

**HEDGE FUND ACTIVISM IN AN AGE OF GLOBAL COLLABORATION
AND FINANCIAL INNOVATION: THE NEED FOR A REGULATORY
UPDATE OF UNITED STATES DISCLOSURE RULES**

JOEL SLAWOTSKY

Abstract

Activist shareholder investing in the United States, once the primary domain of financial entrepreneurs and renegade traders, is now a mainstream strategic investment tactic wielded by large pools of capital. Hedge funds, as a result of having fewer political, regulatory, fiduciary, and legal constraints, have taken on the largest activist shareholder role. Although activist investing is not new, the globalization of financial markets, investment vehicles such as derivatives, and “wolf-pack” tactics have resulted in a striking growth of such activist investing since 2006. As a result of the increased use of such tactics, critics of hedge fund activism claim that hedge fund behavior in this space must be curtailed. Contrarily, supporters claim that such activism keeps corporate management honest. This article explores whether or not securities laws can play a role in striking a balance between legitimate concerns over activist abuses and the benefits of legitimate activism. The Williams Act, passed in 1968, contemplated an environment much less globalized than the one companies and investors face today, and as such, a middle-ground can be found that balances the competing concerns of ousting complacent managers versus abusive hedge fund conduct. After discussing the competing concerns and analyzing how activist shareholders behave in other countries (if at all), this article proposes that the disclosure requirement under the Williams Act should be lowered from 5% to 2.5%.

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I. Introduction

Activist shareholder investing in the United States, once the primary domain of financial entrepreneurs and renegade traders, is now a mainstream strategic investment tactic wielded by large pools of capital.¹ While government pension, private institutional, hedge, and other large funds are all practicing activist investing to a growing extent,² hedge funds are the primary drivers of activism, “emerging as the most dynamic and most prominent shareholder activists.”³

Several factors, including fewer political, regulatory, fiduciary, and legal constraints limiting other large funds from engaging in activist investing, make hedge funds particularly suited for shareholder activism.⁴ “We are observing an evolutionary process in real time. Hedge funds—highly incentivized, mostly unconflicted, and largely unencumbered by regulatory constraints—have become the prime corporate governance and control activists.”⁵

Hedge funds are increasingly flexing their enormous financial power⁶ and are “particularly active in transactions involving

¹ There are approximately 100 funds with \$200 billion in assets that engage (“There are more than 100 hedge funds that have engaged in activism. Activist hedge funds have approximately \$200 billion of assets under management.”).

² See, e.g., Randall Smith, *Some Big Public Pension Funds Are Behaving Like Activist Investors*, N.Y. TIMES, Nov. 29, 2013, at B1 (discussing the growing activism practiced by established institutions.); see also Joel Slawotsky, *Incipient Activism of Sovereign Wealth Funds and the Need to Update United States Securities Laws*, 2015 INT’L REV. L. 1, 3 (2015) (discussing the commencement of activism by sovereign wealth funds).

³ Marcel Kahan & Edward B. Rock, *Hedge Funds in Corporate Governance and Corporate Control*, 155 U. PA. L. REV. 1021, 1028 (2007); see also JONATHAN R. MACEY, *CORPORATE GOVERNANCE* 241 (2008) (“Hedge funds and private equity funds are the newest big thing in corporate governance and are likely to remain an important and controversial feature of the financial and legal landscape for some time to come.”).

⁴ Paul H. Edelman et al., *Shareholder Voting in an Age of Intermediary Capitalism*, 87 S. CAL. L. REV. 1359, 1408-09 (2014) (discussing why hedge funds are in a unique position to engage in activism).

⁵ Kahan & Rock, *supra* note 3, at 1091.

⁶ See Michelle Fox, *Hedge Funds Expect to Top \$3 Trillion in 2015: Deutsche Bank*, CNBC (Mar. 2, 2015, 3:51 PM), <http://www.cnbc.com/id/102469737> [<http://perma.cc/4MAF-6LUK>] (stating that Deutsche Bank estimated hedge funds’ assets to be approximately \$3 trillion as of early 2015). Only a modest percentage of the \$3 trillion is employed in

potential changes in corporate control.”⁷ Activist hedge funds often start their campaigns against public companies by taking large stock positions and then agitating for changes, such as stock repurchases, extraordinary dividends, dispositions of non-core businesses, or an outright sale of the company.⁸ Such campaigns often involve an implicit or explicit threat of a proxy contest to remove some or all of the target board members and senior management if the activists’ demands are not met.⁹ “Ultimately, the activist may receive one or more seats on the target company board, either through a settlement with the target, or success at a stockholder meeting.”¹⁰

While activist investing is not new and has long been the source for significant corporate law developments,¹¹ in recent years

activist investing so there is substantial additional capacity that can be deployed to this strategy. See David Benoit, *Activism’s Long Road From Corporate Raiding to Banner Year*, WALL ST. J. (Dec. 26, 2015, 12:01 AM), <http://www.wsj.com/articles/activisms-long-road-from-corporate-raiding-to-banner-year-1451070910> [<https://perma.cc/5MNC-PRZ6>] (“Activists now manage more than \$120 billion in investor capital, double what they had just three years ago . . .”).

⁷ Kahan & Rock, *supra* note 3, at 1034.

⁸ See Lucian A. Bebchuk et al., *The Long-Term Effects of Hedge Fund Activism*, 115 COLUM. L. REV. 1085, 1093 (2015) (“Hedge fund activists might seek a wide range of actions in the strategy and management of a company. They might propose, for example, divesting assets, changing investment or payout levels, altering the capital structure, or replacing the CEO.”); Marco Becht et al., *The Returns to Hedge Fund Activism: An International Study* 6 (Eur. Corp. Governance Inst., Working Paper No. 402/2014, 2015), available at http://www.ecgi.org/wp/wp_id.php?id=631 [<http://perma.cc/4DVG-8LT4>] (“[W]e show that activists are successful in creating shareholder value even in scenarios that do not involve a takeover, such as restructurings and changes to payout policy.”).

⁹ Thomas W. Briggs, *Corporate Governance and the New Hedge Fund Activism: An Empirical Analysis*, 32 J. CORP. L. 681, 723 (2007) (“Hedge fund activists are not ‘normal’ institutional investors. They threaten and even actually launch proxy fights for corporate control.”).

¹⁰ Mark D. Gerstein, *Hushmail: Are Activist Hedge Funds Breaking Bad?*, HARV. L. SCH. F. ON CORP. GOVERNANCE AND FIN. REG. (July 7, 2014), <http://corpgov.law.harvard.edu/2014/07/07/hushmail-are-activist-hedge-funds-breaking-bad/#more-64293> [<http://perma.cc/LDQ4-DSEG>].

¹¹ See, e.g., *Ivanhoe Partners v. Newmont Mining Corp.*, 535 A.2d 1334, 1345-46 (Del. 1987) (upholding directors’ defensive measures such as a large dividend distribution and a new standstill agreement to thwart activist investor since shares were valued more than the offer); *Revlon Inc. v.*

this phenomenon's growth has been striking.¹² "Since 2006, almost one in every six corporations in the Standard and Poor's 500 index has been the target of activist campaigns."¹³ In particular, hedge fund activism has become increasingly pervasive and has "hardened into the default boardroom agenda."¹⁴

Several developments, including, inter alia, the sheer size of capital available to hedge funds, the globalization of financial markets, new investment vehicles (such as derivatives), the rise of global cooperation among large funds and "wolf-pack" tactics, have proximately caused this phenomenon.¹⁵ These trends are likely to

MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 185 (Del. 1986) (finding directors' misconduct in failing to seek highest price available); *Unocal Corp. v. Mesa Petroleum*, 493 A.2d 946, 958-59 (Del. 1985) (upholding directors' authorization of a large share buyback funded by new debt to thwart activist investor since shares were valued more than the offer).

¹² See Sharon Hannes, *Brave New World: A Proposal For Institutional Investors*, 16 THEORETICAL INQUIRIES L. 245, 258-59 (2015) (discussing the growth of activism in recent years).

¹³ *Id.*

¹⁴ Dennis K. Berman, *For Activists, There are No More Worlds to Conquer*, WALL ST. J., Apr. 23, 2014, at B1.

¹⁵ See Alexandros Seretakos, *Hedge Fund Activism Coming to Europe: Lessons from the American Experience*, 8 BROOK. J. CORP. FIN. & COM. L. 438, 450-51 n.78 (2014) (discussing globalization of financial markets); Benoit, *supra* note 6 ("The financial crisis fanned dissatisfaction with corporate executives and brought low interest rates that helped activists thrive. Activists got more sophisticated about analyzing target companies and built alliances with other big shareholders, including mutual funds."); John C. Coffee, Jr. & Darius Palia, *The Wolf at the Door: The Impact of Hedge Fund Activism on Corporate Governance* 28-38 (Ctr. for Law and Econ. Studies, Colum. Univ. Sch. of Law, Working Paper No. 521, 2015), http://www.wlrk.com/docs/The_Wolf_at_the_Door_The_Impact_of_Hedge_Fund_Activism_on_Corporate_Governance.pdf [<http://perma.cc/EJT2-8PFX>] (discussing "wolf-pack" tactics); Fox, *supra* note 6 ("[T]he hedge fund industry is on track to surpass \$3 trillion in assets this year, according to a new survey by Deutsche Bank."); Matteo Tonello, *Using Cash-Settled Derivatives to Hide Corporate Ownership*, HARV. L. SCH. F. ON CORP. GOVERNANCE AND FIN. REG. (Sept. 12, 2010), <http://corpgov.law.harvard.edu/2010/09/12/using-cash-settled-derivatives-to-hide-corporate-ownership/> [<http://perma.cc/9TDW-KQ72>] ("Derivatives are an important class of financial instruments that has taken center stage in today's capital markets.").

further strengthen activism as a popular strategy among large investors.

The popularity of activism has led to an academic, political, and business dispute over this phenomenon. Hedge fund activism detractors claim activism should be curtailed because the activist investors focus only on short-term profits, which is negative for companies.¹⁶ For example, BlackRock's CEO Leonard Fink emphasizes that "[i]t is critical . . . to understand that corporate leaders' duty of care and loyalty is not to every investor or trader who owns their companies' shares at any moment in time, but to the company and its long-term owners."¹⁷ The controversy over activism thus intersects with the current corporate governance debate with respect to "shareholder value" versus "sustainable capitalism" and touches upon fiduciary duties of directors to monitor and to correct poor management.¹⁸

Moreover, targets of activist funds often claim that the activism distracts company directors and requires them to spend large sums of money and time defending their companies.¹⁹ Activist

¹⁶ See Bebchuk et al., *supra* note 8, at 1093-94 ("Critics of such activist interventions have long put forward the myopic-activists claim that the actions being sought are overall (or on average) value decreasing in the long term even when they are profitable in the short term."); Benoit, *supra* note 6 (observing that although Hillary Clinton criticized "hit-and-run" activist investors during her presidential campaign, she noted that activists "help hold managers accountable"); Michael D. Goldhaber, *Marty Lipton's War on Hedge Fund Activists*, AM. LAW. (Mar. 30, 2015), available at <http://www.law.com/sites/articles/2015/03/30/marty-liptons-war-on-hedge-fund-activists/> [<https://perma.cc/U5JV-8CSZ>] ("Lipton blames 'short-termist' hedge funds for America's economic stagnation and inequality since the financial crisis.").

¹⁷ Letter from Laurence D. Fink, Chairman and Chief Exec. Officer, BlackRock, to the chief executive officers of Standard & Poor's 500 Index (Mar. 31, 2015), <http://www.wlrk.com/docs/S31Duplica15040911540.pdf> [<http://perma.cc/W9L7-TMJS>].

¹⁸ See generally Joel Slawotsky, *Sustainable Capitalism: Revelations from the Japanese Model*, 63 HASTINGS L.J. VOIR DIRE 10 (2012), <http://www.hastingslawjournal.org/wp-content/uploads/Slawotsky-Voir-Dire.pdf> [<https://perma.cc/PDZ6-F9RR>] (analyzing the United States "shareholder value-centric" and the Japanese "stakeholder-centric" corporate governance models).

¹⁹ See Jeff Mordock, *DuPont Spent \$15M to Keep Activist Investor Off Board*, USA TODAY (May 19, 2015, 11:18 AM), <http://www.usatoday.com/story/money/business/2015/05/19/dupont-spent-15m-proxy->

detractors argue that once a fund declares it owns a sizeable stake in a company, the directors and senior management are busy with the threat as opposed to running a profitable business.²⁰ “It wreaks havoc Now you have to manage a lot of other components that you didn’t before, and it’s all-consuming—none of which adds real value.”²¹

A rising chorus of critics such as Chief Justice of the Delaware Supreme Court, Leo Strine, believes that hedge fund activism must be more stringently regulated.²² Some have noted that the employment of financially engineered products such as derivatives can be used to avoid “open ownership” thereby avoiding

fight/27575179/ [http://perma.cc/7AX3-XNR6] (quoting Charles Elson, a professor of corporate governance at the University of Delaware) (“Everyone loses in a proxy fight No one comes out in a better position because they are distracting, expensive and not positive for anyone involved.”). The Delaware Supreme Court in its seminal rulings addressed this change of control topic by applying the enhanced scrutiny test to measures taken to thwart activists. *See, e.g., Unocal Corp. v. Mesa Petroleum*, 493 A.2d 946, 954 (Del. 1985) (“Because of the omnipresent specter that a board may be acting primarily in its own interests, rather than those of the corporation and its shareholders, there is an enhanced duty which calls for judicial examination at the threshold before the protections of the business judgment rule may be conferred.”). The test seeks to balance the potential that directors and management attempt to entrench themselves rather than lose out to an activist with the need to allow shareholders to reap profits. *Id.* at 955 (“The restriction placed upon a selective stock repurchase is that the directors may not have acted solely or primarily out of a desire to perpetuate themselves in office.”).

²⁰ *See* Mordock, *supra* note 19.

²¹ Danielle Berteaux, *The Return of the Puppet Masters*, ABSOLUTE RETURN & ALPHA, Dec. 2010, no. 4, 2010, at 25 (quoting Damien Park, founder and managing partner of Hedge Fund Solutions, a shareholder activist advisory firm).

²² Leo Strine, the Chief Justice of the Delaware Supreme Court, has called for amending the ten day disclosure requirement under section 13(d) of the Securities Exchange Act of 1934. *See* Michael J. de la Merced, *S.E.C. Chief Sees Virtue in Activist Investors*, N.Y. TIMES DEALBOOK (Mar. 19, 2015), http://www.nytimes.com/2015/03/20/business/dealbook/sec-chief-sees-virtue-in-activist-investors.html?ref=dealbook&_r=2

[http://perma.cc/9RYH-JUQU] (“Leo E. Strine Jr., the chief justice of Delaware’s Supreme Court . . . argued in favor of a more sensitive tripwire that involved disclosure in less than 24 hours.”).

the filing requirements of securities laws.²³ Some opponents of hedge fund activism have advocated that the disclosure obligation should be tightened to one day from the present ten days in a bid to eliminate the widespread evasion of disclosure.²⁴ Others have opined that hedge funds should be prosecuted to the extent that activism constitutes stock manipulation.²⁵

Proponents of activism and smaller shareholders argue in response that without activist funds, corporate mismanagement and managerial misconduct will remain largely unaddressed.²⁶ Supporters note that activists will gravitate towards badly managed companies, and without such activists, smaller shareholders are powerless to remedy the situation.²⁷ For example, when activist hedge fund Starboard Value acquired control of Darden Restaurants Inc. it pressured the directors to improve the business and company-operating performance by actually working in the restaurants.²⁸

²³ Tonello, *supra* note 15 (“[I]n a regulatory environment where disclosure requirements are triggered by voting rights rather than economic interest, derivatives can be used to conceal equity ownership of a public company—a practice generally known as ‘hidden ownership.’”).

²⁴ WACHTELL, LIPTON, ROSEN & KATZ LLP, PETITION FOR RULEMAKING UNDER SECTION 13 OF THE SECURITIES EXCHANGE ACT OF 1934 10 (2011), <https://www.sec.gov/rules/petitions/2011/petn4-624.pdf> [<https://perma.cc/EQL6-GABW>] (“We recommend that the Commission require that the initial Schedule 13D filing be made within one business day following the crossing of the five percent ownership threshold . . .”).

²⁵ See Steve Denning, *The Seven Deadly Sins of Activist Hedge Funds*, FORBES (Feb. 15, 2015, 4:46 PM), <http://www.forbes.com/sites/stevedenning/2015/02/15/the-seven-deadly-sins-of-activist-hedge-funds/> [<http://perma.cc/FM8D-YFQ5>] (suggesting that activist hedge funds should be subject to liability for “massive share buybacks amounting to stock price manipulation”).

²⁶ Katherine Rushton, *Carl Icahn Attacks Companies That Protect ‘Unfit’ Chief Executives*, TELEGRAPH (Aug. 12, 2014, 8:17 PM), <http://www.telegraph.co.uk/finance/globalbusiness/11029776/Carl-Icahn-attacks-companies-that-protect-unfit-chief-executives.html> [<http://perma.cc/Z3VP-F4J3>] (quoting Carl Icahn) (“Our current system of corporate governance protects mediocre chief executives and boards that are mismanaging companies and this must be changed.”).

²⁷ See April Klein & Emanuel Zur, *Entrepreneurial Shareholder Activism: Hedge Funds and Other Private Investors*, 64 J. FIN. 187, 222-25 (2009) (finding that activist conduct promotes better governance).

²⁸ Craig Giammona, *Olive Garden’s Hedge Fund Bosses Waited Tables to Aid Turnaround*, BLOOMBERG (June 1, 2015, 10:04 AM), <http://www.>

“Every board member worked a night in a restaurant, said Starboard Chief Executive Officer Jeff Smith, who also is Darden’s chairman. Smith said he waited on tables and served food in the kitchen.”²⁹ Clearly, there is a good type of activism which is counter-balanced by what some feel is short-termism and potential for abusive conduct.

Can securities laws play a role in striking a balance between legitimate concerns over activist abuses and the benefits of legitimate activism? The disclosure requirements imposed by the existing securities laws were approved almost fifty years ago to establish a level playing field for corporate takeovers.³⁰ Enacted in 1968, the Williams Act amended the Securities Exchange Act of 1934 and mandated the disclosure of a 10% (now 5%³¹) or greater interest in a publicly-held company within ten days of reaching the trigger amount through the filing of a section 13(d) statement of ownership.³² As long as investors do not exceed the 5% threshold, no filing is required under section 13(d). “So if Hedge Fund A buys 3 percent of a company’s stock, and Hedge Fund B buys 2 percent, and Hedge Fund C buys 1 percent, then none of them needs to do any 13D disclosure.”³³ However, if the funds are “working together”—in

[bloomberg.com/news/articles/2015-06-01/olive-garden-s-hedge-fund-bosses-waited-tables-to-aid-turnaround](http://www.bloomberg.com/news/articles/2015-06-01/olive-garden-s-hedge-fund-bosses-waited-tables-to-aid-turnaround) [<http://perma.cc/9T32-9QPK>].

²⁹ *Id.*

³⁰ Pub. L. No. 90-439, 82 Stat. 454 (codified as amended at 15 U.S.C. § 78m (2012)); *see also* Jonathan R. Macey & Jeffrey M. Netter, *Regulation 13D and the Regulatory Process*, 65 WASH. U. L. Q. 131, 133-37 (1987) (discussing the history of the Williams Act that added a reporting requirement to the Securities Exchange Act of 1934).

³¹ Initially the Williams Act established a 10% threshold for reporting, which was later reduced to 5%. *See* Pub. L. No. 91-567, 84 Stat. 1497 (1970) (codified at 15 U.S.C. § 78m (2012)).

³² Securities Exchange Act of 1934 § 13(d), 15 U.S.C. § 78m(d) (2012); 17 C.F.R. § 240.13d-1 (2015) (“Any person who . . . is directly or indirectly the beneficial owner of more than five percent of the class shall, within 10 days after the acquisition, file with the Commission, a statement containing the information required by Schedule 13D.”).

³³ Matt Levine, *The SEC Doesn’t Like It When Hedge Funds Talk to Each Other*, BLOOMBERG VIEW (June 5, 2015, 4:12 PM), <http://www.bloombergvew.com/articles/2015-06-05/the-sec-doesn-t-like-it-when-hedge-funds-talk-to-each-other> [<http://perma.cc/6CQ6-885K>].

concerted action and/or in a group,³⁴ individual ownership stakes are aggregated and if the several stakes constitute a 5% or more holding, the group must file a disclosure statement.³⁵

While the main regulatory objective of this disclosure requirement is to level the playing field and provide investors with information about the owners of a 5% stake, thus enabling them to make informed buy and sell decisions,³⁶ interestingly there is another objective—“to provide management of the issuer with information to ‘appropriately protect the interests of its security holders.’”³⁷ “In enacting the original Section 13(d) legislation, Congress made clear that it intended to avoid ‘tipping the balance of regulation either in favor of management or in favor of the person [potentially] making the takeover bid.’”³⁸ Thus, the reporting requirement of the Securities Exchange Act was designed in part to empower company’s management to adopt defensive measures in response to perceived threats to corporate control.

In light of recent developments in finance and the investment markets, disclosure rules have an important role to play in balancing the tension between activists and the potential for abusive hedge fund conduct.³⁹ Recent decades have witnessed a transformation in the global financial markets. The prevalence of derivatives, the large amount of assets wielded by institutions, the ability to communicate instantaneously, and the growing practice of cooperating without formal group formation through “wolf packs” all substantially altered the playing field for companies, activists, and other shareholders.⁴⁰ The Securities and Exchange Commission (SEC) is reportedly

³⁴ 17 C.F.R. § 240.13d-5 (2015) (“When two or more persons agree to act together for the purpose of acquiring, holding, voting or disposing of equity securities of an issuer, the group formed thereby shall be deemed to have acquired beneficial ownership . . . of all equity securities of that issuer beneficially owned by any such persons.”).

³⁵ *Id.*

³⁶ Beneficial Ownership Reporting Requirements and Security-Based Swaps, 76 Fed. Reg. 34,579, 34,581 (June 14, 2011) (codified at 17 C.F.R. pt. 240).

³⁷ *Id.*

³⁸ *Id.*

³⁹ David Daniels, *A Two-Part Disclosure Mandate as a Compromise Solution to the Debate on Section 13(D)’s Disclosure Window*, 4 HARV. BUS. L. REV. 213, 225 (2014) (discussing various conflicts surrounding section 13(d)).

⁴⁰ *See supra* note 15 and the accompanying text.

investigating whether several hedge funds acted “in concert” but failed to disclose their holdings as a group.⁴¹ Therefore, it is both timely and warranted to explore a re-evaluation of the current regulatory architecture.⁴²

This article takes a middle of the road approach. Hedge fund activism is potentially beneficial and should not be banned, limited, or prosecuted. The discouragement of activism may cause inefficient businesses to resist change thus proximately causing losses to shareholders and the economy.⁴³ Shareholder activism has a vital place in the corporate governance landscape. Hedge fund activists, however, are not usual institutional investors; their agility and incentive reward mechanism combined with fewer regulatory limitations make their power and potential to engage in mischief unique among large pools of capital.⁴⁴ Therefore, a heightened regulatory early warning system is needed. This article proposes that the disclosure requirement threshold should be lowered from 5% to 2.5%.

Part II examines activist investing in the United States and its transformation over the years. Part III discusses arguments in support and against hedge fund activism. This part also examines approaches to investor activism in various jurisdictions and concludes with an overview of the SEC position on the emergence and current practices of hedge fund activism. Part IV focuses on the existing disclosure requirements, while Part V advocates a change of the current disclosure regime.

⁴¹ Liz Hoffman et al., *SEC Probes Activist Funds Over Whether They Secretly Acted in Concert*, WALL ST. J. (June 4, 2015, 4:53 PM), <http://www.wsj.com/articles/sec-probes-activist-funds-over-whether-they-secretly-acted-in-concert-1433451205> [<http://perma.cc/6C7J-FAQK>] (“The Securities and Exchange Commission is investigating whether some activist investors teamed up to target companies without disclosing their alliances, potentially in violation of federal securities rules . . .”).

⁴² The SEC appears to be increasingly concerned about activist funds. See Stephen Gandel, *SEC’s Mary Jo White Criticizes Shareholder Activism and Bill Ackman Deal*, FORTUNE (Mar. 19, 2015, 1:43 PM), <http://fortune.com/2015/03/19/mary-jo-white-activist-investors-ackman/> [<http://perma.cc/7FZD-VWBX>] (“The Securities and Exchange Commission hasn’t lost its patience with activist investors. But it is getting close.”).

⁴³ See *infra* Section III.C (discussing the poor performance of Japanese companies and their distaste for shareholder activism).

⁴⁴ See Briggs, *supra* note 9, at 723.

II. *Activist Investing in the United States*

“Corporate America and activist investors have had a war; the activists have won.”⁴⁵ Frequently attacking titans of the U.S. economy—Procter & Gamble, Microsoft, Motorola, eBay, Yahoo, PepsiCo, Dow Chemicals and DuPont—activists are substantially impacting the leading U.S. corporations.⁴⁶ Indeed, the landscape of United States corporate governance is being irreparably impacted by activist investors.⁴⁷

Activist investors . . . are a burgeoning breed. They’re revamping governance and executive-pay practices at companies big and small by doing more than winning or merely threatening proxy fights. They are actually sticking around to make sure improvements happen. That’s a change from the so-called corporate raiders of the past decades, who often wanted to break up a business or simply be paid off to go away. Many institutional holders now prefer activists who “roll up their sleeves and get involved” in fixing corporate underperformers through board seats because a directorship

⁴⁵ *Carl Icahn, Web Mogul*, FIN. TIMES (Oct. 26, 2013), <http://presscuttings.ft.com/presscuttings/s/3/articleText/78423009#axzz3sFgofOg0> [<http://perma.cc/T98V-6Y2F>].

⁴⁶ *See An Investor Calls*, ECONOMIST (Feb. 7, 2015), <http://www.economist.com/news/briefing/21642175-sometimes-ill-mannered-speculative-and-wrong-activists-are-rampant-they-will-change-american> [<http://perma.cc/9XM2-7ZTV>].

⁴⁷ Joann S. Lublin, *In for the Long Haul: More Activists Investors are Winning Board Seats and Helping Companies Revamp Their Governance Practices*, WALL ST. J. (Oct. 17, 2005), <http://www.wsj.com/articles/SB112923609191168027> [<http://perma.cc/NT85-B9XL>].

means “you’ve made a commitment of time and resources.”⁴⁸

Activist investing is a popular tactic and activist investors have a variety of available strategies. At times, activists take stakes in a company with the intent (or hope) of forcing a White Knight to save the company by entering the fray and making a generous offer.⁴⁹ Sometimes, activists want to break up the company because they believe the company’s parts are worth more than the whole.⁵⁰ The strategy of greenmail—the buying of shares often accompanied by litigation or threats of the same—is designed to force the management to buy the shares back from the investor at a premium.⁵¹ Hushmail is an example of another activist strategy, according to which activists withdraw their corporate governance claims in return for the company buying their shares.⁵² Sometimes activists attempt to influence a corporation to issue dividends.⁵³

⁴⁸ *Id.* (quoting Patrick McGurn, an executive vice president of Institutional Shareholder Services, a proxy-advisory firm).

⁴⁹ Bryan Rich, *Watsa’s Blackberry Bid May Not Be the Last One*, FORBES (Sept. 24, 2013, 10:03 AM), <http://www.forbes.com/sites/greatspeculations/2013/09/24/billionaire-watas-blackberry-bid-may-not-be-the-last-one/> [<http://perma.cc/8EGW-WQ7V>] (highlighting potential scenarios following an activist’s bid for a company).

⁵⁰ Mark Scott, *Activist Investor Seeks Breakup of UBS*, N.Y. TIMES DEALBOOK (May 2, 2013, 7:18 AM), http://dealbook.nytimes.com/2013/05/02/activist-investor-seeks-breakup-of-ubs/?_r=0 [<http://perma.cc/5UCY-UXKP>] (“The activist investment firm Knight Vinke called for the breakup of the Swiss bank UBS . . .”).

⁵¹ Michael Parrish, *Occidental Ends Lawsuits Over Cost of Buyout*, L.A. TIMES (Mar. 21, 1992), http://articles.latimes.com/1992-03-21/business/fi-4044_1_david-murdock [<http://perma.cc/DW9X-CUB5>] (“The agreement ends 19 lawsuits filed after Occidental paid Murdock \$194 million in 1984 for his 5% stake in the oil company.”).

⁵² Gerstein, *supra* note 10 (“The buyback price is typically at a slight discount to the current market price, but occasionally it is at a premium. As part of the purchase agreement, the activist may enter into a standstill and non-disparagement agreement with the target. If the activist has representatives on the board of the target, the representatives typically would resign their director positions after the repurchase . . .”). Regulatory changes in late 80s discouraged activists from engaging in greenmail. The line between greenmail and hushmail, however, is often unclear. See Liz Hoffman & David Benoit, *Activist Funds Dust Off ‘Greenmail’ Playbook*, WALL ST. J., June 12, 2014, at C1 (explaining that although the modern

Who are these players and what new factors have transformed them into powerful shapers of corporate governance? The following sections discuss the historical perspective of activist investing, the revolution of the tactic from renegade to mainstream, the recent trends of collaboration, “wolf packs,” and the use of derivatives.

A. The Historical Context

Activist investing in American equity markets is not new.⁵⁴ Surging to prominence in the 1980s, activist investors commenced taking very aggressive approaches with publicly traded companies in the late 1970s and early 1980s.⁵⁵ The activist investor of the 1980s in the American markets was likely a sole investor, a financial entrepreneur,⁵⁶ aiming to shakeup a corporation and unlock shareholder value.⁵⁷ Possibly the most recognizable early activist is

practice of buying back shares from activist hedge funds resembles greenmail of the 1980s it does not involve “buybacks at a premium to the market” and “threats of hostile takeovers”).

⁵³ See, e.g., Elisabeth Behrmann & Yuriy Humber, *Transocean Reaches \$1.1 Billion Dividend Accord With Icahn*, BLOOMBERG (Nov. 11, 2013, 4:20 PM), <http://www.bloomberg.com/news/2013-11-11/transocean-reaches-accord-with-icahn-on-dividend-plan-and-board.html> [<http://perma.cc/T7LM-QAVM>] (“Transocean Ltd. will boost its dividend and cut costs as part of an agreement with Carl Icahn, months after the world’s largest offshore rig contractor won a shareholder battle with the billionaire investor.”).

⁵⁴ See Brian R. Cheffins & John Armour, *The Past, Present, and Future of Shareholder Activism by Hedge Funds*, 37 J. CORP. L. 51, 75-82 (2011) (highlighting the rise of hedge fund shareholder activism over the last thirty years).

⁵⁵ See Iman Anabtawi & Lynn Stout, *Fiduciary Duties for Activist Shareholders*, 60 STAN. L. REV. 1255, 1274-81 (2008) (discussing the historical transition of influence on corporate activities from a company’s management to its shareholders, particularly through the advent of activist hedge funds).

⁵⁶ See *An Investor Calls*, *supra* note 46 (“The old guard includes Carl Icahn, an outrageous and outrageously successful septuagenarian, who has been on the warpath since the 1980s. Nelson Peltz has similarly deep roots, but rather more gravitas.”).

⁵⁷ *Id.* (“In the 1980s activists were called corporate raiders and were the jackals of capitalism, outcasts that attacked and dismembered weak companies to widespread opprobrium but consoling profit. They were

Carl Icahn, “the billionaire financier who gained fame—some would say notoriety—in the 1980s by taking over Trans World Airlines . . . and agitating for change at the likes of Texaco and RJR Nabisco.”⁵⁸ Another legendary activist shareholder is T. Boone Pickens, who was involved in numerous corporate takeover disputes with companies such as Newmont Mining and Unocal Oil.⁵⁹ Pickens was so notorious that he was selected as Time Man of the Year in 1985.⁶⁰ Shareholder activism, and the lawsuits such investments spawned, significantly impacted American corporate law. Numerous seminal judicial decisions were ultimately delivered as a result of litigation undertaken by activist shareholders or corporate boards.⁶¹ These

immortalised in the film *Wall Street*, whose charismatic criminal, Gordon Gekko, showed his mettle by treating greed as good and lunch as for wimps.”); see also Benoit, *supra* note 6 (discussing “corporate raiders” and “greenmailers of the 1980s, whose strategy often involved acquiring large stakes in target companies and then insisting on a sale of these targets).

⁵⁸ Barbara Kiviat, *10 Questions for Carl Icahn*, TIME (Feb. 15, 2007), <http://content.time.com/time/magazine/article/0,9171,1590446,00.html> [<http://perma.cc/WS37-MTY6>].

⁵⁹ See *T. Boone Pickens, Texas Corporate Raider*, N.Y. TIMES (Oct. 16, 2015), http://www.nytimes.com/interactive/2015/10/16/business/dealbook/t-boone-pickens-timeline.html?_r=0###time388_11267

[<http://perma.cc/A263-8ZJ9>] (“The billionaire oilman made his fortune in the 1980s as a buyout artist and raider, jostling the industry when he set his sights on companies like Gulf Oil and Unocal.”). Corporate raiders such as Carl Icahn and T. Boone Pickens gained notoriety during their heyday in the 1980s for acquiring controlling stakes in undervalued companies, aggressively using debt finance and their power to replace boards of directors and force companies to break up. Stephen Gandel, *3 Reasons the Go-Go 80’s Aren’t Back on Wall Street*, FORTUNE (Oct. 20, 2015, 9:03 AM), <http://fortune.com/2015/10/20/wall-street-1980s/> [<https://perma.cc/N6Y5-6QW8>] (discussing leveraged buyout deals of the 1980s); Margaret Isa, *Where, Oh Where, Have All the Corporate Raiders Gone?*, N.Y. TIMES (June 30, 1996), <http://www.nytimes.com/1996/06/30/business/where-oh-where-have-all-the-corporate-raiders-gone.html?pagewanted=all> [<https://perma.cc/335M-NUHZ>] (discussing corporate raiders of the 1980s).

⁶⁰ See *T. Boone Pickens, Texas Corporate Raider*, *supra* note 59 (“T. Boone Pickens’s assault on the oil industry lands him on the cover of Time Magazine in March 1985.”).

⁶¹ See, e.g., *Ivanhoe Partners v. Newmont Mining Corp.*, 535 A.2d 1334, 1345-46 (Del. 1987) (upholding directors’ defensive measures such as a large dividend distribution and a new standstill agreement to thwart activist investor since shares were valued more than the offer); *Revlon Inc. v.*

rulings reinforced the corporate governance model of shareholder-value capitalism.⁶²

While early activist investors were primarily private financiers, and large institutions did not generally participate in activist investing, the California Public Employees' Retirement System (CalPERS) and Teachers Insurance and Annuity Association—College Retirement Equities Fund (TIAA-CREF) did commence using socially responsible investing benchmarks in the 1970s and 1980s.⁶³ Large institutions, however, are now turning

MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 185 (Del. 1986) (finding directors' misconduct in failing to seek highest price available); *Unocal Corp. v. Mesa Petroleum*, 493 A.2d 946, 958-59 (Del. 1985) (upholding directors' authorization of a large share buyback funded by new debt to thwart activist investor since shares were valued more than the offer).

⁶² The United States' model of corporate governance is shareholder-centric as opposed to a stakeholder model. See Slawotsky, *supra* note 18, at 10. In contrast, Norway's corporate governance system values stakeholders. See generally Inger Marie Hagen, *Employee-Elected Directors on Company Boards: Stakeholder Representatives or the Voice of Labor?*, in *RETHINKING CORPORATE GOVERNANCE: FROM SHAREHOLDER VALUE TO STAKEHOLDER VALUE* 121-40 (Roger Blanpain et al. eds., 2011) (discussing Norway's stakeholder model of governance). A socially based investment approach of Norway's sovereign wealth fund illustrates a stakeholder model of corporate governance. The Norwegian fund's ethics-based methodology is designed to enforce corporate compliance with international law and Norway's notions of social responsibility. See *Guidelines, COUNCIL ON ETHICS FOR THE NORWEGIAN GOV'T PENSION FUND GLOBAL*, <http://etikkradet.no/en/guidelines/> [<https://perma.cc/H4W6-VRJV>] (listing criteria for investment decisions). Interestingly, Norway appears to be shifting towards a broadening scope of activism to include shareholder value. While Norway's sovereign wealth fund had previously embraced an activist investment approach based upon social factors, it has now become focused on improving governance in the profits-centric context. See Slawotsky, *supra* note 2, at 20-22.

⁶³ See CALPERS, *TOWARDS SUSTAINABLE INVESTMENT: TAKING RESPONSIBILITY* 5 (2012), <https://www.calpers.ca.gov/docs/forms-publications/esg-report-2012.pdf> [<http://perma.cc/WEU5-UQDG>] (describing CalPERS' efforts at sustainable investing as it pertains to climate change, environmental, and labor issues); TIAA-CREF, *LEADERSHIP IN RESPONSIBLE INVESTMENT, 2015 REPORT* 15 (2015), https://www.tiaa-cref.org/public/pdf/sri_2015_report.pdf [<https://perma.cc/RRC5-LSTZ>] (“[W]e were one of the first institutional investors to engage in dialogue with companies and other investors on [Environmental, Social and

increasingly activist. The next section discusses this new version of institutional activism.

B. The New Institutional Activism

Activist investing has enjoyed a robust resurgence in recent years, and having become popular among “mainstream” institutional funds,⁶⁴ it is now considered an accepted investment strategy.⁶⁵ In particular, “[s]ome of the biggest public pension funds, which have sought to influence companies for years, are now starting to emulate these investors by engaging with, and sometimes seeking to oust, directors of companies whose stock they own.”⁶⁶

Moreover, this mainstream institutional activism has shifted from the socially responsible context of CalPERS and TIAA-CREF to a more profit-centric model.⁶⁷

The new activists have dramatically upped the pressure on corporate executives and boards. Nearly every business day they target another company Their game is simple: They buy stocks they view as undervalued and pressure management to do things they believe will raise the value, such as giving more cash back to shareholders or shedding divisions that they think are driving down the stock price. With increasing frequency they get deeply involved in governance—demanding board seats, replacing CEOs, and

Governance] issues. . . . [T]hese activities are increasingly being applied by institutional investors across asset classes.”).

⁶⁴ *Id.*

⁶⁵ Smith, *supra* note 2 (“Some of the biggest public pension funds . . . are now starting to emulate [activist] investors by engaging with, and sometimes seeking to oust, directors of companies whose stock they own.”).

⁶⁶ *Id.*

⁶⁷ Bill George & Jay W. Lorsch, *How to Outsmart Activist Investors*, HARV. BUS. REV., May 2014, at 88, 90.

advocating specific business strategies.⁶⁸

The following sub-sections address the trends that have led to this new institutional activism.

1. The Financial Strength and Unique Factors of Hedge Funds

a. Firepower

No longer the exclusive realm of single investors with their limited firepower, the new generation of activists is represented by a multibillion dollar operation; usually a hedge fund.⁶⁹ Hedge funds are immensely powerful and have tremendous resources.⁷⁰ Hedge funds have become prominent and have gained a fearsome reputation of forcing management to negotiate or be subject to overthrow.⁷¹

The new establishment includes ValueAct, Third Point and Elliott Advisors, all of which earned their spurs in the 2000s. Its most prominent figure is William Ackman of Pershing Square, who says Warren Buffett is his inspiration. Mr. Ackman has had some disasters, including J.C. Penny, a department store he tried to resuscitate, but also some triumphs, including Allergan, a pharmaceutical firm that was taken over last year. The industry's young guns include Sachem Head and

⁶⁸ *Id.* at 90.

⁶⁹ *Id.* (“Since the start of the 21st century, a new breed of shareholder—the activist hedge fund—has frequently played a decisive role in interactions between corporations and markets.”).

⁷⁰ Total hedge fund assets are approximately \$3 trillion. *See* Fox, *supra* note 6 (“[T]he hedge fund industry is on track to surpass \$3 trillion in assets this year, according to a new survey by Deutsche Bank.”).

⁷¹ *See* George & Lorsch, *supra* note 67, at 90; *see also* Lipton, *supra* note 1.

Corvex, set up by protégés of the old guard.⁷²

Hedge funds are not new⁷³ but currently wield immense financial power and have entered the activist arena vigorously and aggressively.⁷⁴

There are more than 100 hedge funds that have engaged in activism. Activist hedge funds have approximately \$200 billion of assets under management. They have become an “asset class” that continues to attract investment from major traditional institutional investors. The additional capital and new partnerships between activists and institutional investors have encouraged increasingly aggressive activist attacks.⁷⁵

In part this explosive growth in activism is due to its substantial success and immense profits.⁷⁶ “Activist hedge funds have outperformed their non-activist peers and market indices, generating a 19.4% compound annual growth rate since 2009, as

⁷² *An Investor Calls*, *supra* note 46.

⁷³ Frank Partnoy, *US Hedge Fund Activism*, in RESEARCH HANDBOOK ON SHAREHOLDER POWER 101 (Jennifer G. Hill & Randall S. Thomas eds., 2015) (“Hedge funds date back to the 1940s. . . . Scholars generally attribute the development of the first hedge fund to Alfred Winslow Jones, a sociologist and journalist who in 1949 established a private investment partnership that reduced risk by buying one stock while selling short another stock in the same industry.”)

⁷⁴ Lipton, *supra* note 1.

⁷⁵ *Id.*

⁷⁶ See Klein & Zur, *supra* note 27, at 211 (“Hedge fund activists enjoy a 60% success rate. . . . they gain representation on the target’s board 30 out of 41 times, for an achievement rate of 73%. They are 100% successful in getting the firm to buy back its own stock, replace the current CEO, and initiate a cash dividend. Approximately 50% of the time, the target firm changes its operating strategies, drops its merger plans, or agrees to be taken over or merged.”).

compared to 7.5% for all hedge funds and 12.3% for S&P 500 companies.”⁷⁷ It is reasonable to expect that the trend will strengthen and additional funds will seek to join this profitable strategy.

b. Unique Factors

In addition, hedge funds are particularly conducive to activist investing; particularly because of the incentive structure, which can bring enormous financial rewards to hedge fund managers.⁷⁸ “[Hedge funds’] income is largely performance based, usually including a performance fee of 15-20 percent of portfolio profits in addition to a management fee of 1-2 percent of assets under management.”⁷⁹

Furthermore, “hedge funds are less regulated as to the kinds of investments they can make, avoiding the regulatory requirements for diversification imposed on mutual funds, for example.”⁸⁰ Moreover, unlike other institutional investors, hedge funds enjoy more freedom in trading in derivatives.⁸¹ “Hedge fund managers suffer fewer conflicts of interest with companies in their portfolios than fund managers at other institutional investors . . . in contrast to mutual funds, hedge funds do not sell products to the target firms whose shares they hold.”⁸² Moreover, “hedge funds are not subject to extensive political control.”⁸³

These reasons have coalesced to form a compelling directive to hedge funds to engage in activism. In essence, hedge funds are in the right place at the right time to engage in the lucrative business of activist investing.

2. Activist Investing Goes Mainstream

Large institutional pension and private hedge funds have become extensive participants in profits-centric activist investing.⁸⁴

⁷⁷ Hannes, *supra* note 12, at 259.

⁷⁸ Paul H. Edelman et al., *supra* note 4, at 1408.

⁷⁹ *Id.*

⁸⁰ *Id.* at 1409.

⁸¹ *Id.*

⁸² *Id.*

⁸³ *Id.*

⁸⁴ See Smith, *supra* note 2 (“Some of the biggest pension funds, which have sought to influence companies for years, are now starting to emulate these

The fact that non-hedge funds have a growing interest in activism and wolf-pack tactics is an outgrowth of the approach's success.⁸⁵ Many investors seek to profit and are willing to provide capital for continued activist conduct.⁸⁶

Large pension funds are among those investors and recently began to play roles in breaking up companies and forcing director resignations.⁸⁷ With the additional firepower of iconic pension funds, activists are now able to reach virtually any company.⁸⁸

Household names such as Apple, McDonald's, Wendy's, and Hess Corporation—previously out of the reach of activist investors, who lacked the financial resources to amass a sufficiently large stake to influence multibillion-dollar companies—have become targets of hedge fund activists, with hedge funds succeeding in changing their operational performance or corporate governance.⁸⁹

investors by engaging with, and sometimes seeking to oust, directors of companies whose stock they own.”).

⁸⁵ See *supra* notes 76-77 and the accompanying text.

⁸⁶ Antoine Gara, *Activist Hedge Funds Aren't the Reason Capitalism is Coming Up Short*, FORBES (Apr. 17, 2015, 01:59 PM), <http://www.forbes.com/sites/antoinegara/2015/04/17/activist-hedge-funds-arent-the-reason-capitalism-is-coming-up-short/> [http://perma.cc/UQ5J-447Y] (“[S]hareholder activism is one of the fastest-growing and best performing investment strategies in the years since the financial crisis. Between 2009 and the third quarter of 2014, assets under management at activist hedge funds have grown at a compound annual rate of 26.8%, from \$36.2 billion in AUM to \$112.1 billion . . .”).

⁸⁷ Smith, *supra* note 2 (“Calpers is one of several big United States public funds that have played roles in shareholder uprisings in recent years . . .”); Gara, *supra* note 86 (“[P]owerful activist hedge funds have increased pressure on America’s largest corporations, often by putting a time-clock on corporate turnarounds [or] adding an owner to corporate boardrooms . . .”).

⁸⁸ Seretakakis, *supra* note 15, at 440.

⁸⁹ *Id.*

Even passive index funds that do not trade are encouraging activism.⁹⁰

The addition of mainstream institutional funds to the activist arsenal brings substantial additional capital to the new activism.

3. Financial Innovation

In addition to the amount of capital available to the activist funds and the unique factors incentivizing activism, new financial products also contribute to “the new activism.” Recent developments in finance and technological innovations have revolutionized activist investing, allowing buyers such as hedge funds to sever the link between share ownership and economic interest.⁹¹ By buying derivatives referencing shares of a target company, an activist investor is legally enabled to evade disclosure of positions that can be easily converted into reportable holdings at a future point.⁹² Therefore, the 5% trigger can be pulled after amassing a position that normally would require earlier filing.⁹³

One of the examples of novel financial products is a cash-settled total return equity swap, which is an executory contract that copies the cash flows of an investment in shares of a company.⁹⁴ In

⁹⁰ Chris Dieterich, *Activist Hedge Funds Now Fielding Calls from Fund Companies*, BARRON'S (May 7, 2015, 10:06 AM), <http://blogs.barrons.com/focusonfunds/2015/05/07/activist-hedge-funds-now-fielding-calls-from-fund-companies/> [<http://perma.cc/R92A-WF7Q>] (“[Passive] fund companies are stepping up their activism games, in some cases prodding high-profile activist hedge funds to do their bidding.”).

⁹¹ See Tonello, *supra* note 15.

⁹² David A. Katz, *13(d) Reporting Inadequacies in an Era of Speed and Innovation*, HARV. L. SCH. F. ON CORP. GOVERNANCE AND FIN. REG. (Sept. 24, 2015), <http://corpgov.law.harvard.edu/2015/09/24/13d-reporting-inadequacies-in-an-era-of-speed-and-innovation/> [<https://perma.cc/S7L9-42DH>] (highlighting that buying derivatives an investor can acquire “economic interest in excess of formal voting rights” and then easily convert such rights into target’s shares); Tonello, *supra* note 15.

⁹³ Tonello, *supra* note 15.

⁹⁴ An example of hedge funds using derivatives can be found in *CSX Corp. v. Children’s Investment Fund Management (UK) LLP*, 562 F. Supp. 2d 511, 516 (S.D.N.Y. 2008), where the court considered whether two hedge funds’ cooperative acquisition of plaintiff’s shares violated section 13(d) of the Securities Exchange Act. Two hedge funds, TCI and 3G, covertly accumulated positions in CSX through the use of total return equity swaps

an equity-based swap, the long party receives the economic returns on a theoretical amount of shares from the short party without actually owning them.⁹⁵ Upon the close of the contract, the long party is eligible to collect any distributions, such as dividends, plus a cash amount equal to the rise in market value of the shares.⁹⁶ The short party receives the equivalent sum of any decrease in the market value of the shares plus an agreed upon interest rate.⁹⁷

Depending on what the investor's ultimate intentions are, should it decide to exercise the voting rights resulting from the equity position, it may terminate the swap arrangement and purchase the underlying shares from the dealer. . . . [T]his hidden ownership scheme allows the undisclosed retention of de facto voting rights exercisable at the investor's discretion.⁹⁸

and direct investments, initiating a proxy battle in opposition to the sitting directors of CSX. *Id.* at 518. CSX filed suit, requesting that the court nullify any votes cast by TCI and 3G, claiming they violated securities laws by failing to reveal their holdings and group formation in breach of section 13(d). *Id.* at 538. The court agreed with CSX, determining that "(1) TCI did not file the required disclosure within 10 days of acquiring beneficial ownership in 5 percent of CSX shares, and (2) TCI and 3G failed to file the required disclosure within 10 days of forming a group." *Id.* at 568. The Second Circuit remanded the case to the district court without deciding whether derivatives should be accounted for as reportable shares. *CSX Corp. v. Children's Inv. Fund Mgmt. (UK) LLP*, 654 F.3d 276, 279 (2d Cir. 2011).

⁹⁵ *See CSX Corp.*, 562 F. Supp. 2d at 520.

⁹⁶ *Id.*

⁹⁷ *Id.* at 521.

⁹⁸ *See* EUGENIO DE NARDIS & MATTEO TONELLO, KNOW YOUR SHAREHOLDERS: THE USE OF CASH-SETTLED EQUITY DERIVATIVES TO HIDE CORPORATE OWNERSHIP INTERESTS 2 (2010), <https://www.conference-board.org/retrievefile.cfm?filename=DN-009-10.pdf&type=subsite> [<https://perma.cc/2AUA-3B5T>].

Other available strategies include put options, cash-settled call options, and stock futures.⁹⁹ These financial instruments were non-existent in 1968 when the Williams Act added section 13(d) to the Securities Exchange Act of 1934.¹⁰⁰ By acquiring derivatives referencing the equity of a target company, an activist can accumulate an interest exceeding the 5% threshold while formally eluding the disclosure obligation.¹⁰¹ Thus, hedge funds can stealthily acquire a large block exceeding 5% by using the ten-day grace period before filing.¹⁰²

Hedge fund's usage of derivatives has been criticized as facilitating the funds' ability to essentially violate section 13(d) by permitting them to avoid or delay the required disclosure.¹⁰³

4. The Advent of Wolf Packs

A growing practice among activist funds is the strategy of "wolf-pack" attacks wherein several funds avoid the specter of technically forming a group—and thus triggering the filing disclosure requirement.¹⁰⁴ The wolf-pack attacks are a profitable

⁹⁹ See Wolf-Georg Ringe, *Hedge Funds and Risk Decoupling: The Empty Voting Problem in the European Union*, 36 SEATTLE U. L. REV. 1027, 1034-38 (2013) (discussing different types of derivatives).

¹⁰⁰ See *supra* notes 30-35 and the accompanying text; see also Beneficial Ownership Reporting Requirements and Security-Based Swaps, 76 Fed. Reg. 34,579, 34,580 (June 14, 2011) (codified at 17 C.F.R. pt. 240) (explaining how disclosure requirements apply to new investment techniques).

¹⁰¹ See Tonello, *supra* note 15 (explaining that derivatives can be used to conceal acquisition of shares of a public company).

¹⁰² See Coffee & Palia, *supra* note 15, at 33 (suggesting that Schedule 13D filers buy most of their shares on the day they cross the 5% threshold or the day after, well before they are required to make the filing).

¹⁰³ WACHTELL, LIPTON, ROSEN & KATZ, LLP, COMMENTS ON RELEASE NO. 34-64087; FILE NO. S7-10-11 4 (2011), <http://www.sec.gov/comments/s7-10-11/s71011-2.pdf> [<http://perma.cc/WA7P-8AL7>] (“[I]nvestors are increasingly able to acquire any or all of the characteristics of direct stock ownership without triggering disclosure requirements through the use of inventive derivative structures.”).

¹⁰⁴ Coffee & Palia, *supra* note 15, at 7 (“Hedge funds have learned that to the extent they can acquire stock in the target firm before the ‘wolf pack’ leader files its Schedule 13D . . . significant gains will follow for those who have already acquired that stock. . . . [T]his tactic allows activists to acquire

strategy employed by activists.¹⁰⁵ “[H]edge fund wolf packs, who we conservatively estimate to account for roughly a fifth of overall activism, are among the most successful types of activism.”¹⁰⁶

The wolf-pack charge is typically lead by an activist fund who exploits the ten-day grace period for reporting a 5% holding and spreads the word that the fund is unhappy with the target company’s management.¹⁰⁷ This tactic is perfectly legal.¹⁰⁸ However, once the word is out, others are informed and “understand” what is about to unfold.¹⁰⁹ These other funds join in “pack formation” and circle the prey by taking positions.¹¹⁰ Yet no formal group was formed.¹¹¹

Significantly, wolf-pack attacks have attracted non-activist hedge fund partners, some of whom represent well-established funds.¹¹² “Major investment banks, law firms, proxy solicitors, and public relations advisors are now representing activist hedge funds and are eagerly soliciting their business.”¹¹³ Avoiding both the letter and the spirit of the disclosure requirements has become an accepted strategy involving numerous actors with a vested profitable interest in a coordinated yet non-concerted wolf-pack attack.¹¹⁴

a significant stake and negotiating leverage without triggering the target’s poison pill.”).

¹⁰⁵ Becht et al., *supra* note 8, at 38.

¹⁰⁶ *Id.*

¹⁰⁷ Coffee & Palia, *supra* note 15, at 29-34 (explaining that a hedge fund “organizing the activist campaign can quietly buy up to 5% of the target’s stock at a price that does not reflect its incipient campaign[,]” while “it can buy even more stock” during a ten-day grace period after the acquisition of 5% threshold and “before it must file its Schedule 13D”).

¹⁰⁸ *Id.* at 35 (“[T]ipping by the ‘wolf pack’ leader to its allies of its intent to launch an activist campaign may seem to resemble insider trading, but legally it is not equivalent. Although the information may be material and non-public, there is no breach of a fiduciary or other duty.”).

¹⁰⁹ *Id.* at 34.

¹¹⁰ *Id.*

¹¹¹ *Id.* at 28.

¹¹² Lipton, *supra* note 1 (“[I]nstitutional investors . . . have been working with activists . . . by partnering in sponsoring an activist attack such as CalSTRS with Relational in attacking Timken, Ontario Teachers’ Pension Fund with Pershing Square in attacking Canadian Pacific, and Valeant partnering with Pershing Square to force a takeover of Allergan.”).

¹¹³ *Id.*

¹¹⁴ *Id.* (“Many major activist attacks involve a network of activist investors (‘wolf pack’) who support the lead activist hedge fund, but attempt to avoid the disclosure and other laws and regulations that would hinder or prevent

A wolf-pack attack does not violate securities laws because it does not involve an agreement among the members of a pack and therefore no group is formed.¹¹⁵ Members of a “wolf pack” follow the leading investor and purchase stakes in a target company knowing intuitively or learning from media attention to the target that “something is going down.”¹¹⁶

The wolf-attacks unfold according to the following scenario:

First, activists build up a stake in a target, individually or by teaming up with other institutional or activist stockholders to form a ‘wolf pack.’ Next, they apply pressure on the target, including by threatening to oppose a board’s preferred strategic alternatives. Finally, they take action against the board by threatening ‘withhold the vote’ campaigns, demanding board seats, launching a short-slate proxy contest, seeking control of the board, or making aggressive use of derivatives.¹¹⁷

Moreover, in a takeover situation such tactics have proven invaluable in extracting leverage.¹¹⁸ Further, the risk/reward factor of

the attack if they were, or were deemed to be, a group that is acting in concert.”).

¹¹⁵ See Coffee & Palia, *supra* note 15, at 39 (“At the heart of the . . . ‘wolf pack’ tactic is the fact that parallel action by like-minded activist investors, even when accompanied by discussions among them, does not, without more, give rise to a “group” for purposes of Section 13(d)(3).”).

¹¹⁶ *Id.* at 33 (“[T]he high volume of trading . . . on the last eight days preceding the Schedule 13D’s filing is attributable to others (who most likely have been informed by those filing the Schedule 13D of their intentions).”).

¹¹⁷ David A. Katz, *Heightened Activist Attacks on Boards of Directors*, HARV. L. SCH. F. ON CORP. GOVERNANCE AND FIN. REG. (July 24, 2014), <http://corpgov.law.harvard.edu/2014/07/24/heightened-activist-attacks-on-boards-of-directors/> [http://perma.cc/L5T8-DQGK].

¹¹⁸ *Id.* (describing a takeover bid for Allergan made by an “unprecedented” partnership of Pershing Square Capital Management, an activist fund, and Valeant Pharmaceuticals International, “a strategic buyer”).

joining the pack is almost completely in favor of participating.¹¹⁹ Commentators emphasize that participation in a wolf pack “offers near riskless profit.”¹²⁰ “The hedge fund leading the pack can tip its allies of its intent to initiate an activist campaign because it is breaching no fiduciary duty in doing so (and is rather helping its own cause); thus, insider trading rules do not prohibit tipping material information in this context.”¹²¹

In essence, these share acquisitions are collusive, although members of a pack do not enter into an agreement either formally or informally to act as a group.¹²² Ultimately, it is a concerted action that enables a profitable resolution of the activist conduct.¹²³ Yet no securities laws have been broken as section 13(d) disclosures are duly made within ten days.¹²⁴ Moreover, each party has accumulated several stakes which will be leveraged together but do not need to be aggregated by securities law since no group was created.¹²⁵

Activist hedge funds are therefore empowered to engage in a joint strategy without formally triggering a “group” formation. Hedge funds can also draw support from the Second Circuit’s ruling, which affirmed a lower court’s refusal to find a group was formed among several funds for the purposes of section 13(d).¹²⁶ Allegedly the group in that case consisted of three entities, “one was a known raider, two bought stock during the same period, and all three discussed what to do about their investment.”¹²⁷ The district court

¹¹⁹ John C. Coffee, Jr., *The Lessons of DuPont: Corporate Governance For Dummies*, CLS BLUE SKY BLOG (June 1, 2015), <http://clsbluesky.law.columbia.edu/2015/06/01/the-lessons-of-dupont-corporate-governance-for-dummies/> [<http://perma.cc/G75H-7XQU>].

¹²⁰ *Id.*

¹²¹ *Id.*

¹²² See Coffee & Palia, *supra* note 15, at 28 (defining a wolf pack as “a loose network of activist investors that act in a parallel fashion”).

¹²³ *Id.* at 34 (explaining that the lead hedge fund has an incentive to tip other members of a pack “only after it has completed its own purchases (as otherwise it will be forced to buy in a rapidly rising market”). Commentators, thus, emphasize that “much . . . of the buying during the ten-day window seems likely to be by other ‘wolf pack’ members.” *Id.*

¹²⁴ *Id.* at 33-34.

¹²⁵ *Id.* at 34.

¹²⁶ *Hallwood Realty Partners v. Gotham Partners*, 286 F.3d 613, 616-18 (2d Cir. 2002); see also Briggs, *supra* note 9, at 691.

¹²⁷ Briggs, *supra* note 9, at 691.

found these facts insufficient to prove a group for purposes of section 13(d) of the Securities Exchange Act of 1934.¹²⁸

Potential for abuse exists as the drive to make a profit can prompt the funds to acquire shares to “shake-down” otherwise excellent management.¹²⁹ These attacks could also damage well-run targets who, being faced with a wolf-pack attack, must dedicate time and resources fending off or negotiating with a pack wielding insurmountable financial power.¹³⁰

Despite the potential for mischief, wolf-pack investing violates no laws.¹³¹ While the actions of the wolf-pack endorse the spirit of group formation, the reality is that profits are booked on a technically legal strategy that offers minimal downside risks.¹³² The practice of wolf-pack attacks will likely continue to garner additional adherents as long as the risk-reward ratio continues unabated.

5. Collaboration

In addition, the likelihood of hedge funds engaging in synchronized activity with other large investors is relatively high.¹³³

¹²⁸ *Hallwood Realty Partners*, 286 F.3d at 616.

¹²⁹ See *Coffee & Palia*, *supra* note 15, at 64 (“[T]arget firms are often more profitable than the control sample, suggesting that these targets are not poorly performing firms as some advocates for hedge fund activism suggest.”).

¹³⁰ See *Mordock*, *supra* note 19 (quoting Charles Elson, a professor of corporate governance at the University of Delaware) (“Everyone loses in a proxy fight No one comes out in a better position because they are distracting, expensive and not positive for anyone involved.”).

¹³¹ See *Coffee & Palia*, *supra* note 15, at 35.

¹³² *Id.* at 34.

¹³³ See Anne-Sylvaine Chassany & Sabrina Willmer, *CVC Said to Sell 10% Stake to 3 Sovereign-Wealth Funds*, BLOOMBERG (Sept. 18, 2012), <http://www.bloomberg.com/news/articles/2012-09-18/cvc-said-to-sell-10-stake-to-three-sovereign-wealth-funds> [<https://perma.cc/8X3J-ZFYE>] (explaining that some private equity firms sold stakes to sovereign-wealth funds); Song Jung-a, *S Korean Wealth Fund Joins Forces with Peers*, FIN. TIMES (June 19, 2009, 7:13 PM), <http://www.ft.com/intl/cms/s/0/3ccfa982-5cf9-11de-9d42-00144feabdc0.html#axzz3su4pKRzV> [<http://perma.cc/9FZF-8R2B>] (informing that Korea Investment Corporation, South Korea’s SWF, partnered with Malaysia’s Khazanah Nasional Berhad and Australia’s QIC); Jake Spring, *Qatar’s Wealth Fund to Launch \$10 Billion Investment Fund with China’s CITIC*, REUTERS (Nov. 4, 2014, 5:10 PM), <http://in.reuters.com/article/2014/11/04/qatar-china->

Globally, there is a surge in joint activity, coordinated investment, and collaboration between hedge funds and other investors.¹³⁴

In June 2010, the SWFs of Korea, China and Abu Dhabi jointly invested in convertible preferred shares issued by Chesapeake in a \$1.6 billion transaction led by Singapore's Temasek and Hopu Investments, a private equity fund. Several other large non-sovereign institutional investors participated in the transaction including Blackrock Group and Franklin Templeton.¹³⁵

The French state-owned investment fund Caisse des Dépôts et Consignations (CDC) has also announced a strategy of collaboration with SWFs.¹³⁶

sovereign-wealth-idINKBN0IO0QU20141104 [http://perma.cc/GT72-JT9S] (“QIA, which is estimated to have around \$170 billion, and state-owned conglomerate CITIC Group signed a memorandum of understanding to launch the 50-50 investment fund. . . . QIA is looking for new partners as it plans to invest between \$15 billion and \$20 billion in Asia in the next five years”); *FACTBOX-Recent Investments by Qatar's Sovereign Wealth Fund*, Reuters (Dec. 6, 2010, 8:40 AM), <http://www.reuters.com/article/2010/12/06/qatar-investment-idUSLDE6B516E20101206> [http://perma.cc/VZX7-EXNE] (explaining that Qatar's SWF partnered with China's SWF to buy forty percent of Songbird Estates, owner of London's Canary Wharf financial district).

¹³⁴ See SCOTT E. KALB, *THE GROWING TREND OF COOPERATION AMONG SOVEREIGN WEALTH FUNDS* 2-3 (2011), available at http://www.kic.kr/en/pr/pr030000.jsp?mode=view&article_no=474&pager.offset=0&board_no=44&1534-D83A_1933715A=77e0b97632398b6540f8087aacd4d1c7795d492f.

¹³⁵ *Id.*

¹³⁶ Press Release, Caisse des Dépôts, Caisse des Dépôts is to Develop its Subsidiary CDC International by Dedicating it to Investment Partnerships with Sovereign Wealth Funds (Sept. 30, 2013), http://www.caissedesdepots.fr/fileadmin/Communiqu%C3%A9s%20de%20presse/cp/cp_cdc_international_eng.pdf [http://perma.cc/4JPE-6WRQ].

The next section discusses the controversy over activism including the debate over which corporate governance model is preferred.

III. The Controversy Over Hedge Fund Activism

By virtue of their power and leverage, hedge funds shape and significantly influence corporate governance.¹³⁷

Recently, hedge funds have pressured McDonald's to spin off major assets in an IPO; asked Time Warner to change its business strategy; threatened or commenced proxy contests at H.J. Heinz, Massey Energy, KT&G, info USA, Sitel, and GenCorp; made a bid to acquire Houston Exploration; pushed for a merger between Euronext and Deutsche Börse; pushed for "changes in management and strategy" at Nabi Biopharmaceuticals; opposed acquisitions by Novartis of the remaining 58% stake in Chiron, by Sears Holdings of the 46% minority interest in Sears Canada, by Micron of Lexar Media, and by a group of private equity firms of VNU; threatened litigation against Delphi; and pushed for litigation against Calpine that led to the ouster of its top two executives.¹³⁸

There is a vigorous split of opinion in the corporate governance context as to whether activist investors are beneficial or detrimental to shareholders and companies. Some believe activism concentrates too much on short-term results to the detriment of long-

¹³⁷ Kahan & Rock, *supra* note 3, at 1024-25.

¹³⁸ *Id.*

term profitability.¹³⁹ Others note that shareholder activism can prompt positive changes in target companies.¹⁴⁰ The following subsections discuss the controversy over activism.

A. Opponents of Hedge Fund Activism

To activist opponents, hedge fund activism focuses too heavily on short-term results and is thus damaging to the United States economy and its equity markets.¹⁴¹ Critics refer to hedge funds as “vultures,” alleging that they destroy shareholder value, are bad for America, and engaged in essentially illegal activity enabled by prior regulatory laxity and error.¹⁴²

Opponents of activist hedge funds point to a growing body of studies suggesting that the benefits created by activist funds may be exaggerated.¹⁴³ Indeed, there are numerous scholars that point to the

¹³⁹ The world’s largest single asset manager with nearly \$5 trillion has expressed reservations about activism. See BLACKROCK, <http://www.blackrock.com/corporate/en-us/about-us> [<http://perma.cc/MR8K-E6UY>] (cautioning against pitfalls of activism).

¹⁴⁰ Becht et al., *supra* note 8, at 6 (“[W]e show that activists are successful in creating shareholder value even in scenarios that do not involve a takeover, such as restructurings and changes to payout policy.”).

¹⁴¹ See Robert Lenzner, *The Hedge Fund Activists are Not the Flavor of the Month for the Chief Justice of the Delaware Court*, FORBES (Mar. 30, 2014, 10:17 AM), <http://www.forbes.com/sites/robertlenzner/2014/03/30/activist-hedge-fund-corporate-meddlers-take-it-in-the-chops-from-the-high-and-mighty/> [<http://perma.cc/3ML6-GGEP>] (observing how the Chief Justice of the Delaware Supreme Court criticizes hedge fund activists and “questions why the directors and managers of large public corporations ‘must follow the immediate whim of a momentary majority of shareholders’ tempted by the activists into some short-term adventure that could push the stock up”).

¹⁴² Denning, *supra* note 25 (“[A]ctivist hedge funds ferociously pursue ‘the dumbest idea in the world,’ namely, maximizing shareholder value as reflected in the current stock price. . . . Ironically, pursuit of shareholder value as reflected in the current stock price actually destroys real shareholder value.”).

¹⁴³ See generally YVAN ALLAIRE, THE CASE FOR AND AGAINST ACTIVIST HEDGE FUNDS (2015), http://igopp.org/wp-content/uploads/2015/06/IGOPP_Article_Template2014_CaseForAgainstHedgeFunds_EN_Mai2015_v3.pdf [<https://perma.cc/74WS-43TB>] (concluding that (i) hedge fund activists are not as great at finance, strategy, or operations as some seem to believe (and as they relentlessly promote); (ii) their recipes are shop-worn and predictable, and (almost) never include any growth initiatives; (iii) their

negative consequences of hedge fund activism.¹⁴⁴ Commentators emphasize that “immediate wealth to some shareholders” resulting from the activism “may be at the expense of the longer term corporate and societal interests.”¹⁴⁵ Some critics have also linked activism with “increased debt and cuts in capital spending, on long-term corporate health, innovation, job creation and GDP growth.”¹⁴⁶

Corporate law guru Martin Lipton has been vociferous in his critique of hedge funds.¹⁴⁷ Lipton is ideologically opposed to hedge fund activism as he built his legal practice on defending companies from takeovers.¹⁴⁸ Lipton has drawn strong support from scholars who believe that hedge funds do in fact cause damage.¹⁴⁹

Scholars ranging from Columbia Law School’s John Coffee Jr. to Yvan Allaire of the Institute for Governance of Private and Public Organizations find the data ambiguous and methodologically flawed. Both attribute any gains by shareholders to a combination of fleeting takeover premiums and wealth transfers from employees (as the result of layoffs or wage cuts) or

success mostly comes from the sale of the targeted firm (or from “spin-offs”); (iii) their performance otherwise barely matches the performance of the S&P 500 and that of a random sample of firms; (iv) the strong support they receive from institutional investors is rather surprising and quite unfortunate; (v) the form of “good” governance imposed on companies since Sarbanes-Oxley as well as the “soft” activism of institutional funds have proved a boon for the activist funds).

¹⁴⁴ See Holly J. Gregory, *The State of Corporate Governance for 2015*, HARV. L. SCH. F. ON CORP. GOVERNANCE AND FIN. REG. (Jan. 30, 2015), <http://corpgov.law.harvard.edu/2015/01/30/the-state-of-corporate-governance-for-2015/> [<http://perma.cc/2MH6-L7P3>].

¹⁴⁵ *Id.*

¹⁴⁶ *Id.*

¹⁴⁷ See Goldhaber, *supra* note 16 (“Lipton blames ‘short-termist’ hedge funds for America’s economic stagnation and inequality since the financial crisis.”).

¹⁴⁸ *Id.* (“Lipton is most famous as the inventor in 1982 of the ‘poison pill’ defense to corporate takeovers . . .”).

¹⁴⁹ *Id.*

bondholders (as the result of downgrades or bankruptcies). In other words, Ackman and some shareholders are getting rich on the back of workers and pensioners.¹⁵⁰

According to detractors of activist investing, “[t]he power of the activist hedge funds is enhanced by their frequent success in proxy fights and election contests when companies resist the short-term steps the hedge fund is advocating.”¹⁵¹ Activism opponents also note that “[a]ctivist hedge funds have recently exploited loopholes in existing SEC rules under Section 13(d) of the Securities Exchange Act to accumulate significant, control-influencing stakes in public companies rapidly without timely notice to the market.”¹⁵²

The Chief Justice of the Delaware Supreme Court has also weighed in with a similar cautionary view of activist funds. Echoing Lipton’s time delay criticisms, Chief Justice Leo Strine noted that there is a vital need for more timely and comprehensive information regarding activist investments, particularly when the funds seek to alter business strategies.¹⁵³ He notes that section 13(d) requires revisions in response to “current technological and market developments.”¹⁵⁴ Chief Justice Strine advocates requiring hedge funds to “update[e] their filing within twenty-four to forty-eight hours if their ownership interest changes by one percent in any direction, long or short.”¹⁵⁵

B. Supporters of Hedge Fund Activism

¹⁵⁰ *Id.*

¹⁵¹ Martin Lipton, *Current Thoughts About Activism*, HARV. L. SCH. F. ON CORP. GOVERNANCE AND FIN. REG. (Aug. 9, 2013), <http://blogs.law.harvard.edu/corpgov/2013/08/09/current-thoughts-about-activism/> #more-50945 [http://perma.cc/S8VK-E32P].

¹⁵² *Id.*

¹⁵³ *See de la Merced, supra* note 22 (“No less than Leo E. Strine Jr., the chief justice of Delaware’s Supreme Court . . . argued on a panel in favor of a more sensitive tripwire that involved disclosure within 24 hours.”).

¹⁵⁴ Leo E. Strine, Jr., *Can We Do Better by Ordinary Investors? A Pragmatic Reaction to the Dueling Ideological Mythologists of Corporate Law*, 114 COLUM. L. REV. 449, 496 (2014).

¹⁵⁵ *Id.*

Proponents of activist investing argue that shareholder value is positively influenced by shareholder activism.¹⁵⁶

Because institutional investors ultimately decide whether an activist's campaign will succeed, activism potentiates institutional voice by putting choices to the institutions. . . . So in sidelining activist investors, the United Kingdom and the European Union are also sidelining the institutions—just those whose roles are simultaneously sought to be expanded into stewardship.¹⁵⁷

Lucian Bebchuk has written extensively on this topic. His research indicates that hedge fund activism is beneficial and there is no evidence that hedge funds bring adverse consequences either to their companies or the economy.¹⁵⁸ Activism has in fact been extolled as virtuous and as a counter-balance to managerial entrenchment.¹⁵⁹

True corporate democracy does not exist in America and as a result many unfit chief executives are not held accountable. Poison pills and other board tricks disenfranchise stockholders. As a result entrenched chief executives and boards of

¹⁵⁶ Becht et al., *supra* note 8, at 6 (“[W]e show that activists are successful in creating shareholder value even in scenarios that do not involve a takeover, such as restructurings and changes to payout policy.”).

¹⁵⁷ 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, 906 (2013).

¹⁵⁸ See, e.g., Bebchuk et al., *supra* note 8, at 1085 (“We find no evidence that activist interventions . . . are followed by short-term gains in performance that come at the expense of long-term performance.”).

¹⁵⁹ See Rushton, *supra* note 26.

directors may be protected even if they are ineffective.¹⁶⁰

Activists point to examples when activism positively exerted influence on the company and rescued the shareholders from ineffective management.¹⁶¹ One of those examples is Canadian Pacific Railway.¹⁶² “Only after Pershing Square’s Bill Ackman got involved, were necessary operational and managerial changes made, to the benefit of long-term holders.”¹⁶³

Furthermore, while Lipton has championed corporate defensive maneuvering, some have found that takeover defenses are positively linked to companies with lower shareholder value.¹⁶⁴

Studies have indicated that activism does in fact support enhanced corporate functioning.¹⁶⁵ Some of them conclude that “that hedge fund activism through 2007 was followed by improved operating performance during the five years after intervention.”¹⁶⁶ A recent study of nearly 1800 activist “attacks” in almost two dozen

¹⁶⁰ *Id.* (quoting Carl Icahn).

¹⁶¹ *See* Gara, *supra* note 86.

¹⁶² *Id.*

¹⁶³ *Id.*

¹⁶⁴ Although there is no evidence of causation, the correlation should be noted. *See* Lucian A. Bebchuk & Alma Cohen, *The Costs of Entrenched Boards*, 78 J. FIN. ECON. 409, 410 (2005) (“[S]taggered boards are associated with a reduced firm value. The association between staggered boards and firm value is not only statistically significant, but also economically meaningful.”); Lucian A. Bebchuk et al., *Staggered Boards and the Wealth of Shareholders: Evidence from Two Natural Experiments* 23 (Nat’l Bureau of Econ. Research, Working Paper No. 17127, 2011), <http://www.nber.org/papers/w17127.pdf> [<http://perma.cc/4HNR-M4PA>] (finding that staggered boards lead to lower firm value); *see also* Lucian Bebchuk et al., *What Matters in Corporate Governance?*, 22 REV. FIN. STUD. 783, 823 (2009) (demonstrating that staggered boards, limits to shareholder bylaw amendments, poison pills, golden parachutes, and supermajority requirements for mergers and charter amendments are correlated with low value firms).

¹⁶⁵ *See* C.N.V. Krishnan et al., *Top Hedge Funds: The Importance of Reputation in Shareholder Activism* 1 (Vanderbilt Law and Econ. Research Paper No. 15-9, 2015), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2589992 [<http://perma.cc/3AYC-HATR>].

¹⁶⁶ *Id.*

nations from 2000-2010 had several interesting conclusions.¹⁶⁷ These activist moves ranged the gamut from takeover attempts, to engagement over executive compensation, to dividend policy.¹⁶⁸ The study concluded that certain types of activism such as takeovers and restructuring created shareholder value.¹⁶⁹ Other types of conduct failed to do so.¹⁷⁰

Activist hedge funds also help level the playing field with respect to the management agency conflicts by empowering minority shareholders.¹⁷¹ Management agency conflicts are commonly found in jurisdictions such as the United States with generally widely dispersed shareholder bases.¹⁷²

¹⁶⁷ Becht et al., *supra* note 8, at 1 (“[W]e document the incidence and characteristics of public activism across 23 countries in Asia, Europe, and North America. . . . We analyse [sic] in total 1740 activist interventions, mainly initiated by hedge funds and focus funds, during the 2000-2010 period.”).

¹⁶⁸ *Id.* at 2 (“[W]e identify the outcomes of each engagement, including changes to payout policy, governance, corporate restructuring and takeovers.”).

¹⁶⁹ *Id.* at 6, 38.

¹⁷⁰ *Id.* at 7 (“[N]ot all types of activism are equally beneficial. Activist engagements appear to create only modest or no shareholder value when the activist achieves changes in the board structure or the payout policy of target firms without other accompanying outcomes, such as a restructuring.”).

¹⁷¹ See Edward B. Rock, *Adapting to the New Shareholder-Centric Reality*, 161 U. PA. L. REV. 1907, 1922 (2013) (arguing that activists have empowered themselves as well as other shareholders and that the management agency problem has been substantially reduced as a result).

¹⁷² This makes sense as smaller owners do not have the incentive or the time to pursue changes in a company, whereas large owners do. A large owner is in a better position to influence the company and can pressure or even remove management via a proxy fight or takeover. See Andrei Shleifer & Robert Vishny, *Large Shareholders and Corporate Control*, 94 J. POL. ECON. 461, 461 (1986) (“In a corporation with many small owners, it may not pay any one of them to monitor the performance of the management.”); Andrei Shleifer & Robert Vishny, *A Survey of Corporate Governance*, 52 J. FIN. 737, 753 (1997) (“When control rights are concentrated in the hands of a small number of investors with a collectively large cash flow stake, concerted action by investors is much easier than when control rights, such as votes, are split among many of them.”).

There is support for the notion that activists have improved the financial outcomes of smaller holders and have indeed enhanced overall shareholder value.¹⁷³

A recent example involved Novartis's attempt to acquire the 58% of Chiron that it did not already own. Novartis initially offered \$40 per share to the Chiron shareholders. An independent committee of Chiron negotiated this price up to \$45 per share, a 23% premium over Chiron's pre-offer share price. One month after the agreement was announced, ValueAct Capital, a hedge fund and the third largest shareholder of Chiron, sent a "stinging" letter to Chiron's CEO announcing its opposition. This started a shareholder revolt, with mutual fund Legg Mason, the second largest shareholder of Chiron, joining ValueAct's opposition, and Institutional Shareholder Services recommending a vote against the deal. To get the transaction through, Novartis had to raise its offer to \$48 a share, increasing the premium from 23% to 32%.¹⁷⁴

Some mainstream institutional holders support the activism as well.¹⁷⁵ According to one institution, "[t]he hedge funds have done

¹⁷³ See Kahan & Rock, *supra* note 3, at 1037.

¹⁷⁴ *Id.*

¹⁷⁵ John J. Madden, *The Evolving Direction and Increasing Influence of Shareholder Activism*, HARV. L. SCH. F. ON CORP. GOVERNANCE AND FIN. REG. (Dec. 23, 2013), <http://corpgov.law.harvard.edu/2013/12/23/the-evolving-direction-and-increasing-influence-of-shareholder-activism/> [https://perma.cc/A2MA-JCZK] (explaining that activism "that brings a sophisticated analytical approach to

a marvelous job. No matter how we feel about companies, traditional managers simply cannot move as fast to achieve our aims. We were right behind (the hedge funds), but we couldn't have done it without them."¹⁷⁶ The next section discusses the debate in the context of the global corporate governance divide.

C. Activism in the Global Corporate Governance Context

Corporate law rulings have established unequivocally that, in the United States, a company must be managed in the pursuit of the financial interests of the owners—the shareholders.¹⁷⁷ Failure to do so constitutes a violation of the fiduciary duties of directors and managers.¹⁷⁸ Activists ostensibly target companies whose management is involved in agency conflicts with shareholders, often the result of managers pursuing their own self-interest.¹⁷⁹ Activism seeks to change the status quo at these mismanaged businesses and attempts to extract more value to shareholders.¹⁸⁰ Not surprisingly, in

critically examining corporate strategy and capital management” is supported by “mainstream institutional investors, industry analysts and other market participants”).

¹⁷⁶ Louise Armitstead, *Saved by the Growing Power of Hedge Funds*, SUNDAY TIMES, Mar. 13, 2005, at 14.

¹⁷⁷ See, e.g., *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 182 (Del. 1986) (holding that when the sale of a company becomes inevitable, directors have a duty to maximize shareholder value).

¹⁷⁸ *Id.*

¹⁷⁹ See Zohar Goshen, *Controlling Corporate Agency Costs: A United States-Israeli Comparative View*, 6 CARDOZO J. INT'L & COMP. L. 99, 117-18 (1998) (describing managerial agency conflicts that plague companies with a dispersed shareholder base as commonly found in the United States).

¹⁸⁰ See Riva D. Atlas, *Some Funds Taking Role Far Beyond Just Investor*, N.Y. TIMES (Aug. 16, 2005), http://www.nytimes.com/2005/08/16/business/16invest.html?adxnlnx%41124197489-TzwLymvE924SNb11QwP/CA&pagewanted%4all&_r%40

[<http://perma.cc/KNR9-6ESX>] (“[Many] hedge fund managers have taken up Mr. Icahn’s tactics to wage populist battles against chief executives. In letters, often colorfully worded, tacked on to filings with [SEC], they are demanding that executives sell off units, pay dividends or take other actions to raise stock prices quickly.”). In some cases the activists seek board seats. See, e.g., Katya Kazakina, *Billionaire Loeb Confirmed as Sotheby’s New Board Member*, BLOOMBERG (May 29, 2014, 4:02 PM), <http://www.bloomberg.com/news/articles/2014-05-29/billionaire-loeb-confirmed-as-sotheby-s-new-board-member> [<http://perma.cc/37AS-LSQA>] (“Dan Loeb

the United States, where the corporate governance mantra is shareholder value,¹⁸¹ hedge fund activism is vibrant, and markets and corporate law permit and reward activists who can bring enhanced value to shareholders.¹⁸²

The U.S. model of activism has been successful and activists are beginning to copy the strategy in non-U.S. markets.¹⁸³ Activist investing is spreading globally to Europe and Asia.¹⁸⁴ The global

was confirmed as Sotheby's . . . newest director following a . . . proxy fight between the auction house and its largest shareholder. Loeb and five others were officially appointed to the board today at Sotheby's annual shareholder meeting . . . His Third Point LLC owns 9.65 percent of Sotheby's shares . . .").

¹⁸¹ See Stephen Bainbridge, *A Duty to Shareholder Value*, N.Y. TIMES (Apr. 16, 2015, 6:46 AM), <http://www.nytimes.com/roomfordebate/2015/04/16/what-are-corporations-obligations-to-shareholders/a-duty-to-shareholder-value> [<https://perma.cc/AD8N-ZGQH>] (explaining shareholder wealth maximization).

¹⁸² See, e.g., Kaylee Weinmann, *4 Ways Activists Will Continue To Run The Show In 2015*, LAW360 (Jan. 2, 2015, 1:24 PM), <http://www.law360.com/articles/599748/4-ways-activists-will-continue-to-run-the-show-in-2015> [<https://perma.cc/E842-UA8G>] (concluding that 2014 was a busy year for shareholder activists and predicting that 2015 will witness many activists campaigns as well).

¹⁸³ See Becht et al., *supra* note 8, at 38 ("The U.S. model of activism has been successfully copied and suitably adapted by foreign activists, who outperform U.S. activists in their domestic markets.").

¹⁸⁴ Alexandra Stevenson, *U.S. Activist Investor Turns Eyes Toward Europe*, N.Y. TIMES DEALBOOK (Apr. 17, 2014), <http://dealbook.nytimes.com/2014/04/17/u-s-activist-investor-turns-eyes-toward-europe/?module=BlogPost-Title&version=BlogMain&contentCollection=CorporateGovernance&action=Click&pgtype=Blogs®ion=Body> [<http://perma.cc/HU64-7N2A>] ("It was only a matter of time before United States activist investors turned their focus to European companies."); Lawrence Delevingne, *Keith Meister's Corvex Takes Large Stake in Yum Brands: Sources*, CNBC (May 1, 2015, 10:54 AM), <http://www.cnbc.com/id/102631443> [<http://perma.cc/CEM2-94T8>] (noting activist hedge fund Third Point's growing activities in Japan); Paul Garvey, *Activist Hedge Funds are Coming, But are Investors Ready?*, AUSTRALIAN (Apr. 21, 2015, 12:00 AM), <http://www.theaustralian.com.au/business/companies/activist-hedge-funds-are-coming-but-are-investors-ready/story-fn91v9q3-1227312571622> [<http://perma.cc/CUV9-GP3C>] (stating that strong shareholder rights make Australia an "attractive market for activist investors").

trend towards activism is to be expected¹⁸⁵ since “[a]t the end of the day, American shareholders, European shareholders and U.K. shareholders all want the same thing We all want to make money and we all want management and the board to work in alignment to create shareholder value.”¹⁸⁶

However, robust activism has been slower to arrive in nations where shareholder-value is not the *modus operandi* of corporate law. In many countries, such as Japan, stakeholder value is the corporate governance mantra, therefore lessening the perceived importance in shareholder-value driven activism.¹⁸⁷ Also, in Japan, the popular Keiritsu ownership structure—wherein numerous allied entities have a crossholding in each other—greatly lessens the importance of outside shareholders.¹⁸⁸ The inability to acquire a significant percentage of shares prevents an activist from influencing a company at all, let alone replacing its directors.¹⁸⁹ Moreover, most Japanese shareholders are “insiders” in the sense that their interests and loyalty are with colleagues, senior officers, and allied interests

¹⁸⁵ See Sudi Sudarsanam & Tim Broadhurst, *Corporate Governance Convergence in Germany Through Shareholder Activism: Impact of the Deutsche Boerse Bid for London Stock Exchange*, 16 J. MGMT. & GOV. 235, 264-65 (2012) (discussing activism in the context of German corporate governance).

¹⁸⁶ See Stevenson, *supra* note 184 (quoting Jason N. Ader, chief investment officer of SpringOwl).

¹⁸⁷ Carlo Osi, *Board Reforms with a Japanese Twist: Viewing the Japanese Board of Directors with a Delaware Lens*, 3 BROOK. J. CORP. FIN. & COM. L. 325, 349-50 (2009) (“[In Japan] corporations are primarily managed for the stakeholders. This includes employees, banks, suppliers, customers, business partners, the community and, in some respect, shareholders. This stakeholder-oriented model is quite different from the shareholder primacy model advocated in the United States.”).

¹⁸⁸ See Slawotsky, *supra* note 18, at 12-13 (“An important characteristic of Japanese corporate governance is the existence of the Keiretsu—a system of interlocking affiliated companies whose members own shares in one another and transact business together. . . . [T]he system also reinforces the disregard for individual ‘outside’ shareholders.”).

¹⁸⁹ Steven Davidoff Solomon, *Olympus Scandal Reveals How Little Japan has Changed*, N.Y. TIMES DEALBOOK (Nov. 1, 2011, 5:11 PM), <http://dealbook.nytimes.com/2011/11/01/olympus-scandal-reveals-how-little-has-changed-in-japan/> [<http://perma.cc/KHD5-GS7B>] (“Because of keiretsu and cross-holdings, shareholder pressure and oversight have traditionally been minimal. Hostile takeovers are almost nonexistent, as is shareholder activism.”).

rather than overall shareholder performance or the interests of other “outside” shareholders.¹⁹⁰ Therefore, while considered “stakeholder-value” centric, the Japanese model is in fact structured around protecting and furthering the financial interests of “insider shareholders and managers”—while the interests of outside unaffiliated parties are not highly valued or taken into account.¹⁹¹ In light of these factors, vigorous activism in Japan could not develop.¹⁹²

Is the lack of outside shareholders, and thus the near impossibility of activism, disadvantageous to the company and its shareholders? The Olympus scandal provides an exemplar of managerial and director misconduct that would be incomprehensible in a jurisdiction with the potential for vigorous hedge fund activism.¹⁹³ The Olympus CEO, UK national Michael Woodford, was treated as a traitor and fired for disloyalty after questioning senior managers about accounting irregularities and revealing internal accounting fraud.¹⁹⁴ The “disloyalty,” however, was not to

¹⁹⁰ Outside shareholders are owners who are not aligned with an “ally” company and who therefore are outside the group of important stakeholders, such as members of the Keiretsu group, creditors, and so forth. Caslav Pejovic, *Japanese Corporate Governance: Behind Legal Norms*, 29 PENN. ST. INT’L L. REV. 483, 490-91 (2011) (“[M]ost [] Japanese large companies are owned by other companies and banks, which are also owned not by classic types of shareholders, but by other companies in the same *keiretsu* . . .”).

¹⁹¹ Eric Pfanner, *Corporate Japan Looks for Outside Advice*, WALL ST. J. (June 8, 2015, 3:30 PM), <http://www.wsj.com/articles/corporate-japan-looks-for-outside-advice-1433789544> [http://perma.cc/52NN-LR92] (emphasizing that, until recently, “Japan’s top business lobby long opposed the independent-director quota, arguing that outsiders often don’t know enough about company operations to serve effectively”).

¹⁹² See Pfanner, *supra* note 191.

¹⁹³ See Slawotsky, *supra* note 18, at 13 (“In Japan, values such as loyalty, honor, and fidelity are also more important than shareholder profits. But these values are applicable mainly to the relationship between the corporation and its senior managers . . . and other insider stakeholders; they do not apply to outsiders, nonaffiliated businesses, and owners.”). Commentators explain that “[t]he corporation’s owners are at the bottom of the pyramid.” *Id.*

¹⁹⁴ *Id.* at 14 (“Immediately following Mr. Woodford’s disclosure of the financial irregularities, the Olympus board summarily fired him.”); *Former Olympus Boss Woodford Blows Whistle on Company*, BBC NEWS (Nov. 15, 2011), <http://www.bbc.co.uk/news/15742048> [http://perma.cc/JM4L-4JNE]

the company or its shareholders, but rather to the Olympus management and insider directors, all of whom had desired to cover up the accounting fraud.¹⁹⁵ Immediately after Woodford had raised questions regarding Olympus's financial reporting, his colleagues' attitude toward him changed and his work environment became more hostile.¹⁹⁶ Soon after drawing attention to the fraud, a board meeting was convened and Woodford was summarily fired without even having an opportunity to speak.¹⁹⁷ Incredibly, rather than create an internal uproar, the other directors unanimously voted to fire Woodford and no dissenting director came to Woodford's defense.¹⁹⁸ Even Japanese shareholders, who logically would be upset that Woodford was fired, were not complaining.¹⁹⁹ Woodford relates:

("[I]t's a culture of deference and sycophants and yes men. I mean in Japan people respect the position without questioning the person who takes and assumes that position.")

¹⁹⁵ When Woodford questioned Olympus Group President Hisashi Mori about Olympus's questionable business activity and asked Mori who he worked for, rather than respond "Olympus," he said "I work for Mr. Kikukawa [then President and CEO of Olympus]. I am loyal to Mr. Kikukawa." Karl Taro Greenfeld, *The Story Behind the Olympus Scandal*, BLOOMBERG (Feb. 16, 2012), <http://www.bloomberg.com/bw/articles/2012-02-16/the-story-behind-the-olympus-scandal> [http://perma.cc/KT2Q-RW5N]. Moreover, when asked why Woodford was fired, an Olympus spokesman stated simply: "[H]is management style caused a significant divergence between him and other executives." *Id.*

¹⁹⁶ *Id.* ("Woodford noticed that while the two Japanese men had sumptuous plates of sushi before them, he was served a tuna sandwich . . .").

¹⁹⁷ *Id.* ("The board meeting scheduled to discuss concerns relating to the company's M&A activity is canceled. Instead, we have a new agenda. The first is to discuss the motion to dismiss Mr. Woodford . . . Mr. Woodford cannot speak because he is an interested party. All those in favor? . . . All 12 board members present immediately raised their hands.")

¹⁹⁸ *Id.*

¹⁹⁹ Hiroko Tabuchi & Makiko Inoue, *Olympus Shareholders Shake Off Scandal*, N.Y. TIMES (Apr. 20, 2012), http://www.nytimes.com/2012/04/21/business/global/olympus-shareholders-shake-off-scandal.html?_r=0 [http://perma.cc/G4YH-9B3H] (highlighting that at the first shareholders meeting following the accounting scandal, the firing of Woodford, and the massive drop in Olympus stock price, present shareholders overwhelmingly supported Olympus' proposed new slate of directors).

Non-execs are there to hold the executive to account. They are there to look after the interests of the shareholders. Which brings me onto the shareholders. The western shareholders, the American, European, Hong Kong, they are asking me to go back, but the Japanese shareholders have not said anything. I mean the company has lost 80% of its value since I was dismissed three-and-a-half weeks ago. It has now been put on the watch list by the Tokyo Stock Exchange. It's in a critical position. But the Japanese shareholders haven't said a word—one comment by Nippon Life two weeks ago saying we would like the full facts and clarity. That's tepid. You know, it's meaningless.²⁰⁰

In a governance structure and corporate culture wherein a company CEO is ousted for revealing fraud, outside investors attempting governance changes will be met with robust resistance, if not outright hostility. Moreover, based upon the inter-locking ownership structure of the Keiretsu groups, acquiring a dominant or controlling percentage of shares is not merely daunting, it is impossible.²⁰¹ Therefore, engaging in activism in Japan is extremely

²⁰⁰ *Former Olympus Boss Woodford Blows Whistle on Company*, *supra* note 197. Subsequently, Olympus “apologized” for the activity that led to the dismissal. News Release, Olympus Corp., Notice Concerning Past Activities Regarding Deferral in Posting of Losses (Nov. 8, 2011), <http://www.olympus-global.com/en/common/pdf/nr111108e.pdf> [<http://perma.cc/TT7K-XVUB>] (“The Company would like to take this opportunity to sincerely offer our deepest apologies to its shareholders, investors, trading partners and other relevant parties for all inconvenience caused.”).

²⁰¹ *See* Solomon, *supra* note 189 (“Because of keiretsu and cross-holdings, shareholder pressure and oversight have traditionally been minimal. Hostile takeovers are almost nonexistent, as is shareholder activism.”).

difficult.²⁰² The Olympus case illustrates that without activists monitoring and possibly removing directors, company directors and managers have little incentive to avoid conflicts and, in fact, have every incentive to manage the company for their own private interests and the interests of their allies and insider shareholders.

The recent Toshiba scandal also corroborates the poor governance plaguing Japan.²⁰³ Toshiba, once a leading Japanese company employing hundreds of thousands,²⁰⁴ admitted to a huge multi-year billion dollar accounting scandal and the once powerful company has had its debt cut to junk.²⁰⁵ Yet managers and officers seem more concerned with protecting insiders who planned and/or

²⁰² *Japanese Companies: Winds of Change*, ECONOMIST (June 6, 2015), <http://www.economist.com/news/business/21653638-prospects-shaking-up-japanese-firms-have-never-looked-so-good-winds-change> [<http://perma.cc/68YG-4AWN>] (explaining that it is not clear whether Japan will “take the drastic steps that are needed to restore its competitiveness” and emphasizing that the last attempt “to open up firms to outside capital and takeovers . . . petered out as the establishment closed ranks following the departure of Junichiro Koizumi, an earlier reform-minded prime minister”).

²⁰³ Japan’s Toshiba conceded that it had engaged in a multi-billion dollar accounting fraud for almost a decade. See Michal Addady, *Toshiba’s Accounting Scandal Is Much Worse Than We Thought*, FORTUNE (Sept. 8, 2015, 10:23 AM), <http://fortune.com/2015/09/08/toshiba-accounting-scandal/> [<https://perma.cc/QLQ3-XXNP>] (“Toshiba admitted on Monday that it had overstated its profits by nearly \$2 billion over the past 7 years . . .”). Evidently, Toshiba managers “set aggressive profit targets that subordinates could not meet without inflating divisional results were under pressure to report growing profits.” *Id.* After the admission, “Toshiba’s shares fell dramatically.” *Id.*

²⁰⁴ TOSHIBA, ANNUAL REPORT 4 (2012), http://www.toshiba.co.jp/about/ir/en/finance/ar/ar2012/tar2012e_or.pdf [<https://perma.cc/AF7C-868H>].

²⁰⁵ See Finbarr Flynn, *Toshiba’s Credit Rating Lowered Two Levels to Junk by Moody’s*, BLOOMBERG (Dec. 22, 2015), <http://www.bloomberg.com/news/articles/2015-12-22/toshiba-s-credit-rating-lowered-two-levels-to-junk-by-moody-s> [<https://perma.cc/52MU-7CR9>].

profited from the fraud.²⁰⁶ As one governance expert notes, there seems to be “100% tolerance” for managerial cover-ups.²⁰⁷

For example, Toshiba has made some efforts at demonstrating “good governance” by filing a lawsuit against its former employees, but the reality is Toshiba’s action seems to be more show than substance.²⁰⁸ Inexplicably, the amount of money sought in recovery from the former executives constitutes only a fraction of the actual loss in shareholder value.²⁰⁹ Moreover, “Toshiba has yet to fully explain why it is limiting its lawsuit to just five former executives, effectively absolving some current officials who were in senior roles during the years it was padding profits.”²¹⁰ Furthermore, the fact that the fraud still happened despite the fact that Toshiba had previously implemented governance reform speaks volumes.²¹¹

This lack of incentive to improve company performance and the disregard of outside shareholders in order to preserve or enhance the self-interest of management makes activism an important available strategy to prevent insider exploitation. And if insiders and managers can exploit a company’s assets, productivity and overall economic performance will decline. Indeed, a national economy may

²⁰⁶ Chris Cooper, *Season of Scandal Hits Japan With Company Confession Flurry*, BLOOMBERG (Oct. 20, 2015), <http://www.bloomberg.com/news/articles/2015-10-19/season-of-scandal-hits-japan-with-flurry-of-corporate-confession> [<https://perma.cc/JDT4-8JAZ>].

²⁰⁷ *Id.* (quoting Nicholas Benes, representative director of the Board Director Training Institute of Japan, who criticized Toshiba for failure to sanction its directors and officers involved in the accounting fraud).

²⁰⁸ See Makiko Yamazaki, *Toshiba Lawsuit Highlights Japan Governance Reform Still Lacking: Lawyers*, REUTERS (Nov. 12, 2015), <http://www.reuters.com/article/2015/11/12/us-toshiba-lawsuit-idUSKCN0T10AA20151112> [<https://perma.cc/HWY8-CQ6G>] (explaining that Toshiba’s lawsuit against its executives involved in accounting fraud is a “defensive maneuver”).

²⁰⁹ *Id.* (“[\$2.44 million] in damages Toshiba is seeking pales in comparison with the over \$7 billion decline in its stock market value since the accounting problems came to light in early April.”).

²¹⁰ *Id.*

²¹¹ Masao Nakamura, *Has Japan’s Corporate Governance Reform Worked?*, EAST ASIA F. (Oct. 23, 2015), <http://www.eastasiaforum.org/2015/10/23/has-japans-corporate-governance-reform-worked/> [<https://perma.cc/5CUL-Z4Z9>].

be derailed by allowing management to continue to mismanage the corporate sector.

Japan provides an illustrious archetype example of the benefits produced by activism. Japan, once the second mightiest economy in the world, slipped to third place within a short time span and runs the risk of falling to fourth place.²¹² This was at least partially caused by a governance system that disrespected shareholder value.²¹³ Japanese economic problems have proven intractable²¹⁴ and poor governance is acknowledged as a proximate cause.²¹⁵ Despite the enormous wealth and its reign for years as the world's second largest economy, poor corporate governance did not protect Japan from sliding badly.

I used to call Japan a trust-fund baby,” said Jesper Koll, former head of research at JPMorgan Chase & Co. and adviser to Japan’s government. “A trust fund baby can have a C-average because there are no consequences from being lazy. Now Japan is a kid from the Bronx on a scholarship. It’s called survival.”²¹⁶

²¹² See Slawotsky, *supra* note 18, at 17.

²¹³ *Id.* at 18.

²¹⁴ Christopher Whalen, *Is Japan’s Economy Headed for Collapse?*, NAT’L INT. (Sept. 6, 2014), <http://nationalinterest.org/feature/japans-economy-headed-collapse-11217> [<https://perma.cc/PE5J-NSEH>] (“Japan . . . has become known as one of the worst-managed economies in the world. The lost decade of the 1980s has extended into lost decades, with subpar economic growth and a declining population among the list of accomplishments.”).

²¹⁵ Lucy P. Marcus, *Positive Changes in Corporate Governance*, GULF TIMES (Aug. 30, 2015, 11:29 PM), <http://www.gulf-times.com/opinion/189/details/453138/positive-changes-in-corporate-governance> [<https://perma.cc/GN38-9869>] (“Prime Minister Shinzo Abe has emphasised that good corporate governance is critical to long-term economic growth and prosperity.”).

²¹⁶ Dave McCombs & Jason Clenfield, *Japan Inc.’s \$104 Billion Investor Payout Set to Surge*, BLOOMBERG (May 28, 2015, 2:29 AM), <http://www.bloomberg.com/news/articles/2015-05-27/japan-inc-s-104-billion-investor-payout-set-to-surge> [<http://perma.cc/U8CD-NFC2>].

Recently, forced by global competition and the need for capital, Japan seems more inclined to gravitate somewhat towards a U.S. style shareholder value-centric governance.²¹⁷ “Japan’s companies, long known for stinginess with shareholders, doled out record amounts of cash to investors in the last year. It’s just the start of the payouts.”²¹⁸ Japanese Prime Minister Shinzō Abe’s efforts to shift Japan towards a U.S. model of governance is a recognition that Japan’s corporations need to be shaken up.²¹⁹ The Prime Minister has conceded the link between governance and Japan’s lackluster economy.²²⁰ Finding itself in need of capital, corporate Japan has become more shareholder-value oriented.²²¹ According to one analyst, “[t]here is a noticeable attention to shareholder value and corporate governance in recent results meetings”²²²

Prime Minister Shinzo Abe is prodding companies to become more responsive to shareholders. Abe advisers worked with the Tokyo Stock Exchange to develop the JPX-Nikkei Index 400, also known as the Shame Index to get companies focused on investors and profitability. Now companies from Mitsubishi Corp. to Hoya Corp. are raising dividends and announcing billions of dollars worth of share buybacks. Others including Hitachi

²¹⁷ *Id.*

²¹⁸ *Id.*

²¹⁹ *Id.* (“This newfound affection for shareholders is born out of necessity, not sudden generosity.”).

²²⁰ See Slawotsky, *supra* note 18, at 18 (“Japan’s disdain for shareholder profits may be a proximate cause of the astonishingly poor performance of Japan’s overall economy and equity market.”).

²²¹ See McCombs & Clenfield, *supra* note 216 (“Prime Minister Shinzo Abe is prodding companies to become more responsive to shareholders. Abe advisers worked with the Tokyo Stock Exchange to develop the JPX-Nikkei Index 400, also known as the Shame Index to get companies focused on investors and profitability.”).

²²² *Id.* (quoting David Rubenstein, an analyst at Shared Research Inc. in Tokyo).

Ltd. have adopted performance-based pay for executives and bellwethers such as Sony Corp. are setting targets for return on equity, a measure that tends to rise with dividends and buybacks.²²³

Following many years of failure, activists have begun making incipient inroads in Japan.²²⁴ “In an example that would have been inconceivable in years past, the secretive robot-maker Fanuc Corp. was prodded by American activist Daniel Loeb into doubling the percentage of profit it would return to shareholders.”²²⁵ As in the United States, the successful strategy of activism has caused other investors in Japan to join in.²²⁶

Japan provides an exemplar of a governance structure in which the interests of outside shareholders have been trumped by most others and a strategy of activism is difficult to execute.²²⁷ Whether Japan will embrace robust activism which offers a potential solution to Japanese corporate mismanagement and malaise is unknown.

²²³ *Id.*

²²⁴ *Id.*

²²⁵ *Id.*

²²⁶ *Id.* (“Loeb’s success with Fanuc may be a sign foreign activists will finally find success in Japan after decades of failure. In the early 1990s . . . T. Boone Pickens said he was giving up on Japan after losing a battle to gain a board seat at . . . Koito Manufacturing Co. . . . Now activists are likely to be drawn by Loeb’s example—and the record amounts of cash on Japanese balance sheets.”).

²²⁷ See Slawotsky, *supra* note 18, at 12 (“Japanese corporate governance has been characterized by shareholder meetings that are ritualistic and devoid of meaningful discussion of the company’s affairs, a reluctance to employ outside directors and an affinity towards the employment of former government regulators as directors upon retirement from governmental service, great deference to senior managers, and a reluctance to criticize other affiliated companies.”). Commentators emphasize that “[w]hile many of these practices have been reduced, their existence remains and continues to impact corporate Japan.” *Id.* “One manifestation of failed governance is the extremely poor performance of Japan’s equity markets. Already into its third decade of dramatic under performance, the Japanese equity markets have been a dismal performer, particularly in comparison to other large economies.” *Id.* at 16.

In Italy, where concentrated ownership is common, scholars have noted that activists have had mixed results.²²⁸ While many continental European nations have the concentrated system whereby insiders, banks, or families own large percentages of shares, thus “controlling” the company, hedge funds have commenced their activity.²²⁹

For example, activists have demanded the break-up of Dutch financial institution ABN AMRO, pressured the Italian oil company ENI to restructure its operations, launched a proxy fight against the management of French multinational Atos, and succeeded in blocking Deutsche Boerse’s attempts to take over the London Stock Exchange and oust its CEO.²³⁰

Activists are likely to continue their efforts in non-U.S. nations.²³¹ Hedge fund success in these jurisdictions will depend on

²²⁸ See Massimo Belcredi & Luca Enriques, *Institutional Investor Activism in a Context of Concentrated Ownership and High Private Benefits of Control: The Case of Italy 3* (Eur. Corp. Governance Inst., Working Paper No. 225/2013, 2014), <http://ssrn.com/abstract=2325421> [<http://perma.cc/QP2B-GY33>] (examining instances where institutional investors “voiced their discontent with regard to strategies and/or specific managerial decisions”); Matteo Erede, *Governing Corporations with Concentrated Ownership Structure: Can Hedge Funds Activism Play Any Role in Italy?* 44-45 (CLEA 2009 Annual Meeting Paper, 2009), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1397562 [<http://perma.cc/QFD7-J2WV>] (“[A]ctivist hedge funds have taken position in Italian stock market and . . . their investments have been steadily increasing . . . [however they] have actually been quite ‘passive’ either by failing to exercise voting rights connected to their positions . . . or by supporting with their votes the controlling shareholder/s.”).

²²⁹ Seretakis, *supra* note 15, at 450-51 n.78 (“The spread of globalization, the liberalization of capital flows, the rise of institutional investors, and regulatory changes have fundamentally transformed corporate structures in Continental Europe.”).

²³⁰ *Id.* at 440-41.

²³¹ Weinmann, *supra* note 182.

the extent the funds can rally other shareholders to their cause.²³² Undoubtedly, fund activism will be resisted in nations where vested interests of controlling or dominant owners or groups of allied companies collide with the interest of shareholder value. Given the lackluster performance of EU economies,²³³ Europe provides another exemplar as to why activism should be encouraged as a monitor of inefficient management.

D. The SEC Position

Implicating the SEC's regulatory powers, shareholder activists could use activism as a cover to abuse a company and its shareholders.²³⁴ To enable companies and regulators to monitor a company's shares and prevent abuse, the SEC relies on certain regulatory disclosure requirements.²³⁵ The primary disclosure mechanism requires that a buyer of shares inform companies and

²³² *Id.* at 439-40 (“Armed with . . . the support of proxy advisory firms and traditional institutional investors such as mutual funds and pension funds, activist hedge funds are increasing their clout inside corporate boardrooms.”).

²³³ See Bill Greiner, *What's Next Europe's Weak Economy Makes US Look Strong*, FORBES (Sept. 11, 2014, 5:27 PM), <http://www.forbes.com/sites/billgreiner/2014/09/11/whats-next-europes-weak-economy-makes-us-growth-look-strong/#2715e4857a0b74bfac065b5> (“Europe's growth has been so poor that it makes the U.S. economic growth engine look outright stellar.”); Mark Weisbrodt, *Why has Europe's Economy Done Worse Than the US*, GUARDIAN (Jan. 16, 2014), <http://www.theguardian.com/commentisfree/2014/jan/16/why-the-european-economy-is-worse> [<https://perma.cc/7TES-3F6Y>] (“If we compare the economic recovery of the United States since the Great Recession with that of Europe—or more specifically the eurozone countries—the differences are striking, and instructive.”).

²³⁴ See Zeke Faux, *Icahn Says BlackRock's Fink Makes Fixing Bad Businesses Harder*, BLOOMBERG (May 3, 2015, 1:12 PM), <http://www.bloomberg.com/news/articles/2015-05-03/icahn-says-blackrock-s-fink-makes-fixing-bad-businesses-harder> [<http://perma.cc/3RCF-ZZQ2>] (“Some of the other investors who call themselves activists are really out to ‘pump and dump’ stocks, Icahn said. They announce their intentions to pressure management . . . then get out as soon as the share price rises.”).

²³⁵ Beneficial Ownership Reporting Requirements and Security-Based Swaps, 76 Fed. Reg. 34,579, 34,581 (June 14, 2011) (codified at 17 C.F.R. pt. 240).

their shareholders when it obtains 5% or more of a company's shares.²³⁶ A Schedule 13D form must be filed within 10 days of exceeding the 5% threshold.²³⁷ These disclosures are monitored closely by the SEC and are the subject of regular enforcement actions.²³⁸

Currently, the SEC is in agreement with activist proponents who argue that disclosure rules should not be tightened.²³⁹ While SEC Chair Mary Jo White has expressed concern over hedge fund conduct that straddles the legal parameters²⁴⁰ and hedge fund conduct that may obfuscate group formation is under investigation,²⁴¹ the SEC has tread the middle path. The SEC does paint all activists with an equal brush, and is disinclined to regulate it with stringency.²⁴² Indeed, the SEC can be said to tacitly endorse activist conduct,²⁴³ Chair White remarking activist tactics "can be compatible with the kind of engagement that I hope companies and shareholders can foster."²⁴⁴

²³⁶ See Securities Exchange Act of 1934, 15 U.S.C. § 78m(d)(2) (2012); 17 C.F.R. § 240.13d-1.

²³⁷ *Id.*

²³⁸ See de la Merced, *supra* note 22 ("The S.E.C. has recognized disclosure as an issue, noting that [] it brought civil charges against several individuals for failing to update regulatory disclosures in a timely manner."); see also Krishnan et al., *supra* note 165, at 5 ("Congress intended that the filing of a Schedule 13D would notify the market that the filer might seek to force changes or gain control at a target company.").

²³⁹ See Lucian A. Bebchuk & Robert J. Jackson, Jr., *The Law and Economics of Blockholder Disclosure*, 2 HARV. BUS. L. REV. 39, 59 (2012) ("[C]urrent evidence on changes in market practices since the passage of the Williams Act provides no basis for tightening [the disclosure] rules.").

²⁴⁰ See Gandel, *supra* note 42 ("It is not my intent to threaten the vibrancy of anyone's practice," White said, adding that she's worked as a private sector lawyer, too. "But I do think it is time to step away from gamesmanship and inflammatory rhetoric that can harm companies and shareholders alike.").

²⁴¹ See Hoffman et al., *supra* note 41 ("The [SEC] is investigating whether some activist investors teamed up to target companies without disclosing their alliances, potentially in violation of federal securities rules . . .").

²⁴² See de la Merced, *supra* note 22 (quoting SEC Chair Mary Jo White).

²⁴³ See Gandel, *supra* note 42 ("White said . . . the SEC wasn't going to take a side on the matter. But White said that activist investment funds now have \$120 billion under management, up 30% from 2014. That's a good sign that at least investors think activism is a good thing.").

²⁴⁴ *Id.*

In contrast, former SEC Chair Mary L. Schapiro noted in 2011 that the SEC envisioned “a broad review of [the] beneficial ownership reporting rules . . . to modernize [those] rules, and [to] consider[] whether they should be changed in light of modern investment strategies and innovative financial products.”²⁴⁵ Yet so far, the SEC has not amended the rules.

U.S. securities laws require parties to reveal any “plans or proposals” concerning certain relevant corporate events (e.g., business combinations or asset divestitures, changes in the board of directors or senior management team, changes in the financial structure, etc.).²⁴⁶ Activist hedge funds benefit greatly by avoiding early detection—a delay in triggering the ownership threshold makes it more difficult for directors to defend the company by, for instance, activating a poison pill.²⁴⁷ Thus, funds are able to acquire enough shares to exert leverage over a company before having to disclose their holdings, subjecting the target company to a blitzkrieg attack. The following section details the reporting requirements.

IV. 13(d) Disclosure

United States federal securities laws obligate investors, including hedge funds, to publicly disclose certain market

²⁴⁵ Mary L. Schapiro, *Remarks at the Transatlantic Corporate Governance Dialogue*, SEC. EXCHANGE. COMMISSION (Dec. 15, 2011), <http://www.sec.gov/news/speech/2011/spch121511mls.htm> [<http://perma.cc/3SEB-ZUN9>].

²⁴⁶ Securities Exchange Act of 1934 § 13(d), 15 U.S.C. § 78m(d)(1)(C) (2012). Any material change to these plans requires prompt filing of an updated amendment to Schedule 13D. § 78m(d)(2) (“If any material change occurs in the facts set forth, and in the statement filed with the Commission, an amendment shall be filed with the Commission, in accordance with such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.”).

²⁴⁷ See Lipton, *supra* note 1 (“SEC rules do not prevent an activist from secretly accumulating a more than 5% position before being required to make public disclosure and do not prevent activists and institutional investors from privately communicating and cooperating.”); see also Liz Hoffman, *Martin Lipton: Poison Pills Are ‘Critical in the Face of Increased Activism,’* WALL ST. J. (Jan. 29, 2014, 12:27 PM), <http://blogs.wsj.com/moneybeat/2014/01/29/martin-lipton-poison-pills-are-critical-in-the-face-of-increased-activism/> [<https://perma.cc/MK4R-VYFQ>].

activities.²⁴⁸ Such regulations include the “Williams Act” filing requirements of section 13(d), which was designed to “close a significant gap in investor protection under the Federal securities laws by requiring the disclosure of pertinent information to stockholders when persons seek to obtain control of a corporation by a cash tender offer or through open market or privately negotiated purchases of securities.”²⁴⁹ Significantly, two or more persons who have agreed to act together are treated as a single purchaser and their several ownership stakes are aggregated.²⁵⁰ Thus, two hedge funds individually owning 2.5% will be obligated to file a disclosure statement if they are working together as a group.²⁵¹ The controlling inquiry in determining whether a group is formed is whether two or more parties acted in concert with the specific “goal of acquiring, holding, voting or disposing of securities.”²⁵² A group may be found even if no formal agreement is created.²⁵³ However, large hedge funds are sophisticated and have prominent counsel advising them.²⁵⁴ Thus, activist funds will likely be careful to avoid the trappings of forming a “group.”²⁵⁵

Full and prompt section 13(d) disclosure is thus an important regulatory mechanism with many benefits²⁵⁶ and constitutes an

²⁴⁸ See 15 U.S.C. § 78m(d) (requiring public disclosure upon ownership of 5% of a public company’s shares).

²⁴⁹ 113 CONG. REC. 854 (1967) (statement of Sen. Williams).

²⁵⁰ 15 U.S.C. § 78m(d)(3) (“When two or more persons act as a partnership, limited partnership, syndicate, or other group for the purpose of acquiring, holding, or disposing of securities of an issuer, such syndicate or group shall be deemed a ‘person’ for the purposes of this subsection.”).

²⁵¹ *Id.*; see also Coffee & Palia, *supra* note 15, at 28 (“[I]f three ‘persons’ each acquire 2% of the stock in a target company and their relationship makes them a ‘group’, their shares are aggregated by Section 13(d), which treats them as a single ‘person’ who must file a Schedule 13D.”).

²⁵² 15 U.S.C. § 78m(d)(3); see also *CSX Corp. v. Children’s Inv. Fund Mgmt. (UK) LLP*, 654 F.3d 276, 284 (2d Cir. 2011) (“[T]wo or more entities do not become a group within the meaning of section 13(d)(3) unless they ‘act as a . . . group for the purpose of acquiring . . . securities of an issuer.’”)

²⁵³ *CSX Corp.*, 654 F.3d at 283-84 (holding that without evidence supporting that members of the alleged group reached an understanding for the specific “purpose of either acquiring, holding, voting or disposing of securities[,]” it will be difficult to prove a group has been formed).

²⁵⁴ Lipton, *supra* note 1.

²⁵⁵ See *id.*

²⁵⁶ See *supra* notes 36-39 and the accompanying text.

important indicator of potential activist behavior.²⁵⁷ Disclosure informs the regulator and the company of who is buying shares and why. The free flow of transparent information serves many additional interests besides from informing company management and market regulators seeking to curb abuse. Potential acquirers or activists who wish to find other like-minded entities will find out about other large stakeholders through section 13(d) filings.²⁵⁸ Disclosure also allows potential buyers to know the extent of available shares versus the amounts held by other 5% holders.²⁵⁹ Naturally, these other entities can also competitively buy more shares to protect their position or even to make a rival bid which enhances ultimate shareholder value. Existing shareholders who contemplated selling may hold-off in the prospect of changes in management or precipitated by activists.

While activist proponents may believe the concerns regarding potential hedge fund abuse are exaggerated, there is no denying of the vast transformation that has raised the potential for abusive conduct in recent years: the staggering amount of available capital to hedge funds, transformative technology such as the internet, global investor collaboration, and the creative use of new products such as derivatives.²⁶⁰ Critics such as Delaware Supreme Court Chief Justice Leo Strine astutely point out the potential for hedge fund manipulation of the current regulatory structure and call for 13(d) reform.²⁶¹

²⁵⁷ See Krishnan et al., *supra* note 165, at 4 (“Congress intended that the filing of a Schedule 13D would notify the market that the filer might seek to force changes or gain control at a target company. . . . 13D filings could be viewed as a proxy for activism, and databases of 13D filings could be used to assess hedge fund activism . . .”). In addition, all institutional investment managers, including hedge fund managers, are subject to the disclosure provisions of section 13(f) of the Securities Exchange Act, which requires quarterly disclosure of major holdings. Section 13(f) filings also helped researchers gather data on activism. 15 U.S.C. § 78m(f); 17 C.F.R. 240.13f-1.

²⁵⁸ See *supra* note 36 and the accompanying text.

²⁵⁹ This exemplifies the concern raised by critics who argue that “sensing prey” other buyers join and start buying forming a “wolf pack” to attack a company.

²⁶⁰ See *supra* Part B (discussing the new institutional activism).

²⁶¹ de la Merced, *supra* note 22 (“No less than Leo E. Strine Jr. . . . argued on a panel in favor of a more sensitive tripwire that involved disclosure within 24 hours.”).

The potential for playing fast and loose with regard to group formation via the creative usage of derivatives, collaboration, and the legal but extortionist-tinged strategy of the “wolf pack” all point to heightened capacity to engage in mischief and abuse.²⁶² For example, what if a hedge fund has a relationship with another fund or with a venture capital firm (or owns a part of such fund) and both parties reach an understanding that the hedge fund will use its considerable influence to persuade a portfolio company to allocate a special class of newly issued shares to the hedge fund or to the venture capital firm? Such an agreement might implicate the question of whether, under section 13(d), the hedge fund and the other fund acted as a “group” for the purposes of the newly issued shares. There are numerous permutations of this potential. The point is that hedge funds can be expected to utilize their status to influence companies to allocate benefits with respect to “acquiring or disposing” of shares and by doing so, section 13(d) concerns are raised.

Furthermore, activist investors are known to inform other investors of their trades—particularly since section 13(d) provides a ten-day window before filing is required.²⁶³ Hedge fund corporate activism is generally waged as a quasi-political campaign—with a media blitz, publicly disclosed letters to management, and press releases even prior to reaching the 5% trigger.²⁶⁴ During this ten-day window activist investors “keep buying . . . so that when [they] actually disclose [they] might have 6 or 7 or 10 or 30 percent of the

²⁶² *Id.*

²⁶³ See Coffee & Palia, *supra* note 15, at 34 (“From a tactical perspective, it is the interest of the ‘wolf pack’ leader to tip such allies, as the larger the percentage of shares held by loosely affiliated hedge funds, the greater the likelihood of victory in any proxy contest brought by the lead hedge fund.”); Levine, *supra* note 33; Theodore N. Mirvis, *Activist Abuses Require SEC Action on Section 13(d) Reporting*, HARV. L. SCH. F. ON CORP. GOVERNANCE AND FIN. REG. (Mar. 31, 2014), <http://corpgov.law.harvard.edu/2014/03/31/activist-abuses-require-sec-action-on-section-13d-reporting/> [<http://perma.cc/KNE3-XK75>] (raising concerns regarding activist funds “tipping” other funds about acquisitions and arguing for a shortened time frame for reporting from ten days to one day).

²⁶⁴ See, e.g., Li Yuan & Christopher Rhoads, *Icahn Bid Adds to Woes Dogging Motorola’s CEO*, WALL ST. J. (Jan. 31, 2007, 12:01 AM), <http://www.wsj.com/articles/SB117016315344092259> [<http://perma.cc/Q3VA-LHXU>] (detailing Carl Icahn’s purchase of a 1.39% stake in Motorola, the accompanying press release, and the purchase’s effect on the market).

stock instead of just the 5 percent” and also tip other activist funds so they can acquire shares as well.²⁶⁵

Although the above actions raise concerns as to the definition of a “group” for purposes of securities laws, the “wolf pack” acts legally—it does not involve agreed upon concerted action or explicit collaboration.²⁶⁶ Upon media disclosure of a leading investor’s stake, other investors are incentivized to climb aboard for the ride.²⁶⁷ The mutual interests of the new holders to support the main activist are clear. By joining the leading hedge fund, the members of the pack increase their combined leverage against the target’s management.²⁶⁸ Activist opponents note that hedge funds are evading the formation of groups while benefitting from concerted action.²⁶⁹ The next section raises a proposal to address the concerns of wolf packs and other abusive conduct.

V. *Disclosure Update Needed*

Activist adherents acknowledge potential abuse by the activist investors.²⁷⁰ Even Carl Icahn admits there are activists who essentially “pump and dump” shares, and therefore do not promote the noble goal of advancing corporate governance.²⁷¹ However, despite the potential for abuse, it would be counterintuitive to believe that activists only do harm. Directors and managers are charged with the duty to monitor companies on behalf of shareholders and to obtain the best value for shareholders.²⁷² Activism can keep a check

²⁶⁵ See Levine, *supra* note 33.

²⁶⁶ See Coffee & Palia, *supra* note 15, at 28.

²⁶⁷ William W. Bratton, *Hedge Funds and Governance Targets*, 95 GEO. L.J. 1375, 1379 (2007) (“When one hedge fund announces a 5% or 10% position in a company, others follow, forming a ‘wolf pack’ that sometimes has the voting power to force management to address its demands.”).

²⁶⁸ *Id.*; see Coffee & Palia, *supra* note 15, at 34.

²⁶⁹ Andrew R. Brownstein & Trevor S. Norwitz, *Shareholder Activism in the M&A Context*, WACHTELL, LIPTON, ROSEN & KATZ LLP (May 15, 2006), <http://online.wsj.com/public/resources/documents/wlrkmemo51506.pdf> [<http://perma.cc/HY3W-XC3H>] (“Many hedge funds move in loosely aligned packs, testing the limits of securities, reporting and antitrust rules by taking advantage of the ambiguity in concepts like ‘groups’ . . .”).

²⁷⁰ See, e.g., Faux, *supra* note 240 (quoting Carl Icahn).

²⁷¹ *Id.*

²⁷² See *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 176, 182 (Del. 1995) (corroborating that shareholder value is the primary driver

on badly-run companies because their efforts enable smaller shareholders to be rescued from manipulative or corrosive management.²⁷³ In a very real sense, activists can be said to replace directors when directors fail to act.²⁷⁴ Indeed, a recent study of 1800 activist engagements in almost two dozen nations found that activism can be virtuous.²⁷⁵ This study concludes that “increases in shareholder value of firms targeted by activists are not simply short-term. Increases in shareholder value due to activism are also tightly linked to activists achieving their goals.”²⁷⁶

It would therefore be incorrect to presume that all corporate governance initiatives by hedge funds are bad or result purely in gain for the fund. To the contrary, activism can play a vital part in the proper corporate governance of companies and discouraging activism can lead to economic malaise. The Japanese example described above is illuminating. While Japan boomed after World War II and grew to become the second largest economy, decades of under-performance caused Japan to slide to the number three position and is close to falling into fourth place.²⁷⁷ It is noteworthy that both Japanese business culture and the governance architecture is hostile to shareholder activism.²⁷⁸ By keeping activists at bay, thus

of U.S. corporate governance); *see also* Jeffrey N. Gordon, *The Rise of Independent Directors in the United States, 1950-2005: Of Shareholder Value and Stock Market Prices*, 59 STAN. L. REV. 1465, 1510-35 (2007) (detailing judicial opinions holding that “shareholder value... [is] the ultimate corporate objective”); Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439, 439 (2001) (“There is no longer any serious competitor to the view that corporate law should principally strive to increase long-term shareholder value.”); David G. Yosifon, *The Law of Corporate Purpose*, 10 BERKELEY BUS. L. J. 181, 183 (2014) (describing the widely accepted idea that corporate boards’ primary obligation to pursue profits for shareholders).

²⁷³ *See* Gilson & Gordon, *supra* note 157, at 864 (discussing the role of activists who “acquire a significant but noncontrolling stake in a corporation and then try to alter the company’s business strategy initially through persuasion but sometimes through a follow-on proxy contest”).

²⁷⁴ *Id.*

²⁷⁵ Becht et al., *supra* note 8.

²⁷⁶ *Id.*

²⁷⁷ *See* Slawotsky, *supra* note 18, at 17 (“By 2001, China had overtaken Japan which fell to third-place.”).

²⁷⁸ In Japan, the outside shareholder is afforded little respect. Japan has been notoriously unfriendly to activists as their stakeholder model is not shareholder value-centric. *See* Kana Inagaki, *Japan Is Hostile to Activist*

empowering company managers and inside directors to continue to mismanage their companies, Japan may have delayed an economic turn-around. Japan provides a sterling exemplar of why shareholder activism should not be banned, curtailed, or unduly discouraged.

Therefore, only a modest amendment to the regulatory regime is necessary to balance the need for heightened scrutiny while allowing activists to engage in vigorous activism thereby holding management accountable. The regulatory update should focus on the potential for abuse, but hedge funds should not be overly deterred as they can play an important role in corporate governance.

In light of potential manipulation and abuses, the reporting requirements under section 13(d) of the Securities Exchange Act should be modified. Section 13(d) is intended to provide an early detection mechanism for companies to learn about and prepare for an imminent tender offer or other change of control tactic.²⁷⁹ A reduced trigger percentage is warranted. The percentage should be lowered to 2.5%. Such change will enable a more robust and effective monitoring of activists. Yet it will not discourage legitimate activists who seek to redress governance problems.²⁸⁰ This would not be the first time the threshold is amended.²⁸¹ Moreover, since a section 13(d) filer must update the disclosure when there is a material change in ownership stake—and that is considered a one percent increase—the lower threshold will allow for more expeditious reporting and

Investors, WALL ST. J. (May 14, 2013, 12:47 PM), <http://www.wsj.com/articles/SB10001424127887324216004578482943175923954> [<http://perma.cc/VAM5-82NC>] (“Big Japanese investors have generally circled the wagons to protect companies—with which they often had deep shareholding and business ties—from intervention by outsiders.”); *see also* McCombs & Clenfield, *supra* note 218 (“T. Boone Pickens said he was giving up on Japan after losing a battle to gain a board seat at auto-parts maker Koito Manufacturing Co. Steel Partners Chairman Warren Lichtenstein ultimately abandoned his takeover bid for beer-maker Sapporo Holdings Inc. in 2007.”).

²⁷⁹ *See* Beneficial Ownership Reporting Requirements and Security-Based Swaps, 76 Fed. Reg. 34,579, 34,581 (June 14, 2011) (codified at 17 C.F.R. pt. 240).

²⁸⁰ An incentive to activists is the ability to accumulate shares before other investors bid the price up thus securing for the initial buyer a hefty profit. If the percentage is too low, the ability to purchase shares before public disclosure and the associated market price rise would remove this incentive.

²⁸¹ Pub. L. No. 91-567, 84 Stat. 1497 (1970) (codified at 15 U.S.C. § 78m) (lowering the threshold from 10% to 5%).

monitoring.²⁸² Thus, the lower initial trigger will alert investors, management, and regulators more efficiently since the trigger will be reached much sooner. However, it will not block or unduly disincentivize legitimate shareholder activism.

By allowing hedge funds to act in an activist fashion, we enable these funds to serve as important disciplinarians of management and directors with tangible benefits to shareholders.²⁸³ For example, activist funds employ their influence to ensure lackluster managers take necessary action such as amending the governance structure, adding directors, restructuring the capital base, or selling a division or the company outright.²⁸⁴

The deadline for reporting under section 13(d) should not be altered.²⁸⁵ The current rule is vital to providing a significant return on invested capital to activists.²⁸⁶ While an expedited time frame has been suggested, this change will greatly reduce the ability to acquire shares without notification and will only cause frenzy upon the disclosure, which pushes the share price up,²⁸⁷ since section 13(d)

²⁸² Securities Exchange Act of 1934 § 13(d)(2), 15 U.S.C. § 78m(d)(2) (2012) (“If any material change occurs in the facts set forth in the statement filed with the Commission, an amendment shall be filed with the Commission”); 17 C.F.R. § 240.13d-2 (2015) (“An acquisition or disposition of beneficial ownership of securities in an amount equal to one percent or more of the class of securities shall be deemed ‘material’ for purposes of this section.”).

²⁸³ See Becht et al., *supra* note 8, at 6 (“[W]e show that activists are successful in creating shareholder value even in scenarios that do not involve a takeover, such as restructurings and changes to payout policy.”).

²⁸⁴ *Id.*

²⁸⁵ Securities Exchange Act of 1934 § 13(d), 15 U.S.C. § 78m(d)(1) (requiring a person acquiring more than 5% of equity securities to file a Schedule 13D within ten days after the acquisition).

²⁸⁶ Alon Brav et al., *Hedge Fund Activism, Corporate Governance, and Firm Performance*, 63 J. FIN. 1729, 1730 (2008) (“The filing of a Schedule 13D revealing an activist fund's investment in a target firm results in large positive average abnormal returns”); Coffee & Palia, *supra* note 15, at 32 (“Empirically, it is important to understand that most of the stock price appreciation and most of the high trading volume that surrounds the ‘wolf pack’s’ formation occurs just before the filing of the Schedule 13D during the ten-day window permitted by Section 13(d).”); Klein & Zur, *supra* note 27, at 188 (examining confrontational activist interventions in the United States and documenting returns reaching 10.2% around a 13D filing).

²⁸⁷ Klein & Zur, *supra* note 27, at 188.

filings often presage higher than normal share performance.²⁸⁸ A shorter time frame can also remove much of the incentive that activists count on²⁸⁹ since the potential gains are largely controlled by the activist's agility to become a large shareholder without attracting undue attention, activist activity may be sharply curtailed by a shorter filing window.²⁹⁰ Amending the rules as some have suggested to include derivatives for the purpose of ascertaining the trigger percentage will also serve as a sharp deterrence to activists.²⁹¹

VI. Conclusion

United States corporate governance and the business landscape is being profoundly influenced by activist hedge funds.²⁹² Activism and its emphasis on short-term profits has engendered a vigorous debate in the United States and beyond. Proponents and opponents have legitimate arguments.²⁹³ On one hand, activists may be overly focused on immediate profit.²⁹⁴ Moreover, activists can legally avoid reporting requirements because of innovative products and wolf-pack tactics.²⁹⁵ Yet these funds also provide a strong

²⁸⁸ Brav et al., *supra* note 287, at 1730.

²⁸⁹ *Id.*

²⁹⁰ See Gilson & Gordon, *supra* note 157, at 904 (“[T]hehold acquisitions are the major source of the activist's return; these regulatory initiatives would reduce the returns to activism.”).

²⁹¹ See Seretakis, *supra* note 15, at 464 n.163 (“Once disclosure of the activist's economic stake is made, the share price will spike, reflecting the expected value of the intervention. Counting equity derivatives towards the disclosure threshold reduces the returns of the activist by reducing its economic stake.”).

²⁹² See, e.g., David A. Katz, *Shareholder Activism in the M&A Context*, HARV. L. SCH. F. ON CORP. GOVERNANCE AND FIN. REG. (Mar. 27, 2014), <http://corpgov.law.harvard.edu/2014/03/27/shareholder-activism-in-the-ma-context/> [<http://perma.cc/4T2A-QGQJ>] (discussing the importance of activism in corporate mergers and acquisitions).

²⁹³ See *supra* Part III.A-III.B.

²⁹⁴ See Goldhaber, *supra* note 16 (“Lipton blames ‘short-termist’ hedge funds for America's economic stagnation and inequality since the financial crisis.”).

²⁹⁵ See Coffee & Palia, *supra* note 15, at 28 (Wolf pack “mean[s] a loose network of activist investors that act in a parallel fashion, but deliberately avoid forming a ‘group’ under Section 13(d)(3)”); de la Merced, *supra* note 22 (“Several activist investors have used derivatives to quickly build their

incentive for directors to oversee their companies and for managers to embrace shareholder value.²⁹⁶ In commenting on BlackRock's Chairman and CEO Lawrence Fink's anti-activist letter, Carl Icahn noted that "Fink is protecting underperforming executives with his campaign against activist investors."²⁹⁷ "You can't get rid of these guys," Icahn said "A lot of them feel like they can do what they want, because of guys like Larry Fink."²⁹⁸

The example of the Japanese system of corporate governance is illustrative.²⁹⁹ The almost insurmountable challenges to activists operating in Japan may be a strong factor contributing to Japan's lost decades.³⁰⁰ The ability of activists to engage in activism in United States markets may be a tonic preventing the malaise caused by inefficient managers.

Legitimate concerns abound regarding the nature of disclosure and reporting. The Williams Act—enacted in 1968—was created to provide notice to the stakeholders of a publicly traded company.³⁰¹ Yet the era and economic context in which the reporting requirements came into force is now defunct.³⁰² Investors, including hedge funds, are empowered on a scale unimaginable in 1968.³⁰³ The immense assets under hedge fund deployment is staggering. Moreover, technology has enabled instantaneous communication and facilitates a broad potential of cooperation on an international

positions without setting off the securities law requirements, to the consternation of many.").

²⁹⁶ Yaron Nili, *Shareholder Activism: An Engagement Opportunity*, HARV. L. SCH. F. ON CORP. GOVERNANCE AND FIN. REG. (Apr. 10, 2015), <http://corpgov.law.harvard.edu/2015/04/10/shareholder-activism-an-engagement-opportunity/> [<http://perma.cc/5YWE-V939>] ("The recent surge in shareholder activism continues to keep boards on alert heading into the 2015 proxy season.").

²⁹⁷ Faux, *supra* note 240.

²⁹⁸ *Id.*

²⁹⁹ *See supra* Part III.C.

³⁰⁰ *See* Inagaki, *supra* note 279 ("As a historical rule, hostile actions against Japanese corporate managements do not have a track record of success, certainly not by financial investors." (quoting David Baran, co-chief executive at Tokyo fund Symphony Financial Partners Co. and a veteran investor in Japan)).

³⁰¹ *See supra* notes 30-35 and the accompanying text.

³⁰² *See supra* note 15 and the accompanying text.

³⁰³ *See supra* Part II (discussing hedge funds' activism).

scale.³⁰⁴ The section 13(d) reporting requirements served their purpose, but our globalized world where technology and the financial markets fuse requires an updating of these requirements.

It is important to be cognizant of the fact that activism does have a role to play in corporate America. Similar to plaintiffs' counsel and their large lawsuits against manufacturers of dangerous products such as asbestos, Vioxx, and other corporate misconduct where large compensatory and/or punitive damages were imposed, corporate management can be held accountable by activists.³⁰⁵ Without the risk of losing their positions, managers, particularly in dispersed ownership jurisdictions such as the United States, can be expected to engage in various conduct conducive to their own financial self-interest.³⁰⁶ Activists have a vital role to play in preventing or stopping such practices within a company. While detractors of U.S. hedge fund activism argue that activism focuses on short-term profits at the expense of other stakeholders,³⁰⁷ the claims that activism destroys shareholder value have not been proven. Legitimate activism needs to be encouraged and incentivized rather than banned or limited.

This article's proposal seeks to balance the competing interests of the corporate governance divide by lowering the reporting trigger to 2.5%. While a 5% holding was reasonable in 1970, the world has significantly changed over the last fifty years. The 1970s were not a time of extensive activism and hedge funds were not in existence. No one would have predicted the tectonic changes that have occurred, such as extensive globalization and financial market innovation. It is incontrovertible that financial products unavailable fifty years ago present challenges regarding a

³⁰⁴ *See id.*

³⁰⁵ *See* Joel Slawotsky, *Liability for Defective Chinese Products Under the Alien Tort Claims Act*, 7 WASH. UNIV. GLOBAL STUD. L. REV. 519, 537 (2008) (discussing product liability laws in American legal tradition).

³⁰⁶ SHANE GOODWIN, CORPORATE GOVERNANCE AND HEDGE FUND ACTIVISM 24 (2015), <http://www.valuwalk.com/wp-content/uploads/2015/08/SSRN-id2646293.pdf> [<http://perma.cc/FQ49-Z2E9>] (“[C]ontrol of the corporation is placed in the hands of professional managers who have little or no ownership interest. As a result, there is the fear that managers may be acting in their own self-interest instead of in the interests of the corporation.”).

³⁰⁷ *See* Goldhaber, *supra* note 16.

5% threshold provided by section 13(d).³⁰⁸ The 5% rule was set in an age where a single party would be the acquirer. Today, there are usually two if not more “persons” purchasing shares,³⁰⁹ and therefore a 2.5% rule makes sense. The proposal attempts to strike a balance between legitimate concerns over abuse and the need to permit unobstructed activism.

³⁰⁸ See de la Merced, *supra* note 22 (“Several activist investors have used derivatives to quickly build their positions without setting off the securities law requirements, to the consternation of many.”).

³⁰⁹ Coffee & Palia, *supra* note 15, at 28.