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The Virtues of Shareholder Value Driven Activism: Avoiding Governance Pitfalls

Joel Slawotsky*

I. INTRODUCTION

The United States shareholder-value-centric corporate governance architecture obligates corporate management to harness the business to maximize financial returns to the owners — the shareholders — even at the expense of other non-shareholder interests.¹ In contrast to the United States model, the interests of shareholders are not the exclusive driver of managerial conduct in stakeholder governance systems. Under the stakeholder model, a variety of other interests are considered such as employees, suppliers, environmental, social and other interests.² The stakeholder regime is prevalent in both the European Union³ and Asia.⁴ Several nations such as the U.K. and Australia — historically shareholder-value jurisdictions — have apparently embraced an “enlightened

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1. See, e.g., *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986) (finding director misconduct in failing to seek highest price available for shareholders).

2. See YADONG LUO, GLOBAL DIMENSIONS OF CORPORATE GOVERNANCE 37 (2007) (noting the stakeholder model emphasizes various non-shareholder interests depending upon the particular cultural norms of that nation). For example, the Norwegian sovereign wealth fund takes social responsibility into account when making activist investment decisions such as divestment. See also ROGER BLANPAIN ET AL., RETHINKING CORPORATE GOVERNANCE: FROM SHAREHOLDER VALUE TO STAKEHOLDER VALUE 121 (2011) (Norway has a stakeholder model of governance as opposed to a shareholder model).

3. See LUO, *supra* note 2, at 41–48 (describing continental European nations as being primarily stakeholder value driven); see also Franklin Allen et al., *Stakeholder Governance, Competition and Firm Value* 1, (CESifo Group, Working Paper No. 4652, 2014) (“Germany is by no means the only country where the interests of parties other than just shareholders have bearing on companies’ policies. Employees are represented — directly or indirectly — in companies’ boards in several other countries such as Austria, the Netherlands, Denmark, Sweden, Luxembourg and France.”) (internal citations omitted).

4. Allen et al., *supra* note 3, at 1–2 (“Similar arrangements are present in China, where firms are explicitly required to bear in mind their social responsibilities in conducting their business operations. In Japan social norms have similar effects in that it is widely accepted that stakeholder interests, and in particular employee interests, play a predominant role.”) (internal citations omitted).

shareholder value” model⁵ which seeks to promote other stakeholder values, mitigating the otherwise exclusive focus on profits and shareholder returns.⁶ Some political⁷ and business⁸ leaders have advocated a similar model for the United States, referring to it as “sustainable capitalism.”⁹

In the United States, the supreme importance of shareholder value has fostered a cultural encouragement of activism which has been in practice since at least the 1930s.¹⁰ The activist strategy gained traction in the late 1970s¹¹ and rose to prominence in the 1980s, as financial legends such as Carl Icahn¹² and T. Boone Pickens engaged in various corporate take-over

5. See Andrew Keay, *The Duty to Promote the Success of the Company: Is It Fit for Purpose in a Post-Financial World?*, in DIRECTORS' DUTIES AND SHAREHOLDER LITIGATION IN THE WAKE OF THE FINANCIAL CRISIS 50–97 (Joan Loughrey ed., 2013); see also Ruth V. Aguilera et al., *Corporate Governance and Social Responsibility: A Comparative Analysis of the U.K. and the U.S.*, in CORP. GOVERNANCE: AN INT'L REV. 147 (Praveen Kumar & Alessandro Zattoni eds., 2006).

6. See Sarah Kiarie, *At Crossroads: Shareholder Value, Stakeholder Value and Enlightened Shareholder Value: Which Road Should the United Kingdom Take?* 17(11) INT'L CO. AND COM. L. REV. 329, 339 (2006).

7. See Joel Slawotsky, *Sustainable Capitalism: Revelations from the Japanese Model*, 63 HASTINGS L.J. VOIR DIRE 10 (2012) (“Critics of America’s shareholder-centric model allege that it is archaic and a failure, and they believe that the American version of capitalism must undergo a dramatic shift toward a stakeholder-based model emulating other nations President Obama recently echoed the ‘sustainable capitalism’ theme by calling for major changes that would enhance the interests of other stakeholders in order to construct an economy ‘built to last.’”).

8. See James Surowiecki, *A Fair Day’s Wage*, NEW YORKER (Feb. 9, 2015), <http://www.newyorker.com/magazine/2015/02/09/fair-days-wage> (noting CEO Mark Bertolini’s comments on Aetna’s substantial pay raise for its lowest-paid workers: “Companies are not just money-making machines. For the good of the social order, these are the kinds of investments we [corporations] should be willing to make.”).

9. Slawotsky, *supra* note 7, at 10; see also Al Gore & David Blood, *A Manifesto for Sustainable Capitalism*, WALL ST. J., Dec. 14, 2011, at A21 (“Before the crisis and since, we and others have called for a more responsible form of capitalism, what we call sustainable capitalism: a framework that seeks to maximize long-term economic value by reforming markets to address real needs while integrating environmental, social and governance (ESG) metrics throughout the decision-making process.”); Margaret Talev et al., *Hillary Clinton, Bernie Sanders Clash Over Reining In Wall Street*, BLOOMBERG POLITICS (Oct. 13, 2015, 7:57 PM), <http://www.bloomberg.com/politics/articles/2015-10-13/debate-in-vegas-will-hillary-clinton-give-her-competitors-an-opening> (Clinton’s comments about “reigning in capitalism”). However, shareholder value focused corporate governance has served the United States well and should not be changed. Slawotsky, *supra* note 7, at 11 (pointing out that U.S. economic performance is dramatically superior to the stakeholder value model of Japan and noting that the stakeholder system also has corporate scandals).

10. See John Armour and Brian Cheffins, *Offensive Shareholder Activism in U.S. Public Companies, 1900–49* (U. of Cambridge Fac. of L. Legal Stud. Res. Paper Series, Paper No. 09/2011, 2011) (“Our findings indicate that offensive shareholder activism, while not commonplace, did occur and was considerably more prevalent in the 1930s and 1940s than in earlier decades.”).

11. *Id.* at 1 (“Carl Icahn, 1980s corporate raider and currently operator of Trian Partners, a major activist hedge fund, spelled out his business philosophy in a late 1970s memo to prospective investors in Icahn’s initial investment partnership: ‘It is our contention that sizeable profits can be earned by taking large positions in “undervalued” stocks then attempting to control the destinies of the companies in question by: a) trying to convince management to liquidate or sell the company to a “white knight”; b) waging a proxy contest; c) making a tender offer and/or; selling back our position to the company.’”).

12. Carl Icahn remains active. See Ben McLannahan, *AIG Cuts Costs to Deflect Ichan Pressure*,

battles.¹³ Numerous corporate takeover disputes with large corporations¹⁴ spawned major litigation and substantially impacted American corporate law.¹⁵

Shareholder activism is no longer the domain of individual rogue entrepreneurs and “cowboy-capitalists,”¹⁶ but rather an increasingly popular strategy employed since the 1990s in the United States that is substantially influencing a variety of large corporations.¹⁷ In recent years, activism’s growth has been striking.¹⁸ “Since 2006, almost one in every six corporations in the Standard and Poor’s 1500 index has been the target of activist campaigns.”¹⁹ Activism has become increasingly acceptable²⁰ and

FINANCIAL TIMES (Nov. 3, 2015, 3:25 PM), <http://www.ft.com/cms/s/0/3b7981ae-81b7-11e5-a01c-8650859a4767.html#axzz3qQaj2rdG> (“Last week the New York-based insurer came under attack from Carl Icahn, the activist investor, who accused management of dawdling over cost cuts and delivering consistently subpar returns. Mr. Icahn, who has pressed for changes at companies from Apple to Hertz, argued that AIG should immediately split into three since it was ‘too big to succeed’ in its current form, which subjects it to heavy supervision from regulators and constraints on returning capital to shareholders.”).

13. Barbara Kiviat, *10 Questions for Carl Icahn*, TIME (Feb. 15, 2007), <http://content.time.com/time/magazine/article/0,9171,1590446,00.html> (“It has been a busy few weeks for Carl Icahn, the billionaire financier who gained fame — some would say notoriety — in the 1980s by taking over Trans World Airlines (“TWA”) and agitating for change at the likes of Texaco and RJR Nabisco.”).

14. Corporate raiders such as Carl Icahn, Nelson Peltz, and T. Boone Pickens gained notoriety during their heyday in the 1980s by acquiring controlling stakes in undervalued companies, and by aggressively using a combination of power and debt finance to force companies to break up and to replace boards of directors. 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>.

15. Numerous seminal judicial decisions were ultimately delivered as a result of litigation undertaken by activist shareholders or defensive measures undertaken by corporate boards to block activists. See, e.g., *Ivanhoe Partners v. Newmont Mining Corp.*, 535 A.2d 1334 (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); *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (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); *Revlon, Inc.*, 506 A.2d at 173 (finding director misconduct in failing to seek highest price available for shareholders).

16. See Benoit, *supra* note 14 (“The industry has come a long way since the 1980s, when Carl Icahn, Saul Steinberg, T. Boone Pickens and other mavericks would amass large stakes in companies and demand a sale of the entire company. They were called ‘corporate raiders’ and ‘greenmailers’ and were widely criticized. These days activists, while not exactly welcomed in corporate boardrooms, are rarely treated as ill-mannered outsiders.”).

17. Robert C. Pozen, *Institutional Investors: The Reluctant Activists*, HARV. BUS. REV. (Jan.–Feb. 1994), <https://hbr.org/1994/01/institutional-investors-the-reluctant-activists> (noting the nascent rise of institutional activism in the 1990s).

18. *Capitalism’s Unlikely Heroes*, ECONOMIST (Feb. 7, 2015), <http://www.economist.com/news/leaders/21642169-why-activist-investors-are-good-public-company-capitalisms-unlikely-heroes> (noting the “unprecedented” extent of activism).

19. Sharon Hannes, *Brave New World: A Proposal for Institutional Investors*, 16.1 THEORETICAL INQUIRIES L. 245, 258–59 (2015).

20. Benoit, *supra* note 14 (“Activists were a different breed back in the late 1970s and 1980s. They made ‘midnight raids’ on stocks, building large, often controlling, stakes. Then they pushed companies to sell themselves to the highest bidder or to the raider himself, or to buy back their positions at above-market prices, a practice known as greenmail.”).

has “hardened into the default boardroom agenda.”²¹

A diverse array of American businesses are being affected by activists.²² Major brand name, blue-chip companies have been the frequent targets of activists choreographing board coups and successfully pushing for corporate break-ups.

Since 2011, activists have helped depose the CEOs of Procter & Gamble and Microsoft and have fought for the breakup of Motorola, eBay and Yahoo. On January 27th, [2016], Yahoo said it would spin off its stake in Alibaba, a Chinese internet firm, after pressure from the activist Starboard Value. Activists have won board seats at PepsiCo, orchestrated a huge round of consolidation across the pharmaceutical industry, and taken on Dow Chemicals and DuPont.²³

As the tactic has become mainstream, a rising chorus of critics have urged a crackdown on activism. This is hardly surprising as activism intersects with the current corporate governance debate over “shareholder value” versus “sustainable capitalism”²⁴ and touches upon the fiduciary duties of directors to monitor and correct poor management. Delaware Supreme Court Chief Justice Leo Strine argues that shareholder activism must be more stringently regulated by tightening the time frame for disclosing a holding of five percent of a company’s shares.²⁵ Several U.S.

21. Dennis K. Berman, *Activists Wept for There Were No More Worlds to Conquer*, WALL ST. J. (Apr. 23, 2014, 2:23 PM), <http://www.wsj.com/articles/SB10001424052702304049904579517743601484598>.

22. *Capitalism’s Unlikely Heroes*, *supra* note 18 (“Americans encounter firms that activists have targeted when they brush their teeth (Procter & Gamble), answer their phone (Apple), log in to their computer (Microsoft, Yahoo and eBay), dine out (Burger King and PepsiCo) and watch television (Netflix). In December an activist fund called Trian broke new ground by winning a board seat at Bank of New York Mellon, custodian for many of the world’s biggest banks.”).

23. *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>.

24. *See* Renée B. Adams et al., *Board Members’ Values and the Shareholder-Stakeholder Dilemma* 3 (European Corp. Governance Inst. — Fin. Res. Paper Series No.204/2008, 2008) (“Few issues in the fields of strategy and corporate governance remain as contested as the topic of shareholders and stakeholders has been for so long.”); *see also* Slawotsky, *supra* note 7 (noting the recent calls for transforming the United States shareholder value governance regime to one that places stakeholders’ interest higher up); *see also* Benoit, *supra* note 14 (“The debate about whether activism is good for U.S. companies over the long term hasn’t gone away, most recently popping up in the presidential campaign of Hillary Clinton. She has decried ‘hit-and-run’ activists, while also saying some activists help hold managers accountable.”).

25. Delaware Supreme Court Chief Justice Leo Strine has called for amending the ten-day disclosure filing requirement of five-percent holders to one day. *See* Michael J. de la Merced, *infra* note 81; *see also* Joel Slawotsky, *Hedge Fund Activism in an Age of Global Collaboration and*

Senators have recently introduced legislation to tighten the reporting obligation from ten days to two days.²⁶ Others have noted that the employment of financially engineered products such as derivatives can be used to avoid detection, constituting an abusive tactic, and should therefore be treated as owned shares.²⁷ Some critics opine that hedge funds should be prosecuted for some of their activities.²⁸ Politicians, corporations, business interests and scholars have joined the criticism of shareholder activism.²⁹

In response, proponents of activism and smaller shareholders argue that in a corporate governance model devoid of activism, managerial misconduct and/or incompetence will often drive the operation of the company to the detriment of the business and the shareholders. Without activists overseeing the company, advancement of self-interest, operational mismanagement, director failure to monitor, poor corporate governance and other damage to the company and its shareholders would remain unaddressed.³⁰ Supporters also note that activists will gravitate towards

Financial Innovation, 35 REV. BANKING FIN. L. 272 (forthcoming 2016) (providing a detailed discussion of whether 13(d) should be amended).

26. Claire Groden, *These Senators Want to Reign in Activist Investors*, FORTUNE (Mar. 18, 2016, 3:04 PM), <http://fortune.com/2016/03/18/democrats-shareholder-activism/> (proposed bill to reduce the five-percent disclosure obligation from ten to two days). See also Letter from Wachtell et al., Partners at Wachtell, Lipton, Rosen & Katz, to Elizabeth M. Murphy, Sec'y, SEC (Mar. 7, 2011, 8:46 PM), <https://www.sec.gov/rules/petitions/2011/petn4-624.pdf> (arguing that the time period should be reduced to one day).

27. The U.S. securities laws mandate disclosure of an individual's five-percent holding, but if a group exists, each several holding is aggregated. Under the securities laws, if several members of a group jointly own five percent of the shares a disclosure is required. Concerns have been expressed with respect to funds who have formed an alliance but endeavor to avoid the trappings of group formation thus evading the disclosure requirement. See 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>.

28. 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/#65ade6c04447>.

29. See, e.g., Groden, *supra* note 26 ("We cannot allow our economy to be hijacked by a small group of investors who seek only to enrich themselves at the expense of workers, taxpayers and communities," Sen. Baldwin said in a statement. "These reforms will help ensure that no other small towns in America will fall victim to activist hedge funds on Wall Street."); Alexis Leondis & Miles Weiss, *U.S. Chamber Forms Coalition to Fend Off Activist Hedge Funds*, BLOOMBERG BUSINESS (July 2, 2015, 12:17 PM), <http://www.bloomberg.com/news/articles/2015-07-02/u-s-chamber-forms-coalition-to-fend-off-activist-hedge-funds> ("Corporations are turning to the nation's biggest business lobby to help fend off activist investors such as Dan Loeb and Bill Ackman. The U.S. Chamber of Commerce is forming a coalition to make sure 'long-term value creation' drives public companies' decisions, according to a letter it sent Thursday to Securities and Exchange Commission Chair Mary Jo White. The group plans to weigh in on regulations that affect corporate governance, the letter said.")

30. Katherine Rushton, *Carl Icahn Attacks Companies That Protect 'Unfit' Chief Executives*, TELEGRAPH (Aug. 12, 2014), <http://www.telegraph.co.uk/finance/globalbusiness/11029776/Carl-Icahn-attacks-companies-that-protect-unfit-chief-executives.html> (quoting Carl Icahn: "Too many companies in this country are terribly run and there's no system in place to hold the chief executives and boards of these inadequately managed companies accountable Our current system of corporate governance protects mediocre chief executives and boards that are mismanaging companies and this must be

badly managed companies and that, without such activists, smaller shareholders are powerless to remedy a poor management situation.³¹ Defenders of activism note that activists improve the operation of a business. For example, activist hedge fund Starboard Value acquired control of Darden and pressured the directors to improve the business and company operating performance by actually working in the restaurants.

After Starboard Value took over the board of Darden Restaurants Inc., the hedge fund wanted its newly minted directors to have a feel for the business. So it put them to work. 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.³²

Clearly, there is a good type of activism. Lacking a major activist investor, lackluster managerial performance will likely remain.

Do the benefits of shareholder activism outweigh the risks? Examining the issue in the context of corporate governance offers an excellent vehicle to determine whether activism is virtuous or deleterious. Activist detractors point out that short-termism, mass layoffs, terminated CEOs, and financially induced mergers are harmful to "stakeholders" such as the community, employees, or society. However, under the shareholder-value centric model, if the share price rises and dividends distributed, the shareholders are enriched. Pursuant to the shareholder-value model, operating the company towards the goal of shareholder profit is proper and activism is in sync with shareholder value. Therefore, pursuant to the shareholder-value model, activism should be encouraged as long as shareholders benefit, even if such gains are at the expense of other stakeholders.

In contrast, a governance regime encompassing stakeholder value may not encourage activism if other stakeholders of a corporation are disadvantaged by activists. Under the stakeholder model, directors and officers must also, to varying degrees, consider the interests of employees, creditors, the environmental impact, and the community when making

changed.").

31. See, e.g., April Klein & Emanuel Zur, *Entrepreneurial Shareholder Activism: Hedge Funds and Other Private Investors*, 64 J. FIN. 187, 222–25 (arguing that activist conduct supports better governance).

32. Craig Giammona, *Olive Garden's Hedge Fund Bosses Waited Tables to Aid Turnaround*, BLOOMBERG BUSINESS (June 1, 2015, 7:04 PM), <http://www.bloomberg.com/news/articles/2015-06-01/olive-garden-s-hedge-fund-bosses-waited-tables-to-aid-turnaround>.

business decisions. Some governance systems, such as Japan's, may in fact deter shareholder activism through a governance architecture which prevents accumulation of adequate number of shares, and a business culture wherein loyalty and fidelity among insider-shareholder and management trumps outside shareholder interests.³³

Activism encourages superior corporate governance and productive use of company resources. Shareholder activists have the power and assets to correct and improve company performance. The Singapore Stock Exchange CEO noted that activism encourages superior governance and has called on large investors to become activists. In fact "[t]he Singapore Exchange (SGX) has called for greater shareholder activism from institutional investors in Singapore. It said this is *because institutional investors have the clout and resources to improve governance in the companies they invest in.*"³⁴

As will be discussed below, Japan's economy has lost two decades. The difficulty of engaging in activism may in fact be a contributing cause of Japan's economic problems because poorly managed Japanese corporations were allowed to escape the consequences of bad management. The lack of vigorous activism may have perpetuated the under-performance of Japan's economy. Thus, shareholder activism should be encouraged as a virtuous tool of superior corporate governance. This Article opines that encouraging shareholder activism and therefore shareholder value, comports with superior governance and economic performance, and thus concludes that shareholder activism should not be discouraged or unduly restrained. This Article proceeds as follows. Part II discusses the historical context and current controversy over activism in the United States. Part III reviews the arguments set forth by detractors and supporters of activism. Part IV examines the major corporate governance models employed. Part V analyzes whether activism is virtuous, noting the link between a jurisdiction that ranks low on corporate governance/economic performance and a lack of activism.

33. The Keiretsu groups, wherein allied loyal companies own shares in each other and place loyalty and allegiance above the interests of the outside shareholders, is a manifestation of this governance architecture. The business culture also fosters a disdain for the outside shareholders.

34. See Linette Lim, *More Shareholder Activism from Institutional Investors: SGX*, CHANNEL NEWSASIA (Nov. 24, 2015, 5:24 PM), <http://www.channelnewsasia.com/news/business/singapore/more-shareholder-activism/2289042.html> (emphasis added).

II. ACTIVIST INVESTING IN THE UNITED STATES

“Corporate America and activist investors have had a war; the activists have won.”³⁵ Activist investing in the United States, once the primary domain of financial entrepreneurs and renegade traders, is now a mainstream strategic investment tactic wielded by government pensions, private institutions, hedge and other large funds.³⁶ Activists have enjoyed substantial success³⁷ and the time required prior to obtaining profitable results is shrinking, thus further incentivizing activism.³⁸

Shareholder activists present a wide array of demands. Examples include:

Activist . . . campaigns against public company targets by taking large stock positions and then publicly agitating for changes, such as stock repurchases, extraordinary dividends, dispositions of non-core businesses or an outright sale of the company. There is often an implicit or explicit threat of a proxy contest to remove some or all of the target board members and management if their demands are not met. 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.³⁹

35. See *Carl Icahn: The Blogger*, FIN. TIMES (Oct. 25, 2013), <http://app.ft.com/cms/s/67fa6b88-3d91-11e3-9928-00144feab7de.html>.

36. See, e.g., Randall Smith, *Some Big Public Pension Funds Are Behaving Like Activist Investors*, N.Y. TIMES (Nov. 28, 2013), <http://dealbook.nytimes.com/2013/11/28/some-big-public-pension-funds-are-behaving-like-activist-investors/> (noting the growing activism practiced by established and “flagship” institutions). Sovereign wealth funds are also investing in hedge funds. See also *Sovereign Wealth Fund Investors in Hedge Funds*, PREQIN (June 2015), <https://www.preqin.com/docs/newsletters/hf/Preqin-HFSL-June-15-Sovereign-Wealth-Fund-Investors-in-Hedge.pdf> (noting the increasing practice of sovereign wealth fund investments in hedge funds).

37. Paula Schaap, *Dow, DuPont, Yahoo — Activist Shareholders Hit a Trifecta*, BLOOMBERG BUSINESS (Dec 9, 2015, 1:28 PM), <http://www.bloomberg.com/news/articles/2015-12-09/dow-dupont-yahoo-activist-shareholders-hit-a-trifecta> (“What’s more, activists were successful about 74 percent of the time last year in getting companies to make at least some of the changes they requested, according to the report, compiled for an October conference hosted by Schulte Roth & Zabel, a law firm that often works for activists.”).

38. *Id.* (“Activists have had a strong year generally in getting their way. Companies have settled within 56 days on average after an activist demands board representation, compared with 67 days last year and 74 days in 2013, data from Activist Insight show.”).

39. Mark D. Gerstein, *Hushmail: Are Activist Hedge Funds Breaking Bad?*, HARV. L. F. ON CORP. GOVERNANCE & FIN. REG. (July 7, 2014), <https://corpgov.law.harvard.edu/2014/07/07/hushmail-are-activist-hedge-funds-breaking-bad/#more-64293>.

Activist investing is a popular tactic⁴⁰ and activist investors have a variety of available strategies. At times, activists take stakes with the intent (or hope) of forcing a “white knight” to save the company by entering the fray and making a generous offer.⁴¹ Sometimes, activists take stakes in order to break up the company because they believe the company’s parts are worth more than the whole.⁴² The “greenmail” strategy — 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.⁴³ “Hushmail” is the practice of the activists withdrawing their corporate governance concerns in return for the company buying their shares.⁴⁴ At times, activists attempt to influence a corporation to issue dividends.⁴⁵

Activist investing in American equity markets is not new,⁴⁶ but surged to prominence in the 1980s.⁴⁷ The activist investor of the 1980s in the

40. See, e.g., Abram Brown, *Icahn Wants a Seat for Himself on Dell’s Board; Activists Unveil Proposed Directors*, FORBES (May 14, 2013, 8:43 AM), <http://www.forbes.com/sites/abrambrown/2013/05/14/icahn-wants-a-seat-for-himself-on-dells-board-activists-unveil-proposed-directors/#73013f186a18>; Ian Sherr & David Benoit, *Icahn Pushes Apple on Buyback*, WALL ST. J. (Aug. 13, 2013, 8:02 PM), <http://www.wsj.com/articles/SB10001424127887324085304579010971386703480>.

41. 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-watsas-blackberry-bid-may-not-be-the-last-one/#119a2a9316ca>.

42. Mark Scott, *Activist Investor Seeks Breakup of UBS*, N.Y. TIMES (May 2, 2013, 7:18 AM), <http://dealbook.nytimes.com/2013/05/02/activist-investor-seeks-breakup-of-ubs/>.

43. See Michael Parrish, *Occidental Ends Lawsuits Over Cost of Buyout: Settlement: Oxy Will Pay \$3.65 Million to Shareholders Who Objected to the Price David Murdock Got for His Shares in 1984*, L.A. TIMES (Mar. 21, 1992), http://articles.latimes.com/1992-03-21/business/fi-4044_1_david-murdock. The practice of greenmail has been reduced due to regulations imposed to discourage it, but the line between greenmail and hushmail is often not clear. See Stephen Bainbridge, *The Return of Greenmail: Private Rent-Seeking by Activist Shareholders*, PROFESSORBAINBRIDGE.COM (June 12, 2014), <http://www.professorbainbridge.com/professorbainbridge.com/2014/06/the-return-of-greenmail-private-rent-seeking-by-activist-shareholders.html> (“More companies are resorting to an old tactic to get rid of activist investors: Pay them to go away. The practice, which involves buying back shares from activist hedge funds, has raised concerns among some investors because it bears similarities to “greenmail,” a controversial strategy popular in the 1980s The practice differs from greenmail in two crucial aspects. The share buybacks aren’t at a premium to the market but typically at or slightly below the last trading price. They also don’t follow threats of hostile takeovers.”).

44. See Gerstein, *supra* note 39 (describing the phenomenon of “hush money” being paid to activist investors who no longer want to own the company’s shares and sell the shares back to the company at a slight premium or discount to avoid dumping the shares and incurring losses. Following the transaction “the activist may enter into a standstill and non-disparagement agreement with the target.”).

45. Elisabeth Behrmann & Yuriy Humber, *Transocean Reaches \$1.1 Billion Dividend Accord with Icahn*, BLOOMBERG BUSINESS (Nov. 11, 2013, 3:20 PM), <http://www.bloomberg.com/news/articles/2013-11-11/transocean-reaches-accord-with-icahn-on-dividend-plan-and-board>.

46. 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).

47. 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).

American markets was likely a sole investor or a financial entrepreneur⁴⁸ whose stated goal was to shake up a corporation and unlock shareholder value.⁴⁹ In fact,

[p]rivate financiers were the archetype activist investors in the 1980s and 1990s, and large institutions did not generally participate in activist investing (although 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).⁵⁰

Activist investing has enjoyed a robust resurgence in recent years⁵¹ and has become a respected and accepted investment strategy.⁵² Significantly, while once considered "aggressive,"⁵³ the tactic has become respectable with "mainstream" institutional funds and hedge funds together wielding immense financial firepower.⁵⁴ "Funds managed by activists

48. See *An Investor Calls*, *supra* note 23 ("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. Over the years he has attacked Cadbury, Pepsi and Kraft.").

49. See *An Investor Calls*, *supra* note 23 ("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 immortalised in the film *Wall Street*, whose charismatic criminal, Gordon Gekko, showed his mettle by treating greed as good and lunch as for wimps. They faded from prominence after a series of scandals and the collapse of the junk-bond market in the late 1980s.").

50. See ESG Report, *Towards Sustainable Investment: Taking Responsibility* (2012), <https://www.calpers.ca.gov/docs/forms-publications/esg-report-2012.pdf> (describing CalPERS' efforts at sustainable investing including climate change, environmental and labor); see generally *Why TIAA-CREF?*, TIAA, <https://www.tiaa.org/public/sri-funds-why-tiaa-cref-for-responsible-investing> (last visited Mar. 3, 2016) (providing a timeline of TIAA-CREF's history of responsible investing).

51. See also Benoit, *supra* note 14 ("Several factors contributed to this shift, according to corporate executives, activists, bankers and lawyers. 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. And broad shifts in corporate governance gave more power to all shareholders, including activists.").

52. David Bogoslaw, *Icahn's New Megaphone for Shareholder Activism*, CORP. SECRETARY (Oct. 25, 2013), <http://www.corporatesecretary.com/articles/proxy-voting-shareholder-actions/12567/icaohns-new-megaphone-shareholder-activism/> (describing the increasing popularity of shareholder activism).

53. Benoit, *supra* note 14 ("After decades of being treated as boorish gate-crashers, activist investors are infiltrating the boardrooms of large companies like never before.").

54. See *Capitalism's Unlikely Heroes*, *supra* note 18 ("Another is that today's activists belie the scavenging stereotype of the 1980s. They often seek to improve firms' boards rather than strip companies of assets. They work with other shareholders, frequently winning the support of big money-managers such as Capital Group and Fidelity. They are raising longer-term capital and so stretching their investment horizons. ValueAct, based in San Francisco, locks in its investors for three to four

climbed to \$129.7 billion as of mid-2015, almost doubling from the \$65.5 billion they had to play with in 2012, data from HFR show.”⁵⁵ It has been noted that:

Activist investors like Carl C. Icahn, Daniel S. Loeb and William A. Ackman are getting deep pocketed imitators. Some 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.⁵⁶

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

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 advocating specific business strategies.⁵⁷

Part of the explosive growth in activism is due to the substantial success of, and the immense profits available from, activism.⁵⁸ “Activist hedge funds have outperformed their non-activist peers and market indices, generating a 19.4% compound annual growth rate since 2009, as compared to 7.5% for all hedge funds and 12.3% for S&P 500 companies.”⁵⁹ Marcel Kahan and Edward Rock argue:

years and has served on the boards of 37 firms, including Microsoft. Mr Ackman has raised a pile of ‘permanent capital.’”)

55. Schaap, *supra* note 37.

56. Smith, *supra* note 36.

57. Bill George & Jay W. Lorsch, *How to Outsmart Activist Investors*, HARV. BUS. REV. (May 2014), <http://hbr.org/2014/05/how-to-outsmart-activist-investors/ar/1>.

58. Klein & Zur, *supra* note 31 (estimating that approximately seventy percent of the time activists were successful in obtaining a board seat).

59. Hannes, *supra* note 19, at 259.

It is uncontested that activism has played a crucial role in shaping corporate governance. 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.⁶⁰

Since activists often target the large influential corporations, activists have significant power.

In the space of twenty-four hours, DuPont Co. and Dow Chemical Co. — two symbols of U.S. industrial might — and Yahoo! Inc. — a star of the early Internet age — each set in motion a change in course after coming under pressure from activists. *The events were the latest and most dramatic evidence of the increasing power of these shareholders to influence managements of storied American corporations.*⁶¹

As activism's influence on corporate America has become evident, the resulting controversy has increased. Moreover, many activists are brash and aggressive in their pursuit of corporate change contributing to the passionate discourse.⁶² The next section discusses the debate over activism.

60. Marcel Kahan & Edward B. Rock, *Hedge Funds in Corporate Governance and Corporate Control*, 155 U. PA. L. REV. 1021, 1024 (2007).

61. Schaap, *supra* note 37 (emphasis added).

62. See *Capitalism's Unlikely Heroes*, *supra* note 18 ("Their rowdiness seems calculated to distract managers, good or bad. One prominent activist, Carl Icahn, likes to call chief executives 'morons' and tease them on Twitter. Another, Bill Ackman of Pershing Square, has compared Herbalife, a firm he says is a fraud, to the Nazis. When Dan Loeb went for Sotheby's, its then chairman branded him a 'scumbag.' Some have used dubious tactics, including building positions by stealth with derivatives.").

III. THE CONTROVERSY OVER ACTIVISM

A. OPPONENTS OF ACTIVISM

There are differing viewpoints with respect to the questions raised by shareholder activism. Detractors claim activism is damaging and should be curtailed arguing that the obsession with short term profits is a negative for companies⁶³ and that activists exploit weakness for their personal enrichment.⁶⁴ Moreover, the targets of activists often claim that company directors are distracted by the activism and are obligated to defend their companies and forced to spend large sums of money and time defending the corporate bastion.⁶⁵ As one commentator noted, 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. “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.”⁶⁶

BlackRock⁶⁷ CEO Larry Fink has come out against activism stating that “[i]t is critical, however, 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,” in addition to the fact that “they tend to first come up with ideas to enhance the value of an investment in the company, then buy shares with the objective of getting their ideas implemented.”⁶⁸

63. See Michael D. Goldhaber, *Marty Lipton's War on Hedge Fund Activists*, AM. LAW. (Mar. 30, 2015), <http://www.americanlawyer.com/id=1202721058301/Marty-Liptons-War-on-Hedge-Fund-Activists?slreturn=20150330052138>.

64. See *Capitalism's Unlikely Heroes*, *supra* note 18 (“A disgrace, say some; the cult of short-term shareholder value gone mad. Activists have a reputation for stripping cash and assets and loading firms with debt.”).

65. This claim of needing to defend against a change of control is the topic of seminal rulings by the Delaware Supreme Court which uses “an enhanced scrutiny” test in evaluating measures taken to thwart activists. The test seeks to balance the potential that directors and management seek to entrench themselves rather than “lose out” to an activist with the need to allow shareholders to reap profits. See, e.g., *Unocal Corp.*, 493 A.2d at 946.

66. Danielle Beurteaux, *The Return of the Puppet Masters*, ABSOLUTE RETURN + ALPHA (Dec. 9, 2010), <http://www.absolutereturn-alpha.com/Article/2728117/Search/The-return-of-the-puppet-masters.html?Keywords=puppet+masters>.

67. The world’s largest single asset manager with nearly \$5 trillion. BLACKROCK, <http://www.blackrock.com> (last visited Feb. 23, 2016). However, even BlackRock has taken an incipient step towards becoming activist. See Steven Davidoff Solomon, *An Activism-Shy BlackRock Throws a Surprise Punch*, N.Y. TIMES (Apr. 5, 2016), http://www.nytimes.com/2016/04/06/business/dealbook/an-activism-shy-blackrock-throws-a-surprise-punch.html?_r=0 (“BlackRock, the enormous American asset manager with over \$4.6 trillion of assets under management, has waged its first significant activist campaign around the G-Resources Group, a Hong Kong company that owned a gold mine. It may be Hong Kong, and it may be only one campaign, but companies should be fearful.”).

68. Ronald Barusch, *Dealpolitik: BlackRock Letter Delivers Subtle Warning to Corporate*

To activist opponents, activism focuses solely on or excessively on short term results and is thus damaging to the economy of the United States and its equity markets.⁶⁹ Referring to activists as “disastrous” and “vultures,” critics allege that activists destroy shareholder value, are bad for America, and are engaged in essentially illegal activity enabled by prior regulatory laxity and error.⁷⁰

Opponents of activist funds point to a growing body of studies suggesting that the benefits of activism may be exaggerated.⁷¹ Indeed, commentators point to several negative influences of activism.

Although financial activism may return immediate wealth to some shareholders through the sale of assets, payment of special dividends or share buybacks, evidence is mounting that this may be at the expense of the longer term corporate and societal interests. For example, a July 2014 paper by Yuan Allaire and Francois Dauphin, “Activist” Hedge Funds: Creators of Lasting Wealth? (available

Managers, WALL ST. J.: MONEYBEAT (Apr. 17, 2015, 5:38 PM), <http://blogs.wsj.com/moneybeat/2015/04/17/dealpolitik-blackrock-letter-delivers-subtle-warning-to-corporate-managers/?mod=MarketsMain>.

69. 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), <http://www.forbes.com/sites/robertlenzner/2014/03/30/activist-hedge-fund-corporate-meddlers-take-it-in-the-chops-from-the-high-and-mighty/#250095db13e8> (noting 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.”).

70. See Denning, *supra* note 28 (“Activist Hedge Funds Are Vultures, Not Saviors Thus activist hedge funds ferociously pursue ‘the dumbest idea in the world,’ namely, maximizing shareholder value as reflected in the current stock price. Their activities lead to all disastrous consequences of that noxious theory. Ironically, pursuit of shareholder value as reflected in the current stock price actually destroys real shareholder value [T]he regulatory ‘safe harbor’ of 1982 that protects firms and activist hedge funds from prosecution for massive share buybacks amounting to stock price manipulation should be removed.”).

71. See, e.g., Martin Lipton, *The Threat to Shareholders and the Economy from Activist Hedge Funds*, HARV. L. F. ON CORP. GOVERNANCE & FIN. REG. (Jan. 14, 2015), <http://corpgov.law.harvard.edu/2015/01/14/the-threat-to-shareholders-and-the-economy-from-activist-hedge-funds/> (referencing an empirical study conducted by Dr. Yvan Allaire, which concluded:

- Hedge fund activists are not really that great at finance or strategy or operations, as some seem to believe (and as they relentlessly promote);
- Their recipes are shop-worn and predictable, and (almost) never include any growth initiatives;
- Their success mostly comes from the sale of the targeted firm (or from “spin-offs”); their performance otherwise barely matches the performance of the S&P 500 and that of a random sample of firms;
- The strong support they receive from institutional investors is rather surprising and quite unfortunate;

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.).

atwww.igopp.org), concludes that “the most generous conclusion one may reach” is that activist funds “create some short-term wealth for some shareholders” because investors tend to jump into the stock of targeted companies upon the announcement of activist activity. “In a minority of cases, activist hedge funds may bring some lasting value for shareholders but largely at the expense of workers and bond holders; thus the impact of activist hedge funds appears to take the form of wealth transfer rather than wealth creation.” The research further notes that hedge funds tend to be focused on the short term, with half of interventions not lasting nine months. In addition, a growing number of commentators, including senior representatives of some institutional investors, have expressed concern about the impact of hedge fund activism, and associated increased debt and cuts in capital spending, on long-term corporate health, innovation, job creation and GDP growth.⁷²

Martin Lipton has been vociferous in his critique of activists⁷³ and blames activism for a variety of problems:

Much of what is wrong with America today — slow growth, widespread corporate scandals, inadequate investment in long-term projects, low wages that have not kept pace with inflation, wide swings in the economy accompanied by uncertain employment and rising inequality — is attributable to short-termism and attacks, and threats of attacks, by activist hedge funds.⁷⁴

Lipton built his legal practice on defending companies from takeovers⁷⁵ and has drawn strong support from scholars who believe that activist funds do in fact cause damage.

Scholars ranging from Columbia Law School’s John Coffee Jr. to Yvan Allaire of the Institute for Governance of Private

72. See Holly J. Gregory, *The State of Corporate Governance for 2015*, HARV. L. F. ON CORP. GOVERNANCE & FIN. REG. (Jan. 30, 2015), <http://corpgov.law.harvard.edu/2015/01/30/the-state-of-corporate-governance-for-2015/>.

73. See Goldhaber, *supra* note 63.

74. See Benoit, *supra* note 14.

75. *Id.* But see Andrew Schwartz, *Corporate Legacy*, 5 HARV. BUS. L. REV. 237, 268 (2015) (“Contemporary notions of good governance have led almost all existing public companies to shed takeover defenses.”).

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 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.⁷⁶

According to detractors of activist investing, “the 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.”⁷⁷ Opponents also cite to studies that allege long-term value is hurt by activists.

The ability of shareholders, especially activist hedge funds, to determine changes in corporate policies or firm control in the short-term complicates both managerial-decision making and the extent to which other stakeholders want to invest in their relationship with the firm. . . . In both cases, the result is a reduction in long-term firm value. By enhancing shareholders’ ability to pressure directors and managers, hedge fund activism could thus exacerbate the shareholders’ limited commitment problem rather than acting as a beneficial corrective to managerial moral hazard.⁷⁸

These studies conclude that activist benefits are outweighed by negative consequences and while activism addresses legitimate governance issues, other alternatives might work better. In fact the studies

. . . have significant implications for the current corporate governance debate, as they challenge the desirability of an indiscriminate expansion of shareholder rights. While we recognize that managerial moral hazard or having entrenched managers and directors are concrete risks in corporate governance, our research suggests that facilitating the

76. Benoit, *supra* note 14.

77. Martin Lipton, *Current Thoughts About Activism*, HARV. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Aug. 9, 2013, 9:15 AM), <http://blogs.law.harvard.edu/corpgov/2013/08/09/current-thoughts-about-activism/#more-50945>.

78. See Martijn Cremers et al., *Hedge Fund Activism and Long-Term Firm Value*, 4 (Nov 19, 2015), <http://ssrn.com/abstract=2693231>.

interventions of activist hedge funds might be an undesirable solution to address these risks. Indeed, once one takes into account the full range of informational problems faced by shareholders — including both managerial moral hazard (or entrenchment) and the shareholder limited commitment problem — hedge fund activism may carry costs that seem to outweigh its potential benefits. This also suggests that a desirable direction for future empirical research would be to investigate whether alternative corporate governance solutions exist that may better address the trade-offs posed by the multiple informational problems that imbue the shareholder-manager relationship.⁷⁹

Activist opponents also note that “[a]ctivist hedge funds have recently exploited loopholes in existing U.S. Securities and Exchange Commission (“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.”⁸⁰ The Chief Justice of the Delaware Supreme Court, Leo Strine, has also weighed in with a similar cautionary view of activists arguing that there is a vital need for more timely and comprehensive information regarding activist investments particularly when the activists seek to alter business strategies. Echoing Lipton’s time delay criticisms, Justice Strine agrees with Lipton and has noted that he believes the delay in immediately reporting the five percent holding is problematic stating that Section 13(d) will need to be amended in response to “current technological and market developments.”⁸¹ Justice Strine has recently been joined by several U.S. Senators also advocating for a more stringent disclosure requirement.⁸²

79. Cremers et. al., *supra* note 78. See also Bill George, *Dow-DuPont Raises Even More Concerns America Is Abandoning Corporate Research*, FORTUNE (Dec. 12, 2015, 1:47 PM), <http://fortune.com/2015/12/12/dow-dupont-corporate-research-america/> (“In the struggle between research to fuel growth and cutbacks for short-term gains, financial engineers have the upper hand today. While these financial machinations are pleasing short-term traders, the loser will be America’s superior research machine. As a consequence, the U.S. could lose its global edge in research and badly damage its innovative spirit.”).

80. Lipton, *supra* note 77.

81. Michael J. de la Merced, *S.E.C. Chief Sees Virtue in Activist Investors*, N.Y. TIMES (Mar. 19, 2015), <http://www.nytimes.com/2015/03/20/business/dealbook/sec-chief-sees-virtue-in-activist-investor-s.html> (“No less than Leo E. Strine Jr., the chief justice of Delaware’s Supreme Court — wearing a jaunty trilby hat at the conference this year — argued on a panel in favor of a more sensitive tripwire that involved disclosure within 24 hours.”). For a discussion of hedge funds and 13(d) disclosure, see Slawotsky, *supra* note 25.

82. 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) (arguing that holders should “update[e] their filing within twenty-four to forty-eight hours if their ownership interest

B. SUPPORTERS OF ACTIVISM

Proponents of activist investing disagree with the above-cited criticisms and argue that companies are positively influenced by shareholder activism.

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.⁸³

Lucian Bebchuk has written extensively about his research indicating that hedge fund activism is beneficial, with no accompanying evidence that activist funds bring adverse consequences either to their companies or to the economy.⁸⁴

Activism has in fact been extolled as highly beneficial, serving as a counter-balance to managerial entrenchment. Carl Icahn argues as follows:

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 directors may be protected even if they are ineffective.⁸⁵

Activists point to examples when activism positively exerted influence the company and rescued the shareholders from ineffective management. “One example . . . is railroad Canadian Pacific Railway, which languished for years under an inattentive management team base of investors. Only after Pershing Square's Bill Ackman got involved, were necessary operational and managerial changes made, to the benefit of long-term

changes by one percent in any direction, long or short.”); Groden, *supra* note 26 (proposed bill to reduce the five percent disclosure obligation from ten to two days). See also Letter from Wachtell et al., *supra* note 26 (arguing that the time period should be reduced to one day).

83. See 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).

84. See Lucian A. Bebchuk et al., *The Long-Term Effects of Hedge Fund Activism*, 115 COLUM. L. REV. 1085 (2015).

85. Rushton, *supra* note 30 (quoting Carl Icahn).

holders.”⁸⁶

Studies have indicated that activism does in fact support enhanced corporate functioning. The results of these studies,

. . . suggest that hedge fund activism during the periods studied generated significantly higher abnormal stock returns during the window surrounding the announcement of activism than a control sample of passive block holders. This evidence further suggests that hedge fund activists achieved measurable success, at least in terms of traditional metrics of financial performance such as Tobin’s Q and stock price changes, and that these gains were not reversed over the longer term. Indeed, Bebchuk, Brav and Jiang (2013) finds that hedge fund activism through 2007 was followed by improved operating performance during the five years after intervention.⁸⁷

Moreover, activists help level the playing field with respect to management agency conflicts. By leveraging the smaller holders to a powerful activist, the minority shareholders are empowered.⁸⁸ There is support for the notion that activists have improved the financial outcomes of smaller holders and have indeed enhanced overall shareholder value.

As shareholders of target companies, hedge funds have actively opposed several proposed acquisitions and have often succeeded in improving the terms of the transaction. 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

86. Antoine Gara, *Activist Hedge Funds Aren’t the Reason Capitalism is Coming Up Short*, FORBES (Apr. 17, 2015, 1:59 PM), <http://www.forbes.com/sites/antoinegara/2015/04/17/activist-hedge-funds-arent-the-reason-capitalism-is-coming-up-short/>.

87. C.N.V Krishnan et al., *The Second Wave of Hedge Fund Activism: The Importance of Reputation, Clout, and Expertise* (Dec. 8, 2015) (Vanderbilt Law and Econ. Research Paper No. 15-9), <http://ssrn.com/abstract=2589992>.

88. 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 and other shareholders and the management agency problem has been substantially reduced).

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%.⁸⁹

While activist opponents, such as Lipton, are big believers in corporate takeover defense, some have found that takeover defenses are positively correlated to companies with lower shareholder value.⁹⁰ The fact that poison pills exist, it is argued, makes activism an important counterbalance to the power of management to deter legitimate change.⁹¹

Significantly, activists are often supported by mainstream institutional holders. "The hedge funds have done 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."⁹² Accordingly, activists act as potential leaders emboldening smaller and otherwise passive shareholders to more effectively monitor, and if needed, correct corporate mismanagement. The next section will discuss the debate in the context of the global corporate governance divide.

IV. THE ISSUE OF ACTIVISM IN THE GLOBAL CORPORATE GOVERNANCE CONTEXT

Corporate governance is acknowledged as a vital factor in creating superior economic performance⁹³ and nations are endeavoring to improve governance.

89. Kahan & Rock, *supra* note 60, at 1037.

90. 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 (2005); Lucian A. Bebchuk et al., *Staggered Boards and The Wealth of Shareholders: Evidence From Two Natural Experiments* (Nat'l Bureau of Econ. Res., Working Paper No. 17127, 2011), <http://www.nber.org/papers/w17127.pdf> (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 (2009) (staggered boards and poison pills linked to lower firm value).

91. *Capitalism's Unlikely Heroes*, *supra* note 18 ("One reason is that plenty of companies suffer from rotten management. About a tenth of big American firms, and even more smaller ones, still employ tactics like 'poison pills' and staggered boards that shelter incompetent managers.").

92. Louise Armistead, *Saved by the Growing Power of Hedge Funds*, SUNDAY TIMES (Mar. 13, 2005), <http://www.thesundaytimes.co.uk/sto/business/article103547.ece>.

93. See Asli Demirgüç-Kunt & Ross Levine, *Finance, Financial Sector Policies, and Long-Run Growth* (The World Bank, Policy Research Working Paper 4469, Jan. 2008), <https://openknowledge.worldbank.org/bitstream/handle/10986/6443/wps4469.pdf?sequence=1>.

Around the world, the corporate governance landscape is shifting, as efforts to improve business practices and policies gain support and momentum. The wave of reform has become visible everywhere — from tough new regulations in Japan to sovereign wealth funds like Norway’s Norges Bank Investment Management taking a more active approach to their investments — and it is certain to continue rising.⁹⁴

There are various factors which are converging to incentivize nations to improve their competitive edge through superior governance.

Three factors are driving these developments. First, today’s deep economic uncertainty has broadened ordinary people’s awareness of the influence that companies have on politics, policy, and their own daily lives. And, as I have noted previously, people are not only paying greater attention; they also have more power than ever before to make their voices heard. Second, there has been a burgeoning awareness among governments that economic growth requires a proactive regulatory approach. The third, and perhaps most important, factor underpinning recent changes in corporate governance has been the sharp rise in cross-border investing.⁹⁵

Is activism a virtuous component of improving a nation’s corporate governance? A review of the various governance models is useful in examining the question. Management agency conflicts such as shirking, looting and positional⁹⁶ are commonly found in jurisdictions with generally widely dispersed shareholder bases (such as in the United States).⁹⁷ In

94. 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>.

95. *Id.*

96. See Zohar Goshen & Richard Squire, *Hedge-Fund Activism: Principle Costs, Agency Costs, and Governance Structures* 15 (2014) (unpublished manuscript) (on file with the Northwestern Law Soshnick Colloquium on Law and Economics), http://www.law.northwestern.edu/research-faculty/collouquium/law-economics/documents/2014_Goshen_Hedge_Fund.pdf.

97. This makes sense as smaller owners do not have the incentive or the time to pursue changes in a company. A large owner has the monetary incentive to do so. To monitor and pursue legal action is costly and of course by virtue of its large number of votes has influence in the company with respect to removing and electing directors 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. OF POL. ECON. 461, 461 (1986); Andrei Shleifer & Robert Vishny, *A Survey of Corporate Governance*, 52 J. OF FIN. 737, 753–54 (1997).

dispersed ownership jurisdictions, small individual owners have no influence on the company and managers have little or no concern for these owners.⁹⁸ In jurisdictions such as Japan, while there is concentrated ownership, it is generally among allied companies, the outside individual shareholders are dispersed and hold relatively few shares. In the absence of a substantial shareholder, controlling owners, together with managers and directors, are free to engage in self-serving strategy to the detriment of the outside shareholders and the company. In the absence of the sword of disciplinary action over their heads, directors and managers are emboldened to treat the company's resources as their own personal assets. The following sub-sections describe the contrasting models of corporate governance.

A. SHAREHOLDER-VALUE MODEL

United States corporate governance serves as the quintessential exemplar of the shareholder-value model. United States corporate governance is concerned with the fiduciary relationship between management (directors, officers, and senior managers) and the shareholders in the context of conflicts of interest. These divergent interests tend to manifest themselves in three sometimes overlapping ways known as management agency conflicts. One tension is the shirking conflict where managers opt to concentrate on activities that will personally enrich themselves rather than focus on corporate profits.⁹⁹ The second conflict is looting where the managers procure for themselves salaries and benefits not commensurate with their work contribution to the company or the results of the company.¹⁰⁰ The third is positional where the managers seek to entrench themselves by ensuring that they cannot easily be replaced.¹⁰¹

Illustrations of these conflicts can be gleaned from the case of Simon-World-Wide, a publicly traded company in the United States, wherein a major shareholder alleged that the directors and officers were engaged in all three conflicts vis-à-vis the company and its shareholders. In a regulatory filing, a major shareholder sent a letter to the company's directors outlining the conflicts of interest between the company's

98. See *supra* note 97 and accompanying text.

99. See Melvin Aron Eisenberg, *The Structure of Corporation Law*, 89 COL. L. REV. 1461, 1471 (1989) ("All agents have a potential interest in working at a slack pace and in avoiding the effort and discomfort involved in adapting to changed circumstances, such as the emergence of new technologies.").

100. *Id.* ("All agents have a potential interest in diverting the principal's assets to their own use.").

101. *Id.* at 1472. ("[T]op corporate managers have the power to give expression to still a third potential divergence of interest: an interest in maintaining and enhancing their positions even at the shareholders' expense.").

managers, directors, and the shareholders.¹⁰² The letter alleged that the directors: (1) had failed to hold a shareholders' meeting for four years (positional conflicts), (2) were being paid exorbitant salaries in light of the business's failure to earn any income (looting conflicts), and (3) were in fact not even working at their offices (shirking conflicts).¹⁰³

United States corporate governance is focused on addressing and deterring these conflicts. Lawsuits are frequently filed in American courts alleging that a company's managers were engaged in one or more of these conflicts which conflict with the shareholder-value mantra of United States corporate governance.¹⁰⁴ Delaware courts have adopted standards for evaluating director conduct alleged to be tainted by these conflicts of interest between management and shareholders.¹⁰⁵

Pursuant to the shareholder-value approach, shareholders — as owners of the business — are entitled to have the business run solely for the benefit of the shareholders.¹⁰⁶ Under the shareholder-centric model, the directors are obligated to conduct the affairs of a company with the objective of profit maximization for the shareholders.¹⁰⁷ The rationale in the shareholder-centric model is that the shareholders are the owners and therefore the risk-bearers since the shareholders have risked their capital to create a firm and employment opportunities.¹⁰⁸ Because shareholders are vital to economic prosperity, and have placed their money at risk, they deserve to reap the rewards of their efforts. This theme is central to judicial opinions in the United States that ascribe ultimate import to the shareholder-value standard in evaluating director conduct, obligating the directors to focus on shareholder profits and the corporation's well-being.

102. Simon Worldwide Inc., Filing of Amendment to Schedule 13D (Form 13D/A) (May 11, 2006), <http://www.sec.gov/Archives/edgar/data/864264/000092189506001187/0000921895-06-001187.txt>.

103. Simon Worldwide Inc., *supra* note 102.

104. See, e.g., *In re The Walt Disney Litig.*, 825 A.2d 275, 283–84 (Del. Ch. 2003); see *In re The Walt Disney Co. Derivative Litig.*, 906 A.2d 27 (Del. Ch. 2006); see also Emon Reiser, *Office Depot-Staples Deal 'Fraught with Conflict of Interest,' Complaint Alleges*, S. FLA. BUS. J. (Apr. 6, 2015, 3:29 PM), <http://www.bizjournals.com/southflorida/news/2015/04/06/office-depot-staples-deal-fraught-with-conflict-of-interest.html>; see *Chen v. Howard-Anderson*, 87 A.3d 648 (Del. Ch. 2014) (alleging that directors were engaging in conflicts of interest with shareholders).

105. See Bernard Sharfman, *Shareholder Wealth Maximization and Its Implementation Under Corporate Law*, 66 FLA. L. REV. 389, 393 (2014) (“Delaware is the state where the majority of the largest U.S. companies are incorporated, and its corporate law often serves as the authority that other U.S. states and countries look to when developing their own statutory and case law.”).

106. See, e.g., *Revlon Inc.*, 506 A.2d at 183. (“Although such considerations [of non-stockholder corporate constituencies and interests] may be permissible, there are fundamental limitations upon that prerogative. A board may have regard for various constituencies in discharging its responsibilities, provided there are rationally related benefits accruing to the stockholders.”).

107. *Unocal Corp.*, 493 A.2d 946 (holding that board's obligation is to act in “the best interests of the corporation and its shareholders”); see *Paramount Communications v. Time*, 571 A.2d 1140 (1989).

108. Justin Fox & Jay W. Lorsch, *What Good Are Shareholders?*, HARV. BUS. REV. (July 2012), <https://hbr.org/2012/07/what-good-are-shareholders>.

Thus, under Delaware law, it is the responsibility of the directors to maximize shareholder value as opposed to looking out for the interests of other stakeholders.¹⁰⁹ Directors in the United States may therefore have liability for conduct that inhibits or diminishes the profits of shareholders.

B. ENLIGHTENED SHAREHOLDER-VALUE MODEL

The United States was historically not alone in having this shareholder-value focus. The United Kingdom, Australia, and Canada were also traditionally considered shareholder-value countries. However, in recent years, the trend in these other historically shareholder-centric nations has been to mitigate the focus on profits by turning to what some have referred to as “enlightened shareholder value.” Even some American political¹¹⁰ and business leaders¹¹¹ have come to advocate this model.

The United Kingdom has been the leader of the “enlightened shareholder” trend.¹¹² Pursuant to this model, “corporations should pursue shareholder wealth with a long-run orientation that seeks sustainable growth and profits based on responsible attention to the full range of relevant stakeholder interests.”¹¹³ This approach was codified in the United Kingdom by the landmark Companies Act 2006, which represented a key shift away from the United States shareholder model towards a stakeholder model.¹¹⁴

The Companies Act 2006 obligates directors to manage the company in the “best interests” of the business.¹¹⁵ “Best interest” is arguably in

109. See, e.g., *Revlon*, 506 A.2d at 173 (finding director misconduct in failing to seek highest price available); see *Ivanhoe Partners v. Newmont Mining*, 535 A.2d 1334 (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).

110. See Slawotsky, *supra* note 7 (“Critics of America’s shareholder-centric model allege that it is archaic and a failure, and they believe that the American version of capitalism must undergo a dramatic shift toward a stakeholder-based model emulating other nations President Obama recently echoed the ‘sustainable capitalism’ theme by calling for major changes that would enhance the interests of other stakeholders in order to construct an economy ‘built to last.’”).

111. See James Surowiecki, *A Fair Day’s Wage*, NEW YORKER, (Feb. 9, 2015), <http://www.newyorker.com/magazine/2015/02/09/fair-days-wage> (noting Aetna’s CEO Mark Bertolini stating “[c]ompanies are not just money-making machines” and commenting on pay raises: “[f]or the good of the social order, these are the kinds of investments we [corporations] should be willing to make.”).

112. Sarah Kiarie, *At Crossroads: Shareholder Value, Stakeholder Value and Enlightened Shareholder Value: Which Road Should the United Kingdom Take?*, 17 INT’L CO. AND COMM. L. REV. 329, 339 (2006).

113. DAVID MILLON, *Enlightened Shareholder Value, Social Responsibility and the Redefinition of Corporate Purpose Without Law*, in CORPORATE GOVERNANCE AFTER THE FINANCIAL CRISIS, Ch. 4 (Edward Elgar, 2012).

114. See Keay, *supra* note 5; see also Aguilera, *supra* note 5.

115. See John Lowry, *Codifying the Corporate Opportunity Doctrine: The (UK) Companies Act 2006*, INT’L REV. OF L. 5 (2012).

between pure shareholder and stakeholder — a sort of middle ground.¹¹⁶ This middle ground is referred to as “enlightened shareholder value” or “sustainable capitalism”¹¹⁷ and clearly marks a shift in United Kingdom (“U.K.”) governance towards a stakeholder model.¹¹⁸ The fiduciary obligations of U.K. directors were thus broadened by the 2006 U.K. Companies Act to encompass interests other than shareholders. U.K. directors are now obligated to act to promote the “success of the company,” which envisions taking into account a varied list of stakeholders including: employees, suppliers, customers, environmental concerns, the community, and reputational business conduct.¹¹⁹

Directors in the U.K. are therefore under the threat of potential civil liability for failure to take into regard these other stakeholders when making business decisions.¹²⁰ The enlightened shareholder model has also made advances into traditionally shareholder-value nations, such as Canada.¹²¹

C. STAKEHOLDER VALUE MODEL

The stakeholder value model is popular in the European Union and Asia, and is growing globally¹²² although in an example of a “counterattack,” the shareholder value-centric approach is also making inroads into Norway, a historically stakeholder-centric jurisdiction.¹²³

116. See Cynthia A. Williams & John M. Conley, *An Emerging Third Way? The Erosion of the Anglo American Shareholder Value Construct*, 38 CORNELL INT’L L. J. 493, 500 (2005).

117. See, e.g., Gore & Blood, *supra* note 9 (“Before the crisis and since, we and others have called for a more responsible form of capitalism, what we call sustainable capitalism: a framework that seeks to maximize long-term economic value by reforming markets to address real needs while integrating environmental, social and governance (ESG) metrics throughout the decision-making process.”).

118. Alissa Mickels, *Beyond Corporate Social Responsibility: Reconciling the Ideals of a For-Benefit Corporation with Director Fiduciary Duties in the US and Europe*, 32 HASTINGS INT’L & COMP. L. REV. 271, 293 (2009).

119. Companies Act 2006, c. 46, § 172 (Eng.).

120. Lowry, *supra* note 115.

121. BCE Inc. v. 1976 Debentureholders (2008), [2008] 3 S.C.R. 560 (BCE), at para 81 (Canadian Supreme Court ruled that directors must balance various stakeholder interests “in accordance with their fiduciary duty to act in the best interests of the corporation, viewed as a good corporate citizen.” (emphasis added). The court in fact stated “[i]n considering what is in the best interests of the corporation, directors may look to the interests of, inter alia, shareholders, employees, creditors, consumers, governments and the environment to inform their decisions.” *Id.* at par. 40. See also Peoples Department Stores Inc. (Trustee of) v. Wise, [2004] SCC 68 (Can.), at para 42 (“We accept as an accurate statement of law that in determining whether [directors] are acting with a view to the best interests of the corporation it may be legitimate, given all the circumstances of a given case, for the board of directors to consider, inter alia, the interests of shareholders, employees, suppliers, creditors, consumers, governments and the environment.”).

122. See Slawotsky, *supra* note 7, at 11; see also Corrine M. Fiesel, *Fiduciary Duties of Directors, Corporate, Governance and the end of Shareholder Primacy*, in CORPORATE GOVERNANCE AND SECURITIES REGULATION IN THE 21ST CENTURY (Butterworths, 2004).

123. See BLANPLAIN ET AL., *supra* note 2 (Norway has a stakeholder model of governance as

Under the stakeholder model, where the company is considered as a nexus of “unwritten” contracts between various constituencies of the business who may have an interest in it, it is the contract which determines the rights and obligations of the various stakeholders.¹²⁴ In terms of corporate governance and company law, directors are to make decisions that take into account the interests of these various “constituents” who are considered as having “rights” in the company. These stakeholders in the business encompass a wide array of interests including: creditors, employees, suppliers, customers, the environment, and the community.

Pursuant to this governance architecture, the goal of a business should not be strictly a grab for profits and shareholder returns. Rather, other interests should be afforded a voice in corporate decision making. By taking into account the concerns of not only shareholders but employees, consumers, suppliers, the environment, local community impact, and the wider global audience, the company’s success becomes the interest of numerous stakeholders. Presumably, numerous stakeholders will encourage the company’s long-term success. Therefore, under the stakeholder theory, director conduct that favors non-shareholders may not necessarily constitute a breach of a fiduciary duty since the directors are permitted to take into account and in fact possibly favor non-shareholders.

For example, pursuant to a stakeholder approach, a merger bid for a higher share price may result in environmental degradation, and therefore be voted down in favor of a lower bid from a rival with a better environmental record, or a commitment not to pollute. Or directors could favor customers, suppliers, or any stakeholder under the banner of enlightened shareholder value. In the European Union, for example, affirmative action programs are viewed in the broader context of governance, as diversity in the boardroom constitutes a stakeholder value.

The European Union and its member states are also taking an increasingly active approach to corporate governance, including regulations concerning boardroom diversity. Italy, France, Spain, Norway and others have all enacted boardroom gender quotas, with companies required to fill

opposed to a shareholder model). *But see* Ruth Sullivan, *Norwegian Wealth Fund Set to Raise Bar on Governance*, FIN. TIMES (Sept. 1, 2013, 6:41 AM), <http://www.ft.com/intl/cms/s/0/ea0ede56-0fc9-11e3-99e0-00144feabdc0.html#axzz2zs3qenxh> (Norway’s state owned SWF is shifting its traditional corporate social responsibility based activism towards a broadening scope of activism to include shareholder value. The Norwegian SWF is therefore moving towards a profits-centric shareholder value activism); *see also* *Investor Muscle*, FIN. TIMES (Aug 8, 2013, 11:00 PM), <http://www.ft.com/intl/cms/s/0/8eeb7524-002f-11e3-9c40-00144feab7de.html#axzz2zs3qenxh>.

124. *See* Xin Denga et al., *Corporate Social Responsibility and Stakeholder Value Maximization: Evidence from Mergers*, 110 J. FIN. ECON. 87, 87–88 (2013).

30-40% of independent board seats with women. The latest example can be found in Germany, where, after much debate, new quotas require that from 2016 large companies fill 30% of non-executive board seats with women.¹²⁵

Thus, in a stakeholder jurisdiction, if the impact of a proposed transaction could result in mass layoffs, then directors may be empowered to block the transaction. In the context of a sale, directors in stakeholder nations may be correct in exercising their business judgment by accepting a lower offer if the lower offer arises from a competing bidder that has agreed not to terminate employees or a bidder that will be more community-oriented or will donate ten percent of profits to a human rights organization. This would be distinguishable from the shareholder model of the United States and its *Revlon* duties wherein directors are obligated to achieve the maximum profit for the shareholders.

In Delaware, directors owe *Revlon* duties once a sale of the corporation has been decided.¹²⁶ *Revlon* duties mandate that the directors obtain the best price possible for shareholders. In the United States accepting a lower offer for any of the above-stated reasons would constitute a violation of directors' fiduciary obligations. In a shareholder-value model, social or societal considerations are of little or no interest in the drive for profits. In contrast, in a stakeholder-model, society's interest in advancing diversity may constitute a "stakeholder interest."

In a shareholder-value model, enacting measures that make activist conduct more difficult will be examined in light of the interests of the shareholder. But in a stakeholder model, blocking activists may be seen as acceptable or even beneficial if the activist plans to consolidate divisions and terminate the excess employees. Under the stakeholder-model, the potential permutations represent a daunting challenge in balancing various stakeholder interests.

D. WILL U.S. STYLE ACTIVISM SPREAD?

As a shareholder-value-driven jurisdiction, the mantra of enhanced shareholder returns fosters an environment conducive to activism in the United States. As discussed above, activism is thriving in the United States and has become a mainstream tactic to enhance shareholder returns.

125. 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>.

126. *Revlon*, 506 A.2d at 173 (finding director misconduct in failing to seek highest price available).

Shareholder activism has been slower to arrive in nations where shareholder-value is not the modus operandi of corporate law. Indeed, in many non-U.S. jurisdictions, activism is not viewed as virtuous and has not been embraced.

European and Asian shareholders say they do not need activists because they have more power than American investors over managers' pay and appointments. They typically dismiss Mr. Icahn and his friends as an American solution to an American problem. And, for cultural reasons, the few European activists tend to be more diplomatic and consultative than their brash cousins.¹²⁷

However, despite previous reservations or hostility, activists are beginning to copy the strategy in non-U.S. markets.¹²⁸ This is hardly a surprising development since "at 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."¹²⁹

Activist investing is spreading globally,¹³⁰ beginning to appear, for example, in Australia,¹³¹ Japan¹³² and Germany.¹³³ Even in India, where "[s]hareholders in listed companies . . . are known for their apathy towards

127. *Capitalism's Unlikely Heroes*, *supra* note 18. See also Marlow, *infra* note 129 ("[T]he brash approach has been less effective in the more conservative and stuffy boardrooms of Europe and the UK, where pushy outsiders can find it difficult to exert any real influence.").

128. Marco Becht et al., *The Returns to Hedge Fund Activism: An International Study* (Oct. 30, 2014) (unpublished manuscript) (on file with Erasmus Research Institute of Management), <http://www.irim.eur.nl/fileadmin/irimcontent/documents/Wagner1104.pdf>.

129. Alexandra Stevenson, *U.S. Activist Investor Turns Eyes Toward Europe*, N.Y. TIMES (Apr. 17, 2014, 4:00 AM), <http://dealbook.nytimes.com/2014/04/17/u-s-activist-investor-turns-eyes-toward-europe/?module=BlogPostTitle&version=BlogMain&contentCollection=CorporateGovernance&action=Click&pgtype=Blogs®ion=Body>. See also Ben Marlow, *Bosses beware: Activist raiders are targeting UK plc*, TELEGRAPH (Aug. 17, 2015), <http://www.telegraph.co.uk/finance/comment/11808504/Bosses-beware-Activist-raiders-are-targeting-UK-plc.html> ("After years of false starts, it looks like shareholders are starting to demand change at some of Britain's big corporates.").

130. Stevenson, *supra* note 129 ("It was only a matter of time before United States activist investors turned their focus to European companies.").

131. Paul Garvey, *Activist Hedge Funds are Coming, but are Investors Ready?*, THE 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>.

132. 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> (noting activist hedge fund Third Point's growing activities in Japan).

133. See also 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 (2012) (discussing activism in the context of German corporate governance).

corporate governance and lack of active participation in companies' decision-making process,"¹³⁴ activism is starting to develop. In fact, "[i]n recent times, especially due to the passage of investor friendly provisions in the new Companies Act of 2013 and an increasingly proactive role played by the Securities & Exchange Board of India (SEBI), there has been increasing shareholder activism and participation in the country."¹³⁵

Although many continental European nations have a concentrated shareholder ownership system whereby insiders, banks or families own large percentages of shares thus "controlling" the company, shareholder activists have commenced their activity. "Shareholder activism is an ever-present challenge to corporations in the US. Now, the trend has spread to Europe."¹³⁶ In Italy, where concentrated ownership is common, scholars have noted that activists have met with mixed success.¹³⁷

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.¹³⁸

In another example, even South Korean shareholders — historically not conducive to activists¹³⁹ — have concluded that governance is

134. See Jay Sayta, *Era of Shareholder Activism?*, THE STATESMAN (Nov. 26, 2015), <http://www.thestatesman.com/news/supplements/era-of-shareholder-activism/106554.html> ("However, in recent times, especially due to the passage of investor friendly provisions in the new Companies Act of 2013 and an increasingly proactive role played by the Securities & Exchange Board of India (SEBI), there has been increasing shareholder activism and participation in the country.").

135. *Id.*

136. See Latham & Watkins: *Shareholder Activism is on the Rise*, EUROPEAN CEO (Nov. 30, 2015), <http://www.europeanceo.com/business-and-management/latham-watkins-shareholder-activism-is-on-the-rise/> ("[A]ctivists in Europe have taken a more cooperative approach due to differing characteristics in the legal and business framework. Historically speaking, this framework amounts to a less confrontational tone in business communications and management approach from institutional shareholders, greater union powers, mandatory co-determination requirements, and a requirement for actions to focus on all stakeholders, not just shareholders.").

137. See Massimo Belcredi & Luca Enriques, *Institutional Investor Activism in a Context of Concentrated and High Private Benefits of Control: The Case of Italy* (Eur. Corp. Governance Inst., Working Paper No. 225/2013, 2014), <http://ssrn.com/abstract=2325421>; Matteo Erede, *Governing Corporations with Concentrated Ownership Structure: Can Hedge Fund Activism Play Any Role in Italy?*, CLEA ANNUAL MEETING PAPER (2009), <http://papers.ssrn.com/sol3/papers.cfm?abstractid=1397562>.

138. See Alexandros Seretakakis, *Hedge Fund Activism Coming to Europe: Lessons From the American Experience*, 8 BROOK. J. CORP. FIN. & COM. L. 438 (2014).

139. U.S. *Hedge Fund Galvanizes Korean Shareholders to Pressure Samsung*, South Korea's Richest Family, FOX BUS. (June 24, 2015), <http://www.foxbusiness.com/technology/2015/06/24/us-hedge-fund-galvanizes-korean-shareholders-to-pressure-samsung-south-korea/>.

important and are objecting to being unfairly treated.¹⁴⁰

Activists have commenced making incipient inroads in Japan,¹⁴¹ after having failed for decades.¹⁴² Activists are somewhat emboldened as they perceive recent moves towards governance reforms favorably.¹⁴³ For example, activist investor Third-Point

“continued to add to” its investment in Seven & i, it said in a letter to investors Friday, without disclosing how large of a stake it holds. It also proposed the Japanese company’s unit Ito-Yokado Co., which has “notable record of underperformance,” should be spun off and restructured as a standalone company.¹⁴⁴

Notwithstanding these stirrings, as discussed in Part V, activism in Japan is sharply limited due to both the governance structure and the business environment.

While activists are likely to continue their efforts in non-U.S. nations, success in these jurisdictions will depend on the extent the activist can acquire an adequate number of shares to vote directors onto the board and replace managers. Cultural business norms will also substantially influence the prospects of a successful activist campaign. Therefore, the governance architecture and business environment are key to determining whether activism can thrive thus forcing inefficient businesses to become more productive. The next section examines Japan and the difficulty activists face because of the governance model as well as the corporate culture.

140. *Id.*

141. See Dave McCombs & Jason Clenfield, *Japan Inc.’s \$104 Billion Investor Payout Set to Surge*, BLOOMBERG BUS. (May 28, 2015, 11:29 PM), <http://www.bloomberg.com/news/articles/2015-05-27/japan-inc-s-104-billion-investor-payout-set-to-surge> (“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.”).

142. *Id.* (“Loeb’s success with Fanuc may be a sign foreign activists will finally find success in Japan after decades of failure”).

143. See Tsuyoshi Inajima, *Loeb’s Third Point Takes Stake in Japan’s Seven & I Holdings*, BLOOMBERG BUS. (Oct. 31, 2015, 6:03 PM), <http://www.bloomberg.com/news/articles/2015-10-31/loeb-s-third-point-takes-stake-in-japan-s-seven-i-holdings> (“Loeb’s investments come as he has extolled Prime Minister Shinzo Abe’s efforts to improve corporate governance, saying the move opens the way for activist investors to gain by helping improve the way companies deploy cash. The Seven & i investment is at least Loeb’s fifth in two years in Japan and follow his bets in Suzuki Motor Corp., robot maker Fanuc Corp., Sony Corp. and jet engine maker IHI Corp.”).

144. *Id.*

V. IS SHAREHOLDER-VALUE DRIVEN ACTIVISM VIRTUOUS?

The context of governance models provides an excellent framework from which to examine whether activism is virtuous. The above section provided the general parameters of the various systems. The Article now examines Japan and discusses whether hostility to shareholder activism has negatively implications for economic performance.

A. DISCOURAGING ACTIVISM: THE EXAMPLE OF JAPAN

Japan holds stakeholder value as the corporate mantra.¹⁴⁵ However, Japanese corporate governance and the corporate environment makes clear that “stakeholder value” is dedicated to the interests of the select “corporate community.” This community consists of insiders, key employees, and allied companies — the popular Keiretsu ownership structure — wherein numerous allied entities have a crossholding in each other.¹⁴⁶ Significantly, these cross-holdings greatly reduce the importance of outside shareholders as “outsiders” cannot meaningfully challenge the incumbent managers and board due to a lack of voting power. Therefore, the prevalence of Keiretsu groups substantially reduces the ability to implement a hostile take-over: “[t]here are many more friendly mergers, which typically occur between Keiretsu and other related firms, than mergers based on hostile takeovers. Most hostile takeovers of poorly functioning firms or takeover attempts have failed.”¹⁴⁷

Moreover, in Japan, the corporate culture fosters conformity and loyalty within this corporate community. A large number of parties are thus allied with each other and constitute “company insiders” in the sense that these interests and loyalties are with the company and its senior management rather than to overall shareholder performance or the interests

145. Carlo Osi, *Board Reforms with a Japanese Twist: Reviewing the Japanese Board of Directors with a Delaware Lens*, 3 BROOK. J. CORP. FIN. & COM. L. 325, 336, 352 (2009) (“In post-war corporate 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.”).

146. See Zenichi Shishido, *Japanese Corporate Governance: The Hidden Problems of Corporate Law and their Solutions*, 25 Del. J. Corp. Law 189, 202 (2000) (“The Company Community consists of management, board members, and core employees who share an identity as ‘company men.’ In Japan, the word “company” refers to the collective Company Community Within their own minds, members of the Company Community owe their loyalty to both the Community itself and their fellow members.”).

147. 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/>.

of other “outside” shareholders.¹⁴⁸ Corporate insiders are loyal to each other and enjoy interlocking relationships which confer benefits to club members.¹⁴⁹

The prevalence and entrenchment of these Keiretsu cross-holdings dissuade foreign capital and other potential outside shareholders from risking capital in these businesses.¹⁵⁰ Interestingly, these cross-holders, who are in effect the quintessential loyal long-term investors, have reaped the adverse financial consequences of their passivity.¹⁵¹ While the Keiretsu structure has diminished over the last several years, it remains a powerful characteristic of corporate Japan.¹⁵²

Moreover, in corporate Japan, values such as loyalty, honor, and fidelity trump shareholder value.¹⁵³ These values are applicable to the relationship among the senior managers and officers, allied companies, business partners, and other insider stakeholders; they do not apply to outsiders, nonaffiliated businesses, and “other” shareholders. The corporation’s outside owners’ interests lie dormant at the bottom of the pyramid.¹⁵⁴ Allied investors will continue to support a scandal plagued business rather than institute reform. For example:

148. Caslav Pejovic, *Japanese Corporate Governance: Behind Legal Norms*, 29 PENN. ST. INT’L L. REV. 483, 495–96 (2011) (“If one company has difficulties, it is likely to be assisted by other companies from the same keiretsu (the same as the villagers would help each other in case of calamities); more powerful companies are expected to support smaller ones. The sense of obligation towards the company may be linked with the sense of belonging to a family and the responsibility towards one’s own family. In the same sense, keiretsu also represents a kind of family with members that feel close to each other. In this sense, keiretsu is not purely an economic concept but a cultural one, as well.”)

149. Such insiders include senior officers, directors, government regulators, allied companies within the keiretsu and other loyal parties. The allegiance to each other among insiders trumps all other interests. See Osi, *supra* note 145, at 325 (discussing the phenomenon of conformity and loyalty in Japan and the importance of banding together against outsiders. Also the fact that government regulators know that they will land well-paying jobs post-government if they “play the game.”). As will be detailed below, the recent Olympus and Toshiba frauds exemplify these characteristics of corporate Japan. See *Former Olympus Boss Woodford*, *infra* note 153.

150. See Leo Lewis, *Japanese Banks to Accelerate Unwind of Cross-Shareholdings*, FIN. TIMES (Feb. 21, 2016, 12:14 PM), <http://www.ft.com/intl/cms/s/0/bf714ea6-8b76-11e5-8be4-3506bf20cc2b.html#axzz3rejueQj6> (“The cozy, opaque relationships locked into the cross-shareholdings, say analysts, are among many turn-offs for would-be investors.”).

151. See Shuli Ren, *Japan’s Corporate Governance Woes*, BARRONS (Oct. 24, 2015), <http://www.barrons.com/articles/japans-corporate-governance-woes-1445665396> (“Japan’s banks suffer by operating as passive investors.”).

152. See Lewis, *supra* note 150.

153. See *Former Olympus Boss Woodford Blows Whistle on Company*, BBC NEWS (Nov. 15, 2011), <http://www.bbc.co.uk/news/15742048> (“But it’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.”).

154. As noted below, this disregard for outside shareholders has played a significant role in discouraging badly needed capital investment.

Despite ISS' shareholder-rights campaign, the presidents of Japan's top 200 companies received median voting support of 96.6% Even the president of Toshiba (6502.Japan), which lost a third of its market value from an accounting scandal and write-downs, got a 94% approval rating. Some 76% and 91% of investors voted against dividend hikes and share buybacks, respectively.¹⁵⁵

Japan's governance architecture and business culture is not friendly to outsiders and represents:

. . . a deeply insular culture. Only 274 of some 40,000 directorships are held by foreigners. A mesh of shareholdings still binds big firms together. Japan's business lobby group, Keidanren, fought to dilute the new reforms. The banks still keep weak companies afloat: the fact that not one of Japan's listed firms went bankrupt last year, for the first time since 1991, reflects not just a zippier economy, but also lenders' clubby ties to borrowers. For all his reformist zeal, Mr Abe has yet to embrace measures that make it easier for firms to hire and fire. Hobbesian, Japan is not.¹⁵⁶

Viewed as outsiders, it is thus hardly surprising that activists have not been welcomed by other shareholders.¹⁵⁷

Another manifestation of Japan's lack of good corporate governance is Japan's common "parent-child" ownership structure, which is viewed by activists as an invitation to abuse.¹⁵⁸ Activists have accordingly focused their energy on these parent-child situations.¹⁵⁹ This is ". . . mainly a

155. Ren, *supra* note 151.

156. See *Meet Shinzo Abe, Shareholder Activist*, ECONOMIST (June 6, 2015), <http://www.economist.com/news/leaders/21653610-last-japan-has-introduced-corporate-governance-reforms-will-make-difference-meet-shinzo>.

157. See Kana Inagaki, *Japan Is Hostile to Activist Investors*, WALL ST. J. (May 14, 2013, 12:47 PM) <http://www.wsj.com/articles/SB10001424127887324216004578482943175923954> ("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. Historically, those networks of big investors held large enough stakes that they could prevent hostile campaigns from succeeding.")

158. Tom Redmond & Toshiro Hasegawa, *Japan Post's Unique IPO Turns Spotlight on Parent-Child Listings*, BLOOMBERG BUS. (Oct. 28, 2015, 5:44 PM), <http://www.bloomberg.com/news/articles/2015-10-29/japan-post-s-unique-ipo-turns-spotlight-on-parent-child-listings> ("Such listings are already decreasing, according to data from Nomura. They fell to 284 at the end of March, an eighth straight year of declines since 2007, when the Tokyo bourse said in a statement that parent-child arrangements were "not always desirable.").

159. *Id.*

problem if units don't increase their independence from the parent after listing and eventually become separate entities This has been a common pattern in Japan."¹⁶⁰

In a bid to reform governance and bring it in line with global "best practices" Japan Post is being privatized.¹⁶¹ As a result:

That's putting the spotlight back on a practice seen as open to abuse: parent-child listings. The structure is a 'barbarous relic' that has largely disappeared from other markets, according to CLSA Ltd.'s Nicholas Smith, a strategist at the brokerage, who notes the possibility for listed subsidiaries to be plundered by their parents or forced into unprofitable business at their behest.¹⁶²

In sum, ordinary owners — the individual outside shareholders who are not part of the web of alliances — are disdained. Therefore, the key distinction between the United States and Japanese models of corporate governance is Japan's low regard for the interests of outside corporate owners and high regard for the other stakeholders. In Japan, the interest of non-insider shareholders is at the bottom of the pyramid, while other stakeholders, such as employees, suppliers, creditors, and particularly the "corporate community" of key insiders and allied companies, all trump the interests of outside shareholders.¹⁶³

Thus, the lack of vigorous activism in Japan to date has been caused by a lack of truly outside shareholders and the Japanese business culture, which has been hostile to activism for many years.¹⁶⁴ The inability to acquire a significant let alone a controlling percentage of shares prevents an activist from influencing a company, let alone replacing the directors. Moreover, unlike the United States, the other large holders are likely to side with their fellow club insiders since concern for shareholder value is not as important as loyalty and fidelity to allied interests. The difficulties

160. Redmond & Hasegawa, *supra* note 158.

161. Redmond & Hasegawa, *supra* note 158 ("It seems likely that changes in corporate governance codes will ultimately put an end to this barbarous relic," Smith wrote in a report this year. "Parent-child listings seem a clear violation of the principle of equal treatment of shareholders.")

162. Redmond & Hasegawa, *supra* note 158.

163. Caslav Pejovic, *Japanese Corporate Governance: Behind Legal Norms*, 29 PENN. ST. INT'L L. REV. 483, 489–90 (2011).

164. See Dave McCombs & Jason Clenfield, *Japan Inc.'s \$104 Billion Investor Payout Set to Surge*, BLOOMBERG BUS. (May 27, 2015, 11:29 pm), <http://www.bloomberg.com/news/articles/2015-05-27/japan-inc-s-104-billion-investor-payout-set-to-surge> ("In the early 1990s, hostile-takeover pioneer 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.").

activists have encountered may very well be both a symptom of the economic malaise afflicting Japan and an impediment to an improvement.

1. *The Economic Context*

After World War II, Japan enjoyed robust economic growth which at its peak created the world's second biggest economy, just behind the United States.¹⁶⁵ Japan's fall from second place is starkly framed when viewed from the perspective of the 1980s when Japan was perceived to possibly overtake the United States.¹⁶⁶

For Japan, whose economy has been stagnating for more than a decade, the figures reflect a decline in economic and political power. Japan has had the world's second-largest economy for much of the last four decades, according to the World Bank. And during the 1980s, there was even talk about Japan's economy some day overtaking that of the United States.¹⁶⁷

However, Japan's performance has been so lackluster that it has fallen behind China, and is now the world's number three economy. Japan is perilously close to slipping to the fourth position and being replaced by India.¹⁶⁸ By some measures India has already taken the number three position from Japan.¹⁶⁹

Japan's economic downturn commenced in the early 1990s and has continued into 2016 — a twenty-five year malaise coinciding with the rise of intensified globalization and competition. The Japanese economy has

165. See Justin McCurry & Julia Kollewe, *China Overtakes Japan's World's Second-Largest Economy*, THE GUARDIAN (Feb. 14, 2011, 1:38 PM), <http://www.theguardian.com/business/2011/feb/14/china-second-largest-economy> ("China has leapfrogged Japan to become the world's second-largest economy, a title Japan has held for more than 40 years.").

166. Dhruva Jaishankar, *The Specter of Japan-Like Stagnation*, U.S. NEWS (Feb. 19, 2015, 10:35 AM), <http://www.usnews.com/opinion/blogs/world-report/2015/02/19/japans-economic-stagnation-is-a-cautionary-tale-for-europe> ("By the 1980s, Japan was a global economic powerhouse, giving us Sony, Toyota and Nintendo, pioneering the bullet train and buying up American real estate. Business leaders the world over scrambled to learn the secrets behind the country's success.").

167. David Barboza, *China Passes Japan as Second-Largest Economy*, N.Y. TIMES (Aug. 15, 2010), <http://www.nytimes.com/2010/08/16/business/global/16yuan.html?pagewanted=all>.

168. See Enda Curran & Keiko Ujikane, *Planes, Trains and Automobiles Showcase Japan Innovation Push*, BLOOMBERG BUS. (Jan. 4, 2016, 7:00 AM), <http://www.bloomberg.com/news/articles/2016-01-04/planes-trains-and-automobiles-showcase-japan-innovation-push> ("As part of Prime Minister Shinzo Abe's drive to reinvigorate the world's third-largest economy.").

169. See Ankit Panda, *World Bank: India Overtakes Japan as World's Third Largest Economy*, DIPLOMAT (May 1, 2014), <http://thediplomat.com/2014/05/world-bank-india-overtakes-japan-as-worlds-third-largest-economy/> (noting World Bank conclusion that Japan had fallen into fourth place).

been marked by recession, deflation, and low growth for many years.¹⁷⁰ In fact, Japan entered its fourth recession in twenty years in 2015.¹⁷¹

2. Recognizing Governance as a Problem

In response to this economic under-performance, corporate governance reform has become an urgent task.¹⁷² Prime Minister Shinzo Abe has urged companies to transform their corporate governance “with more transparency and independent board members.”¹⁷³ Abe has pressured Japanese companies to become more attractive to foreign investors noting Japan requires more capital from global investors.¹⁷⁴

As a result, “[t]he main focus of these changes . . . is really to bring Japanese board practices in line with other western countries in a bid to attract greater investment from overseas institutions Abe’s government is seeking ‘a total governance revolution.’”¹⁷⁵

The reforms seek to foster “a more equal environment among shareholders, by ensuring more disclosure and transparency, by specifying the responsibilities of company boards, and by requiring outside independent directors on company boards, the codes enshrine changes that make Japan more attractive for foreign investors.”¹⁷⁶

Prime Minister Shinzo Abe is prodding companies to become more responsive to shareholders. Abe[’s] advisers worked with the Tokyo Stock

170. See OECD Economic Surveys: JAPAN 4 (Apr. 2015), <http://www.oecd.org/eo/surveys/Japan-2015-overview.pdf> (“Two decades of sluggish growth and persistent deflation have reduced Japanese living standards below the OECD average.”).

171. See Keiko Ujikane, *Japan Falls Into Recession for Second Time Under ‘Abenomics,’* BLOOMBERG BUS. (Nov. 15, 2015, 6:58 PM), <http://www.bloomberg.com/news/articles/2015-11-15/japan-s-economy-contracted-entered-recession-in-third-quarter> (“Japan’s economy contracted in the third quarter as business investment fell, confirming what many economists had predicted: The nation fell into its second recession since Prime Minister Shinzo Abe took office in December 2012.”).

172. See Nakamura, *supra* note 147 (“Noting the generally robust performance of the economies of the US, Australia, Canada, New Zealand, and the UK, the Japanese government decided to adopt a US (or, more broadly, Anglo-American) style corporate governance system over the last decade or so. A range of corporate governance reforms were instituted, aiming to facilitate market based transactions, competition, individual shareholder rights, as well as transparency and information disclosure. Japan’s economic regulatory institutions were also reformed. New laws were introduced and existing laws revised, including company law, the commercial code, the anti-monopoly law, and the financial instruments and exchange act.”).

173. Chris Cooper, *Season of Scandal Hits Japan with Flurry of Corporate Confessions*, JAPAN TIMES (Oct. 21, 2015), <http://www.japantimes.co.jp/news/2015/10/21/business/season-scandal-hits-japan-flurry-corporate-confession/#.VkWQSnYrK70>.

174. *Id.*

175. See *Foreign Investors and Japanese Corporate Governance*, BLOOMBERG PROFESSIONAL (July 20, 2015), <http://www.bloomberg.com/professional/blog/foreign-investors-and-japanese-corporate-governance/>.

176. 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>.

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 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.¹⁷⁷

Under the new governance code, Japanese corporations must explain why they have ownership interests in various entities. “The cozy, opaque relationships locked into the cross-shareholdings, say analysts, are among many turn-offs for would-be investors.”¹⁷⁸ Corporate Japan has commenced reducing these cross-holdings:

. . . actually starting to realize some of their cross-shareholdings, which frees up capital within the business, not only to return to shareholders but also to focus on more capital efficiency within the organization. Quite often that leads to enhanced shareholder returns either in the shape of dividends or share buybacks.¹⁷⁹

However, it remains to be seen whether these governance proposals will in fact be the tonic Japan urgently needs.¹⁸⁰ Recent examples demonstrate that real reform will be difficult to implement.¹⁸¹ Despite promises, a transformed governance architecture, systemic failures continue to plague Japan.¹⁸² As will be discussed in the following subsection, the Olympus and Toshiba frauds are a manifestation of deeply embedded traits of corporate loyalty, cover-up, and lack of accountability

177. See McCombs & Clenfield, *supra* note 164.

178. See Lewis, *supra* note 150.

179. See *Foreign Investors*, *supra* note 175.

180. See Nakamura, *supra* note 147 (“But have the issues that motivated the reforms been solved in the decade since they were adopted? Has the market for corporate control achieved competitive market principles, transparency and information disclosure? And was the share value maximization principle fully adopted by Japanese managers? The answer to these questions are mostly no. This was largely predictable given Japan’s historical reaction to the transplantation of Western institutions over the long sweep of history since the Meiji Restoration in 1868.”).

181. See Nakamura, *supra* note 147 (“But the fact that the problem was continuing even though Toshiba had already implemented a US-style executive committee board system is an example of reform failure. Clearly their outside directors did not function as expected. And neither did the accounting firm that audited Toshiba.”).

182. See Cooper, *supra* note 173 (“Three companies disclosed internal malfeasance in the space of 24 hours last week, including a firm that says one of its units tried to cover up the faulty construction of an apartment building that started to tilt, and another that says one of its units falsified reports on the quality of rubber used in trains and ships. The admissions come after Toshiba Corp. admitted to artificially inflating profits for almost seven years, and Takata Corp. said it supplied faulty air bags, leading to the recall of more than 40 million vehicles.”).

which do not bode well for governance improvement.¹⁸³ In the context of Toshiba, which had presumably accepted governance reform, the immense governance failures corroborates concerns that Japan is not meaningfully changing.¹⁸⁴

3. Recent Examples of Governance Failures and the Link to an Absence of Activism

The problem of Japanese governance has been evident for some time.¹⁸⁵ However, the Olympus accounting scandal provides an exemplar of managerial and director misconduct that would be almost incomprehensible in a jurisdiction with the potential for vigorous shareholder activism.¹⁸⁶ The Olympus CEO, U.K. national Michael Woodford, was literally treated as an “enemy” and an “outcast” and fired for “disloyalty” in revealing a massive internal accounting fraud.¹⁸⁷

Woodford’s fall commenced after he had serious questions concerning the company’s accounting. Woodford raised the possibility that accounting improprieties had taken place and was immediately branded a “disloyal

183. See Cooper, *supra* note 173 (noting “tolerance for employee wrongdoing, in contrast to the zero-tolerance policies at the world’s best-managed companies”).

184. See *The Rot Inside Japan Inc.*, WALL ST. J. (Sept. 9, 2015, 7:51 PM), <http://www.wsj.com/articles/the-rot-inside-japan-inc-1441842664> (“Toshiba shows the need for a corporate-governance overhaul”).

185. Questions about nuclear safety arose in connection with Tokyo Electric. See *Japanese Corporate Scandals: A Critical Mass of Disgust?* ECONOMIST (Sept. 5, 2002, 11:41 AM), <http://www.economist.com/node/1318056> (“The latest company to be caught deceiving the public is Tokyo Electric Power (TEPCO), Japan’s largest utility, which turns out to have filed at least 29 falsified reports to nuclear-safety regulators since the 1980s.”).

The issue of company loyalty to managers causes companies to cover-up problems even if the outside shareholders will bear the brunt of future losses. *Id.* (“In Japan, however, businessmen and bureaucrats often respond to such public worries by engaging in more secrecy rather than less. Occasionally, this leads to an even bigger scandal, and thus more hand-wringing.”).

Indeed, the 2011 Fukushima nuclear plant crisis was the product of “the disturbing catalog of accidents that have occurred over the years and been belatedly reported to the public, if at all. See also *Scandal Ridden Energy Company behind Japan’s Nuke Crisis*, CBS NEWS (Mar. 7, 2011), <http://www.cbsnews.com/news/scandal-ridden-energy-company-behind-japans-nuke-crisis/>; *Fukushima report: Key points in nuclear disaster report*, BBC NEWS (Jul. 5, 2012), <http://www.bbc.com/news/world-asia-18718486> (“Collusion and lack of governance: the TEPCO Fukushima Nuclear Power Plant accident was the result of collusion between the government, the regulators and [private plant operator] TEPCO, and the lack of governance by said parties. They effectively betrayed the nation’s right to be safe from nuclear accidents. Therefore, we conclude that the accident was clearly ‘manmade’ . . . We believe that the root causes were the organizational and regulatory systems . . . rather than issues relating to the competency of any specific individual.”).

186. See Slawotsky, *supra* note 7, 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, employees, allied companies, business partners, and other insider stakeholders; they do not apply to outsiders, non affiliated businesses, and owners. The corporation’s owners are at the bottom of the pyramid.”).

187. See Slawotsky, *supra* note 7, at 13

traitor”¹⁸⁸ and disrespected at the company.¹⁸⁹ The “disloyalty” was not to the company and its owners but rather to the Olympus management, insider directors, and senior officers who had clearly benefited from the criminal activity and thus desired to cover up the accounting fraud. Shortly thereafter, a board meeting was convened and without any discussion of the accounting fraud and without any interest in hearing Woodford and discussing the fraud despite his presence, Woodford was summarily and unanimously fired.¹⁹⁰ Incredibly, rather than create an internal uproar, the directors were unanimous in their disdain for Woodford and no dissenting director came to Woodford’s defense. Subsequent to his firing, even the Japanese shareholders who logically would be upset that Woodford was fired were not complaining. Woodford relates:

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.¹⁹¹

188. See *Former Olympus Boss Woodford*, *supra* note 153. (“But it’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.”).

189. See Karl Taro Greenfield, *The Story Behind the Olympus Scandal*, BLOOMBERG BUS. (Feb. 16, 2012, 5:38 PM), <http://www.bloomberg.com/bw/articles/2012-02-16/the-story-behind-the-olympus-scandal#p4> (“Woodford noticed that while the two Japanese men had sumptuous plates of sushi before them, he was served a tuna sandwich.”).

190. See *id.* (“The board met the next morning, Friday, October 14. Kikukawa took to the podium and read a prepared statement. ‘The board meeting scheduled to discuss concerns relating to the company’s M&A activity is cancelled. Instead, we have a new agenda. The first is to discuss the motion to dismiss Mr. Woodford as president, representative director, and CEO. Mr. Woodford cannot speak because he is an interested party. All those in favor?’ (Board meetings at Olympus were simultaneously translated from Japanese to English and vice versa.) All 12 board members present immediately raised their hands.”).

191. See *Former Olympus Boss Woodford*, *supra* note 153 (“Subsequently, Olympus “apologized” for the dismissal.”); see also OLYMPUS CORP., NOTICE CONCERNING PAST ACTIVITIES REGARDING DEFERRAL IN POSTING OF LOSSES (2011), available at <http://www.olympus-global.com/en/common/pdf/nr111108e.pdf>.

The Olympus saga provides the archetype exemplar of loyalty among allied insider shareholders and employees at the expense of the disdained outside shareholders.

The recent Toshiba scandal also corroborates the tale of poor governance plaguing Japan.¹⁹² Toshiba, once a leading Japanese company employing hundreds of thousands,¹⁹³ admitted to a huge multi-year, billion dollar accounting scandal, after being caught. The once mighty business entity has suffered huge financial losses, a plunging share price and debt cut to junk.¹⁹⁴ Yet Toshiba managers and officers were more concerned about protecting insiders who planned/profited and or covered up the fraud than promoting the interests of the outside shareholder-owners. As one governance expert notes, there seems to be “100% tolerance” for managerial cover-ups.

Nicholas Benes, representative director of the Board Director Training Institute of Japan, was critical of Toshiba this month when the company said it had identified 30 executives who had been involved in the accounting scandal — and none of them would lose their jobs. He said the company was showing “100 percent tolerance” for employee wrongdoing in contrast to the zero-tolerance policies at the world’s best-managed companies.¹⁹⁵

While Toshiba has made some efforts at showing “remorse” and demonstrating “concern” the reality is more show than substance.¹⁹⁶ The

192. 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), <http://fortune.com/2015/09/08/toshiba-accounting-scandal/> (“Toshiba admitted on Monday that it had overstated its profits by nearly \$2 billion over the past 7 years, the Wall St. Journal reports Evidently, Toshiba managers “set aggressive profit targets that subordinates could not meet without inflating divisional results were under pressure to report growing profits After the admission, Toshiba’s shares fell dramatically.”).

193. *Annual Report, Operational Review 2012*, TOSHIBA, <http://www.toshiba.co.jp/about/ir/en/finance/ar/ar2012/tar2012eor.pdf>.

194. See Akashi Mochizuki & Eric Pfanner, *Toshiba, Facing \$4.5 Billion Loss, Plans Deep Cuts*, WALL ST. J. (Dec. 21, 2015), <http://www.wsj.com/articles/toshiba-expects-4-5-billion-loss-for-current-fiscal-year-1450686830> (“Toshiba, racked by one of Japan’s biggest accounting scandals, also said it would eliminate nearly 8,000 jobs amid heavy restructuring costs at the conglomerate. The accounting scandal has morphed into a wider crisis affecting nearly all of Toshiba’s significant units. Shares in the company plunged 9.8% Monday and have lost more than half their value since March.”). See Finbarr Flynn, *Toshiba’s Credit Rating Lowered Two Levels to Junk by Moody’s*, BLOOMBERG (Dec. 22, 2015, 1:39 AM), <http://www.bloomberg.com/news/articles/2015-12-22/toshiba-s-credit-rating-lowered-two-levels-to-junk-by-moody-s> (“Toshiba Corp.’s long-term senior bond rating was cut two levels by Moody’s Investors Service to Ba2, its second-highest junk rating, from Baa3. That was followed by a downgrade to sub-investment grade by Standard & Poor’s.”).

195. Cooper, *supra* note 173.

196. See Makiko Yamazaki, *Toshiba Lawsuit Highlights Japan Governance Reform Still Lacking*:

amount of money sought in recovery from former officers constitutes only a fraction of the actual loss in shareholder value.¹⁹⁷ 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.”¹⁹⁸

Furthermore, and troubling, Toshiba had already implemented corporate governance reform. The fact a multi-billion dollar fraud occurred post-reform speaks volumes. “[T]hat the problem was continuing even though Toshiba had already implemented a US-style executive committee board system is an example of reform failure. Clearly their outside directors did not function as expected. And neither did the accounting firm that audited Toshiba.”¹⁹⁹

In a governance structure where a company CEO is summarily ousted for revealing internal fraud, and directors are more concerned about protecting their friends and allies rather than recovering company assets, activist investors attempting governance changes will also likely 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. Therefore, engaging in activism in Japan is extremely difficult. Without activists monitoring and possibly removing directors, the directors and managers of a company have little incentive to avoid conflicts of interest and in fact have every incentive to manage the company for the advancement of their own private interests and the interests of their allied companies/shareholders.

If insiders and managers can exploit a company’s assets, productivity and overall economic performance will decline. An economy may thus be derailed by allowing management to continue to mismanage the corporate sector. This lack of incentive to improve shareholder 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.

The Japanese governance architecture and corporate Japan’s emphasis on loyalty to insiders served Japan well until globalization and intensive

Lawyers, REUTERS (Nov. 12, 2015), <http://www.reuters.com/article/2015/11/12/us-toshiba-lawsuit-idUSKCN0T10AA20151112> (“Toshiba Corp’s (6502.T) lawsuit against former executives linked to a \$1.3 billion accounting scandal is a defensive maneuver that highlights a lack of sincere reform, lawyers and corporate governance experts said.”).

197. *See id.* (“The 300 million yen (\$2.44 million) in damages Toshiba is seeking pales in comparison with the over \$7 billion decline in stock market value since the accounting problems came to light in early April.”).

198. *Id.*

199. Nakamura, *supra* note 147.

competition rendered many companies inefficient. Japan, by keeping activists at bay, appears to be delaying the solution to what ails corporate Japan. The lack of activism over the last twenty-five years may have delayed the governance turn-around so crucial to reforming corporate Japan. While the lack of activism was certainly a boon to managers and inside directors, enabling them to retain their positions and reap the rewards, the absence of activism allowed managers and directors to continue to mismanage their companies causing severe damage to Japan.

Whether Japan can successfully implement the vital governance reform is an open question. Corporate Japan has largely resisted implementing the spirit of reform.

Independent, outside directors have been put in place, but they do not seem to function as they do in the US. And, transparency and information disclosure have proven difficult to implement in many established Japanese firms. The continuing prevalence of Japan's 'dango' practice (rigged bidding), for example, clearly violates the reforms' transparency and information disclosure as well as fair competition objectives.²⁰⁰

There is precedent for the unwillingness to embrace Western political and economic models.

Since Japan opened up to the West in the early 19th century, there have been repeated attempts to import Western political and economic institutions, laws, technologies and even cultural practices. But rather than being adopted in their original forms, Western practices have been selectively adapted to suit Japan's needs, tastes and preferences with varied success.²⁰¹

Without meaningful changes in the governance of Japan Inc., any influx of foreign capital may be a short-term phenomenon. In fact, "[f]oreign investors flocked to Japan earlier this year and then just as quickly exited in the past few months."²⁰² It should be noted that:

200. Nakamura, *supra* note 147.

201. *Id.*

202. Ren, *supra* note 151. See also Anna Kitanaka et al., *Black Rock Joins \$46 Billion Japan Pullout*, BLOOMBERG (Apr. 10, 2016, 8:00 AM), <http://www.bloomberg.com/news/articles/2016-04-10/abonomics-rebuked-as-blackrock-joins-46-billion-japan-pullout> ("Starting in the first days of

The problems that motivated the Japanese reforms are far from being solved. Foreign firms will still need to beware of the implications of this in doing business in Japan. Corporate governance reforms to implement US-style practices are ongoing in other countries in East Asia, such as China and South Korea. Large pyramidal business groups in both countries (that is, state-owned enterprise groups and chaebols) present serious challenges to those reform efforts too. Implanting institutions and practices from other countries rarely succeeds. Japan's experiences, both successes and failures, may prove helpful to Western business practitioners and policymakers interested in understanding business conditions in East Asia.²⁰³

Japan provides an illustrious example of the perils inherent in a governance structure that gives little heed to shareholder value and simultaneously provides perhaps the archetype example of the benefits of shareholder activism.

B. THE VIRTUES OF UNITED STATES ACTIVISM

Not surprisingly, activism is vibrant in the United States, where the governance mantra is shareholder value. This is in keeping with corporate law rulings emphasizing that a company must be managed to maximize the value to the company and its shareholders.²⁰⁴ Activists ideally target companies whose management is involved in various agency conflicts with shareholders. These conflicts can be shirking, where the managers shirk their obligations in favor of pursuing their own self-interest, or looting, where the managers exploit the assets of the company for their personal advantage.²⁰⁵ Activism seeks to change the status quo and attempts to extract more value to shareholders.

2016, foreign traders have been pulling out of Tokyo's stock market for 13 straight weeks, the longest stretch since 1998. Overseas investors dumped \$46 billion of shares as economic reports deteriorated, stimulus from the Bank of Japan backfired and the yen's surge pressured exporters. The benchmark Topix index is down 17 percent in 2016, the world's steepest declines behind Italy.")

203. Nakamura, *supra* note 147.

204. See *Revlon*, 506 A.2d at 173 (finding director conduct impermissible and a violation of their fiduciary duties in not sharing the highest value for the shareholders).

205. See Zohar Goshen, *Controlling Corporate Agency Costs: A United States-Israeli Comparative View*, 6 CARDOZO J. INT'L & COMP. L. 99, 105 (1998) (describing managerial agency conflicts that plague companies with a dispersed shareholder base as commonly found in the United States).

Taking advantage of regulatory changes and a public mood, oriented toward rooting out corporate misdeeds, a growing number of 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 the Securities and Exchange Commission, they are demanding that executives sell off units, pay dividends or take other actions to raise stock prices quickly.²⁰⁶

Corporate law rulings have established unequivocally that in the United States, a company must be managed in the pursuit of the interests of the owners — the shareholders. Failure to do so is a violation of the fiduciary duties of directors and managers. Therefore, the United States markets and corporate law permit and reward activists who can bring enhanced value to shareholders.

By allowing an environment conducive to activism, the United States enables activists to serve as backup monitors of management and directors. There are tangible benefits to shareholders. Jurisdictions which discourage activism, greatly increase the risks of bad corporate governance. By eliminating or lessening the options for activists, managerial slack can become entrenched. Insulating directors and managers affords them the opportunity to exploit the business for their own self-interest. The decision of whether to close divisions or to liquidate the company itself may be tinged with director and managerial conflicts of interest.

The "market for corporate control" is vital in imbuing activists with the ability to transform an inefficiently run business to the benefit of the company and its shareholders. In fact:

The "market for corporate control" idea is that poor and inefficient management of a public company depresses its stock price. And if the stock price is sufficiently low, a hostile outsider can buy a controlling block, even at a premium, and turn a profit by shifting control from the

206. 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/some-funds-taking-role-far-beyond-just-investor.html>.

Sometimes the activists seek board seats. See Katya Kazakina, *Billionaire Loeb Confirmed as Sotheby's New Board Member*, BLOOMBERG (May 29, 2014 9:02 AM), <http://www.bloomberg.com/news/2014-05-29/billionaire-loeb-confirmed-as-sotheby-s-new-board-member.html>.

("Billionaire hedge-fund manager Dan Loeb was confirmed as Sotheby's (BID) newest director following a closely watched 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 in New York. The activist investor sat in the front row of the room. His Third Point LLC owns 9.65 percent of Sotheby's shares, according to a regulatory filing.")

incumbent board to a new board selected by the outsider. That new board will likely terminate the incumbent senior executives — clearly a poor outcome for them. Executives are aware of this, and thus the market for corporate control incentivizes executives to work hard to keep the share price high and rising, so as not to end up a casualty of a hostile takeover. The disciplining effect of the threat of hostile takeover is widely viewed as a powerful way to align the interests of management with those of shareholders, a core issue at the heart of the public corporation.²⁰⁷

In contrast to Japan where a change in corporate control is difficult for activists to achieve,²⁰⁸ the take-over market is robustly encouraged in the United States by a shareholder-value centric governance model.

Moreover, real economic benefits in the form of shareholder returns, managerial performance, and long-term operating income arise from activism.²⁰⁹ A recent analysis of activism on the operating performance of target companies had important conclusions:

[Activist] intervention is associated with productivity gains at the plants of the targeted companies. We also measure the performance of plants that were sold subsequent to intervention and find that they were among the worst performing plants at the time of divestiture, but later experience a substantial improvement under new ownership relative to a matched sample. We find that employees of target firms experience a reduction in work hours and stagnation in wages while their productivity improves. These results support the view that hedge fund activists facilitate improvements in productive efficiency by improving the productivity of assets-in-place and by capital re-allocation. Overall, the evidence provided in the paper

207. See Schwartz, *supra* note 75, at 241.

208. Nakamura, *supra* note 147 (“But have the issues that motivated the reforms been solved in the decade since they were adopted? Has the market for corporate control achieved competitive market principles, transparency and information disclosure? And was the share value maximization principle fully adopted by Japanese managers? The answer to these questions are mostly no.”).

209. See Alon Brav et al., *Hedge Fund Activism, Corporate Governance, and Firm Performance*, THE J. OF FIN. Vol. LXIII, No. 4 (Aug. 2008), <https://www0.gsb.columbia.edu/mygsb/faculty/research/pubfiles/4128/Hedge%20fund%20activism%20Final.pdf> (“To summarize, we find that hedge fund activism is associated with an almost immediate increase in payout, heightened CEO discipline, and an improvement in analyst sentiment. On the other hand, the improvement in operating performance takes longer to manifest.”).

highlights the real and fundamental effects that hedge fund activists facilitate at target firms.²¹⁰

Improving the performance of companies will clearly have a positive effect on national economic performance including incentivizing more innovation.²¹¹ Another benefit of activism is a counterbalance to the rising influence of “lazy investors” such as passive index funds and ETFs that do not involve themselves in company performance as their function is to track the shares or the overall index. Doing so gives a “free ride” to directors and managers and governance will suffer. As a result:

[A]ctivists fill a governance void that afflicts today’s public companies. A rising chunk of the stock market sits in the hands of lazy investors. Index funds and exchange-traded funds mimic the market’s movements, and typically take little interest in how firms are run; conventional mutual funds and pension funds that oversee diversified portfolios dislike becoming deeply involved in firms’ management. In the face of Wall Street’s provocateurs, America’s lazy money is waking up. Whether their ideas are barmy or brilliant, the activists make it harder for investors to stay on the sidelines. Mutual funds and pension funds are being forced to take a view, and hence become more active and forward-looking. European and Asian shareholders say they do not need activists because they have more power than American investors over managers’ pay and appointments. They typically dismiss Mr. Icahn and his friends as an American solution to an American problem. And, for cultural reasons, the few European activists tend to be more diplomatic and consultative than their brash cousins. Yet wherever there are stock markets you will find underperforming companies, clubbable bosses and lazy capital. The public company was never meant to be a bureaucracy run by distant managers accountable to funds

210. Alon Brav et al., *The Real Effects of Hedge Fund Activism: Productivity, Asset Allocation, and Labor Outcomes*, THE REV. OF FIN. STUD. (2015), rfs.oxfordjournals.org/content/early/2015/06/26/rfs.hhv037

211. Julian Atanassov, *Do Hostile Takeovers Stifle Innovation? Evidence from Antitakeover Legislation and Corporate Patenting*, THE J. OF FIN., Vol. 68, pp 1097–1131 (2013) (finding a negative correlation between jurisdictions that enact anti-takeover laws with patents).

run by computers. The activist revolt will help give it a new lease of life.²¹²

The superior economy enjoyed by the United States demonstrates the virtues of activism. While United States economic performance is not without soft patches, as compared to both continental Europe and Japan, the United States has significantly better national economic performance.²¹³ Indeed, the need to foster activism globally is demonstrated by at least one study bolstering the case for encouraging activism across borders. A study of nearly 1800 activist “attacks” in almost two dozen nations on target companies from 2000-2010 had several interesting conclusions.²¹⁴ These activist moves ranged the gamut from takeover attempts to engagement over executive compensation to dividend policy.²¹⁵ The study concluded that certain types of activism, such as takeovers and restructuring, created shareholder value.²¹⁶ The analysis also concluded that other, non-activist types of conduct, failed to increase shareholder value,²¹⁷ while “[a]ctivist engagements that are successful in achieving a corporate restructuring, particularly a takeover, or multiple objectives, generate significant value for shareholders.”²¹⁸

Although, as in anything, potential for abuse exists,²¹⁹ it would be counter-intuitive to believe that activists do not substantially benefit portfolio companies.²²⁰ Directors and managers are charged with the duty to monitor companies on behalf of shareholders and to obtain the best value

212. *Capitalism’s Unlikely Heroes*, *supra* note 18.

213. See Eduardo Porter, *Economic Health? It’s Relative*, N.Y. TIMES (Oct. 16, 2012), http://www.nytimes.com/2012/10/17/business/us-economy-is-doing-well-compared-with-other-nations.html?_r=0 (“A more illuminating question is how we have done relative to other countries that were caught in the global financial cataclysm. By that standard, economic growth in the United States has done surprisingly well.”).

214. *Id.*

215. *Id.*

216. *Id.*

217. *Id.*

218. *Id.*

219. Zeke Faux, *Icahn Says BlackRock’s Finks Makes Fixing Bad Businesses Harder*, BLOOMBERG (May 3, 2015), <http://www.bloomberg.com/news/articles/2015-05-03/icahn-says-blackrock-s-fink-makes-fixing-bad-businesses-harder> (“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, he said, then get out as soon as the share price rises.”).

220. *Capitalism’s Unlikely Heroes*, *supra* note 18 (“*The Economist* has analysed the 50 largest activist positions in America since 2009. More often than not, profits, capital investment and R&D have risen.”); Becht et al., *supra* note 128 (“Our analysis however provides evidence 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. In Europe and North America, where activists are more successful in achieving outcomes, gains for shareholders are larger than in Asia, where activists have seen limited success.”).

for shareholders,²²¹ yet frequently fail to do so.²²² Activism can keep a check on badly run companies and activists' efforts enable smaller shareholders to be rescued from manipulative or corrosive management. In a very real sense, activists can be said to replace directors when directors fail to act.²²³

U.S.-style activism is good; it works. Accordingly, calls for curtailing or eliminating shareholder activism should be rejected. While modifications in disclosure regulations may be justified given technological advancement and financial product innovation, activism is virtuous and should be encouraged.²²⁴

VI. CONCLUSION

The United States business landscape and the governance architecture is being profoundly influenced by activist funds.²²⁵ "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."²²⁶

Activism and has engendered a vigorous debate in the United States and beyond. Proponents and opponents have legitimate arguments. On one hand, these activists may be overly focused on immediate profit and may employ stealth techniques to acquire shares. Yet, activists also

221. See *Revlon*, 506 A.2d at 173 (corroborating that shareholder value is the primary driver of U.S. corporate governance). See also David G. Yosifon, *The Law of Corporate Purpose*, 10 BERKELEY BUS. L.J. 181 (2014) (maximization of shareholder value is centric to United States corporate law); Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO L.J. 439, 439 (2000-2001) ("There is no longer any serious competitor to the view that corporate law should principally strive to increase long-term shareholder value."); 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, 510-35 (2007) (detailing the judicial opinions holding that "shareholder value . . . as the ultimate corporate objective").

222. *Capitalism's Unlikely Heroes*, *supra* note 18 ("Yet wherever there are stock markets you will find underperforming companies, clubbable bosses and lazy capital. The public company was never meant to be a bureaucracy run by distant managers accountable to funds run by computers. The activist revolt will help give it a new lease of life.").

223. See 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 (2013) (noting the roles of activists in corporate governance).

224. See Groden, *supra* note 26 (noting some opponents claim that activists' use of derivatives may straddle the line of legality). This raises a legitimate question but rather than ban or discourage activism, an updated disclosure requirement is a preferred approach. Slawotsky, *supra* note 25 (discussing whether 13(d) should be amended in light of transformations in financial markets).

225. See, e.g., Alan M. Klein, *Shareholder Activism in M&A Transactions*, HARV. L. SCH. F. ON CORP. GOVERNANCE AND FIN. REG. (2014), <https://corpgov.law.harvard.edu/2014/02/26/shareholder-activism-in-ma-transactions/> (noting the importance of activism in corporate mergers and acquisitions).

226. Joann S. Lublin, *In for the Long Haul: More Activist Investors Are Winning Board Seats and Helping Companies Revamp Their Governance Practices*, THE J. REP.: CORP. GOVERNANCE (Oct. 17, 2005), <http://pages.stern.nyu.edu/~adamodar/NewHomePage/articles/activistinvesting.htm>.

provide a strong incentive for directors to oversee their companies and for managers to embrace shareholder value. In commenting on BlackRock Fink's anti-activist letter, Carl Icahn noted that "Fink is protecting underperforming executives with his campaign against activist investors,"²²⁷ stating that "[y]ou can't get rid of these guys, A lot of them feel like they can do what they want, because of guys like Larry Fink. I can't remember one time that they [BlackRock] voted for us."²²⁸

The almost insurmountable challenges to activists operating in Japan may be a strong factor contributing to Japan's lost decades. Japanese economic performance has been lackluster for over two decades. The difficulty to engage in activism in Japan has prevented inefficiently run companies from being transformed into productive businesses and has prolonged Japan's economic malaise. Japan provides a sterling exemplar of why activism should not be banned or curtailed. In contrast, the ability of activists to engage in activism in United States markets may be a tonic preventing the managers from continuing to be inefficient and/or exploit the company.

Therefore, activism does have a role to play in corporate America, especially when activists employ their influence to ensure lackluster managers take actions such as amending the governance structure, adding directors, restructuring the capital base or selling a division or the company outright. Without the risk to their positions, managers and directors and, where applicable, other insider interests, can be expected to engage in various conduct conducive to their own financial self-interest. Activists can and do prevent or stop such practices within a company. While detractors of United States activism claim that activism focuses on short-term profits at the expense of other stakeholders, does a stakeholder system or a model of governance that does not ascribe overwhelming importance to shareholder value really deliver superior results? No. Accordingly, legitimate activism as a virtuous component of corporate governance needs to be encouraged and incentivized rather than banned or limited.

227. Lublin, *supra* note 226.

228. *Id.*