 (2009) (finding that “when the fund’s engagement objectives are achieved, there are economically large and statistically significant positive abnormal returns around the announcement date of the change”); Willard T. Carleton et al., *The Influence of Institutions on Corporate Governance Through Private Negotiations: Evidence from TIAA-CREF*, 53 J. FIN. 1335, 1336 (1998) (presenting empirical evidence concerning private contacts of the Teachers Insurance Annuity Association–College Retirement Equities Fund’s contacts with investee companies).

In spite of this favourable trend, board-shareholder engagement is still problematic. Public disclosure and insider trading rules set legal constraints on board-shareholder engagement. However, the reach of these constraints should not be overstated, as they do not appear to ban outright any private dialogue between directors and shareholders. In this regard, recommendations within corporate governance and stewardship codes, and from practitioners, play a major role in developing a practical framework for director-shareholder dialogue that seeks to prevent the violation of insider trading and public disclosure rules, and to make dialogue more effective.

This Article will proceed as follows. Part II will describe the increasing practical relevance of board/shareholder engagement as a key stewardship tool. Part III will provide an overview of potential legal constraints on board/shareholder in Europe engagement and will show that legal constraints deriving from selective disclosure and insider trading regime and the principle of equal treatment of shareholders do not pose any absolute ban on board-shareholder dialogue. Part IV will consider practical solutions that could facilitate board-shareholder engagement in Europe and make it more effective. Part V will conclude.

II. PRIVATE CONVERSATIONS WITH MANAGEMENT AND THE BOARD AS A KEY INSTITUTIONAL INVESTORS' ENGAGEMENT TOOL

Over the last few years, due to increased calls for engagement from institutional investors, directors have been increasingly engaging in dialogue with them. Corporate governance and stewardship codes adopted in many European Member States require institutional investors to intensify their stewardship role over portfolio companies, and sets of recommendations are being developed to make the process of director-shareholder engagement more effective and compliant with the existing regulatory context.

The debate concerning board-shareholder engagement was initiated in Europe by the European Commission's Action Plan on European company law and corporate governance,¹⁶ which resulted in the subsequent proposal for a directive reforming the Shareholders Rights Directive of 2007.¹⁷ The first draft of the amending directive included provisions concerning director-institutional shareholder dialogue, which have been maintained in the final text of Directive 2017/828/EU amending Directive 2007/36/EC as regards

16. See *Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: Action Plan: European Company Law and Corporate Governance – a Modern Legal Framework for More Engaged Shareholders and Sustainable Companies*, at 8, COM (2012) 740 final (Dec. 12, 2012).

17. See *Commission Proposal for a Directive of the European Parliament and of the Council Amending Directive 2007/36/EC as Regards the Encouragement of Long Term Shareholder Engagement and Directive 2013/34/EU as Regards Certain Elements of the Corporate Governance Statement*, COM (2014) 213 final (Apr. 9, 2014).

the encouragement of long-term shareholder engagement.¹⁸ Namely, Recital 16 to the SRD II emphasizes that

Institutional investors and asset managers are often not transparent about their investment strategies, their engagement policy and the implementation thereof. Public disclosure of such information could have a positive impact on investor awareness, enable ultimate beneficiaries such as future pensioners optimise investment decisions, facilitate the dialogue between companies and their shareholders, encourage shareholder engagement and strengthen their accountability to stakeholders and to civil society.

Against this backdrop, Article 3g SRD II provides that institutional investors and asset managers shall, under a comply or explain-rule, develop and publicly disclose an engagement policy that describes how they integrate shareholder engagement in their investment strategy. The policy, among other things, shall describe how institutional investors and asset managers “conduct dialogues with investee companies”.¹⁹ Article 3j SRD II further requires proxy advisors to disclose on an annual basis, among other things, “whether they have dialogues with the companies which are the object of their research, advice or voting recommendations and with the stakeholders of the company, and, if so, the extent and nature thereof”.

The provisions laid down by the SRD II are relevant insofar as they confirm that EU law favours dialogue between companies and their shareholders, and promotes shareholder engagement by choosing a comply or explain mechanism. As noted by the ESMA,

[o]ne of the assumptions underpinning the revision of Directive 2007/36/EC is that the monitoring role of shareholders is insufficient and that engagement should be reinforced to reduce excessive focus on short-term returns by management. This fundamental objective is highlighted in the actual title of the revised directive which indicates that the encouragement of long-term shareholder engagement is its key goal.²⁰

Nevertheless, within the EU regulatory framework, board-institutional shareholder dialogue is still in the main regulated by stewardship and corporate governance codes adopted at the national level, which provide

18. SRD II, *supra* note 3, at recital 3.

19. Another reference to director-shareholder dialogue is included in recital 49 of the SRD II, which recognizes that shareholders and investors can engage with the company on the implementation of the remuneration policy. Due to the introduction of the “say-on-pay” vote executive compensation is a privileged area of engagement both in the US and in Europe. See Joseph W. Yockey, *On the Role and Regulation of Private Negotiations in Governance*, 61 S.C. L. REV. 171, 214-218 (2009); Randall S. Thomas et al., *Dodd-Frank’s Say on Pay: Will it Lead to a Greater Role for Shareholders in Corporate Governance?*, 97 CORNELL L. REV. 1213, 1256 (2012) (noting that “[t]he say-on-pay votes mandated by Dodd-Frank, in these commentators’ eyes, appear to have catalyzed greater management attention to shareholder concerns, an increased shareholder interest in voting on corporate governance, and a broader dialogue on pay issues between management and shareholders (and proxy advisory firms)”).

20. ESMA, *supra* note 7, at 53.

companies and their shareholders with detailed guidelines on how to conduct director-shareholder dialogue.²¹ Indeed, director-shareholder dialogue is widely recognized as an important means of engagement by all main stewardship codes.

According to the UK Stewardship Code 2020, signatories are expected to engage with issuers to maintain or enhance the value of assets under management and engagement methods include meeting the chair or other board members, holding meetings with management.²² The EFAMA Code includes a similar recommendation.²³ Institutional investors should interact with investee companies on an ongoing basis in order to protect and secure value over the long term; initial discussions can entail, for example, meeting with the chief executive officer, senior independent director, or the chair of the supervisory board, as the case may be, or with other independent directors or board members. More generally, when investors have concerns about the company's strategy and performance, the EFAMA Code recommends that they should seek to ensure that the appropriate members of an investee company's board are made aware of them.

As far as issuers are concerned, the provisions of corporate governance codes on director-shareholder dialogue are fundamental. The UK Corporate Governance Code recommends that "[i]n addition to formal general meetings, the chair should seek regular engagement with major shareholders in order to understand their views on governance and performance against the strategy. Committee chairs should seek engagement with shareholders on significant matters related to their areas of responsibility. The chair should ensure that the board as a whole has a clear understanding of the views of shareholders"²⁴

Provisions similar to those contained in the UK Corporate Governance Code can be found in corporate governance codes adopted in other Member States. The 2020 Belgian Code on Corporate Governance recommends that the board should "ensure an effective dialogue with shareholders and potential shareholders through appropriate investor relation programmes, in order to achieve a better understanding of their objectives and concerns"²⁵ and "encourage shareholders, and in particular, institutional investors, to

21. Klaus J. Hopt, *Comparative Corporate Governance: The State of the Art and International Regulation*, 59 AM. J. COMP. L. 1, 10–14 (2011) (recognizing that corporate governance codes represent, across several countries, a building block for the corporate governance regulatory framework).

22. Fin. Rep. Council, *The UK Stewardship Code 2020* (Dec. 2019), 17, https://www.frc.org.uk/getattachment/5aae591d-d9d3-4cf4-814a-d14e156a1d87/Stewardship-Code_Dec-19-Final.pdf.

23. EFAMA CODE, *supra* note 6, at 6-8.

24. See Fin. Reporting Council, *The UK Corporate Governance Code 4* (2018), [hereinafter UK Corporate Governance Code], <https://www.frc.org.uk/directors/corporate-governance-and-stewardship/uk-corporate-governance-code>.

25. Corp. Governance Comm., *The Belgian 2020 Code on Corporate Governance 24* (2020) [hereinafter Belgian Code on Corporate Governance], <https://www.corporategovernancecommittee.be/en/over-de-code-2020/2020-belgian-code-corporate-governance>.

communicate their evaluation of the company's corporate governance prior to the general shareholders' meetings and at least through participation in the general shareholders' meeting".²⁶ The Danish recommendations on corporate governance are modelled along the same lines,²⁷ stating that "the management through ongoing dialogue and interaction ensures that shareholders, investors and other stakeholders gain the relevant insight into the company's affairs, and that the board of directors obtains the possibility of hearing and including their views in its work. any".²⁸ Director-shareholder dialogue is also recommended under the Italian Corporate Governance Code, according to which "[t]he board of directors promotes dialogue with shareholders and other stakeholders which are relevant for the company, in the most appropriate way" and to this end "the board of directors adopts and describes in the corporate governance report a policy for managing dialogue with the generality of shareholders, taking into account the engagement policies adopted by institutional investors and asset managers".²⁹

Director-shareholder dialogue has been particularly discussed amongst German scholars and practitioners.³⁰ The debate focuses on dialogue between shareholders and the supervisory board (Aufsichtsrat), since closer engagement with the supervisory board is considered to be crucial in allowing institutional investors to perform an active role in the monitoring of listed companies. Guiding Principles for dialogue between investors and German supervisory boards, which were drafted by a group comprised of academics and representatives of issuers and institutional investors, were published in 2016³¹ In addition, the German Corporate Governance Code (Deutscher Corporate Governance Kodex) – whose last update was approved

26. *Id.*

27. Danish Comm. on Corp. Governance, Danish Recommendations on Corporate Governance 10 (2020), https://corporategovernance.dk/sites/default/files/media/anbefalinger_for_god_selskabsledelse_engelsk.pdf.

28. *Id.* (further stating that "[t]he board of directors' insight in the dialogue could for instance take place through feedback from meetings held with shareholders, investors and other stakeholders or through other regular reports from the executive management. The board of directors should, through its chairperson, ensure a good and constructive relationship with the shareholders").

29. Corp. Governance Comm., Corporate Governance Code 5-6 (2020), <https://www.borsaitaliana.it/comitato-corporate-governance/codice/2020eng.en.pdf>.

30. See Hopt, *supra* note 22, at 4-6 (arguing that "[t]he reactions to the new suggestions of the Code (and the Guiding Principles) have been mixed. The institutional investors and large corporations as well as portions of the financial press and academia approved of them. Others, in particular other corporations, lawyers and traditional academia, criticized them, some very harshly").

31. Ger. Inv. Funds Ass'n, Guiding Principles for Dialogue Between Investors and German Supervisory Boards (2016), https://www.bvi.de/uploads/tx_news/2016_07_11_Guiding_Principles_for_Shareholder_Communications_with_Supervisory_Board.pdf.

in December 2019 –³² includes a “suggestion”³³ (introduced in 2017³⁴) according to which “the Supervisory Board Chair should be available – within reasonable limits – to discuss Supervisory Board-related issues with investors”.³⁵

In conclusion, an overview of the European regulatory framework clearly shows that private dialogue between directors and shareholders is a common (and progressively growing) practice, which is strongly recommended by both legislators and corporate governance best practices as an important tool for institutional investor engagement.

III. LEGAL CONSTRAINTS ON BOARD-SHAREHOLDER ENGAGEMENT

In spite of the fact that director-institutional investor dialogue is recognized as an essential element of the system of corporate governance for listed companies, a not negligible number of issuers and investors have voiced concerns about the economic and legal impediments to engagement. Amongst the economic impediments, time and resource constraints, along with an “unwillingness to talk”, seem to be of primary importance.³⁶ From

32. Regierungskommission, Deutscher Corporate Governance Kodex 4 (2019) [hereinafter German Corporate Governance Code], https://www.dcgk.de/files/dcgk/usercontent/en/download/code/191216_German_Corporate_Governance_Code.pdf.

33. See Hopt, *supra* note 22, at 5 (noting that “[t]he original proposal of the Commission went further than the present version in one important point. The Code distinguishes sharply between ‘shall’ (‘soll’), as found in the proposal, and ‘should’ (‘sollte’), as found in the present version the first case this would have been a ‘recommendation’ which, while of course not binding, would nevertheless have required that any deviation from it must be disclosed under § 161 of the Stock Corporation Act. The present version has been softened to a mere ‘suggestion’, which the board might consider but which it can drop without further ado and without having to disclose this fact”). In fact, as explained by the introductory notes of the German Corporate Governance Code, recommendations of the Code are indicated in the text by using the word ‘shall’. Corporations may depart from recommendations, but in this case they are obliged to disclose and explain any departures each year (comply or explain). This enables corporations to reflect sector- or company-specific requirements. Well-justified departures from recommendations of the Code may be in the best interests of good corporate governance. Thus, the Code contributes to greater flexibility and more self-regulation in the German corporate constitution. Additionally, the Code contains suggestions from which corporations may depart without disclosure; suggestions are indicated in the text by using the word ‘should’. The remaining passages of the Code that do not use these words relate to descriptions of statutory requirements and explanations. See GERMAN CORPORATE GOVERNANCE CODE, *supra* note 32, at 2.

34. The 2019 version of the German Corporate Governance Code will enter into force only after the adoption of the Act for Implementing the Second EU Shareholder Rights Directive (“ARUG II”). The Code version dated 7 February 2017 acts as the basis of the Declaration of Compliance until the new Code has been published in the German Federal Gazette.

35. GER. INV. FUNDS ASS’N, *supra* note 32, at 5. The recommendation adopted in the revised German Corporate Governance Code is shorter than that included in an earlier draft of October 2016, according to which “under appropriate conditions, the Chairman of the Supervisory Board shall be prepared to engage into discussions with investors on Supervisory Board-related topics. These are items resting in the sole responsibility of the Supervisory Board thus exclusively to be decided by the latter. Discussions on aspects, which are to be decided jointly by the Management Board and the Supervisory Board, shall be led solely by the Management Board or by the Chairman of the Supervisory Board together with the Management Board”.

36. See Dimson, *supra* note 13, at 29-31. See also ESMA, *supra* note 7, at 64.

the legal standpoint, director-shareholder dialogue can cause non-public information to be selectively disclosed, and the Market Abuse regime and the principle of equal treatment have been the main sources of constraint for dialogue within the European legal framework.³⁷

Nevertheless, this Part will show that the role of such (potential) legal constraints should not be overstated, as they only apply to the communication of material non-public information and do not hinder dialogue that does not reach the threshold of materiality, as long as such communication does not involve inside information. When performing their stewardship functions, institutional investors are primarily interested in communicating their views, or concerns, to investee companies, and do not wish to receive material non-public information so that they can freely trade securities issued by investee companies.

A. SELECTIVE DISCLOSURE AND INSIDER TRADING REGIME

Due to its approach to insider trading based on the principle of equal access to information, the European market abuse regime provided for under the Market Abuse Regulation³⁸ seems to place a strict constraint on director-institutional shareholder engagement.

According to the parity of information principle, Article 17 MAR sets out an issuers' obligation to promptly disclose inside information,³⁹ stating that "[a]n issuer shall inform the public as soon as possible of inside information which directly concerns that issuer". Article 7 MAR defines inside information as "information of a precise nature, which has not been made public, relating, directly or indirectly, to one or more issuers or to one or more financial instruments, and which, if it were made public, would be likely to have a significant effect on the prices of those financial instruments or on the price of related derivative financial instruments". The rationale

37. See McCahery et al., *supra* note 13, at 2920-2922; Goldstein, *supra* note 13, at 29-31; Lisa M. Fairfax, *Mandating Board-Shareholder Engagement?*, U. ILL. L. REV. 821, 834-838 (2013); Yockey, *supra* note 19, at 205-214. See also ESMA, *supra* note 7, at 64.

38. See Marco Ventoruzzo, *Comparing Insider Trading in the United States and in the European Union: History and Recent Developments*, 11 EUR. COMPANY & FIN. L. REV. 554, 571 (2014) (highlighting that there is no general duty to disclose all material information under US law and this feature of the American system can be pointed out as a major comparative difference with the current European approach). However, the SEC requires issuers to disclose, by filing a Form 8-K, 'on a rapid and current basis' material information regarding a wide list of events. Thus, the distinction between US and EU regime is in practice less significant than might at first seem. See, e.g., JOHN ARMOUR ET AL., *PRINCIPLES OF FINANCIAL REGULATION* 175-76 (2016) (noting that "[t]he distinction between the two regimes at first blush appears to be that the US mandates ongoing disclosure in relation to any of a specified list of events, whereas the EU does not specify the events which trigger disclosure, rather looking to the consequence of events on the stock price. However, the distinction in practice may be rather more modest").

39. Ventoruzzo, *supra* note 39, at 581-582 (pointing out that "[t]he default rule in Europe, therefore, is that inside information should be promptly disclosed to the market. This is interesting because it suggests that European law does not accept the principle that inside information belongs to the issuer and can be misappropriated by insiders, but rather that it "belongs" to all investors and, as a general matter, should be shared with the investing public").

underlying the mandatory disclosure rule is clearly presented by recital 49 to the MAR, according to which issuers are required to inform the public as soon as possible of any inside information because “the public disclosure of inside information by an issuer is essential to avoid insider dealing and ensure that investors are not misled”.⁴⁰

The European market abuse regime seems to be averse to board-shareholder engagement also in another respect. Article 8 MAR lays down an absolute prohibition on insider dealing, according to which inside information cannot be used “by acquiring or disposing of, for its own account or for the account of a third party, directly or indirectly, financial instruments to which that information relates”. This rule applies to any person who possesses inside information as a result of: (a) being a member of the administrative, management or supervisory bodies of the issuer or emission allowance market participant; (b) having a holding in the capital of the issuer or emission allowance market participant; (c) having access to the information through the exercise of an employment, profession or duties; or (d) being involved in criminal activities. Article 8 also applies to any person who possesses inside information under circumstances other than those referred to in the first subparagraph where that person knows or ought to know that it is inside information.

Article 8 MAR makes it clear that the EU insider trading regime does not require that there be a fiduciary or fiduciary-like relationship, or a duty of trust or confidence, between the source the information and the recipient of the information. According to the theory of equal access to information, the prohibition on trading on the basis of material non-public information set out by the MAR is absolute in nature, irrespective of how such information is obtained.⁴¹ In keeping with Article 8(4) MAR, in order to enforce the rules on insider trading it is only necessary to demonstrate that the recipient of the information knows, or ought to know, that information constitutes inside information.

Thus, it appears that the general prohibition against trading on the basis of material non-public information laid down by Article 8 MAR can have a significant impact on dialogue between directors and institutional shareholders. Specifically, the market abuse regime set out by the MAR may discourage institutional investors from engaging with directors, as they are

40. Sergio Gilotta, *The Regulation of Outsider Trading in EU and the US*, 13 EUR. COMPANY & FIN. L. REV. 631, 638 (2016) (recalling that “EU law does not make all the subtle distinctions that the US legal system makes and takes a sharp egalitarian stance toward informed trading by outsiders. It prohibits all trading that is carried out on the basis of material non-public information, without giving much relevance as to whether the trader qualifies as an insider or an outsider, or how precisely he obtained the information”).

41. According to Article 10 (1) of the MAR “for the purposes of this Regulation, unlawful disclosure of inside information arises where a person possesses inside information and discloses that information to any other person, except where the disclosure is made in the normal exercise of an employment, a profession or duties”. Commission Regulation 596/2014 of April 16, 2014, on market abuse regulation, 2014 O.J. 331 (L 173) 1.

actually faced with a double risk. First, the Article 8 MAR prohibition on trading usually represents an unacceptable burden for active institutional investors, whose business model is based on the ability to trade. Secondly, under the EU market abuse regime, shareholders that engage with directors face the risk of being fined even if they asked not to receive inside information, or if they are not actually aware of having received inside information. Dialoguing with directors could (at least at first glance) turn out to be a dangerous practice for shareholders in Europe.

However, concerns related to the MAR should not be overstated, as is suggested by recital 19 to the MAR, which clearly affirms that:

This Regulation is not intended to prohibit discussions of a general nature regarding the business and market developments between shareholders and management concerning an issuer. Such relationships are essential for the efficient functioning of markets and should not be prohibited by this Regulation.

In fact, in spite of the general provisions of Articles 8 and 17 MAR, the EU market abuse regime seems to leave enough room for director-shareholder dialogue, without exposing directors and shareholders to the risk of infringing insider trading prohibitions and public disclosure obligations.

First of all, the duty to disclose set by Article 17 (1) MAR is not absolute. Article 17 (8) MAR provides for an exception to the general ban on selective disclosure by stating that:

Where an issuer, or a person acting on its behalf or for its account, discloses any inside information to any third party in the normal course of the exercise of an employment, profession or duties as referred to in Article 10 (1)⁴², they must make complete and effective public disclosure of that information, simultaneously in the case of an intentional disclosure, and promptly in the case of a non-intentional disclosure. However, this paragraph shall not apply if the person receiving the information owes a duty of confidentiality, regardless of whether such duty is based on a law, on regulations, on articles of association, or on a contract⁴³.

In contrast to what might appear at first sight, Article 10 MAR does not prohibit dialogue between directors and selected institutional investors. Although the European Court of Justice has held that the selective disclosure exemption laid down by Article 10 MAR must not be strictly interpreted, according to the ECJ Grand Chamber's decision in the *Grøngaard and Bang* case,⁴³ information is only considered to have been disclosed in the normal

42. *Id.*

43. Case C-384/02, Criminal proceedings against Knud Grøngaard and Allan Bang, EU:C:2005, at para. 27 (stating that “[e]ven if that rule, having regard to the terms used, is capable of covering very different situations, it must, as an exception to a general prohibition and in the light of the objective

course of the exercise of an employment, profession or duties where there is a close link between disclosure and the exercise of the employment, profession or duties, and disclosure is strictly necessary for the exercise of that employment, profession or duties. If this decision is considered in greater detail, it is still unclear whether the disclosure of inside information to key shareholders falls within the scope of the exemption provided for under Article 10 MAR. However, when interpreting the exemption, it must be considered that recital 19 to the MAR clearly favours director-shareholder engagement. As has recently been pointed out by Hansen,

A too narrow interpretation of the exemption in Art 10 MAR runs the risk of preventing active engagement by shareholders and should be avoided, where the selective disclosure is reasonable and made in orderly circumstances whereby the circle of recipients is known.⁴⁴

Furthermore, pursuant to Article 17(8) MAR, directors are allowed to disclose selectively material non-public information to recipients who have signed a confidentiality agreement. If the recipient enters into such an agreement, he/she is subject to the prohibition on trading laid down by Article 8 MAR, and cannot use any inside information in his possession. Thus, according to Article 10, when institutional investors agree to keep the information received confidential, and not to trade on the basis of such information, directors are allowed to freely dialogue with them and to disclose (also) material non-public information.

Nevertheless, the confidentiality-based exemption under Article 10 MAR could at first glance appear to be quite unattractive for active institutional investors, who usually want to be free to exit from investee companies. According to Article 10 MAR, a recipient of selective inside disclosures is definitely subject to the prohibition on trading the securities to which the inside information refers. The selective disclosure regime could therefore discourage institutional investors from engaging with directors. However, as the trading ban only applies where inside information is communicated, if the information disclosed during director-shareholder dialogues is not material, institutional investors will be free to trade the company's shares.

In order to assess the compatibility of board-shareholder engagement with the European market abuse regime, it is also worth noting that Article 11 MAR is comprised of specific provisions concerning market soundings, *i.e.* interactions between a seller of financial instruments and one or more potential investors prior to the announcement of a transaction in order to gauge the interest of potential investors in a potential transaction and its pricing, size and structuring. As recital 32 to the MAR explicitly

pursued by Directive 89/592, be interpreted strictly"). See, e.g., Jesper L. Hansen, *Market Abuse Case Law – Where Do We Stand With MAR?*, 14 EUR. COMPANY & FIN. L. REV. 367, 373, 375 (2017).

44. HANSEN, *supra* note 43, at 374-375.

recognizes,⁴⁵ market soundings are a highly valuable tool for enhancing dialogue with shareholders, and measure their interest in participating in a possible transaction (e.g. an issuance of additional equity).

As market soundings may entail the disclosure of inside information,⁴⁶ Article 11 MAR requires that procedural safeguards be put in place in order to prevent infringements of the market abuse regime. Pursuant to Articles 10(1) and 11(4) MAR, market soundings involving inside information should be considered to be compliant with the market abuse regime only if such information is disclosed during the normal course of the exercise of a person's employment, profession or duties. Disclosure of inside information made in the course of a market sounding will be deemed to be made in such a way only when issuers or other persons disclosing inside information ("disclosing market participants") comply with paragraphs Article 11(3) and (5) MAR.⁴⁷

45. See Recital 32 of the MAR ("[m]arket soundings are interactions between a seller of financial instruments and one or more potential investors, prior to the announcement of a transaction, in order to gauge the interest of potential investors in a possible transaction and its pricing, size and structuring. Market soundings could involve an initial or secondary offer of relevant securities, and are distinct from ordinary trading. They are a highly valuable tool to gauge the opinion of potential investors, enhance shareholder dialogue, ensure that deals run smoothly, and that the views of issuers, existing shareholders and potential new investors are aligned. They may be particularly beneficial when markets lack confidence or a relevant benchmark, or are volatile. Thus, the ability to conduct market soundings is important for the proper functioning of financial markets and market soundings should not in themselves be regarded as market abuse"). Commission Regulation 596/2014 of April 16, 2014, on market abuse regulation, 2014 O.J. 331 (L 173) 32.

46. Article 11(2)-(7) MAR recognizes that market soundings can entail disclosure of material non-public information, as explicitly confirmed also by the recital 34 to the MAR stating that "[c]onducting market soundings may require disclosure to potential investors of inside information. There will generally only be the potential to benefit financially from trading on the basis of inside information passed in a market sounding where there is an existing market in the financial instrument that is the subject of the market sounding or in a related financial instrument. Given the timing of such discussions, it is possible that inside information may be disclosed to the potential investor in the course of the market sounding after a financial instrument has been admitted to trading on a regulated market or has been traded on an MTF or an OTF. Before engaging in a market sounding, the disclosing market participant should assess whether that market sounding will involve the disclosure of inside information". However, market soundings do not necessarily lead to a disclosure of inside information: see Stefano Lombardo & Federico M. Mucciarelli, *Market soundings: The Interaction Between Securities Regulation and Company Law in the United Kingdom and Italy* 20-21 (Eur. Corp. Governance Inst., Law Working Paper No. 362/2017, 2017), http://ssrn.com/abstract_id=3012183

47. See recital 35 to the MAR stating that "[i]nside information should be deemed as being disclosed legitimately if it is disclosed in the normal course of the exercise of a person's employment, profession or duties. Where a market sounding involves the disclosure of inside information, the disclosing market participant will be considered to be acting within the normal course of his employment, profession or duties where, at the time of making the disclosure, he informs and receives the consent of the person to whom the disclosure is made that he may be given inside information; that he will be restricted by the provisions of this Regulation from trading or acting on that information; that reasonable steps must be taken to protect the ongoing confidentiality of the information; and that he must inform the disclosing market participant of the identities of all natural and legal persons to whom the information is disclosed in the course of developing a response to the market sounding. The disclosing market participant should also comply with the obligations, to be set out in detail in regulatory technical standards, regarding the maintenance of records of information disclosed. There should be no presumption that market participants that do not comply with this Regulation when conducting a market sounding have unlawfully disclosed

Article 11 (3) requires that disclosing market participants, prior to conducting a market sounding, specifically consider whether the market sounding will involve disclosure of inside information, and to make a written record of their conclusions and the reasons therefore. Moreover, in order to ensure that market soundings do not violate insider trading rules, Article 11 provides that also the person receiving the market sounding shall assess for itself whether it is in possession of inside information, or when it ceases to be in possession of inside information. In order to prevent insider trading rules (especially the trading ban associated) from applying to a person receiving market soundings who is unwilling to receive inside information, the disclosing market participant is requested to obtain prior consent to the disclosure of inside information. If the person receiving the market sounding consents to receiving material non-public information, insider trading rules will apply to him/her. Thus, the person receiving market soundings is prohibited from using that information by trading financial instruments to which the inside information relates, and is obliged to keep the information confidential.

Article 11(5) further requires disclosing market participants to keep records (and to provide them to the competent authority upon request) of all information given to persons receiving the market sounding, including information given within the market sounding, the identity of the potential investors to whom information has been disclosed, including but not limited to the legal and natural persons acting on behalf of the potential investor, and the date and time of each disclosure.

As has been made clear by the ESMA,⁴⁸ the market soundings regime only applies to communications that are intended to assess the interest of potential investors in a possible transaction, and the conditions relating to it, such as its potential size or pricing, but not to investor relations communications generally. Therefore, the provisions of Article 11 MAR do not directly apply to the broader area of director-shareholder dialogue concerning governance or strategic issues, on which this article is focused.

Nevertheless, the market soundings regime seems to confirm indirectly that the MAR leaves sufficient scope for director-shareholder dialogue. First of all, recital 34 and Article 11 of the Regulation clearly show that persons

inside information but they should not be able to take advantage of the exemption given to those who have complied with such provisions”.

See also Lombardo & Mucciarelli *supra* note 46, at 19 (noting that meeting the special procedural conditions set in Article 11 is likely to replace the strict requirements for selective disclosure of inside information set forth by the ECJ in *Grøngaard*).

48. European Securities and Markets Authority [ESMA], Discussion Paper, Policy Orientations on Possible Implementing Measures Under the Market Abuse Regulation, ESMA/2013/1649, at para. 62 (Nov. 14, 2013), <https://www.esma.europa.eu/press-news/consultations/esma%E2%80%99s-policy-orientations-possible-implementing-measures-under-market> (highlighting that “[i]t is important to note that the market soundings regime under MAR is not intended to inhibit relations between the issuer and its investors. The regime only applies to communications intending to gauge the interest of potential investors in a possible transaction and the conditions relating to it such as its potential size or pricing, and not to investor relations communications more generally”).

involved in market soundings are free to exchange non-material information, and that the procedural safeguards outlined in Article 11 MAR are much more significant where inside information is disclosed within market soundings.⁴⁹ This is consistent with the general approach of the MAR, according to which the prohibition on insider trading and the public disclosure obligation only apply to inside information, as defined in Article 7 MAR. Put differently, Article 11 seems to support that the view that the communication of non-material information is by no means constrained by the MAR.⁵⁰

Secondly, although the market soundings regime only covers board-shareholder communications that are directed at gauging the interest of potential investors in a possible transaction, the provisions of Article 11 MAR are useful in defining a legal framework applicable to director-shareholder dialogue that falls outside the scope of market soundings, on which this article is focused. Specifically, there is a question as to whether, in order to prevent possible breaches of market abuse law, the procedural steps designed by Article 11 of the MAR may give rise to the same protective effects if applied to director-shareholder dialogue concerning governance or strategic issues. It would appear reasonable to answer this question in the affirmative as the voluntary application of procedures set out in Article 11 MAR,⁵¹ which are aimed at preventing infringements of the market abuse regime, can create a safer context for director-shareholder dialogue and incentivize intuitional investors to engage with issuers.

In conclusion, the mandatory disclosure and insider dealing regime laid down by the MAR only represents a relative constraint on director-shareholder dialogue, insofar as it prohibits directors from disclosing inside information within private meetings with shareholders, unless shareholders agree to sign a confidentiality agreement and abstain from trading financial instruments to which inside information relates. Although they do give rise to some problematic issues, and can discourage engagement by institutional investors, these constraints should be scaled back. As noted before, investors generally do not intend to receive inside information, since this would

49. See Lombardo & Mucciarelli *supra* note 46, at 20 (noting that “[i]n this case, the discloser faces simplified duties regarding the minutes and the records that are to be kept. In particular, the discloser should indicate that the recipient is about to receive information that ‘the disclosing market participant considers not to be inside information’ and the recipient should consent to such disclosure on a ‘non-wall-crossed’ basis”).

50. HOPT, *supra* note 10, at 7 (pointing out that only director-shareholder dialogue concerning inside information are prohibited by the MAR).

51. Director-shareholder dialogue concerning governance and strategic issues is clearly beyond the scope of Article 11 MAR because, unlike market soundings, it is not intended to gauge interest in a transaction. See generally Cleary Gottlieb, *Market Abuse Regulation: A Balanced Approach to the Market Sounding Regime’s Applicability in Capital Markets Transactions* (June 26, 2017), <https://www.clearygottlieb.com/~media/cgsh/files/2017/publications/alert-memos/mar—a-balanced-approach-to-the-market-sounding-regimes-applicability-6-27-17.pdf> (highlighting that “[r]egular outreach by an issuer to its existing investor base to keep it informed of notable developments (when no transaction is planned) should not constitute a market sounding”).

restrain their freedom in trading the securities concerned.⁵² During engagement-related dialogue, institutional investors mainly seek to communicate their opinions and concerns regarding corporate governance matters, strategies or individual transactions. Although the MAR requires that safeguards be established in order to prevent inside information from being communicated, and this can increase compliance costs for both the issuers and institutional investors, the European market abuse regime, as is also apparent from practice, does not genuinely hinder dialogue between directors and key shareholders.

B. THE PRINCIPLE OF EQUAL TREATMENT FOR SHAREHOLDERS

As mentioned above, one further hurdle that may hinder director-shareholder dialogue within the European context is the principle of equal treatment for shareholders⁵³ laid down by Article 17 of Directive 2004/109/EC,⁵⁴ according to which “the company shall ensure equal treatment for all shareholders who are in the same position”. Similarly, Article 46 of Directive 2012/30/EU⁵⁵ provides that “for the purposes of the implementation of this Directive, the laws of the Member States shall ensure equal treatment to all shareholders who are in the same position”. Although with respect to equal treatment the European Court of Justice has rejected the view that the existence of “certain provisions relating to the protection of minority shareholders is not sufficient in itself to establish the existence of a general principle of Community law, in particular if the scope of those provisions is limited to rights which are well defined and certain”,⁵⁶ Article 17 of Directive 2004/109/EC (and the corresponding national implementation rules) is still viewed as a substantial constraint on board-shareholder engagement.⁵⁷

Since director-shareholder dialogue may give rise to an informational advantage for the shareholders involved, its compatibility with the equal treatment principle is questionable. In spite of its relevance, the compatibility

52. See e.g. Eugene Soltes, *What Can Managers Privately Disclose to Investors*, 36 YALE J. REG. BULLETIN 148, 149 (2018-2019).

53. HOPT, *supra* note 10, at 8-10.

54. Directive 2004/109 of the European Parliament and of the Council of 15 December 2004 on the Harmonisation of Transparency Requirements in Relation to Information About Issuers Whose Securities are Admitted to Trading on a Regulated Market and Amending Directive 2001/34/EC, 2004 O.J. (L 390/38).

55. Directive 2012/30 of the European Parliament and of the Council of 25 October 2012 on Coordination of Safeguards Which, for the Protection of the Interests of Members and Others, are Required by Member States of Companies Within the Meaning of the Second Paragraph of Article 54 of the Treaty on the Functioning of the European Union, in Respect of the Formation of Public Limited Liability Companies and the Maintenance and Alteration of their Capital, with a view to Making Such Safeguards Equivalent, 2012 O.J. (L 315/74).

56. Case C-108/08, *Audiolux SA v. Grp. Bruxelles Lambert SA (GBL)*, 2009 E.C.R. I- 09823 (ECLI:EU:C:2009:626). See also LOMBARDO & MUCCIARELLI *supra* note 46, at 35–36.

57. See Hopt, *supra* note 10, at 7

of director-shareholder dialogue with selective disclosure has not been seriously addressed in the literature, or by the courts.

One significant exception concerns a decision by the Danish Supreme Court in the Vase case concerning an acquisition by merger by acquisition where the directors had established contact with selected shareholders in order to seek their views concerning the transaction.⁵⁸ The compatibility of private dialogue between directors and the relevant shareholders with the principle of equal treatment of shareholders was questioned by a minority shareholder who had bought the company's shares in view of the takeover. Some time later, as it seemed apparent that no takeover would take place, the shareholder decided to sell his shares. However, a few days after he sold his shares, the takeover bid was launched. The shareholder alleged that if he had been informed about the future offer at the same time as the major shareholders had been, he (as well as other minority shareholders who were not involved in the dialogue that had taken place with key shareholders) would have had the opportunity to take advantage of the positive market price reaction to the takeover announcement.

The Danish Supreme Court did not accept the minority shareholder's view. Instead, it stated that directors can lawfully consult with the controlling shareholder and with major shareholders. The case was decided on the basis of two arguments. First, under the corporate governance model characterizing Nordic public companies, the influence of controlling shareholders is considered to be normal and "beneficial" for the company. Therefore, dialogue with relevant shareholders is an ordinary and widely accepted practice.⁵⁹ Secondly, there had been no breach of the principle of equal treatment of shareholders since this principle applies to shares, and not to shareholders as such. As a shareholder's "weight" within the company depends on the number of shares it holds, not all shareholders are the same.

The Danish Supreme Court's opinion is consistent with the wording of Article 17 of Directive 2004/109/EC, which provides that only shareholders "who are in the same position" should be treated in an equal manner. Consequently, it is reasonable to assume that, under European company and financial markets law, major shareholders cannot be considered to be in the same position as retail investors with minimal holdings, and the directors should be allowed to engage in dialogue with selected relevant shareholders.

Nonetheless, dialogue between directors and (significant) shareholder is subject to limitations. As has recently been observed by Lombardo and Mucciarelli,

58. A summary of the arguments made by the Danish Supreme Court's in the Vase case is provided by Jesper L. Hansen, *The Role of Shareholders in Public Companies in the Nordic Countries*, in GERMAN AND NORDIC PERSPECTIVES ON COMPANY LAW AND CAPITAL MARKETS LAW 81, 86 (Holger Fleischer et al. eds., 2015).

59. Hansen, *supra* note 43, at 375 (arguing that the Danish Supreme Court, in its decision in the Vase case, held that selective and confidential disclosure from the board to major shareholders was legitimate under the Danish system of corporate governance).

Directors can never behave arbitrarily vis-à-vis their shareholders, and even if discrimination is allowed, it is reasonable to expect that the applicable company law regime requires such discrimination to be supported by specific justifications for the benefit of the company as a whole, although the precise contours of these limits on directors' powers may vary across jurisdictions.⁶⁰

This leads us to a key issue, namely whether private meetings between directors and selected shareholders are supported by specific justifications for the benefit of the company as a whole. This issue has mainly been addressed by German scholars within the intense debate that followed the introduction into the German Corporate Governance Code of a specific recommendation concerning dialogue between members of the supervisory board and shareholders.⁶¹ According to the prevailing opinion, the principle of the equal treatment of shareholders does not preclude dialogue with relevant shareholders, including specifically with institutional investors, provided there are objective reasons underlying the choice of investor that is granted or offered meetings.⁶²

Dialogue with relevant shareholders certainly benefits the company as a whole where transactions are initiated that require shareholder approval, as is typically the case for a capital increase.⁶³ Were the company to announce its intention to raise new capital without previously having sounded out its major shareholders and having obtained their informal approval, there would be a risk that the issuer might suffer losses in addition to reputational losses. The failure to execute an announced capital increase can negatively impact on market prices of the company's shares, which would result in a loss for its shareholders. The issue is clearly addressed by the market sounding regime set out by the MAR. Article 11(2) MAR states that disclosure of inside information by a person intending to make a takeover bid for the securities of a company, or a merger with a company, to parties entitled to the securities, shall also constitute a market sounding, provided that the willingness of parties entitled to the securities to offer their securities is reasonably required for the decision to make the takeover bid or merger.

The answer to the further question as to whether ongoing dialogue between the directors and the relevant shareholders benefits the company as a whole is less obvious⁶⁴ Still, there are sound reasons for answering in the

60. LOMBARDO & MUCCIARELLI, *supra* note 46, at 35. *See also* Hopt, *supra* note 10, at 8.

61. *See* Part II above.

62. *See* GER. INV. FUNDS ASS'N, *supra* note 31, at *Introduction*.

63. *See* Hopt, *supra* note 10, at 9 (highlighting that "dialogue by the board with institutional investors outside of the general assembly is justified if the board considers it to be in the interest of the corporation and if no new material inside information is distributed to the public ahead of the ad hoc-disclosure").

64. This issue was debated in some jurisdictions before the MAR entered into force, including the possibility of deriving a general principle of the legitimacy of dialogue between the board and (significant) shareholders from the recognized legitimacy of those entered into on specific occasions, in particular in relation to capital increases and mergers. *See* for Germany, Hopt, *supra* note 10, at 9; *see*

affirmative. As Hopt has observed, engaging in dialogue with relevant shareholders, especially with institutional investors, is *per se* consistent with the interests of the company, since sound investor relations are crucial for listed companies.⁶⁵ Therefore, any deviation from the principle of equal treatment of shareholders for these purposes is not arbitrary, but legitimate. Institutional shareholders and minority retail shareholders cannot be considered to be in the same position, both due to the size of their holdings as well as their attitude towards being active shareholders.⁶⁶ Furthermore, the overlap between private dialogues between directors and relevant shareholders and the issuers' interests is clearly apparent from SRD II, as well as from the corporate governance codes mentioned above, both of which encourage effective dialogue between directors and shareholders.⁶⁷

Moreover according to the MAR the duty to ensure equal access to information only applies to inside information.⁶⁸ Similarly, the disclosure obligation under Article 17 MAR only applies to inside information, as defined under Article 7. Therefore, the MAR seems to confirm that a principle of equal information is not absolute in nature.⁶⁹ Rather, the MAR allows institutional investors to gain an informative advantage from dialogue with directors, as long as this does not entail the disclosure of inside information.⁷⁰ The same also applies when, if the information received from directors is combined with further pieces of information to form a mosaic, the shareholder concerned may arrive at material information.⁷¹ Consequently, neither two-way director-shareholder dialogue not involving the disclosure of inside information nor "listen-only" sessions where directors learn about the positions of institutional shareholders violate the equal treatment principle under EU law.

Belgium, Koen Geens, *Corporate Boards in Belgium*, in *CORPORATE BOARDS IN LAW AND PRACTICE* 120, 148 (Paul Davies et al. eds., 2013).

65. Hopt, *supra* note 10, at 9.

66. *Id.* at 738.

67. *See supra* Part II.

68. Also the ECJ seems to recognize that the duty to ensure equal access to information only applies to inside information. Also the ECJ seems to recognize that the duty to ensure equal access to information only applies to inside information. *See* Case C-45/08, *Spector Photo Grp. NV v. Commissie voor het Bank, Financien Assurantiewezen*, ECLI:EU:C:2009:806, ¶ 48 (noting that the purpose of insider trading prohibition "is to ensure equality between the contracting parties in stock-market transactions by preventing one of them who possesses inside information and who is, therefore, in an advantageous position vis-à-vis other investors, from profiting from that information, to the detriment of those who are unaware of it").

69. *See* Holger Fleischer, *Investor Relations und informationelle Gleichbehandlung im Aktien-, Konzern- und Kapitalmarktrecht*, 38 *ZEITSCHRIFT FÜR UNTERNEHMENS- UND GESELLSCHAFTSRECHT (ZGR)* 505, 512-513 (2009).

70. Of course, directors can extend face-to-face contacts with major shareholders to other shareholders if this is in the interest of the corporation. *See* Hopt, *supra* note 10, at 10 (noting also that, according to the MAR, "[a]t a minimum all new material facts made available in such a dialogue must be promptly disclosed" and arguing that "It may be advisable to go further and to allow other shareholders direct access to the dialogue, but this goes far and cannot yet be considered to be generally acknowledged good corporate governance").

71. *See* Fleischer, *supra* note 70, at 512-513.

IV. DESIGNING A PRACTICAL FRAMEWORK FOR BOARD-SHAREHOLDER ENGAGEMENT

As has been shown above, private meetings between directors and institutional investors fly under the radar of the insider trading and disclosure regime when (as normally occurs)⁷² they concern non-material information and the disclosure of material non-public information within director-shareholder dialogue does not violate the mandatory disclosure and insider trading regime where recipients agree to sign a confidentiality agreement. In addition, it is worth noting that the risk of disclosing material information is overcome where issuers only listen to shareholders' opinions and concerns.⁷³

Detecting the transfer of material information raises more substantial problems within two-way dialogue. In this case, the issuers and institutional investors involved seem to be exposed to significant compliance costs, even if there is lack of recent empirical evidence demonstrating the level of compliance costs associated with insider trading and public disclosure rules.⁷⁴ Moreover, participants in dialogue run the risk of infringing disclosure obligations and insider trading prohibitions, and consequently being fined. With the aim of reducing these potential drawbacks, issuers and investors are recommended to adopt specific procedures in order to avoid the communication of material non-public information. In this regard, recommendations from corporate governance and stewardship codes, and practitioners, play a major role as they assist in developing a practical framework for safe director-shareholder dialogue and in making dialogue more effective. Against this backdrop, this part focuses on three aspects that are crucial for safe dialogue, concerning identification of both of the topics to be discussed, and the participants involved, and the issuers' adoption of a policy defining the format and procedure for dialogue.

A. TOPICS FOR DIALOGUE

Selecting the issues for discussion is not problematic where the shareholders involved agree to treat the information disclosed in confidence. If this is the case, the MAR allow for the selective disclosure of inside information. In the most prevalent case, where institutional investors are not willing to sign confidentiality agreements and the entry into dialogue with

72. See Stefano Cascino et al., *Who Uses Financial Reports and for What Purpose? Evidence from Capital Providers*, 11 ACCT. EUR. 185, 209 (2014) (empirical findings collected).

73. Stephen Davis & Stephen Alogna, *Talking Governance: Board-Shareholder Communications on Executive Compensation*, YALE SCH. OF MGMT. 10 (2008), <http://som.yale.edu/news/news/millstein-report-board-shareholder-communication-next-frontier-governance>.

74. See, e.g., for the U.S., See Richard H. Walzer, Dir., Div. of Enf't, U.S. Sec. & Exch. Comm'n, Remarks Before the Rocky Mountain Securities Conference (May 18, 2001), <https://www.sec.gov/news/speech/spch492.htm> (reporting that "a survey by PricewaterhouseCoopers (PwC) found that 57% of respondents have not incurred any incremental compliance costs in connection with Regulation FD. Of the 43% who have incurred such costs, 90% reported that the costs were moderate or low. In contrast, a study by the Securities Industry Association (SIA) finds that Regulation FD imposes "significant costs . . . well in excess of those originally estimated by the SEC").

investee company directors could constrain their trading *activity*,⁷⁵ it is recommended that issuers only choose issues for which there is a lower risk of the disclosure of inside information, and adopt specific precautionary measures in order to prevent inside information from being disclosed during private meetings with shareholders.

Specifically, in order to prevent breaches of insider trading rules, participants should make it clear prior to entering into dialogue whether or not they are willing to communicate, or receive, price sensitive information. The Efama Stewardship code is very explicit in this respect, recommending that institutional investors may not wish to receive inside information, and expect that, absent their consent, issuers and their advisors avoid communicating information that, according to the insider trading regime outlined in the MAR, may constrain their ability to trade the issuers' shares.⁷⁶

Risks associated with the disclosure of inside information may also be reduced by focusing on the timing of dialogue. For example, the Dutch Corporate Governance Code recommends that meetings with financial analysts – although the same is certainly also the case for dialogue with shareholders – do not take place during the period immediately preceding the publication of periodical financial information in order to prevent information concerning the company's economic performance during the relevant reference period from being selectively disclosed.⁷⁷ Further precautionary measures that may be taken by issuers include the early definition of the issues to be discussed and a check as to their materiality, as well as participation of legal advisors in private meetings with shareholders.

As mentioned above, converging recommendations are contained in the corporate governance codes adopted in various Member States. The UK Corporate governance code recommends that the boards' chair discusses with relevant shareholders on corporate governance and strategy issues.⁷⁸ The Belgian Code on Corporate Governance encourages shareholders, especially institutional investors, to assess carefully the corporate governance structure of investee companies.⁷⁹ More detailed recommendations are to be found in the Guiding principles for dialogue between investors and German supervisory boards, according to which

75. See *supra* Part III.A.

76. EFAMA CODE *supra* note 6, at 5.

77. Dutch Corp. Governance Code Monitoring Comm., Dutch Corporate Governance Code § 4.2.3. (2016), <http://www.mccg.nl/?page=4738>.

78. See *supra* note 24. Such a recommendation is in line with the empirical evidence illustrated by ESMA, (showing that “ESG / sustainability related factors (20% - 41 respondents) and remuneration of directors (19% - 39 respondents) were seen as the main topics for engagement, *supra* note, 7, at 62. Board appointments (including board diversity, independency and tenure, 17% - 36 respondents) followed together with decisions on pay-out policy (14% - 30 respondents). Finally related-party transactions were flagged by less than 10% of the responses (20 respondents). Other topics mentioned as a means of mitigating undue short-termism were long-term contracts for directors, company reporting and auditing, appointment of minority directors, shareholder rights, climate change, oversight of strategy and risk, fraud and corruption”).

79. BELGIAN CODE ON CORPORATE GOVERNANCE, *supra* note 25, at 24.

topics for dialogue depend on the directors involved.⁸⁰ In relation to members of the Supervisory Board (whose role is roughly comparable to that of non-executive directors),⁸¹ the Guiding principles state that they should only engage in dialogue with institutional shareholders concerning matters falling under the Supervisory Board's responsibilities, leaving all other matters for discussion to the management board in its capacity of the company's legal representative.⁸² Thus, the composition of the supervisory board, its appointment process, as well as its remuneration system, can be discussed within dialogue. More specifically, dialogue may involve the supervisory board's report and matters raised in the corporate governance report that are relevant for the supervisory board, the internal organization of the supervisory board, the design of control and participation processes, committee formation, as well as the supervisory board's efficiency review, and measures resulting from the review. The results of the efficiency review regarding individual members of the supervisory board should not be discussed. The requirement profile for management board members and the division of duties therein may be discussed in the dialogue. In addition, the remuneration system of the management board, contemplated changes, possible suggestions for improvement, as well as interpretation and, if applicable, the exercise of the discretionary powers of the supervisory board pertaining to remuneration-related matters may also be discussed with investors. On the other hand, specific proposals for elections to the supervisory board, or proposals concerning individual candidates should not be discussed. Furthermore, dialogue should not involve the development and implementation of corporate strategies, since these are matters falling under the responsibility of the management board. The supervisory board should only explain to shareholders that its role is within the process of strategy definition, and its assessment of its implementation.

Stewardship principles seem to provide less restrictive guidance, since dialogue with shareholders is recommended on any issue of interest for institutional investors. According to the UK Stewardship Code 2020, institutional investors should engage with investee companies to maintain or enhance the value of assets.⁸³ Likewise, Italian Stewardship Principles recommend that institutional investors intervene, for example, where they have significant concerns regarding the strategy and performance of investee issuers, their governance structure, or their approach to environmental and

80. See GER. INV. FUNDS ASS'N, *supra* note 31, at 3-4. See also Marcus Lutter, *Stellungnahme zum Vorschlag der Regierungskommission Ziff. 5.2 des Kodex um einen neuen Abs 2* (2016), <http://www.dcgk.de/en/consultations/commentsreceived.html?file=files/dcgk/usercontent/de/Konsultationen/2016/Stellungnahmen%202016/161213%20Stellungnahme%20Prof.%20Lutter.pdf>.

81. Paul L. Davies & Klaus J. Hopt, *Corporate Boards in Europe - Accountability and Convergence*, 61 AM. J. COMP. L. 301, 309-315 (2013).

82. See *supra* note 80.

83. FRC, *supra* note 22, at 17.

social issues.⁸⁴ In spite of their wider approach, the provisions of stewardship codes do not appear to result in an increased risk of violating the market abuse regime. In fact, stewardship principles recommend that institutional investors communicate their concerns to investee companies, and thereby only refer to one-way dialogue, during which issuers do not communicate information. This should exclude the risk of breaching the regulatory framework.

The precautionary measures mentioned above should reduce the risks associated with the disclosure of material non-public information within director-shareholder dialogues. However, topic restrictions and the predetermination of the format of dialogue could chill communication, and convert the shareholder-board relationship into a lawyer-driven, sterile interaction.⁸⁵ Furthermore, in order to serve as effective monitors of directors, institutional investors may find it necessary to exchange information when interacting with directors, as is typically the case when communicating their concerns regarding strategies or specific transactions.⁸⁶ In order to avoid such a potential chilling effect National Supervisory Authorities or the ESMA may consider the provision to boards and shareholders of more detailed guidance concerning (corporate governance) topics that can be discussed within board-shareholder dialogue. Even if such a solution would not establish a proper safe harbour, it could help reduce (at least in part) compliance costs for both issuers and institutional investors.

For example, in order to facilitate engagement on the part of institutional investors that have a long-term horizon and can help mitigating short-termism in financial markets, the ESMA could explicitly state that dialogues concerning ESG matters generally do not lead to infringements of market abuse regime.⁸⁷

B. PARTICIPANTS IN DIALOGUE

Selecting the directors to be involved in dialogue with institutional shareholders is another key aspect of the engagement process. Debate currently focuses on the involvement of non-executive directors in dialogue with relevant shareholders, it being acknowledged that executive directors and managers play the role of leading shareholder engagement with respect to operating performance, financial matters, strategic execution, and other

84. ITALIAN STEWARDSHIP PRINCIPLES, *supra* note 6, para. 3 (highlighting that “[a]n intervention may be found to be necessary regardless of the investment style and in order to protect the best interests of the collective investment undertakings or portfolios managed”).

85. See Edward B. Rock, *Shareholder Eugenics in the Public Corporation*, 97 CORNELL L. REV. 849, 905 (2012).

86. Yockey, *supra* note 19, at 206.

87. Interestingly, as far as the takeover regime is concerned, the ESMA seems to be willing to take action in this area. Namely, the ESMA is intended to assess whether the ESMA White List of activities that shareholders can cooperate on without the presumption of acting in concert under the Takeover Bids Directive, “should explicitly include coordination activities among institutional investors in the area of ESG risks in order to address potential obstacles to related engagement”. See *supra* note 7, at 68-69.

operational and performance matters for which they are directly responsible. Due to their monitoring role within the board, non-executive directors are the preferred point of contact for institutional investors performing their stewardship function.

European corporate governance codes stress that the chairperson of the board should play a central role in board's engagement with shareholders.⁸⁸ The UK corporate governance code recommends that the chair should seek regular engagement with major shareholders in order to understand their views on governance and performance against the strategy, and ensure that all directors are made aware of their major shareholders' issues and concerns.⁸⁹ According to the German Guiding principles for dialogue between investors and German supervisory boards, the board's chair represents the supervisory board in communications with investors and informs the entire supervisory board members about the dialogue. The chair is also entitled to decide whether to engage in specific dialogue. The central role played by the board's chair is underscored also by the suggestion A.3 of the German Corporate Governance Code, which states that the chairperson of the supervisory board should be available – within reasonable limits – to discuss supervisory board-related issues with investors.

Furthermore, it is a mainstream view within Europe that director-shareholder dialogue should also involve non-executive directors other than the board chair. Specifically, the lead independent director and the chairpersons of the board's committees should be involved where the board deems it appropriate, or if requested by the shareholders. The UK Corporate Governance Code states that “[c]ommittee chairs should seek engagement with shareholders on significant matters related to their areas of responsibility”.⁹⁰ Moreover, the Guidance on Board Effectiveness elaborated by the FRC recommends that “[w]hen called upon, the senior independent director should seek to meet a sufficient range of major shareholders in order to develop a balanced understanding of their views. Non-executive directors should take opportunities such as attendance at general and other meetings, to understand the concerns of shareholders”.⁹¹ As far as the role of the senior independent director is concerned, the Guidance also recommends that “[t]he senior independent director should also be available to shareholders if they

88. Similarly, for the United States Business Roundtable, Principles of Corporate Governance at 26, (2016), <https://s3.amazonaws.com/brt.org/Principles-of-Corporate-Governance-2016.pdf> (stating that “[d]irect communication between directors and shareholders should be coordinated through — and with the knowledge of — the board chair, the lead independent director, and/or the nominating/corporate governance committee or its chair”).

89. UK Corporate Governance Code, *supra* note 24, at 4.

90. *Id.* See also FIN. REPORTING COUNCIL, GUIDANCE ON BOARD EFFECTIVENESS 11 (2018), <https://www.frc.org.uk/directors/corporate-governance-and-stewardship/uk-corporate-governance-code/frc-guidance-for-boards-and-board-committees> (“the chairs of the audit, remuneration and nomination committees should be available to answer questions at the AGM. The chair should encourage them to make a statement on the activities and achievements of the committee over the year. This could include details of engagement with shareholders on significant matters”).

91. Fin. Reporting Council, Guidance on Board Effectiveness, *supra* note 91 at 11.

have concerns that contact through the normal channels of chair, chief executive or other executive directors has failed to resolve or for which such contact is inappropriate”.⁹²

Selecting participants in dialogue on behalf of the company is more complex in Italy, where the Consolidated Act on Finance (*Testo Unico della Finanza*) requires that at least one member of the board be elected by minority shareholders by means of the so-called slate system for electing directors.⁹³ Therefore, as regards the boards of Italian listed companies, a distinction is necessary between executive and non-executive-independent directors on the one hand and directors elected by the majority or respectively the minority on the other hand. This peculiar feature of the current Italian regulations of corporate governance raises the question as to whether directors drawn from the minority slate are allowed to make contact directly the minority shareholders that elected them. Since minority slates are usually presented by institutional investors, the establishment of a direct channel of communication with minority-elected directors would entail granting institutional investors direct and permanent access to the board. Guidance concerning the role of directors elected by the minority is provided by the Italian Stewardship Principles, which were significantly overhauled in 2016.

Under the previous version of the Principle No. 3, any institutional investors that had significant concerns regarding the strategy and performance of investee listed issuers were encouraged to intervene by requesting a meeting with the management and/or the auditors (the chairperson of the administrative body, executive directors, the lead independent director, the chairperson of the auditing body or independent directors elected by investment management companies and institutional investors, where present)⁹⁴ More specifically, according to the Principles as previously applicable, discussion with independent minority members of the board was viewed as a valid form of intervention and active communication for institutional investors, provided that: it was carried out within an organized and collective procedure; it occurred upon request by minority members of the board, or on the initiative of institutional investors, provided in the latter case that a meeting had previously been held with the chairperson, executive directors, or the lead independent director of the investee issuer.

These recommendations raised concerns among issuers, who considered that they were not fully in line with international practice. In fact, the Italian Stewardship Principles allowed minority members of the board to engage in dialogue directly with the institutional investors who had elected

92. *Id.* at 20.

93. See Giovanni Strampelli, How to Enhance Directors' Independence at Controlled Companies, 44 J. CORP. L. 103, 132-138 (2018).

94. See ASSOGESTIONI, ITALIAN STEWARDSHIP PRINCIPLES 17 (2015), https://ecgi.global/sites/default/files/codes/documents/principi_it_stewardship_settembre2015_en.pdf

them without even any requirement to request the other board members, the auditing body, or other managers whether they wished to participate in the meetings concerned.

Also following these criticisms, Italian Stewardship Principle No. 3 was reviewed in 2016. At present, the reviewed version of Principle No. 3 recommends that institutional investors meet with the chairman of the board, the executive directors, the lead independent director, the chairperson of the auditing body, the chairperson of an internal committee or other independent directors, including minority members, taking account also of the allocation of functions within corporate bodies. Furthermore, the Principle makes it clear that dialogue between directors and institutional investors should be conducted according to an organized and collective procedure which, among other things, ensures compliance with the general principle of no limits in terms of the mandate granted by the shareholders who proposed or approved the candidacy.

The review of the Italian Stewardship Principles must be viewed positively. The revised version of Stewardship Principle No. 3 seems appropriately to favour more effective dialogue between the board and institutional investors. The selection of the board's minority members involved in dialogue is no longer dependent on the nominating shareholders but on the roles performed by the director concerned (e.g. committee chair), in line with international best practice.⁹⁵ Thus, the reviewed version of Principle No. 3 prohibits minority-elected directors from meeting privately with the shareholders who proposed or approved their candidacy, unless other board members or representatives of the company are involved. The Italian experience offers an insight that may be repeated in other jurisdictions, such as the US, that allow minority shareholders to elect board members.⁹⁶

Having said that, two additional points must be made regarding the selection of board members involved in dialogue with institutional shareholders. First, director-institutional shareholder dialogue should avoid information asymmetries within the board. It is therefore crucial that all board members be informed in good time concerning any dialogue with institutional investors. In this respect, as clearly stated by the Italian Corporate Governance Code,⁹⁷ a key role should be played by the board's

95. The Shareholder-Director Exchange, Introduction and SDX Protocol 14 (2014), <http://www.sdxprotocol.com/what-is-the-sdx-protocol/> ("The company will specify participating directors based on the specific topic(s) to be discussed. Participants will be chosen based on experience, expertise, board role, and past relationship with the investor. The independent non-executive chairman, lead director, or relevant board committee chair will be one of the attendees.").

96. See, e.g., JOHN ARMOUR ET AL., *THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH* 50–51 (3d ed. 2017). (For an overview of national rules allowing minority shareholders to appoint their representatives).

97. GOVERNANCE COMM., *CORPORATE GOVERNANCE CODE*, *supra* note 29, at 6 (stating that "[t]he chair ensures that the board of directors is in any case informed, within the first suitable meeting, of the development and the significant contents of the dialogue that has taken place with all the shareholders").

chair. The possibility for an individual board member to engage in direct dialogue with the shareholders that proposed or approved his/her election can restrict the board's cohesiveness and undermine trust among directors.⁹⁸ Second, whilst a flexible approach is theoretically preferable, allowing for case by case decisions as to which non-executive directors should be involved in the dialogue based on the issues to be discussed, an individual board member should only ever privately meet with institutional shareholders in exceptional cases.⁹⁹ Where the chairperson of the board and the lead independent director cannot take part to the meeting with institutional investors, or where it is appropriate that they not be involved, or where institutional investors request dialogue with other non-executive independent directors, the non-executive board member selected should meet the shareholders along with a company manager, usually the person responsible for investor relations. This is useful in order to avoid that director-shareholder dialogue giving rise to information asymmetries within the board, and to restrict the risk of breaching insider and market abuse rules.

C. POLICY ON DIRECTOR-SHAREHOLDER MEETINGS

The format and subject matter of dialogue with shareholders should ideally be decided on a case by case by the directors, based on a variety of factors including, for example, the appropriateness of the proposed topic, the specific investors asking for the meeting and their approach to investment and corporate governance.¹⁰⁰ However, many issuers adopt a policy on director-shareholder communication that regulates the same issues on a pre-determined basis.¹⁰¹ For example, as regards the process by which shareholders can request direct dialogue with the board, policies define which directors must be involved in dialogue, and which topics must be discussed. In addition, many corporate governance experts recommend the adoption of a policy on director-shareholder dialogue, as this helps to

98. It is questionable whether dialogue with shareholders needs a prior agreement of the whole board. See HOPT, *supra* note 10, at 12 (arguing that “[t]he chairman will be well advised to secure an informal general agreement of the board for having such dialogues with investors. On the other hand, having to seek agreement for each individual dialogue and even having to obtain a formal board resolution for this would be too much and cannot be seen as being required by the law. In any case, if the board does not oppose the dialogue, it is up to the chairman of the board to have the dialogue with the investors since the chairman represents the board in the public”).

99. See Catherine Bromilow et al., *Director Dialogue with Shareholders*, CORP. BOARD 3 (May–June 2014), <https://www.weil.com/~l.../directordialoguewithshareholders.pdf>.

100. THE SHAREHOLDER-DIRECTOR EXCHANGE, *supra* note 95, para. 2.

101. For the U.S. See Tonello & Gatti, *supra* note 10. (Noting that formal, written policies for companies to regulate board shareholder engagement are more commonly seen among larger firms and have become prevalent in the financial sector. When adopted, these policies most frequently state: how investors can solicit an interaction with corporate directors; the allocation of engagement responsibilities among the board, the investor relations function, and other members of the senior management team; who at the board level is expected to lead the engagement process; and the topics on which the engagement is permitted. Detailed engagement calendars are seldom included.)

increase shareholder awareness as to how the company enters into dialogue and what its expectations are.¹⁰²

Nevertheless, it would be useful if corporate governance codes were to recommend the adoption and disclosure of a policy on director-shareholder dialogue. In this respect, the Dutch regulatory approach may be taken as a reference. Article 4.2.2 of the Dutch Corporate Governance Code recommends that “the company should formulate an outline policy on bilateral contacts with the shareholders and should post this policy on its website”. In keeping with the comply or explain mechanism, the company must provide a substantive and transparent explanation when it does not adopt such a policy. The Dutch Code does not regulate the contents of the policy, but in most cases practice shows that the policy applies to procedural aspects and the format of dialogue. For example, the policy on bilateral contacts with the shareholders adopted by Heineken (a Dutch leading brewing company) states that

Conversations with shareholders in general take place in Annual General Meetings of Shareholders, but may also be held on a bilateral basis or in (small) groups. Heineken determines at its sole discretion whether it accepts invitations to engage in bilateral contacts with shareholders. Heineken takes into consideration all reasonable requests from shareholders. The initiative to enter into a conversation with a shareholder can also be taken by Heineken. Heineken may request a shareholder to provide certain written information prior to a bilateral conversation in order to assess whether a conversation outside an Annual General Meeting of Shareholders would be in the interest of Heineken. This information may include the objective of the conversation, the matters to be discussed, the opinion of the shareholder on these matters and information in respect of the shareholder and its interest in Heineken. Heineken is generally represented by its Investor Relations Director during these interactions. However, in a limited number of occasions, one or more members of senior management and the Executive Board of Heineken may accompany the Investor Relations Director. In some circumstances, the Investor Relations Director may delegate the interaction with a shareholder to the Investor Relations Manager. The subject matter of bilateral communications ranges from individual queries from shareholders to more elaborate discussions following Heineken disclosures, such as its annual and interim reports. In principle, Heineken holds no meetings with any shareholders during silent periods.¹⁰³

102. *Supra* note 99, at 3.

103. *See* HEINEKEN N.V., POLICY ON BILATERAL CONTACTS WITH THE SHAREHOLDERS 2-3 (2018), <https://www.theheinekencompany.com/sites/theheinekencompany/files/investor/governance/policies/Heineken-N.V.-Policy-on-bilateral-contacts-with-shareholders-Heineken-NV.pdf>. (Following the model of the Dutch Code, a similar recommendation is provided by the Italian Corporate Governance code, according to which “Upon proposal of the chair in agreement with the chief executive officer, the board of directors adopts and describes in the corporate governance report a policy for managing dialogue with the generality of shareholders, taking also into account the engagement policies adopted by institutional investors and asset managers”). *See* CORP. GOVERNANCE COMM., CORPORATE GOVERNANCE CODE, *supra* note 29, at 6.

In order to favour effective dialogue with institutional shareholders, corporate governance experts further recommend that issuers disclose their engagement activities, including specifying which directors were involved, what topics were discussed and what action the board has taken in response to institutional shareholders' concerns.¹⁰⁴

Issuers could report on which shareholders, and with what frequency, they entered into dialogue, and disclose a very short description of the contents of discussions, considering that a wider disclosure could result in an excessive administrative burden and discourage activist shareholders.¹⁰⁵ Specifically, the board should, on a quarterly or semi-annually basis, disclose certain standard details concerning the meeting, such as the identity of the counterparty, the date, and the start and end times, along with a brief description of the corporate purpose of the meeting, should be supported.¹⁰⁶ Following the example of the market soundings regime outlined by Article 11 MAR, issuers could also be required to keep records of their meetings with shareholders. Disclosing information concerning board-shareholder dialogue would benefit all shareholders (including retail shareholders),¹⁰⁷ since it would secure an awareness of the identity of shareholders that have entered into dialogue with the issuer and facilitate enforcement of the MAR.¹⁰⁸

V. CONCLUSION

Within a corporate governance landscape characterized by the growing importance of institutional shareholder engagement, board-shareholder dialogue is becoming an increasingly common practice in Europe. Board-shareholder dialogue is essential in order to enable institutional investors to fulfil their stewardship functions. Board-shareholder engagement is also core to listed companies' communication strategies, since the growing demand for engagement by institutional investors has rendered traditional investor relations insufficient.

Nevertheless, director-shareholder dialogue occurs within an area of tension between corporate governance trends and financial markets law.

104. See PRICEWATERHOUSECOOPERS, DIRECTOR-SHAREHOLDER ENGAGEMENT: GETTING IT RIGHT 6-7 (2020), <https://www.pwc.com/us/en/governance-insights-center/publications/assets/pwc-director-shareholder-engagement-getting-it-right.pdf>.

105. Martin Bengtzen, *Private Investor Meetings in Public Firms: The Case for Increasing Transparency*, 22 FORDHAM J. CORP. & FIN. L. 33, 122-126 (2017).

106. *Id.*, at 125 (arguing that "from the perspective of the recipients, the publicity of the fact that they have met management should be a small price to pay for an information advantage provided by the firm and indirectly paid for by its shareholders as a group"). See also Solomon & Soltes, *supra* note 13, at 353-354 (pointing out that "[o]ne possible solution is to publicly publish a transcript of these private interactions as firms currently provide for quarterly earnings conference calls with analysts").

107. Solomon & Soltes, *supra* note 13, at 353-354 ("[s]uch a practice would continue to facilitate private meetings but also allow all market participants access to the information being disclosed regardless of their ability to gain private access").

108. *Supra* note 105, at 128-129.

Private meetings between directors and institutional investors raise concerns with respect to the financial markets law framework in the EU, as they may lead to the disclosure of material non-public information to selected shareholders. In particular, the EU market abuse regime seems to hinder dialogue between directors and key shareholders as it requires the disclosure of inside information, and prohibits anyone receiving inside information from trading in the issuers' securities.

However, legal constraints deriving from EU financial markets law should not be overstated, as they do not definitely prohibit board-shareholder dialogue. First, insider trading and disclosure rules only apply to the communication of material non-public information. Therefore, as has been recognized by European lawmakers, they do not hamper dialogue as long as it does not concern inside information. Furthermore, when fulfilling their stewardship functions, institutional investors are primarily interested in communicating their views or concerns to investee companies and do not want to receive material non-public information so that they may freely trade securities issued by investee companies. Recommendations from corporate governance and stewardship codes, as well as good practice standards drafted by corporate governance experts and institutions, outline a practical framework that reduces the risk of violating disclosure rules and favours board-shareholder engagement. However, the provisions of codes and statements of best practice are not binding, as issuers and institutional investors are free to decide not to adopt them, and stipulate only a limited safe harbour. Judges and supervisory authorities can take action against issuers and institutional investors based on alleged breaches of the disclosure and insider trading legal framework.

Incentives for directors' and institutional investors to engage could be enhanced were the European Regulators to provide directors and investors with more detailed guidance concerning the topics that can be discussed within board-shareholder dialogue, and the precautionary measures that could be adopted. Whilst this would not establish a safe harbour, it could help to promote board-shareholder engagement by limiting compliance costs for both issuers and institutional investors.