Brooklyn Journal of Corporate, Financial & Commercial Law

Volume 13 | Issue 2 Article 2

5-1-2019

Activist Shareholders at De Facto Controlled Companies

Gaia Balp

ACTIVIST SHAREHOLDERS AT DE FACTO CONTROLLED COMPANIES

Gaia Balp[*]

ABSTRACT

Activist campaigns are likely to increasingly target controlled companies. Studies concerning activism at controlled companies focus on shareholder-empowering tools, such as the right to nominate and elect minority directors on the board, as a pathway for limiting the principal-principal agency problem. However, not enough attention has been paid to the distinction between de jure and de facto controlled companies. Building on a recent case concerning a leading Italian corporation, this Article analyzes the possible unexpected corporate governance consequences of successful activist intervention at de facto controlled companies, showing that, where minority shareholders are granted the right to appoint directors on the board, such a distinction can be relevant. Under certain conditions, the interplay of activism, shareholder rights and de facto control can result in an inefficient corporate governance structure. In situations where institutional investors make up a significant portion of a company's shareholder base, and board representation rights apply, institutions teaming up with activists can bring about changes in the governance structure of the firm, particularly at the board level, so substantive that they reverse the balance of power between minority and majority shareholders—an outcome not even conceivable at de jure controlled companies. In such situations, both the disadvantages of not having a controller and those associated with contestable control combine. In addition, the monitoring role played by non-activist institutional shareholders becomes pivotal.

Highlighting the potential unexpected corporate governance effects of activism at de facto controlled companies can help frame the U.S. debate surrounding shareholder empowerment and refine the claim that activists' board representation could solve the principal-principal agency problem at controlled companies as well as complement the skeptical view about promoting shareholder engagement without more closely considering the impact of engagement-related costs.

INTRODUCTION

Activist campaigns are not new to the U.S. corporate scene. However, in recent years they have "spiked, almost hyperbolically."[1] From 2014 to 2017, the number of companies publicly targeted each year by activists has

---

* Assistant Professor of Business Law, Bocconi University, Milan.

1. John C. Coffee, Jr. & Darius Palia, *The Wolf at the Door: The Impact of Hedge Fund Activism on Corporate Governance*, 41 J. CORP. L. 545, 548 (2016).

ranged from more than 300 to nearly 500.[2] Hedge funds in particular have increasingly targeted investee companies with a goal of bringing about change in their governance practices, business plans and operations, capital structure or strategic direction, although usually not in their corporate control.[3] By taking up a significant but non-controlling equity position in a public company[4] and exercising shareholder rights in a demanding or even aggressive manner, activists exert pressure on the company to bring about the changes advocated.[5] Activists seek to earn profits by taking advantage of the increased stock price performance which usually follows such changes, typically where—as is mostly the case—underperforming firms are targeted.[6] In fact, activists operate as special information traders, in that they are ready not only to "spend resources to identify strategic changes that they believe will increase the share price of the targeted public company,"[7] but also to take large positions in that company and "spend even more resources to try to get the company to implement those changes."[8] Depending on the circumstances, activists will push through any strategy

2. *See* SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP & AFFILIATES, ACTIVIST INSIGHT, ACTIVIST INVESTING IN EUROPE: A SPECIAL REPORT 3 (2017), https://www.skadden.com/insights/publications/2017/10/activist-investing-in-europe-a-special-report-2017 [hereinafter SKADDEN-ACTIVIST INSIGHT].

3. *See* Marcel Kahan & Edward B. Rock, *Hedge Funds in Corporate Governance and Corporate Control*, 155 U. PA. L. REV. 1021, 1060–70 (2007) (illustrating the characteristic features of hedge fund activism as compared to activism by traditional institutions: the former being aimed at achieving significant changes in individual companies, rather than small, systemic changes, entailing higher costs, and being strategic and ex ante, rather than incidental and ex post). The reasons for these differences lie in the incentive structures of hedge fund managers, and in the fact that traditional institutional investors are faced with regulatory and political constraints, as well as conflicts of interest that render activism less profitable for institutional investors as compared to hedge funds. *Id.* Moreover, traditional investors pursue a diversification strategy that is difficult to combine with strategic activism. *See also* Brian R. Cheffins & John Armour, *The Past, Present, and Future of Shareholder Activism by Hedge Funds*, 37 J. CORP. L. 51 (2011) (distinguishing between hedge funds' "offensive" activism, as opposed to mainstream institutional investors' "defensive" activism).

4. *See* Marco Becht, Julian Franks, Jeremy Grant & Hannes F. Wagner, *Returns to Hedge Fund Activism: An International Study*, 30 REV. FIN. STUD. 2933, 2934 (2017) (finding that stakes built up by hedge funds average approximately 11%).

5. *See* William W. Bratton, *Hedge Funds and Governance Targets*, 95 GEO. L.J. 1375, 1379 (2007).

6. *See* Lucian A. Bebchuk, Alma Cohen & Scott Hirst, *The Agency Problems of Institutional Investors*, 31 J. ECON. PERSP. 89, 104–05 (2017) (explaining that activists' incentives to spend on stewardship depend on the likeliness of inducing large governance-generated value increases); Bratton, *supra* note 5, at 1379 (illustrating that activists' demands "likely include one or more actions assuring a quick return on investment—sale of the company at a premium, unbundling of the company through the sale or spin-off of a large division, or a large cash payment to the shareholders in the form of a special dividend or share repurchase"); Cheffins & Armour, *supra* note 3, at 57 (noting that activist hedge funds' targets, "despite usually having sound operating cash flows and returns on assets, typically have a low share price relative to book value and low dividend payout ratios").

7. Bernard S. Sharfman, *Activist Hedge Funds in a World of Board Independence: Creators or Destroyers of Long-Term Value*, 2015 COLUM. BUS. L. REV. 813, 829 (2015).

8. *Id.*

they believe will correct the target's underperformance. Therefore, activist hedge funds are looked upon as actors fueling a "market for corporate influence"—a market based on stepping-up pressure as minority shareholders, from persuasion behind the scenes up to a proxy contest for representation on a company's board of directors, and ultimately profit on improved returns that follow responsive changes made by the target's management—as opposed to the market for corporate control.[9]

In Europe, activist engagement lags behind the United States in terms of its scale.[10] However, it is significantly on the rise, being driven, at least in part, by "a higher incidence of foreign activists looking for opportunities as the U.S. market has become increasingly picked over."[11] In 2017, more than 100 European companies were publicly targeted by activists, and the most high-profile campaigns were often run by U.S. activists;[12] the absolute number of European companies targeted by non-European activists "was at a four-year high," with foreign funds accounting "for around 25% of campaigns."[13] With almost three-quarters of foreign campaigns led by U.S. activists, "U.S. interest in Europe has increased and the groundwork has been laid for a sustained level of activism."[14] European targets accounted for nearly one-quarter of all activist capital deployed and campaigns launched in the first half of 2018.[15] After the United States, activism among large economies is "relatively most frequent in Italy, the Netherlands, Germany and Switzerland (in declining order), none of which are typically labeled as having active markets for corporate control."[16] And, interestingly, in relative terms, activism is "less frequent [in the United States and the UK] after adjusting for the number of listed companies than in Italy or Germany."[17]

Recent international empirical research has found activist campaigns to be fairly successful, in that they very often lead to at least some of the corporate changes sought, whether regarding payout policy, governance matters, corporate restructuring or takeovers.[18] Evidence indicates that,

---

9. Cheffins & Armour, *supra* note 3, at 59.

10. *See* SCHULTE ROTH & ZABEL, ACTIVIST INSIGHT, THE ACTIVIST INVESTING ANNUAL REVIEW 2018 3 (2018), https://www.activistinsight.com/resources/reports [hereinafter SCHULTE ROTH & ZABEL-ACTIVIST INSIGHT] (noting that "the bulk of activism continues to take place in the U.S.").

11. *See* SKADDEN-ACTIVIST INSIGHT, *supra* note 2, at 3.

12. *Id.*

13. *Id.*

14. *Id.*

15. *See* LAZARD, REVIEW OF SHAREHOLDER ACTIVISM - 1H 2018 1 (2018), https://www.lazard.com/media/450655/lazards-review-of-shareholder-activism-1h-2018.pdf.

16. Becht et al., *supra* note 4, at 2940.

17. *Id.*

18. *Id.* at 2934 ("For the entire sample [of 1,740 activist engagements across twenty-three countries], the unconditional probability of an activist being successful in achieving at least one engagement outcome is 53%. However, the incidence of outcomes varies considerably across countries. In North America activists achieve outcomes in 61% of all engagements and 50% in

following hedge fund intervention, "target firms tend to decrease their capital expenditures, increase their payouts, and increase their incidence of asset divestitures, restructurings, or employee layoffs."[19] Hedge fund activism is also "associated with the highest rates of organizational change."[20] As a result of their efforts, activists also often obtain board seats.[21] In the United States, "activists on average have received just over one board seat for every two campaigns announced in a particular year."[22] Hence, although only a minority of hedge funds are actually activist shareholders,[23] activist hedge funds "have an outsized role in the debate about corporate governance because they have had an important effect on the manner in which public companies operate."[24] Indeed, "the emergence of high profile activists like hedge funds has led to warranted debate as to the desired level of their involvement in governance."[25]

If costly activist campaigns are often successful, this does not occur simply due to the sizable stake built up by activists in the targeted company, but much more so because activist proposals are backed by other investors, most notably traditional institutions such as actively managed mutual funds,

---

Europe, but only 18% in Asia."). Moreover, activism generates "positive alpha on average in large firms," although "in all engagements the returns crucially depend on the activist achieving outcomes." *Id.* at 2935. Data referred in this study to the United States is consistent with previous country-specific research. *See* Alon Brav, Wei Jiang, Frank Partnoy & Randall Thomas, *Hedge Fund Activism, Corporate Governance, and Firm Performance*, 63 J. FIN. 1729, 1744 (2008); April Klein & Emanuel Zur, *Entrepreneurial Shareholder Activism: Hedge Funds and Other Private Investors*, 64 J. FIN. 187, 189 (2009). However, by formulating shareholder activism as a sequential decision process, in which a more hostile tactic is conditional on having passed through less confrontational stages in order to measure the actual costs of activist monitoring, the overall success rate of activism has been estimated as 29.17%, lower than other studies. *See* Nickolay Gantchev, *The Costs of Shareholder Activism: Evidence from a Sequential Decision Model*, 107 J. FIN. & ECON. 610, 620 (2013).

19. Matthew R. Denes, Jonathan M. Karpoff & Victoria B. McWilliams, *Thirty Years of Shareholder Activism: A Survey of Empirical Research*, 44 J. CORP. FIN. 405, 413 (2017) (surveying the relevant literature).

20. *Id.*

21. *See, e.g.*, Gantchev, *supra* note 18, at 612 (finding that the activist tactic of requesting board representation "is effective in 39.33% of the cases").

22. SULLIVAN & CROMWELL LLP, 2016 U.S. SHAREHOLDER ACTIVISM REVIEW AND ANALYSIS 12 (2016), https://www.sullcrom.com/siteFiles/Publications/SC_Publication_2016_U.S._Shareholder_Activism_Review_and_Analysis.pdf. The article further notes that in recent years, "approximately 47% of all proxy contests, short or control slates, resulted in the activist investor obtaining one or more seats on the board." *Id.* at 19.

23. Kahan & Rock, *supra* note 3, at 1046.

24. Leo E. Strine, Jr., *Who Bleeds When the Wolves Bite: A Flesh-and-Blood Perspective on Hedge Fund Activism and Our Strange Corporate Governance System*, 126 YALE L.J. 1870, 1886 (2017).

25. Yaron Nili, *Missing the Forest for the Trees: A New Approach to Shareholder Activism*, 4 HARV. BUS. L. REV. 157, 203 (2014) (arguing that the calls for regulatory changes in the United States are construed both too narrowly, since they target specific activists such as hedge funds, and too widely, since "calls to import specific arrangements from other jurisdictions [do not consider] the full spectrum of models of activism").

pension funds and passive investors.[26] Due to their business model and incentive structures, traditional institutions usually adopt a passive, or at best reactive, stance as regards engagement with investee companies.[27] However, with increasing frequency, institutions are sharing the views of activists whom they consider to be a credible actors,[28] and are willing to support their campaigns either privately or publicly and to vote in line with them at the shareholders' meeting.[29] More so, proxy advisors' voting recommendations often offer additional support to activist campaigns.[30] This institutional support also helps to explain why even large-cap

26. Paul H. Edelman, Randall S. Thomas & Robert B. Thompson, *Shareholder Voting in an Age of Intermediary Capitalism*, 87 S. CAL. L. REV. 1359, 1408, 1415–17 (2014); 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, 867 (2013); *see also, e.g.*, Becht et al., *supra* note 4, at 2934; Cheffins & Armour, *supra* note 3, at 87. For the United States, see Ian R. Appel, Todd A. Gormley & Donald B. Keim, *Standing on the Shoulders of the Giants: The Effect of Passive Investors on Activism* (Nat'l Bur. of Econ. Research, Working Paper No. 22707, 2016), http://www.nber.org/papers/w22707 (documenting that the rise in passive investing is associated with more frequent confrontational activist campaigns and a higher likelihood for the activist to obtain board representation or the sale of the targeted company); Alon Brav, Wei Jiang & Tao Li, *Picking Friends Before Picking (Proxy) Fights: How Mutual Fund Voting Shapes Proxy Contests* (Colum. Bus. Sch., Research Paper No. 18-16, 2018), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3101473 (documenting a positive correlation between the propensity for targeting by activists and pro-activist voting by mutual funds, so that a relatively pro-activist shareholder base is a key factor driving activists' selection of targets).

27. *See* Serdar Çelik & Mats Isaksson, *Institutional Investors as Owners: Who Are They and What Do They Do?* 22–33 (OECD Publ'g, Paris, OECD Corp. Governance Working Papers, No. 11, 2013), http://dx.doi.org/10.1787/5k3v1dvmfk42-en; *see also* ORG. FOR ECON. & COOP. DEV., THE ROLE OF INSTITUTIONAL INVESTORS IN PROMOTING GOOD CORPORATE GOVERNANCE 19–63 (2011), https://www.oecd.org/daf/ca/49081553.pdf.

28. *See* SCHULTE ROTH & ZABEL-ACTIVIST INSIGHT, *supra* note 10, at 6 (asserting that "[i]ncreasingly, an activist's track record matters," in terms of its credibility, for the resonance of its ideas). This is in line with C.N.V. Krishnan, Frank Partnoy, Randall S. Thomas, *The Second Wave of Hedge Fund Activism: The Importance of Reputation, Clout, and Expertise*, 40 J. CORP. FIN. 296, 297 (2016) (finding that some top hedge funds succeed, not merely because of superior ability to select targets, but because "they acquire a reputation for having the ability to pressure managers in credible ways," i.e. for their "'clout and expertise,' including the demonstrated ability to succeed in the most difficult interventions by targeting large firms, launching successful proxy fights, initiating lawsuits, pressuring target boards using the media, overcoming strong anti-takeover defenses, and replacing board members"). Activists' successes at difficult targets "appear to result more from board representation, improved performance, and monitoring management than from capital structure or dividend policy changes." *Id.* at 296.

29. *See supra* note 26 and accompanying text.

30. *See, e.g.*, Cindy R. Alexander, Mark A. Chen, Duane J. Seppi & Chester S. Spatt, *Interim News and the Role of Proxy Voting Advice*, 23 REV. FIN. STUD. 4419, 4433 (2010) (finding that in 44.9% of cases Institutional Shareholder Services (ISS) recommends in favor of the dissident slate, and that ISS recommendations for the dissident slate increase the probability of victory in proxy contests by 14% to 30%); Thomas W. Briggs, *Corporate Governance and the New Hedge Fund Activism: An Empirical Analysis*, 32 J. CORP. L. 681, 692–93 (2007) (explaining that "regulatory action mandating responsible fiduciary proxy voting by institutional investors" has rendered proxy advisors influential, which encouraged shareholder activism, especially hedge fund activism, due to proxy advisors' "activist bent" (e.g., by supporting "only the weakest kinds of poison pills" and supporting dissident candidates and positions at director elections)); Edelman et al., *supra* note 26, at 1419–20.

companies are becoming increasingly targeted by activists, both in the United States and Europe.[31]

Moreover, in a significant number of cases, simply the threat of aggressive campaigns has resulted in ex ante settlements with the board by which the activist typically secures representation on the board.[32] This representation may then allow the activists to facilitate the changes they seek.[33] Again, the "growing willingness of institutional investors and proxy advisors to support activists" has been identified as a relevant driver for the increase in the number of ex ante settlements, which "strengthen[s] the credibility of the activists' threat to win seats in a proxy contest."[34]

However, securing representation on the board of directors does not necessarily mean the activist is likely to commit to its investment over the long term: although their holding periods have lengthened over time,[35] hedge funds typically exit after a period of no more than two or three years, or, at any rate, "after a period that is brief in terms of the life cycle of a corporation or an ordinary human investor."[36] Therefore, unlike other investors, employees and corporate creditors, hedge funds usually will not

---

31. *See* SCHULTE ROTH & ZABEL-ACTIVIST INSIGHT, *supra* note 10, at 3 (referring to the trend towards large-cap targets as a "natural result of an increase in the flow of assets to activist funds based on the success of activist strategies, particularly as a counterbalance to the overall trend of investors shifting toward passive vehicles"). "The recognition by institutional investors of the benefits of activism has also increased their willingness to lend support, allowing activists to engage even larger companies with performance and operational issues." *Id.*

32. *See* SULLIVAN & CROMWELL LLP, *supra* note 22, at 17–20, 22 (noting that "[s]ince 2013, companies and activists have been able to settle, on average, one in five proxy contests"). "[I]n the context of control slates . . . activists have agreed to settle, withdraw or otherwise end their proxy contests before a vote approximately 57% of the time on average." *Id.* at 19.

33. *See* Lucian A. Bebchuk, Alon Brav, Wei Jiang & Thomas Keusch, *Dancing with Activists* 26, 32 (Colum. Bus. Sch., Research Paper No. 17-44, Harvard Law and Econ., Discussion Paper No. 906, 2017), https://ssrn.com/abstract=2948869 (finding that settlements affecting board composition are associated with "subsequent increases in CEO turnover, payouts to shareholders, and the likelihood of a strategic transaction"; no evidence is found that settlements enable activists to extract significant rents at the expense of other investors by introducing directors not supported by other investors or by facilitating "greenmail" buybacks of activist shares at a premium over the market price).

34. *Id.* at 4; *see also* SULLIVAN & CROMWELL LLP, *supra* note 22, at 22. However, settlement agreements are becoming a source of concern for major institutional investors as noted by State Street Global Advisors Rakhi Kumar and Ron O'Hanley. *See* Rakhi Kumar & Ron O'Hanley, *Protecting the Interests of Long-Term Shareholders in Activist Engagements*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Oct. 17, 2016), https://corpgov.law.harvard.edu/2016/10/17/protecting-the-interests-of-long-term-shareholders-in-activist-engagements/ (discussing how "a recent rise in settlement agreements entered into rapidly between boards and activists and without the voice of long-term shareholders concerns us [(institutional investors)], as we see evidence of short-term priorities compromising longer-term interests").

35. *See* Ethan A. Klingsberg & Elizabeth Bieber, *Activism in 2018,* HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Jan. 29, 2018), https://corpgov.law.harvard.edu/2018/01/29/activism-in-2018/ (noting that "[t]he activists are now regularly holding investments for four to five years and focusing more consistently during the initial years of their investments on advocating for operational turnarounds").

36. Strine, *supra* note 24, at 1906.

remain involved long enough to participate fully in the actual long-term effects of the changes they put in place.[37]

The (positive or negative) corporate effects of hedge fund activism have long been debated.[38] However, even empirical research does not conclusively support any clear answer to the question as to whether hedge fund activism is beneficial or detrimental to the interests of the targeted company and its shareholders, and whether it should therefore be favored or opposed by regulation.[39]

One particularly interesting aspect to the debate on activist engagement is its focus on whether, and if so how, activism is affected by the structure of corporate ownership. In effect, activist interventions focus not only on companies with widely dispersed ownership and no one shareholder holding a stake large enough to secure voting control, but also on controlled companies, where the (absolute or relative) majority of the votes are held by a stockholder or a coalition of shareholders.[40] Minority-empowering shareholder rights, such as the right to appoint directors on the board, coupled with institutional voting support of activist proposals, can encourage activism at controlled companies.[41] One widely shared view about activism at controlled companies considers how activists exercise a disciplining effect on the controlling shareholders, in that they help to curb private benefit extraction at the hands of controlling shareholders by catalyzing support from institutional shareholders and supporting their stewardship function.[42] However, as this Article will attempt to show, such an approach is not comprehensive in relation to cases involving de facto control.

Studies concerning shareholder activism at controlled companies seem to feature a significant limitation in that they do not draw a clear dividing line between de jure and de facto controlled companies.[43] Such distinction is not a trivial one, as in one recent case concerning the leading Italian telecommunications company, Telecom Italia,[44] has shown: where a company is under de facto control and minority-empowering devices apply—specifically, board representation rights—activist engagement can bring about substantial changes in the governance structure of the firm,

---

37. *Id.* at 1928.
38. *See infra* Part I.
39. *See infra* Part I.
40. *See infra* Part II.
41. *See infra* Part II.
42. *See infra* Part II.
43. A de jure controlling stockholder holds an absolute majority of the voting rights; a de facto controlling shareholder does not, but is nonetheless able to actually control voting outcomes and the corporation due to the particular circumstances—the composition of the shareholder base, with small and very small passive minority shareholders who do not participate in the governance of the company, low voter turnout, etc. *See infra* Part III.
44. *See infra* Part IV.

typically at the board level, and even terminate control, regardless of any change in the company's ownership and the associated voting rights.[45]

The Telecom Italia case calls for an assessment of the possible corporate governance consequences of activist engagement at de facto controlled companies that may arise out of the interplay between factual circumstances and regulatory tools. Although the possible consequences of potentially unexpected outcomes of such interplay cannot be predicted in a straightforward manner, an activist's power to exert substantial influence over the company's management premised on a small equity stake, coupled with the presence of a much larger, but (theoretically) disempowered, blockholder is likely to cause instability at the corporate-governance level. This further enhances the essential gatekeeping role played by mainstream institutional investors, with dubious results in terms of the efficiency of corporate governance. Analyzing the possible unexpected effects of activist engagement at de facto controlled companies is of interest (also) from the U.S. perspective. In effect, concentrated ownership is also significant in the United States,[46] and U.S.-based controlled companies are not immune from being targeted by activists.[47] Moreover, from the standpoint of the regulatory implications of activism at controlled companies, the adoption of minority-empowering tools that feature similarities with the Italian slate voting system for board elections[48]—which has been key in the Telecom Italia case—is supported within U.S. literature as an effective instrument for enhancing both controller accountability to public investors and board independence when dealing with conflicted decisions.[49]

This Article proceeds as follows. Based on findings from empirical research, Part I provides an overview of the ambiguous corporate effects of activist hedge fund engagement with investee companies. Part II focuses on the impact of the corporate ownership structure on activism, highlighting minority-empowering shareholder rights, such as a voice in board elections, as one of the drivers of activist intervention at controlled companies.

---

45. *See infra* Part IV.

46. *See, e.g.*, Edward Kamonjoh, *Controlled Companies in the Standard & Poor's 1500: A Follow-up Review of Performance & Risk,* INV. RESP. RES. CTR. INST. 15 (2016), https://www.issgovernance.com/library/controlled-companies-standard-poors-1500-follow-review-performance-risk/ (reporting that, as of October 2015, 7% of the constituents of the S&P 1500 index were controlled firms: "there are two primary control mechanisms in the updated study group: 1) multi-class capital structures with unequal voting rights (78 study companies); and 2) control through ownership of at least 30 percent of a class of single-vote stock by a person or group (27 firms)"); *see infra* Part II–III.

47. *See infra* Part II.

48. Under slate voting, the board of directors is elected from competing slates (or "lists") of nominees, which are usually submitted by sponsoring shareholders. The majority of directors will be elected from the slate that received the largest number of votes at the shareholders' meeting (so-called "majority slate"), but at least one director must be picked from the slate that obtained the largest number of votes after the majority slate (so-called "minority slate"). *See infra* Part II.

49. *See infra* Part II.

Against this background, and based on a discussion of the general implications drawn from the Telecom Italia case, Part III and IV argue that it is necessary to draw a clearer divide between de jure and de facto controlled companies when analyzing the corporate-governance effects of activism at controlled companies: in point of actual fact, activist intervention can potentially affect de facto controlled companies, along with the balance of interests surrounding it, far more substantially than de jure controlled, or widely held, companies. Next, Part V analyzes the definition of a (de facto) controlling shareholder and the corporate-governance consequences of corporate control in terms of a controller's fiduciary duties. Taking account of these consequences, Part VI assesses the potential upsides and downsides of the rise in cooperation between activists and institutional investors in terms of possible corporate-governance consequences at companies dominated by a de facto controller. The gatekeeping and stewardship functions of institutional investors' is bound to remain pivotal in order to counteract the inefficiency plausibly affecting a firm's corporate governance following successful activist intervention. This analysis will help frame the debate concerning shareholder empowerment and the regulatory implications of activism.

I. THE AMBIGUOUS CORPORATE EFFECTS OF ACTIVIST ENGAGEMENTS

As has been noted by Chief Justice Strine, "[f]ew topics are sexier among commentators on corporate governance now than whether activist hedge funds are good for, a danger to, or of no real consequence to public corporations and the people who depend upon them."[50] The question as to whether positive or negative externalities are associated with hedge fund activism has long been debated, but is as yet unresolved, sharply dividing activists' supporters and opponents.[51] Even empirical evidence concerning the long-term effects and other aspects of activist hedge fund interventions is not straightforward.

A. ARGUMENTS FOR ACTIVISTS

Those who view activists as valuable corporate monitors that benefit all shareholders and advocate for enhanced shareholder power argue that activist intervention, including investment-limiting and adversarial interventions, does not create short-term gains at the expense of long-term

50. Strine, *supra* note 24, at 1871.

51. *See* Simone M. Sepe, *Board and Shareholder Power, Revisited*, 101 MINN. L. REV. 1377, 1379 (2017) (noting that in the current corporate environment, the debate on the optimal allocation of power between boards and shareholders "has intensified due to recent developments—such as the rise of hedge fund activism—which have shifted the balance of corporate power from boards to shareholders").

performance.[52] On the contrary, there is no evidence that the positive stock-price increase that normally accompanies activist intervention is followed by negative abnormal returns over a five-year period.[53] Moreover, no evidence has been found regarding "pump-and-dump patterns" in which the departure of an activist is followed by abnormal negative returns over a three-year window.[54]

Rather, further evidence highlighted an increase in operating performance at firms targeted by hedge funds.[55] Activism has been associated with positive externalities on industry peers: peers that are not targeted are induced to respond proactively to the threat of possible activist intervention by implementing policy changes that mimic those undertaken by targeted firms.[56] This apparently results in reduced agency costs, improved operating performance and higher stock valuations.[57]

Based on these findings, activist shareholders seem to be far from having detrimental effects on the interests of targeted companies and their long-term shareholders, and therefore, can be viewed in a favorable light. Furthermore, activists are considered an essential factor that promotes institutional investor stewardship.[58] Under this view, "specialists in monitoring combine through the capital markets with specialists in low-cost diversification to provide a form of market-based stewardship."[59] In fact, "[a]s governance intermediaries or governance arbitrageurs, activist shareholders can, in the right circumstances, serve to reduce the market's undervaluation of governance rights to the advantage of all shareholders."[60]

52. *See* Lucian A. Bebchuk, Alon Brav & Wei Jiang, *The Long-Term Effects of Hedge Fund Activism*, 115 COL. L. REV. 1085, 1150–54 (2015) (arguing that their findings: (i) "weaken the case for using staggered boards and weigh in favor of having annual elections for all directors," as well as of "reforms that provide shareholders with candidates on the corporate ballot, and they undermine a key objection to an effective shareholder franchise"; (ii) "eliminate a key motivation for proposals to limit the rights of short-term shareholders"; (iii) "weigh against a tightening of disclosure rules that would discourage and reduce the incidence of such activism"; and (iv) "should inform how corporate directors view and engage with activists," in that "boards should be open to the activist's ideas and to discussing them with the activist"). It should be noted that findings from event studies regarding short-term stock returns associated with the announcement of activist engagements mostly converge. For a survey of the relevant literature, see Denes et al., *supra* note 19, at 410.

53. Bebchuck et al., *supra* note 52, at 1130.

54. *Id.* at 1134–35.

55. *See* Denes et al., *supra* note 19, at 411–12.

56. *See* Nickolay Gantchev, Oleg Gredil & Chotibhak Jotikasthira, *Governance Under the Gun: Spillover Effects of Hedge Fund Activism* 2, 4 (Eur. Corp. Gov. Inst. (ECGI), Working Paper No. 562/2018, 2018), https://ssrn.com/abstract=2356544.

57. *Id.*

58. *See* Gilson & Gordon, *supra* note 26, at 867.

59. *Id.*

60. *Id.* at 877.

B. ARGUMENTS AGAINST ACTIVISTS

Those who oppose challenging the centrality of the board by adopting legal rules and corporate arrangements that facilitate activism rely instead on evidence "supporting the view that the substantial private gains hedge funds realize through activism come at the expense of long-term firm value, rather than from the activists' ability to hold managers more accountable."[61]

First, selection effects undermine the reliability of empirical results.[62] In particular, any findings that a set of comparable control firms not targeted by activists have better long-term financial performance compared to targeted firms underpin the claim that the value increases following hedge fund interventions are unlikely to be caused directly by activist actions.[63] Rather, "other governance mechanisms or actors have been on average more successful than the typical activist hedge fund in turning these relatively poorly performing firms around."[64] A study focusing on Germany draws a distinction between more and less aggressive hedge fund engagements, finding that "more aggressive hedge funds generated only initially higher returns and their outperformance quickly reversed, whereas non-aggressive hedge funds ultimately outperformed their aggressive peers."[65] Another study evaluated the impact of activist interventions on shareholder wealth and the market at-large by taking account of the distribution of returns across larger and smaller firms and, in particular, value-weighted average long-term stock returns, finding no strong support to the hypothesis that activist interventions drive long-term benefits for the typical shareholder.[66]

---

61. Martijn Cremers, Saura Masconale & Simone M. Sepe, *Activist Hedge Funds and the Corporation*, 94 WASH. U. L. REV. 261, 264 (2016) (claiming that re-empowering U.S. corporate boards by restoring their ability to use defensive measures such as staggered boards to resist activist hedge fund interventions would effectively secure a firm's commitment to long-term value creation); *see also* Yvan Allaire & François Dauphin, *"Activist" Hedge Funds: Creators of Lasting Wealth? What Do the Empirical Studies Really Say?*, INST. FOR GOVERNANCE OF PRIV. AND PUB. ORGS. 2 (July 2014), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2460920 (highlighting the "limit[ations] of econometric tool kit[s]" and their "weak ability to cope with complex phenomena").

62. *See* Martijn Cremers, Erasmo Giambona, Simone M. Sepe & Ye Wang, *Hedge Fund Activism, Firm Valuation and Stock Returns* 2–3 (June 16, 2018), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2693231&download=yes.

63. *See id.* at 3, 21, 37 (explaining that "selection effects arise because hedge funds tend to target underperforming firms so that endogenous turnaround actions by managers and directors of targeted firms, rather than hedge fund activism per se, could explain any subsequent change in the targets' corporate policies and valuations"). Additional qualitative evidence seems to further confirm this view. *See* Cremers et al., *supra* note 61, at 285–94.

64. Cremers et al., *supra* note 61, at 284.

65. Wolfgang Bessler, Wolfgang Drobetz & Julian Holler, *The Returns to Hedge Fund Activism in Germany*, 21 EUR. FIN. MGMT. 106, 106, 109 (2015) (suggesting that aggressive hedge funds attempt to expropriate the target firm's shareholders by exiting at temporarily increased share prices).

66. *See* Ed deHaan, David F. Larcker & Charles McClure, *Long-Term Economic Consequences of Hedge Fund Activist Interventions* 7 (Rock Ctr. for Corp. Gov. at Stan. U.,

Second, activism couples with market imperfections to increase the risk of mistakenly removing sound managers or forcing inefficient changes in a firm's policies.[67] Since market prices do not immediately reflect the private information available to directors and managers until the implications of that information show up in cash flows, "shareholders may take the fall in short-term stock prices following the undertaking of a profitable long-term project to signal managerial underperformance and, hence, rationally decide to remove the manager or seek other changes in existing firm policies, or otherwise dump their shares, increasing the likelihood of a change in control."[68] This is referred to as the "limited commitment problem" which affects shareholders as a consequence of market imperfections.[69] The costs associated with the limited commitment problem include those arising from the increased likelihood that "ex ante, fear of shareholder retribution will induce managers to pass up profitable long-term projects that are more likely to be associated with lower short-term firm outcomes or overinvest in less profitable short-term projects."[70] Based on evidence that the relative underperformance of firms targeted by activists (as compared to control firms) is more pronounced at firms that rely either on research and development (R&D) investments, intangible assets and patents on the one hand, or on longer-term stakeholder relationships on the other hand, activism is deemed "to exacerbate the limited commitment problem."[71]

While noting that R&D expenditures tighten following activist interventions, supporters of activism highlight further findings that innovation output (as measured by patent counts and citations) increases at targeted companies, and hence conclude that activist-driven "[r]eallocation of innovative resources, redeployment of human capital, and change to board-level expertise all contribute to improve target firms' innovation."[72] However, the view that activism has a perverse deterrent effect on management's long-term focus by distorting ex-ante incentives of both managers and other stakeholders to invest optimally in the firm is not an isolated one. Findings that R&D investments decrease following activist intervention appear to be particularly worrisome because they suggest that "hedge fund activism may be leading to a broad and systemic shift by American corporations from investment to payout and particularly toward

Working Paper No. 236; Stan. U. Graduate Sch. of Bus., Research Paper No. 18-47; Eur. Corp. Gov. Inst. (ECGI), Finance Working Paper No. 577/2018, 2018), https://ssrn.com/abstract=3260095.

67. Cremers et al., *supra* note 61, at 278.

68. *Id.*

69. *Id.*

70. *Id.*

71. *Id.* at 285.

72. Alon Brav, Wei Jiang, Song Ma & Xuan Tian, *How Does Hedge Fund Activism Reshape Corporate Innovation?*, J. OF FIN. ECON. (forthcoming 2018) (manuscript at 1), https://ssrn.com/abstract=2409404.

avoidance of investments in R&D."[73] Moreover, the extent to which activist campaigns deter overall R&D investments should also be measured by considering non-targeted firms' ex ante responsiveness to the threat of possible activist intervention.[74] The implementation of activist proposals to limit investments may well result in increased returns on assets;[75] however, the question remains as to whether the price paid for achieving such increased returns might subsequently turn out to have been simply too high.

In defense of activist investment-limiting proposals, it has been argued that the reining in of investments effectively curbs the management's bias towards inefficient expansion and empire building.[76] However, that argument has been objected to as being outdated: usually, any increase in a firm's size adversely affects stock price growth, which does not have the effect of inflating executive pay wherever—as is increasingly commonplace—compensation is equity-based rather than cash-based.[77] In addition—with the plausible exception of a few limited cases[78]—there is little reason to believe that an activist has superior knowledge, skills or expertise at running the business, as compared to the firm's management.[79] Hence, limiting management's discretion "through sudden and concealed activist campaigns would not necessarily lead to optimal outcomes."[80] After

73. Coffee & Palia, *supra* note 1, at 593 (drawing attention to the recent activist interventions at Allergan and DuPont as illustrating examples).

74. *Id.* at 594.

75. *See* Heqing Zhu, *The Preventive Effect of Hedge Fund Activism*, SOC. SCI RESEARCH NETWORK 36 (Nov. 1, 2013), http://ssrn.com/abstract=2369533 (finding that "in proactive response to an increase in the likelihood of hedge fund intervention, firms cut CEO pay, reduce cash holdings and leverage, limit capital investment and R&D expenses, and raise shareholder distributions and CEO turnover"). "As a result of these policy improvements, return on assets increases significantly." *Id.*

76. *See* Nickolay Gantchev, Merih Sevilir & Anil Shivdasani, *Activism and Empire Building* 2 (Kelley Sch. of Bus., Research Paper No. 17-74; SMU Cox Sch. of Bus., Research Paper No. 18-10; Eur. Corp. Gov. Inst. (ECGI), Finance Working Paper No. 575/2018, 2018), https://ssrn.com/abstract=3062998 (suggesting that activists perform an influential governance role in the market for corporate control by disciplining inefficient acquirers, hence mitigating value destruction from empire building).

77. Coffee & Palia, *supra* note 1, at 593–94.

78. *See* Strine, *supra* note 24, at 1908–09 (acknowledging that, in some cases, owing to the funds' track record and its managers management expertise, the activist may assume "the duties and economic consequences of becoming a genuine fiduciary with duties to other stockholders and of holding its position for a period of five to ten years, during which it is a constructive participant in helping the rest of the board and management improve a lagging company," and indicating Nelson Peltz—having been "a successful CEO of several businesses for decades, and [] applauded for his willingness to get into the thicket of important work when serving on target boards"—and his Trian Fund Management as a possible example: "[p]recisely because in this story the hedge fund is not really short-term, at least in comparison to the rest of the participants in our short-term markets, whatever business ideas it has are likely to be ones that have to consider long-term effects more closely").

79. *Id.* at 1953–54.

80. Coffee & Palia, *supra* note 1, at 593–94 (also noting that some campaigns might not be based on sound strategies but be initiated mainly in order "to roil the waters on the premise that

all, most hedge fund managers are financial experts, and not operational or management experts, and have no special skills in the specific business of their target firms.[81]

Third, the view that hedge fund activism is beneficial overall is challenged by findings which suggest that hedge fund interventions expose target firms' creditors and employees to adverse outcomes.[82] Following activist intervention, "the average bankruptcy risk measure is 10% higher for the targeted firms than for the controls in the first three years and is 11% higher thereafter."[83] Activists advocate the implementation of riskier projects or an increase in financial leverage because these measures are usually associated with positive short-term stock returns.[84] Thus, activism increases corporate risk-taking and heightens the risk of wealth-transfers from creditors to shareholders.[85] Further, studies found that despite improved production and labor efficiency following hedge fund activism, workers' productivity-adjusted wages stagnate.[86] This indicates that workers "relinquish most of the surplus to equity investors after hedge fund intervention."[87] In addition, defined benefit employee pension plans of target firms have experienced greater underfunding in the wake of hedge fund activism.[88] This suggests that "[s]hareholder gains from activism appear to partly come from raiding deferred compensation promised to workers" and, potentially, taxpayers (owing to the guarantees provided in the event of a default by the sponsoring employer).[89]

---

noisy activism will be read by the market as signaling a possible takeover or restructuring," allowing the activist to profit therefrom by exiting at an early point).

81. Brav et al., *supra* note 18, at 1755; Strine, *supra* note 24, at 1953–54.

82. *See* Cremers et al., *supra* note 61, at 298–99.

83. *Id.* at 300.

84. *Id.* at 299.

85. April Klein & Emanuel Zur, *The Impact of Hedge Fund Activism on the Target Firm's Existing Bondholders*, 24 REV. FIN. STUD. 1735–37, 1766 (2011) (finding that abnormal stockholder returns are negatively related to the abnormal bondholder returns for both short-run and long-run windows, which underpins the view that activist intervention can result in wealth transfers to the detriment of corporate creditors). Also, findings that "bond returns are inversely related to subsequent changes in dividends and leverage and directly related to subsequent changes in cash on hand and assets" are deemed "consistent with the view that, on average, hedge fund activism increases credit risk." *Id.* at 1736. *But see* Brav et al., *supra* note 18, at 1732 (finding instead that hedge fund activism is unlikely to shift wealth from the creditors to the shareholders). One recent study further suggests that "banks adjust their loan pricing [following activist intervention] to reflect their concerns about wealth expropriation." *See* Sandeep Dahiya, Issam Hallak & Thomas Matthys, *Targeted by an Activist Hedge Fund, Do the Lenders Care?*, SOC. SCI. RESEARCH NETWORK 1 (June 4, 2018), https://ssrn.com/abstract=3191072.

86. *See* Alon Brav, Wei Jiang & Hyunseob Kim, *The Real Effects of Hedge Fund Activism: Productivity, Asset Allocation, and Labor Outcomes*, 28 REV. FIN. STUD. 2723, 2726 (2015).

87. *Id.*

88. *See* Anup Agrawal & Yuree Lim, *The Dark Side of Hedge Fund Activism: Evidence from Employee Pension Plans*, 29TH ANN. CONF. ON FIN. ECON. & ACCT. 2018 3 (Sept. 29, 2017), https://ssrn.com/abstract=3000596.

89. *Id.* at 1.

The positive picture which portrays hedge funds as providers of a market-driven corrective for managerial moral hazard[90] has also been called into question based on, amongst other things, findings that despite public criticism of excessive executive pay as an established activist strategy, activism does not lead to significant changes in executive compensation at targeted firms over the long term compared to compensation levels at control firms.[91] This casts doubts on the ability of activists to effectively discipline entrenched managers.[92]

Finally, hedge fund representation in the board of directors is associated with an increase in informed trading in the corporation's stock, suggesting that activist board representation imposes new agency costs through widened bid/ask spreads and informed trading.[93]

Based on these findings, it would appear on the whole that corporations, including well-run, high-performing companies, are increasingly faced with:

> (1) pressure to deliver short-term results at the expense of long-term value, whether through excessive risk-taking . . . , avoiding investments that have long-term horizons or taking on substantial leverage to fund buybacks and special payouts to shareholders; (2) challenges in trying to balance competing interests due to excessively empowered special interest and activist shareholders; and (3) significant strain from the misallocation of corporate resources and energy into mandated activist or governance initiatives that provide no meaningful benefit to investors or other critical stakeholders.[94]

---

90. In principal-agent relationships, the problem of moral hazard is one of incentives. *See* Sanford J. Grossman & Oliver D. Hart, *Corporate Financial Structure and Managerial Incentives*, *in* THE ECONOMICS OF INFORMATION AND UNCERTAINTY 107 (John J. McCall, ed., U. of Chicago Press, 1982) ("[I]n a corporation owned by many small shareholders there is an 'incentive problem'; i.e., the managers (or directors) have goals of their own, such as the enjoyment of perquisites or the maximization of their own income, which are at variance with the goals of shareholders, which we assume to be profit or market value maximization.").

91. Cremers et al., *supra* note 61, at 303. *But see* Jana P. Fidrmuc & Swati Kanoria, *Hedge Fund Activism and CEO Compensation* 2–4 (Oct. 4, 2017), https://ssrn.com/abstract=3047917 (finding that: (i) activist hedge funds reduce excess overall CEO pay; and (ii) pay-for-performance sensitivity decreases after activism: a result conjectured to reflect monitoring by activist hedge funds, which substitutes for incentive-laden compensation in motivating CEOs to improve firm value).

92. Cremers et al., *supra* note 61, at 303.

93. *See* John C. Coffee, Jr., Robert J. Jackson, Jr., Joshua R. Mitts & Robert E. Bishop, *Activist Directors and Agency Costs: What Happens When an Activist Director Goes on the Board?* 2 (Colum. Bus. Sch., Research Paper No. 18-15, 2018), https://ssrn.com/abstract=3100995.

94. Martin Lipton, *Will a New Paradigm for Corporate Governance Bring Peace?*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Oct. 15, 2015), https://corpgov.law.harvard.edu/2015/10/05/will-a-new-paradigm-for-corporate-governance-bring-peace/.

II. ACTIVISM AND THE STRUCTURE OF CORPORATE OWNERSHIP

One increasingly significant aspect to the debate concerning activism lies in its focus on whether, and if so how, activism is affected by the structure of corporate ownership. In keeping with the fact that activist campaigns need to attract the support of other investors to be successful, hedge funds primarily seek out targets whose shareholder base features a significant proportion of institutional investors.[95] This, however, does not necessarily mean that activists only focus on companies with widely dispersed ownership. In fact, activist intervention also occurs at controlled companies, where gaining influence over the company and the votes at shareholder meetings should reasonably be expected to be more challenging.[96] This suggests that dispersed ownership can no longer typically be regarded as "a necessary precondition for an influence-based intervention."[97]

Probably the most apparent indication that activism actually occurs at controlled companies is drawn from experience within European countries, where concentrated corporate ownership prevails.[98] Although in France and Germany activists target companies with relatively dispersed ownership,[99] in Italy—a country known for high levels of ownership concentration—activist hedge funds have "taken position in a great variety of listed companies regardless of the presence of controlling shareholders."[100] As mentioned above, after the United States, activism is relatively more frequent in Italy.[101]

Although concentrated ownership helps to explain why Europe lags behind the United States in terms of the overall level of activist

95. Becht et al., *supra* note 4, at 2936.

96. *See*, *e.g.*, Wolf-Georg Ringe, *Shareholder Activism: A Renaissance*, *in* THE OXFORD HANDBOOK OF CORPORATE LAW AND GOVERNANCE 393–94 (Jeffrey N. Gordon & Wolf-Georg Ringe eds., 2018) ("It is, first of all, more difficult to push through activist initiatives for minority shareholders in a controlled firm, since the 'controller' normally has the voting power to sanction the incriminated act or behavior. Second, the minority activist will usually find it more difficult to argue their case, and to show that their own ideas will benefit all shareholders, not just the majority.").

97. Cheffins & Armour, *supra* note 3, at 69 (in fact acknowledging that exceptions can exist).

98. On the international structure of corporate ownership and their patterns, see generally, more recently, Gur Aminadav & Elias Papaioannou, *Corporate Control around the World* (Nat'l Bur. of Econ. Res., Working Paper No. 23010, 2016), http://www.nber.org/papers/w23010 (where extensive references can be found).

99. *See* Becht et al., *supra* note 4, at 2968.

100. Matteo Erede, *Governing Corporations with Concentrated Ownership Structure: An Empirical Analysis of Hedge Fund Activism in Italy and Germany, and Its Evolution*, 10 EUR. COMPANY & FIN. L. REV. 328, 354, 358 (2013) (further noting that "differences in the ownership structure of the target companies also seem to have had no impact on activists' investment choices"); *see also* Becht et al., *supra* note 4, at 2940 (documenting that after the United States, activism is relatively more frequent in Italy).

101. *See* Becht et al., *supra* note 4, at 2940.

engagement,[102] at European controlled companies, activists can exercise a wider range of powers granted to the shareholders as compared to the powers available to U.S. shareholders. Activists can exert pressure on the controlling shareholder and the company's management by exploiting minority shareholder protection rights provided for under European Member State national law.[103] In this respect, it is important to stress that, in 2007 and 2017, the European Union (EU) adopted Shareholder Rights Directives (SRD I[104] and SRD II[105]), which are explicitly intended to enhance shareholders' rights and to encourage shareholder participation and engagement with investee companies, thus also paving the way for increased activism.[106] Especially where the shareholder base includes U.S. institutional investors—as is increasingly the case throughout Europe[107]—this factor seems to provide further support for activism. In fact, U.S.

102. *See id.* at 2944, 2968 (illustrating that blockholders, such as families or founders and employee shareholders, will generally support the incumbent, and that activists more easily target companies where blocks are largely absent and that are more susceptible to the votes of foreign institutional shareholders).

103. For references to Italy, see Erede, *supra* note 100, at 359; Nili, *supra* note 25, at 192 (noting that "when the relationship route fails, some hedge funds do resort to more aggressive tactics by going directly and openly against the controlling shareholder, leading public campaigns, and trying to sway other shareholders, the public, and regulators against management").

104. Directive 2007/36/EC of the European Parliament and of the Council of 11 July 2007 on the exercise of certain rights of shareholders in listed companies, 2007 O.J. (L 184) 17 [hereinafter SRD I] (introducing new rules on transparency regarding the information provided prior to the meeting: timely and fast access to such information (Article 5); voting by proxy (Article 10); participation in general meetings at a distance via electronic means (Article 8); voting by correspondence (Article 12); granting shareholders the right to place items on the agenda and to table draft resolutions concerning agenda items, subject to a threshold (if any) not exceeding 5% of the company's share capital (Article 6); and to ask questions concerning agenda items, which the company is required to answer (Article 9)).

105. Directive (EU) 2017/828 of the European Parliament and of the Council of 17 May 2017 amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement, 2017 O.J. (L 132) 1 [hereinafter SRD II].

106. *See* María Gutiérrez & Maribel Sáez Lacave, *Strong Shareholders, Weak Outside Investors*, 18:2 J. CORP. L. STUD. 277, 302 (2018).

107. According to the European Commission, non-national shareholders—most of which are institutional intermediaries—hold some 44% of the shares issued by EU listed companies. *Proposal for a Directive of the European Parliament and the Council Amending Directive 2007/36/EC as Regards the Encouragement of Long-Term Shareholder Engagement and Directive 2013/34/EU as Regards Certain Elements of the Corporate Governance Statement*, at 3, COM (2014) 213 final, 2014/0121 (COD) (Apr. 9, 2014), https://eur-lex.europa.eu/resource.html?uri=cellar:59fccf6c-c094-11e3-86f9-01aa75ed71a1.0003.01/DOC_1&format=PDF. A substantial proportion of shares in EU listed companies under foreign ownership is held by large U.S.-based investors: for the UK, see OFF. FOR NAT'L STAT., *Ownership of UK Quoted Shares: 2016*, para. 3, 5, 11, https://www.ons.gov.uk/economy/investmentspensionsandtrusts/bulletins/ownershipofukquotedshares/2016.

institutional investors exerted significant influence on the level of activism in non-U.S. countries.[108]

Given the prominent role played by U.S.-based actors, it is not surprising that activism at controlled companies occurs in the United States as well. In spite of the prevailing widely dispersed corporate ownership structures, controlled companies have been on the rise in recent years, at least partly as a result of the increasing trend to go public with a dual class structure.[109] In particular, activism at U.S. controlled companies is more consistent where encouraged by "a few motivating forces that increase activists' bargaining power vis-à-vis controllers," such as, most importantly, "the ability to nominate and elect minority directors in certain dual-class firms or effectively-controlled firms . . . ."[110] In particular, public shareholders' ability in certain U.S. dual-class firms to nominate and elect minority representatives to the board accounts for a significant share of publicly-disclosed engagements with controlled companies, and generated a high success rate.[111]

This finding allows a parallel to be drawn with European-style minority-empowering shareholder rights such as the right to a voice in board elections, which are arguably some of the most effective means of ensuring consideration for minority interests and enhancing oversight over the controlling shareholders or management.[112] The Italian regime for

---

108. *See* Becht et al., *supra* note 4, at 2968–69 (noting that "[t]he increase and spread of U.S. foreign institutional holdings has significantly contributed to hedge fund activism becoming a global phenomenon").

109. *See, e.g.*, Lucian A. Bebchuk & Assaf Hamdani, *Independent Directors and Controlling Shareholders*, 165 U. PA. L. REV. 1271, 1279 (2017); Albert H. Choi, *Concentrated Ownership and Long-Term Shareholder Value*, 8 HARV. BUS. L. REV. 53, 56–57 (2018) (citing well-known U.S. examples); Ronald J. Gilson, *Controlling Shareholders and Corporate Governance: Complicating the Comparative Taxonomy*, 119 HARV. L. REV. 1641, 1660 (2006); Gutiérrez & Sáez Lacave, *supra* note 106, at 281 (noting that "[a]s controlled firms grow in importance, tunneling, self-dealing, and other types of investor expropriation could become significant concerns in the US").

110. Kobi Kastiel, *Against All Odds: Hedge Fund Activism in Controlled Companies*, 2016 COLUM. BUS. L. REV. 60, 67–68 (2016); *see also* Cheffins & Armour, *supra* note 3, at 69 (mentioning the right to select a director in a company that provides for cumulative voting for directors as a means by which to put pressure on a company's dominant shareholder and its directors).

111. Kastiel, *supra* note 110, at 90, 93–94 (explaining that due to past restraints, major U.S. exchanges imposed on the use of dual-class structures; up "until the mid-1980s, controllers who wanted to use a dual-class structure in order to maintain control over the company even when they liquidated some of their position had no choice but to provide public holders with the right to elect minority directors").

112. While the Italian slate voting regime is quite unique, other countries provide shareholder minorities with different forms of special legal appointment rights to the board: specifically, Poland, Spain and Austria provide for cumulative voting. For an overview, see Paul Davies, Klaus J. Hopt, Richard Nowak & Gerard Van Solinge, *Boards in Law and Practice: A Cross-Country Analysis in Europe*, *in* CORPORATE BOARDS IN LAW AND PRACTICE 41–42 (Oxford Uni. Press Ed., 2013). Minority-elected directors are viewed as a viable regulatory option to possibly be introduced in other European countries in order to counter the principal-principal conflicts, which

corporate elections at listed companies is particularly illustrative of this aspect. In fact, the Italian regime is considered with some interest within U.S. literature.[113] Based on the mandatory adoption of the so-called slate voting system, the Italian regime is intended to ensure that at least one of the seats on the board is reserved for minorities, provided that minority shareholders actually submit a slate of nominees to be voted on at the shareholders' meeting.[114] Such system offers minority shareholders a relatively easy way of gaining access to the boardroom and obtaining direct insight into the company's affairs. Activation of this pathway requires a willingness to submit a slate of director nominees to be voted on according to the applicable rules and procedures, and to bear the (non-negligible) cost associated.[115] Importantly, alongside the shift towards the institutional-investor friendly "record date" system for identifying shareholders who are entitled to vote at the general meeting,[116] the right to elect minority

---

are typical for concentrated ownership, more effectively than through independent directors. *See* María Gutiérrez & Maribel Sáez, *Deconstructing Independent Directors*, 13 J. CORP. L. STUD. 63, 65 (2013).

113. *See* Jill E. Fisch, *The Destructive Ambiguity of Federal Proxy Access*, 61 EMORY L.J. 435, 498 (2012); David A. Skeel, Jr., *Inside-Out Corporate Governance*, 37 J. CORP. L. 147, 163 (2011); Danielle Vukovich, *Proxy Access Voting: Evaluating Proxy Access and the Recent Phenomenon of Corporations Adopting Shareholder Protective Policies*, 19 SAN DIEGO INT'L L.J. 437, 466–67 (2018); Bebchuk & Hamdani, *supra* note 109, at 1291; Kastiel, *supra* note 110, at 128–29.

114. *See* Decreto Legislativo 24 febbraio 1998, n. 58, Art. 147-ter (It.) (Consolidated Law on Finance), available in English at http://www.consob.it/web/consob-and-its-activities/laws-and-regulations/documenti/english/laws/fr_decree58_1998.htm (stating that shareholders holding a minimum threshold of shares—set by the Italian Supervisory Authority and currently varying between 0.5% and 4.5%—can present lists of candidates for election to the board). At least one member must be elected from the minority slate, having obtained the largest number of votes, and this person must not be linked in any way, even indirectly, to the shareholders who presented or voted on the list which received the largest number of votes. *Id.* According to the Italian Supervisory Authority, 96—out of 242—listed companies' boards currently include at least one minority-appointed director. *See* COMMISSIONE NAZIONALE PER LE SOCIETÀ E LA BORSA (CONSOB), REPORT ON CORPORATE GOVERNANCE OF ITALIAN LISTED COMPANIES 15 (2017), http://www.consob.it/web/consob-and-its-activities/report-on-corporate-governance. Moreover, several bylaws, especially of larger corporations, have actually made room for two or three minority-appointed directors, and the average number of directors appointed by the minority is approximately two. Piergaetano Marchetti, Gianfranco Siciliano & Marco Ventoruzzo, *Disclosing Directors* 7 (Bocconi Legal Studies, Research Paper No. 3264763; Eur. Corp. Gov. Inst. (ECGI), Law Working Paper No. 420/2018, 2018), https://ssrn.com/abstract=3264763.

115. The fact that setting up a slate of director nominees is costly may indirectly be inferred from the practice of slate voting in Italy. In fact, since the adoption of the slate voting system for board elections, the Italian Investment Managers Association (Assogestioni)—a non-profit association representing most of the Italian and foreign asset managers operating in Italy—has been playing a central role in selecting candidates and submitting minority slates, hence serving as a tool to minimize members' engagement-related costs. *See* Giovanni Strampelli, *How to Enhance Directors' Independence at Controlled Companies*, 44 J. CORP. L. 103, 136 (2018); *see also infra* note 139 and accompanying text.

116. In many EU Member States—amongst which Italy—share blocking during a certain period in advance of the general meeting, and up to the end of the meeting, was a requirement for participation and voting prior to enactment of SRD I. Share blocking was found to inhibit

directors under slate voting has favored activism at companies listed in Italy.[117]

At any rate, aside from the Italian slate voting system for corporate elections, the link between shareholders' rights and an activist's ability to convincingly engage with targeted companies regarding corporate governance or performance matters has been empirically tested.[118] This relationship is one of dependency: specifically, the frequency of activist intervention increases depending upon the extent to which shareholder rights are protected from managerial discretion.[119]

Against this backdrop, one view of activism at controlled companies is that:

> in cases of corporations dominated by controlling shareholders where the agency cost shifts from being one between managers and shareholders to one between controlling and minority shareholders, activist initiatives are aimed at curbing private benefit extraction by controlling shareholders. Hedge fund activists seek to discipline controlling shareholders by

---

institutional shareholder voting, since it overly restricted their ability to trade their shares. Therefore, share blocking was prohibited and replaced by a system based on a "record date." *See* SRD I, *supra* note 104, at Art. 7(1)(a) and 7(2) (stating, respectively, that: "the rights of a shareholder to participate in a general meeting and to vote in respect of any of his shares are not subject to any requirement that his shares be deposited with, or transferred to, or registered in the name of, another natural or legal person before the general meeting"; and that "the rights of a shareholder to participate in a general meeting and to vote in respect of his shares shall be determined with respect to the shares held by that shareholder on a specified date prior to the general meeting (the record date)"). Under the record date scheme, the shareholders entitled to vote are those of record as of a specified cut-off date in advance of the general meeting, irrespective of whether such formally entitled shareholders will actually still hold their shares on the day of the meeting. *See id.* at Art. 7(1)(b) ("[T]he rights of a shareholder to sell or otherwise transfer his shares during the period between the record date . . . and the general meeting . . . are not subject to any restriction to which they are not subject at other times . . . .") Therefore, shareholders may attend a meeting and exercise voting rights even if they transfer their shares after the record date.

117. *See* Massimo Belcredi & Luca Enriques, *Institutional Investor Activism in a Context of Concentrated Ownership and High Private Benefits of Control: The Case of Italy* 20–22, 31 (Eur. Corp. Gov. Inst. (ECGI), Working Paper No. 225/2013, 2014), http://ssrn.com/abstract=2325421 (further noting the rise, in recent years, of hedge funds successfully resorting to legal tools and remedies made available by reforms in the last two decades to aggressively targeting listed companies engaging in controversial transactions); *see also* Elisabetta Bellini, *Hedge Fund Activism in Italy*, 9 J. CORP. L. STUD. 201, 231, 233 (2009).

118. *See* Dionysia Katelouzou, *Worldwide Hedge Fund Activism: Dimensions and Legal Determinants*, 17 U. PA. J. BUS. L. 789, 830–52 (2015).

119. *Id.* at 853 (mentioning the right to exercise a veto over board initiatives, to appoint and remove directors, and to bring litigation as effective levers by which to affect changes in corporate policy and governance: "the ability of activist hedge funds to engage with directors of companies on issues concerning the corporate governance or the performance of the target company is largely dependent on the law protecting shareholder rights—meaning . . . legal rules governing the scope that activist hedge funds have to utilize the shareholder decision–making procedures to affect changes in corporate policy and governance, to exercise a veto over board initiatives, to appoint and remove directors, and to bring litigation").

cooperating with fellow minority shareholders and utilizing the protective tools granted by the legal regime to minority shareholders.[120]

Anecdotal evidence from Italy suggests that activist initiatives seem to seek "to curb the extraction of private benefits by dominant shareholders."[121]

There is considerable support for the argument that activist intervention can play a beneficial corporate-governance role by catalyzing support from traditional institutional investors and stimulating the exercise of their stewardship function.[122] Where evidence supporting the value-enhancing view of activist engagements is relied on, the regulatory implication drawn regarding shareholder empowerment in the United States is that shareholders unaffiliated with the controllers should be granted the right to elect minority directors to potentially "make controlling shareholders more accountable to other public shareholders by creating an effective platform for activist involvement."[123]

---

120. Alexandros Seretakis, *Hedge Fund Activism Coming to Europe: Lessons from the American Experience*, 8 BROOK. J. CORP. FIN. & COM. L. 438, 450–51, 455 (2014) (adding that it is "crucial . . . that activist hedge funds are not controlling shareholders able to impose their desired changes in the company's strategy or governance, but rather large influential shareholders who invest in monitoring and propose value-enhancing changes to other shareholders").

121. *See* Belcredi & Enriques, *supra* note 117, at 2. *But see* Erede, *supra* note 100, at 362, 382 (finding that hedge funds behave rather passively in Italy, and hypothesizing that this might entail a conscious strategy aimed at obtaining "other, generally higher gains than those made possible by following a genuinely activist strategy," concealing "a form of 'bad relational investing' as a mean to obtain higher gains").

122. *See* Ringe, *supra* note 96, at 420 (noting that "as activists need to convince other funds that their strategic plans are beneficial for the company as such (and do not create idiosyncratic benefits for the hedge fund), this process mitigates the potential extraction of short-term private benefits and ensures that activism is channeled into mutually beneficial activities"); Gilson & Gordon, *supra* note 26, at 897–98. In regard to controlled companies see Belcredi & Enriques, *supra* note 117, at 2 (providing "anecdotal evidence of activist initiatives aimed to curb the extraction of private benefits by dominant shareholders"); Seretakis, *supra* note 120, at 451.

123. Kastiel, *supra* note 110, at 132. For a similar view, see Yu-Hsin Lin, *Controlling Controlling-Minority Shareholders: Corporate Governance and Leveraged Corporate Control*, 2017 COLUM. BUS. L. REV. 453, 454 (2017) (arguing that the participation of institutional investors and shareholder activists is "essential to counteract the superpower of controlling-minority shareholders and to govern their midstream opportunistic behaviors"). With a view to promoting shareholder empowerment, criticism has targeted the tightening of European rules on disclosure of major shareholdings at listed companies, which was brought about by the Transparency Directive (Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004) on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC, 2004 O.J. (L 390) 38 and its 2013 amendments. *See* Directive 2013/50/EU of the European Parliament and of the Council of 22 October 2013 amending Directive 2004/109/EC of the European Parliament and of the Council on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market, Directive 2003/71/EC of the European Parliament and of the Council on the prospectus to be published when securities are offered to the public or admitted to trading and Commission Directive 2007/14/EC laying down detailed rules for the implementation of certain provisions of Directive 2004/109/EC, 2013 O.J. (L 294) 13. Due to the Directive's minimum harmonisation approach, which does not prevent Member States from introducing, or leaving in

Similarly, the rise of activist hedge fund board representation in the United States and the UK amounts to a mechanism for creating a "market for corporate quasi-control" in contexts of widely dispersed corporate ownership.[124] While falling short of actual corporate control, a seat on the board is associated with a degree of power that is indeed greater than mere influence.[125] As a consequence, activists' minority board representation may provide a solution to the problem of shareholder-manager agency costs and temper some of the most vocal criticisms of hedge fund activism, such as excessive focus on the short-term and weak commitment to improving operations and corporate strategies at targeted companies.[126]

However, as is illustrated in greater detail below, skepticism regarding positive views of activism, specifically in relation to de facto controlled companies, does not appear to be misplaced when also considering the potential corporate-governance consequences of successful activist intervention.

III. THE NEED TO DISTINGUISH BETWEEN DE JURE AND DE FACTO CONTROLLED COMPANIES

Despite the growing relevance of shareholder activism at controlled companies and the increased attention paid to it by corporate governance scholars and practitioners, existing analyses in this area feature a significant limitation by not drawing a clearer dividing line between de jure and de facto controlled companies. In the presence of some factual circumstances, such distinction can substantively affect the corporate-governance consequences of hedge fund engagement with de facto controlled companies.

place, rules stricter than those dictated at the European level, a number of the Member States chose to further restrict national rules disciplining the thresholds triggering disclosures, the timeframe for notification, and the inclusion of some derivatives in the disclosure requirements. *See* Seretakis, *supra* note 120, at 460–61. These measures have been criticized on the grounds of their deterrent effect on activist engagements: as compared to the corresponding U.S. federal regulations, which compel earlier disclosure in the process of building up consistent equity positions at firms targeted by activists. *See* 15 U.S.C. § 78m(d) (2012); 17 C.F.R. § 240.13d-1 (2011) (requiring beneficial owners of more than 5% of voting class of registered company's equity to file within ten days a Schedule 13D reporting acquisition and other information such as identity and background of acquirer and purpose of purchase). Therefore, the European rules have been regarded as "fail[ing] to balance the costs imposed by hedge fund activists in terms of compromising market transparency with the benefits of activism for shareholders and companies." Seretakis, *supra* note 120, at 463–65, 467 (highlighting that the overhaul of European disclosure rules was not preceded by adequate policy analysis).

124. Anna L. Christie, *The New Hedge Fund Activism: Activist Directors and the Market for Corporate Quasi-Control*, J. CORP. L. STUDIES 1, 3, 14 (2018) (illustrating that "[g]aining board representation can be described as *quasi-control* rather than *influence* as even winning one seat on a company board has enabled activists to make sweeping changes to companies, including fundamental changes to corporate strategy and dismissal of the CEO or the CFO").

125. *Id.* at 14 (referring to that category of influence in terms of "quasi-control").

126. *See id.* at 40.

Activist engagement is reported to involve U.S.-based controlled companies both where the controlling shareholders hold 50% or more of the voting rights—which in fact suggests that activists do not appear to focus on "easier" targets—and where they hold less than 50% of the voting rights: 44% of the engagements examined in a recent article involved companies where the controller's ownership stake varied either between 30% and 40% (29% of the sample) or between 40% and 50% (14%).[127] However, a closer inquiry into any possible non-overlapping consequences that activism might have for de jure and de facto controlled companies is needed. As corporate control can come in different—both stronger and weaker—forms, it might be useful to consider this de jure versus de facto distinction in regard to activism at controlled companies.

Essentially, a distinction should be drawn depending upon whether or not the controlling shareholder holds more than 50% of the voting rights (irrespective of its share in cash flow rights). Where votes within a company must be approved by a majority, de facto control can nonetheless be established on the basis of a stake accounting for less than 50% of the votes where this block secures control over voting outcomes due to the particular circumstances, including shareholder composition and actual voter turnout.[128] Although activism at controlled companies does not seem to differ significantly in nature from that prevailing within widely held corporations,[129] in situations of de facto control, the potential impact of activist intervention on the company, and the effect on the balance of interests surrounding it, can be much more far-reaching than in companies under de jure control.

The recent case concerning Telecom Italia has clearly shown that, where de facto controlled companies are involved and minority-

127. *See* Kastiel, *supra* note 110, at 87–88 (further finding that activist engagements with "fully controlled" companies are almost as successful as those with companies whose controllers hold only 30% to 40% of the voting rights).

128. *See, e.g.*, Cheffins & Armour, *supra* note 3, at 58 n.37 (illustrating that corporate influence differs from voting control in that "in a voting environment characterized by majority rule, an influential, as opposed to controlling, stake will be one where the purchaser holds some proportion α (where $0 < \alpha < 1$) of the voting rights, such that $0 < \alpha < 0.5$. *With a firm with dispersed stock ownership, it will typically be possible to control the outcome of a vote on most issues with a block less than 50% of the votes*. If we take n to represent the fraction of the voting rights necessary to secure a majority vote with certainty (where $0 < n < 0.5$), then we can add an additional constraint, namely that $0 < \alpha < n < 0.5$") (emphasis added).

129. Kastiel, *supra* note 110, at 85–88 (finding that contrary to possible expectations, activists that engage with controlled companies: (i) do not primarily focus on governance changes, but also target core business and financial matters (such as demands to divest assets, initiate a capital restructuring, return cash via dividends or buybacks, review strategic alternatives, seek or block mergers, etc.); (ii) do not use only low profile, collaborative strategies to achieve their goals, but also employ aggressive, hostile strategies (such as a threatened or actual proxy contest or a lawsuit); and (iii) do not pick "easier" targets (i.e. companies whose controllers hold between 30% and 40% of the voting rights), but also target fully controlled companies).

empowering devices apply,[130] activist engagement can bring about substantial changes in the governance structure of the firm and even terminate control, regardless of any change in the company's ownership and the voting rights attached.[131] As will be illustrated in more detail below, the May 4, 2018 vote at the shareholders' meeting of Telecom Italia proved to be critical for the company's de facto controlling shareholder, Vivendi SA, a French media and communications group.[132] Thanks to slate voting and voting support provided by both institutional investors and the Italian State, the slate submitted by Elliott Management Corporation affiliates—which collectively held a stake of only around 9%—won a majority (albeit narrow) of the votes.[133]

In keeping with Telecom Italia's by-laws, Elliott thus won two-thirds of the seats on the board of directors.[134] As a result, Vivendi's control over Telecom Italia ended, in spite of the fact that, with its nearly 24% stake, Vivendi was still the major shareholder, retaining a relative majority of the voting rights.[135] Such an outcome is obviously not even conceivable at de jure controlled companies, where voting outcomes at the shareholders' general meeting will obviously, and necessarily, coincide with the controlling shareholder's vote, irrespective of any diverging votes by cohesive minorities.

The Telecom Italia case calls for an assessment of the possible consequences of activist engagement at de facto controlled companies that may arise out of the interplay between factual circumstances and regulatory tools. On the one hand, the ownership composition of the targeted company matters, as does the stance adopted by traditional institutional shareholders in relation to voting. On the other hand, the legal definition of a controlling shareholder needs to be considered, alongside the legal regime applicable to controlled companies, as well as minority empowering regulatory devices governing board elections, such as the Italian regime of slate voting at director elections.

---

130. Specifically, board representation rights based on slate voting at director elections. *See supra* note 114 and accompanying text.

131. *See infra* Part IV.

132. *See infra* Part IV.

133. *See infra* Part IV.

134. *See* Press Release, Telecom Italia, Tim Shareholders' Meeting Held (May 4, 2018), http://www.telecomitalia.com/content/dam/telecomitalia/en/archive/documents/investors/AGM_and_Meetings/2018/CS_post_assemblea-ENG.pdf.

135. *See infra* note 157.

IV. WHY ACTIVIST ENGAGEMENTS AT DE FACTO CONTROLLED COMPANIES CAN BE DIFFERENT: THE TELECOM ITALIA CASE

For a variety of reasons, the Telecom Italia case may certainly be a peculiar one. However, the constellation of circumstances which triggered it cannot be dismissed as unique, thus allowing the conclusion that its outcome cannot possibly be replicated and should therefore be disregarded. A closer consideration of the relevant facts will show which general implications can be drawn from the case in terms of potential consequences of activism at de facto controlled companies.

The events of May 4, 2018 briefly illustrated above were preceded by a set of circumstances following Vivendi's entry in Telecom Italia as part of a wider strategic media-buying plan which included, amongst other things, building an influential position within Mediaset, a major media and broadcasting listed company.[136] Vivendi became Telecom Italia's major shareholder in 2014, following the conclusion of a share purchase agreement with the Spanish Telefonica, and subsequently increased its stake up to 24.9%—just below the 25% threshold triggering a mandatory takeover bid under Italian law.[137] At the December 2015 shareholders' meeting, Vivendi gained four seats on the board of directors and

136. Following its stake building in Mediaset in 2016, due to the potential for de facto control over multiple entities in the telecommunications and media sector threatening violation of EU antitrust regulation and media pluralism, Vivendi was required by the Italian Communications Authority (Autorità per le Garanzie nelle Comunicazioni) to reduce its position in either Mediaset or Telecom Italia. *See* Autorità per le Garanzie nelle Comunicazioni, Delibera 178/17/CONS (Apr. 18, 2017), available in Italian at https://www.agcom.it/documentazione/documento?p_p_auth=fLw7zRht&p_p_id=101_INSTANCE_ls3TZlzsK0hm&p_p_lifecycle=0&p_p_col_id=column-1&p_p_col_count=1&_101_INSTANCE_ls3TZlzsK0hm_struts_action=%2Fasset_publisher%2Fview_content&_101_INSTANCE_ls3TZlzsK0hm_assetEntryId=7533934&_101_INSTANCE_ls3TZlzsK0hm_type=document. Vivendi chose to cap its voting rights at Mediaset just below 10% by transferring the shares exceeding that threshold to a blind trust, and to retain full voting rights at Telecom Italia. *See* Press Release, Autorità per le Garanzie nelle Comunicazioni (Apr. 11, 2018), available in Italian at https://www.agcom.it/documentazione/documento?p_p_auth=fLw7zRht&p_p_id=101_INSTANCE_ls3TZlzsK0hm&p_p_lifecycle=0&p_p_col_id=column-1&p_p_col_count=1&_101_INSTANCE_ls3TZlzsK0hm_struts_action=%2Fasset_publisher%2Fview_content&_101_INSTANCE_ls3TZlzsK0hm_assetEntryId=10238311&_101_INSTANCE_ls3TZlzsK0hm_type=document.

137. *See* Decreto Legislativo 24 febbraio 1998, n. 58, Art. 106 (It.) (Consolidated Law on Finance), available in English at http://www.consob.it/web/consob-and-its-activities/laws-and-regulations/documenti/english/laws/fr_decree58_1998.htm?hkeywords=&docid=0&page=0&hits=20&nav=false (according to which "[a]nyone who, following acquisitions or increased voting rights, holds a stake greater than the thirty percent threshold or holds more than thirty percent of the voting rights of the same, promotes a takeover bid addressed to all security holders for the totality of the securities admitted for trading on a regulated market in their possession," and further adding that "[i]n companies other than SMEs [(small-to-medium entities)], the offer referred to in section 1 can be promoted also by anyone who, subsequent to acquisitions, comes to hold a stake greater than the threshold of twenty-five per cent, where there is no other shareholder with a higher stake").

successfully opposed a proposed conversion of non-voting shares into voting shares, which would have significantly diluted existing shareholders' voting rights.[138] This was followed by a change of Telecom's CEO and, in May 2017, by new board elections at which the slate of nominees submitted by Vivendi secured a narrow majority of the votes cast (49.3% as against 49% obtained by the short slate of independent candidates submitted by institutional investors through Assogestioni, the Italian asset managers' association).[139] Vivendi hence secured two-thirds of the board seats for a three-year term.[140] On account of the broader circumstances, and based on the relevant definitions under Italian law and the International Financial Reporting Standards, Vivendi was thus classified as Telecom Italia's de facto controlling shareholder, as was confirmed by Consob, the Italian Supervisory Authority in September 2017, following an inquiry by the company's board of statutory auditors.[141]

Against this background, in March 2018, Elliott built a stake close to 9% (8.85%) in Telecom Italia and submitted a proposal that six Vivendi-affiliated directors be removed and replaced with the new independent directors proposed by Elliot, to be voted on at the annual general meeting scheduled for April 24, 2018.[142] Next, on April 5, 2018, Treasury-owned

---

138. *See* Press Release, Telecom Italia, Telecom Italia Shareholders' Meeting Held (Dec. 15, 2015), https://www.telecomitalia.com/tit/en/archivio/media/comunicati-stampa/telecom-italia/corporate/economico-finanziario/2015/shareholders-meeting-held-december-15-2015.html.

139. Assogestioni, the Italian Investment Managers Association, actually plays a key role in selecting candidates and submitting minority slates. *See* Strampelli, *supra* note 115, at 134. Strampelli's article illustrating that,

> the engagement strategy adopted by Assogestioni and the affiliated institutional investors is very different from that usually adopted by activist hedge funds. Assogestioni seeks to achieve "less confrontational engagement with the management of portfolio companies," and focuses almost exclusively on the election of directors through the presentation of minority lists comprised of a list of candidates numbering less than half of the positions to which appointments are to be made. This clearly shows that the institutional investor engagement promoted by Assogestioni is primarily aimed at minimizing "the agency costs arising from the presence of a controlling shareholder by sharing management decisions, and thus by exercising closer monitoring," and not—in contrast to the usual approach of hedge funds—at forcing major changes in corporate strategy or replacing management.

Id. at 135–36.

140. *See* Press Release, Telecom Italia, TIM Shareholders' Meeting Held (May 4, 2017), https://www.telecomitalia.com/tit/en/archivio/media/comunicati-stampa/telecom-italia/corporate/economico-finanziario/2017/PR-AGM-TIM-04-05-17.html.

141. Commissione nazionale per le società e la borsa (Consob), Decision No. 0106341 of Sept. 13, 2017, available in English at http://www.consob.it/web/consob-and-its-activities/other-regulatory-measures/documenti/english/resolutions/c0106341.htm.

142. *See* Press Release, Telecom Italia, TIM: Request to Supplement the Agenda for the Shareholders' Meeting (Mar. 15, 2018), https://www.telecomitalia.com/tit/en/archivio/media/comunicati-stampa/telecom-italia/corporate/economico-finanziario/2018/CS-Integrazione-Assemblea-150318.html.

Cassa Depositi e Prestiti announced that it would buy Telecom Italia shares up to a maximum 5% stake.[143]

In response to Elliott's proposal, eight of the fifteen board members resigned.[144] Under the terms of the by-laws, this resulted in the resignation of the entire board, and thus required new board elections to be held.[145] The board of directors decided by a majority to exclude Elliott's March 2018 proposal from the agenda for the April 24th shareholder's meeting, considering it moot on account of the events that had subsequently occurred.[146] The board's decision was upheld by the courts, rejecting objections alleged by the company's board of auditors.[147] Thus, elections of a full new board were on the agenda of a special shareholders' meeting on May 4, 2018.[148] Interestingly, the prominent proxy advisory firm, Institutional Shareholder Services (ISS), considered the board's decision to challenge its own auditors in court to raise questions concerning the independence of the board; ISS stated that Telecom Italia shareholders should vote for Elliott's slate even though this would grant Elliott control of the board.[149]

Vivendi and Elliott each submitted its own slate.[150] Non-activist institutional investors (including many leading asset managers, like BlackRock, Vanguard, State Street, and Fidelity) did not, and the vast

143. *See* Press Release, Cassa Depositi e Prestiti, CDP: il Cda delibera l'ingresso, con una prospettiva di lungo periodo, nel capitale di Telecom Italia S.p.A. (TIM) (Apr. 5, 2018), https://www.cdp.it/media/comunicati-stampa/cdp-il-cda-delibera-lingresso—con-una-prospettiva-di-lungo-periodo—nel-capitale-di-telecom-italia-s-p-a—tim.kl.

144. *See* Press Release, Vivendi, Vivendi Representatives Resign from Telecom Italia's Board of Directors (Mar. 22, 2018), https://www.vivendi.com/en/investment-analysts/press-releases/vivendi-representatives-resign-from-telecom-italias-board-of-directors/.

145. *See* Press Release, Telecom Italia, Shareholders' Meeting to Renew the Whole Board of Directors Called for 4 May 2018 (Mar. 22, 2018), https://www.telecomitalia.com /tit/en/archivio/media/comunicati-stampa/telecom-italia/corporate/istituzionale/2018/PR-BoD-220318.html.

146. *Id.*

147. *See* Press Release, Telecom Italia, TIM: Judge Suspends Effectiveness of the Board of Statutory Auditors' Resolution on Agenda for the AGM of April 24 (Apr. 23, 2018), https://www.telecomitalia.com/tit/en/archivio/media/comunicati-stampa/telecom-italia/corporate/istituzionale/2018/TIM-appeal-230418.html; *see also* Press Release, Telecom Italia, TIM Notifies Appeal Against Supplementation of the Agenda for the AGM on 24 April (Apr. 13, 2018), https://www.telecomitalia.com/tit/en/archivio/media/comunicati-stampa/telecom-italia/corporate/economico-finanziario/2018/TIM-CS-Ricorso-130418.html.

148. *See* Press Release, Telcom Italia, *supra* note 145.

149. *See* Scott Deveau, *ISS Urges Investor Support for Elliott's Telecom Italia Nominees*, BLOOMBERG (Apr. 16, 2018, 17:37 CEST), https://www.bloomberg.com/news/articles/2018-04-16/iss-urges-investor-support-for-elliott-s-telecom-italia-nominees.

150. *See* Press Release, Vivendi, Vivendi Announces Board Candidates for Telecom Italia (Apr. 5, 2018), https://www.vivendi.com/en/investment-analysts/press-releases/62337/; *see also* Press Release, Telecom Italia, TIM: Elliot International LP, Elliot Associates LP e The Liverpool Limited Part[n]ership have filed the Slate for the Renewal of the Board of Directors (Apr. 10, 2018), https://www.telecomitalia.com/tit/en/archivio/media/comunicati-stampa/telecom-italia/corporate/economico-finanziario/2018/CS-LISTA-ELLIOT-CdA-Maggio-2018.html.

majority of these chose instead to support Elliott's candidates.[151] Vivendi's slate featured five independent directors out of ten, while all ten nominees on Elliott's slate were classified as independent.[152] Elliott also sought support from fellow shareholders in an open letter dated April 26, 2018.[153] This letter criticized Telecom Italia's conflicted governance structure on account of Vivendi's allegedly negative influence and self-serving behavior, and illustrated the need to refresh and empower the board "to correct the persistent undervaluation that is clearly present at [Telecom Italia]," while affirming support of the company's CEO and business plan.[154]

Eventually, with the backing of an impressive number of institutional investors, and also of Cassa Depositi e Prestiti, which had actually bought up a 4.78% stake by May 4th, Elliott's slate received 49.84% of the votes cast (equaling 33.47% of the share capital), as compared to Vivendi's slate, which garnered 47.17% of the votes (31.68% of the share capital).[155] As a result, the new board was made up of all ten directors drawn from Elliott's slate, and five picked from Vivendi's "minority" slate, including the former CEO, whom the new board re-confirmed as chief executive.[156]

Thus, power within the board shifted to activist-appointed independent directors, with Vivendi unable to exercise control over Telecom Italia, despite maintaining the largest stake (with 23.94% on May 4th) and a corresponding share of the voting rights.[157]

---

151. *See* The Minutes of the May 4, 2018 Shareholders' Meeting (in Italian), http://www.telecomitalia.com/tit/en/investors/shareholders/agm/assembly-4-05-2018.html; *see also* Sahil Mahtani, *Telecom Italia Vote Shows How Activists and Passive Investors Can Work Together*, COLUM. L. SCH. BLOG ON CORP. & CAP. MARKETS (May 16, 2018), http://clsbluesky.law.columbia.edu/2018/05/16/telecom-italia-vote-shows-how-activists-and-passive-investors-can-work-together.

152. *See* Press Release, Telecom Italia, Vivendi Has Filed the Slate for the Renewal of the Board of Directors (Apr. 5, 2018), https://www.telecomitalia.com/tit/en/archivio/media/comunicati-stampa/telecom-italia/corporate/economico-finanziario/2018/CS-LISTA-VIVENDI-CdA-Maggio-2018.html; Press Release, Telecom Italia, *supra* note 150.

153. Letter from Elliot Advisors (UK), to Telecom Italia Shareholders Ahead of May 4th Vote, BUS. WIRE (Apr. 26, 2018), https://www.businesswire.com/news/home/20180426006737/en/Elliott-Advisors-UK-Limited-Statement-Telecom-Italia.

154. *Id.*

155. See the relevant documents concerning the May 4, 2018 Shareholders' Meeting, including the Minutes and a Summary Report of the Votes, http://www.telecomitalia.com/tit/en/investors/shareholders/agm/assembly-4-05-2018.html.

156. *See* Press Release, Telecom Italia, Fulvio Conti Appointed Chair, Amos Genish Chief Executive Officer (May 7, 2018), https://www.telecomitalia.com/tit/en/archivio/media/comunicati-stampa/telecom-italia/corporate/istituzionale/2018/PR-TIM-BoD-070518.html; *see also* Press Release, Telecom Italia, TIM Shareholders' Meeting Held (May 4, 2018), https://www.telecomitalia.com/content/dam/telecomitalia/en/archive/documents/media/Press_releases/telecom_italia/Corporate/Institutional/2018/PR-TIM-Shareholders-meeting-040518-EN.pdf.

157. *See* Press Release, Telecom Italia, TIM: Vivendi's Direction and Coordination Ceases (May 16, 2018), https://www.telecomitalia.com/tit/en/archivio/media/comunicati-stampa/telecom-italia/corporate/istituzionale/2018/PR-BoD-Governance-160518.html.

Drawing upon this factual background, a number of points make the Telecom Italia case an interesting one in respect of the general issue of activism at de facto controlled companies. First, the case clearly shows how enhanced minority-shareholder rights and their interplay with the composition of the shareholder base can facilitate activist intervention, mobilize mainstream institutional investors' "receptive" stewardship, and ultimately favor successful—and indeed even disruptive—activist campaigns at de facto controlled companies.[158] The role played by the Italian State in the Telecom Italia case should not be overstated, even leaving aside considerations of national interest. Of course, had Cassa Depositi e Prestiti not taken on an almost 5% equity stake in Telecom Italia and voted in support of the activist's proposal, Elliott's slate might not have garnered a majority of the votes cast; however, the outcome might well have been the same had, all else remaining equal, a significant number of independent shareholders not decided to cooperate and to vote in support of Elliott's slate.[159] At the same time, the case shows the significance of the changes to corporate governance within contexts of concentrated ownership in recent years, specifically in the form of "increased shareholder participation and voting as foreign institutional investors have challenged the market norm of letting large (but not necessarily controlling) shareholders hold sway."[160]

Second, and more interestingly, the case teaches that at de facto controlled companies—by leveraging on public investors' voting support and submitting long slates of director nominees[161]—an activist can win a majority of the seats on the board of directors and hence potentially gain substantial influence over the firm's management for the duration of the board members' term in office without having to gain a majority equity stake in terms of the cash flow rights. At the same time, the loss of control over the board by the former controlling shareholder as a consequence of activist intervention entails a loss of its control over the company, even if that shareholder's stake remained the same as it was before as the largest

158. *See supra* notes 118–119, 155 and accompanying text.

159. *See* Mahtani, *supra* note 151.

160. Federica Soro, Glass, Lewis & Co., *Shareholder Battles at Telecom Italia*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (June 8, 2018), https://corpgov.law.harvard.edu/2018/06/08/shareholder-battles-at-telecom-italia/.

161. Interestingly, the frequency of long-slate campaigns conducted globally—in which an activist seeks to replace at least 50% of the board—spiked in the first half of 2018. *See* LAZARD, *supra* note 15, at 7 (reporting that long-slate campaigns accounted for one-third of all board nomination campaigns in the first half of 2018, the highest level since 2014, and explaining that "the prevalence of long-slate campaigns is notable because they often portend actual or effective changes in control[;] [i]n 53% of long-slate nomination campaigns, the result was an activist winning the proxy fight, settling for more than 50% board change or the company ultimately selling itself[;] [b]y contrast, such change in control outcomes resulted from only 16% of short-slate campaigns").

shareholder in the company: which, *inter alia*, entails the application of a less stringent regime governing material related-party transactions.[162]

V. DE FACTO CORPORATE CONTROL IN THE UNITED STATES

It is important to analyze possible unexpected (and, perhaps, surprising) effects of activist engagement at de facto controlled companies, such as those which occurred at Telecom Italia, not only in relation to Europe, where large blockholders who rank close to de facto control are not unusual and enhanced minority shareholder rights are well established under Member State laws.[163] Given that U.S.-based controlled companies are also targeted by activists, the issue seems to be of interest for the United States context as well. Moreover, it is of particular interest considering that U.S. literature supports the adoption of minority-empowerment tools for director elections featuring similarities with the Italian slate voting regime as an effective way of making controlling shareholders more accountable to other public shareholders by creating an effective platform for activist involvement and enhancing board independence when dealing with conflicted decisions.[164]

162. According to Article 8 of Consob Regulation No. 17221 of 12 March 2010 on transactions with related parties, the board may approve material related party transactions (transactions "of greater importance," as identified through a set of quantitative parameters) only if favorable advice has been previously given by a committee of independent directors involved in the negotiations; however, company-specific related party procedures may stipulate that the board may approve the transaction despite the negative opinion from the committee if, and only if, a shareholders' meeting is convened and a majority of unrelated shareholders approve the transaction (the so-called whitewash). Art. 8, Consob. Reg. No. 17221/2010, http://www.consob.it/web/consob-and-its-activities/laws-and-regulations/documenti/english/laws/reg17221e.htm?hkeywords=&docid=12&page=0&hits=24&nav=false). Instead, transactions "of lesser importance" may be approved by the board notwithstanding the negative opinion of the committee, who, in addition, is not required to lead the negotiations, and without recourse to the shareholders' meeting whitewash. *See* Art. 7, Consob. Reg. No. 17221/2010, http://www.consob.it/web/consob-and-its-activities/laws-and-regulations/documenti/english/laws/reg17221e.htm?hkeywords=&docid=12&page=0&hits=24&nav=false. According to Annex 1 of Consob Regulation No. 17221 (concerning definitions functional to the definitions of related parties and related party transactions), an entity is a related party to a company if, among others, the party "controls the company, is controlled by, or *is under common control*[.]" *See* Annex 1, Consob. Reg. No. 17221/2010, http://www.consob.it/web/consob-and-its-activities/laws-and-regulations/documenti/english/laws/reg17221e.htm?hkeywords=&docid=12&page=0&hits=24&nav=false (emphasis added). Therefore, losing control over Telecom Italia means that the regime on related parties will no longer apply to further Vivendi-controlled entities. On the Italian regime for related-party transactions see Strampelli, *supra* note 115, at 144–45.

163. As noted earlier, since activist engagements are found to largely depend on shareholder rights protection, this factor, coupled with the frequency of large, de facto dominating stockholders, arguably enhances the probabilities of surprising outcomes of shareholder empowerment in Europe. *See* Katelouzou, *supra* note 118, at 853.

164. *See* Bebchuk & Hamdani, *supra* note 109, at 1315 (arguing that in order "[t]o make independent directors more effective in overseeing conflicted decisions, . . . public investors should have the power to influence the election or retention of some 'enhanced-independence' directors [playing] a key role in vetting conflicted decisions, [while not being empowered] to

In addition, recent Delaware decisions seem to show a willingness to "cast a gimlet eye" on the special and unique circumstances that, from case to case, lead a shareholder with a relatively low ownership stake to end up as a controlling shareholder.[165] The recent Tesla Motors case is particularly illustrative in this respect.[166] Certain transactions involving influential stockholders are thus subject to entire fairness review, unless they are approved in advance by both an independent committee and endorsed by an informed and uncoerced vote by a majority of the minority shareholders.[167]

Indeed, where corporate control exists, a wide array of functional rules apply in virtually all jurisdictions, each body of rules serving the specific purpose of its own particular regulatory framework. Corporate control is relevant, e.g., under capital markets law, accounting law, competition law, as well as company law. While a consideration of all of the many regulatory implications of corporate control falls beyond the scope of this Article, it is important to highlight how corporate control affects corporate governance.

Although with different intensity, in situations involving corporate control, U.S. federal securities regulations and Delaware law (the most significant jurisdiction for corporate-law purposes) require, amongst further aspects, ex post disclosure of material transactions concluded between the company and the controlling stockholder, and ex ante heightened procedural safeguards, which must be applied to such transactions in order for the business judgment defense to be applicable.[168] Since related party transactions involve an agency problem, those safeguards are intended to protect the company and its non-controlling shareholders against potential

---

prevent the controller or their fellow directors from making other corporate decisions")]; *see also* Kastiel, *supra* note 110, at 132 (urging regulators and institutional investors to require controlled issuers to grant shareholders unaffiliated with the controllers the right to elect minority directors).

165. Ann Lipton, *Tesla Case Reveals the Poverty of Our Definition of a Controlling Stockholder*, BUS. L. PROF. BLOG (Mar. 31, 2018), http://lawprofessors.typepad.com/business_law/2018/03/tesla-case-reveals-the-poverty-of-our-definition-of-a-controlling-stockholder.html.

166. *See generally In re* Tesla Motors, Inc. S'holder Litig., Consolidated C.A. Mo. 12711-VCS, 2018 Del. Ch. LEXIS 102, 102 (Del. Ch. Mar. 28, 2018) (finding Tesla's 22.1% shareholder and chairman of the board to be a controlling stockholder based on "the chairman's voting influence, his domination of the board during the process leading up to the acquisition against the backdrop of his extraordinary influence within the company generally, board level conflicts that diminished the board's resistance to his influence, and the company's and the chairman's own acknowledgements of his outsized influence").

167. Entire fairness is the highest standard of review in corporate law, which applies where a majority of the directors approving the transaction are self-interested or where a majority stockholder stands on both sides of the transaction or receives different consideration from the transaction than the other stockholders. The entire fairness standard requires the board to demonstrate that the transaction is entirely fair to the stockholders as to both process (fair dealing) and substance (fair price). *See infra* notes 200–205 and accompanying text.

168. *See* Geeyoung Min, *The SEC and the Courts' Cooperative Policing of Related Party Transactions*, 2014 COLUM. BUS. L. REV. 663, 667–68 (2014).

value diversion or misappropriation by controlling shareholders.[169] For these protective mechanisms to apply, corporate control is obviously assumed as a precondition, since it is regarded as a source for potential abuse or exploitation. Hence, protective devices only apply as long as corporate control—whether de jure or de facto—is in place.

Against this backdrop and focusing on corporate governance effects of corporate control, in order to establish the extent to which activism may affect de facto controlled companies, it is necessary to consider the legal definition of a de facto controlling stockholder and the consequences of corporate control vis-à-vis the rules applicable to related-party transactions.

In the United States, corporate control is covered both by a set of rules dealing with related party transactions and also by common law.[170]

Depending on whether they kick in after or before the transaction takes place, regulations dealing with related party transactions are basically categorized into two groups.[171] The first group of regulations focuses on ex post monitoring and oversight over related party transactions.[172] Specifically, SEC regulation S-K Item 404(a) requires the disclosure (in the company's annual filings and its proxy statements) of any transaction that has occurred since the beginning of the company's last fiscal year, or that is currently proposed, between the company and any 5% shareholder where the amount involved exceeds $120,000 and the 5% shareholder has a direct or indirect material interest in the transaction.[173] In addition, in order to provide users of financial statements with adequate information concerning related party transactions, PCAOB Auditing Standard 2410, which is applicable to SEC registrant audits, requires the auditor "to test the accuracy and completeness" of information relating to related party transactions.[174] The disclosure of related party transactions is in fact required by the Financial Accounting Standards Board's Accounting Standards Codification (ASC) Topic 850.[175]

The second group of regulations (ex ante regulations) require certain procedures to be put in place for the prior screening of related party transactions.[176] At the federal level, SEC Regulation S-K Item 404(b)

169. *See* Luca Enriques, Gerard Hertig, Hideki Kanda & Mariana Pargendler, *Related-Party Transactions*, *in* THE ANATOMY OF CORPORATE LAW 145 (R. Kraakman et al. eds., 2017).

170. In fact, controlling shareholders fall under the relevant definition of a related party, which, according to Instruction 1(b)(i) to Item 404(a) of SEC Regulation S-K, also includes 5% shareholders. *See* 17 C.F.R. § 229.404(a) (2011).

171. *See* Min, *supra* note 168, at 676–80 (referring to transactions between the company and its directors).

172. *Id.* at 677.

173. 17 C.F.R. § 229.404(a) (2014).

174. AUDITING STANDARDS, AS 2410: Related Parties, § 14 (Pub. Co. Accounting Oversight Bd. 2017).

175. *See* JOANNE M. FLOOD, WILEY GAAP 2017: INTERPRETATION AND APPLICATION OF GENERALLY ACCEPTED ACCOUNTING PRINCIPLES 1200 (2017); Min, *supra* note 168, at 677.

176. *See* Min, *supra* note 168, at 677.

requires public companies to disclose their policies and procedures for the review, approval or ratification of related party transactions.[177] In addition, major stock exchanges require related party transactions to be reviewed and evaluated for potential conflicts of interest by an appropriate body within the company involved, such as the audit committee or another comparable body.[178]

Aside from federal law, in contrast to transactions between the company and its directors and officers, Delaware's corporate statute does not provide a safe harbor provision setting out pre-conditions to address conflicts of interest affecting transactions between the company and its controlling shareholders.[179] However, the common law duty of loyalty applies to transactions involving a controlling shareholder.[180] As a matter of fact, related party transactions are most often subjected to formal check during litigation, where the courts review any transactions involving the controlling shareholder's alleged breach of its duty of loyalty.[181] Therefore, defining whether or not a shareholder (or a coalition of shareholders) should be regarded as a controlling shareholder becomes paramount, particularly in cases other than the (much simpler) case of de jure control.

As has been noted by Justice Holland, there is no fixed meaning for the term "control" under Delaware law: "[i]ts definition varies according to the context in which it is being considered, e.g., fiduciary responsibility, tort liability, filing consolidated tax returns, sale of control."[182] Within the context of the imposition of fiduciary liabilities upon the controlling shareholder in relation to particular transactions with the corporation, the distinction between de jure and de facto corporate control is well established from a theoretical standpoint.[183] A shareholder with less than 50% of the voting rights may nonetheless qualify as a (de facto) controlling

177. 17 C.F.R. § 229.404(b) (2011).

178. *See* NYSE Listed Company Manual 314.00; Nasdaq Rule 5630 (a very similar standard). Under certain conditions, exchanges also require "shareholder approval prior to the issuance of common stock, or of securities convertible into or exercisable for common stock, in any transaction" related to substantial security holders of the company. NYSE Listed Company Manual 312.03; *see also* Nasdaq Rule 5635.

179. DEL. CODE ANN., tit. 8, § 144 (a)(1)–(3) (2018) (offsetting voidability of conflicted transactions between the company and its directors or officers where the transaction satisfies certain disclosure requirements, is approved by disinterested directors or shareholders, and is fair to all shareholders).

180. *See, e.g.*, Michelle M. Harner, *Corporate Control and the Need for Meaningful Board Accountability*, 94 MINN. L. REV. 541, 545 (2010).

181. *See* Min, *supra* note 168, at 679.

182. Weinstein Enters. v. Orloff, 870 A.2d 499, 507 (Del. 2005).

183. *See* Jonathan Rosenberg & Alexandra Lewis-Reisen, *Controlling-Shareholder Related-Party Transactions Under Delaware Law*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG 1 (Aug. 30, 2018), https://corpgov.law.harvard.edu/2017/08/30/controlling-shareholder-related-party-transactions-under-delaware-law/.

shareholder where, depending on the facts and circumstances, he has, and actually "*exercises control* over the business affairs of the corporation."[184]

Whether a minority blockholder exercises control over the company's business affairs is, however, a strongly factual issue because "there is no absolute percentage of voting power that is required in order for there to be a finding that a controlling stockholder exists."[185] Therefore, "the analysis of whether a controlling shareholder exists must take into account whether the stockholder, as a practical matter, possesses a combination of stock voting power and managerial authority that enables him to control the corporation, if he so wishes."[186]

A range of factors are considered to determine whether—despite the gap between the shareholder's ownership stake and a voting majority—it is reasonably conceivable that the minority shareholder actually dominates and controls the corporation, its board or the deciding committee, whether generally or with respect to a specific transaction, or both.[187] In order to show that the minority stockholder "[has] such formidable voting and managerial power that [he], as a practical matter, [is] no differently situated than if [he] had majority voting control,"[188] relevant circumstances typically include the power—also stemming from sources extraneous to stock ownership—to influence a contested election, or a stockholder vote, to bring about significant changes at the company, including the removal of board members, or the inability of the company to take action without the stockholder's consent.[189] The controller may directly dominate the board's process through his actual presence in the boardroom, or his presence may "be more of a 'looming' nature manifested by the board's awareness of his ability to make changes at the board level or to push other coercive levers should he be displeased with the board's performance or decision

184. Kahn v. Lynch Commc'n Systems, Inc., 638 A.2d 1110, 1113–14 (Del. 1994) (emphasis in original); *see also* Kahn v. Tremont Corp., 694 A.2d 422, 429–30 (Del. 1997); *In re* KKR Fin. Holdings LLC S'holders Litig., 101 A.3d 980, 993–94 (Del. Ch. 2014); *In re* Zhongpin, Inc. S'holders Litig., C.A. No. 7393-VCN, 2014 Del. Ch. LEXIS 252, at *18–19 (Del. Ch. Nov. 26, 2014).

185. *In re* PNB Holding Co. S'holders Litig., 2006 Del Ch. LEXIS 158, at *32 (Del. Ch. Aug. 18, 2006).

186. *In re* Cysive, Inc. S'holders Litig., 836 A.2d 531, 553 (Del. Ch. 2003).

187. *In re* Tesla Motors, Inc. S'holder Litig., Consolidated C.A. Mo. 12711-VCS, 2018 Del. Ch. LEXIS 102, at *32 (Del. Ch. Mar. 28, 2018) (citing *In re* Rouse Props., Inc. Fiduciary Litig., 2018 Del. Ch. LEXIS 93, at *28–29 (Del. Ch. Mar. 9, 2018)).

188. *In re PNB Holding*, 2006 Del. Ch. LEXIS 158, at *31; *In re* Morton's Restaurant Grp. Inc. S'holders Litig., 74 A.3d 656, 665 (Del. Ch. 2013).

189. *In re Tesla Motors*, 2018 Del. Ch. LEXIS 102, at *33; Corwin v. KKR Fin. Holdings LLC, 125 A.3d 304, 307 n.7 (Del. 2015) (citing *In re KKR Fin. Holdings LLC*, 101 A.3d at 991–95); *see also In re* Crimson Exploration Inc. S'holder Litig., C.A. No. 8541-VCP, 2014 Del. Ch. LEXIS 213, at *32–39 (Del. Ch. Oct. 24, 2014) (presenting a list of significant cases examining whether a minority stockholder satisfied the actual control test, and highlighting "the importance and fact-intensive nature of the actual control factor").

making."[190] One way or another, the stockholder's power must be "so potent that independent directors and minority stockholders cannot freely exercise their judgment, fearing retribution from the controlling minority blockholder."[191] As a matter of fact, a "director [might be] sufficiently loyal to, beholden to, or otherwise influenced by an interested party to undermine the director's ability to judge the matter on its merits."[192] Therefore, the significant contextual factors indicative of de facto controlling shareholder status often include the shareholder being chairman of the board and chief executive officer and having "managerial clout" over the company's managers and/or fellow board members, whether as a consequence of family or personal relationships and business connections,[193] the lack of substantial independence of a majority of directors,[194] or the stockholder's factual ability to dominate the corporate decision-making process.[195] Public statements made by the stockholder or the company regarding the extent of the stockholder's influence are also meaningful for informing the decision whether such stockholder should be regarded as a controlling shareholder.[196] Interestingly, a tendency within the courts of Delaware "to cast a gimlet eye on the webs of social and business relationships . . . that often tie boards together . . . [which] may not only evince a lack of independence, but may even count toward controlling shareholder status . . . ."[197] Cases like *Oracle* and *Tesla* seem to show that the willingness to leverage indicia, in addition to and other than stock ownership, might render the Delaware courts more inclined to "aggressively" find that a

190. *In re* Rouse Props., Inc. Fiduciary Litig., 2018 Del. Ch. LEXIS 93, at *29 (Del. Ch. Mar. 9, 2018)

191. *In re PNB Holding*, 2006 Del. Ch. LEXIS 158, at *30 (citing *In re* Pure Res., 808 A.2d 421, 443–45 (Del. Ch. 2002)).

192. *In re* Oracle Corp. Derivative Litig., C.A. No. 2017-0337-SG, 2018 Del. Ch. LEXIS 92, at *47 (Del. Ch. Mar. 19, 2018) (citation and internal quotation marks omitted).

193. *In re* Cysive, Inc. S'holders Litig., 836 A.2d 531, 552–53 (Del. Ch. 2003).

194. N.J. Carpenters Pension Fund v. Infogroup Inc., C.A. No. 5334-VCN, 2011 Del. Ch. LEXIS 147, at *9 (Del. Ch. Sept. 30, 2011).

195. *In re* Crimson Exploration Inc. S'holder Litig., C.A. No. 8541-VCP, 2014 Del. Ch. LEXIS 213, at *38 (Del. Ch. Oct. 24, 2014) (summarizing that "a large blockholder will not be considered a controlling shareholder unless they actually control the board's decisions about the challenged transaction").

196. *See In re* Tesla Motors, Inc. S'holder Litig., Consolidated C.A. Mo. 12711-VCS, 2018 Del. Ch. LEXIS 102, at *44–45 (Del. Ch. Mar. 28, 2018) (relying on Tesla's prior SEC filings and further public statements by Tesla and Elon Musk, the company's chairman, CEO and owner of a 22.1% stake, in considering Musk's status as a controlling stockholder).

197. Gail Weinstein, Robert C. Schwenkel & Steven J. Steinman, *Controlling Shareholder Transactions*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Apr. 26, 2018), https://corpgov.law.harvard.edu/2018/04/26/controlling-shareholder-transactions/; *see also* Lipton, *supra* note 165.

stockholder with a relatively low ownership stake (at the level of 22% in *Tesla*) is a controlling shareholder.[198]

The presence of a controller is an important factor in enforcing fiduciary obligations and achieving redress in the event that a controlling shareholder abuses his power. Controlling shareholders owe fiduciary duties to minority shareholders, which are similar to the duties of directors.[199] According to the fiduciary duties doctrine, transactions between a de facto controlling shareholder and the company are subject—just as are those involving a de jure controlling shareholder—to ex post judicial scrutiny according to the entire fairness standard of review, and not to the less stringent business judgment rule.[200] Cases of self-dealing most often concern the controlling stockholder's duty of loyalty, which, essentially, "mandates that the best interest of the corporation and its shareholders takes precedence over any interest possessed by a director, officer or controlling shareholder and not shared by the stockholders generally."[201] An action based on a breach of the duty of loyalty will therefore require an assessment as to whether the terms of the self-interested transaction concerned were dictated by the controlling shareholder, and whether there is any special benefit for the controlling stockholder that the minority stockholders do not share.[202] In fact, under the entire fairness standard of review, both procedural fairness and financial fairness are relevant.[203] As has been illustrated in the context of parent-subsidiary mergers,

> [t]he concept of fairness has two basic aspects: fair dealing and fair price. The former embraces questions of when the transaction was timed, how it was initiated, structured, negotiated, disclosed to directors, and how the approvals of the directors and the stockholders were obtained. The latter aspect of fairness relates to the economic and financial considerations of the proposed merger, including all relevant factors: assets, market value,

198. *See In re* Crimson Exploration, 2014 Del. Ch. LEXIS 213, at *37 n.68 (reporting that then-Chancellor Strine acknowledged that the Court had made its perhaps "most aggressive" finding in the *Cysive* opinion, where a 35% stockholder was considered to be a controller).

199. *See, e.g.*, Sinclair Oil Corp. v. Levien, 280 A.2d 717, 719 (Del. 1971); Kahn v. Lynch Commc'n Systems, Inc., 638 A.2d 1110, 1113–14 (Del. 1994).

200. *See* Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334, 1344 (Del. 1987); *Lynch*, 638 A.2d at 1115–16; Kahn v. Tremont, 694 A.2d 422, 428–29 (Del. 1997); *see also* Corwin v. KKR Fin. Holdings, 125 A.3d 304, 305 (Del. 2015) (illustrating that the business judgment rule is the appropriate standard of review for a fiduciary-duty action based on disinterested stockholder approval of a transaction *with a party other than a controlling stockholder*) (emphasis added).

201. *In re* Oracle Corp. Derivative Litig., C.A. No. 2017-0337-SG, 2018 Del. Ch. LEXIS 92, at *63 n.283 (Del. Ch. Mar. 19, 2018) (citing Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 361 (Del. 1993)).

202. *Sinclair Oil Corp.*, 280 A.2d at 720–22; Gilbert v. El Paso Co., 490 A.2d 1050, 1055 (Del. Ch. Nov. 27, 1984), 575 A.2d 1131, 1146 (Del. 1990).

203. *Lynch*, 638 A.2d at 1115.

> earnings, future prospects, and any other elements that affect the intrinsic or inherent value of a company's stock.[204]

While it falls to the plaintiff challenging the transaction to provide some justification for invoking the fairness obligation, it is ultimately for the controlling shareholder to prove the entire fairness of the transaction—and thus compliance with fiduciary duties towards the company and other shareholders.[205] However, where particular protective procedural devices that mimic arm's length transactions have been adopted, the burden of demonstrating that the transaction was unfair to the minority entirely shifts to the plaintiff.[206] Specifically, under the *Lynch* line of doctrine, either the approval of the transaction by a well-functioning committee of independent directors or an informed vote by a majority of the minority shareholders will enable the burden of proof as regards the issue of entire fairness to be shifted from the controlling shareholder to the plaintiff.[207]

Importantly, a novel exception as regards the applicable standard of review was recently adopted in *Kahn v. M & F Worldwide Corp*.[208] The Delaware Supreme Court held that the business judgment presumption revives where a dual-approval prerequisite is met.[209] In order to satisfy the *M & F Worldwide* prerequisites, the transaction must be conditional from the outset on *both* independent-director negotiation and approval, *and* on informed and uncoerced approval of a majority of shareholders unaffiliated with the controlling shareholder.[210] More specifically, under *M & F Worldwide*, the business judgment standard applies to controller transactions:

> *if, and only if*: (i) the controller conditions the procession of the transaction on the approval of both a Special Committee and a majority of the minority stockholders; (ii) the Special Committee is independent; (iii) the Special Committee is empowered to freely select its own advisors and to say no definitively; (iv) the Special Committee meets its duty of care in negotiating a fair price; (v) the vote of the minority is informed; and (vi) there is no coercion of the minority.[211]

---

204. Weinberger v. UOP, Inc., 457 A.2d 701, 711 (Del. 1983).

205. *Id.* at 710; *Cede & Co.*, 634 A.2d at 361.

206. *Weinberger*, 457 A.2d at 703 (referred to a parent-subsidiary merger "approved by an informed vote of a majority of the minority shareholders").

207. *Lynch*, 638 A.2d at 1117.

208. Kahn v. M & F Worldwide, 88 A.3d 635 (Del. 2014).

209. *Id.* at 644.

210. *Id.* at 642; *see also In re* Pure Res., 808 A.2d 421, 435 n.16 (Del. Ch. Oct. 1, 2002); Olenik v. Lodzinski, C.A. No. 2017-0414-JRS, 2018 Del. Ch. LEXIS 246, at *36 (Del. Ch. July 20, 2018) (explaining that the ab initio requirement is to ensure that the deal structure truly "mimic[s] arms-length dealing, and to neutralize the controller's influence").

211. *M & F Worldwide*, 88 A.3d at 645 (emphasis in original); *see also In re* Zhongpin, C.A. No. 7393-VCN, 2014 Del. Ch. LEXIS 252, at *28 (Del. Ch. Nov. 26, 2014).

Where only one of these dual procedural protections is employed, or any or all of the six conditions enumerated above are not met, the controller will only receive burden-shifting within the framework of the entire fairness standard of review, in keeping with the *Lynch* line of doctrine.[212]

Of course, each of the protections required under *M & F Worldwide* needs to be effective for the business judgment standard to apply.[213] This is why the majority-of-the-minority stockholder vote must be a fully informed and uncoerced one, and the special committee must "function in a manner which indicates that the controlling stockholder did not dictate the terms of the transaction and that the committee exercised real bargaining power 'at arm's length.'"[214]

Although established within the context of mergers, the *M & F Worldwide* dual-approval framework should arguably apply to non-merger controlling shareholder transactions as well. Such an extension would appear to be consistent with previous evolution of Delaware law, given that the "Delaware courts expanded the [] *Lynch* entire-fairness test from merger cases to other controlling-shareholder transactions, with Chancellor Allen stating that there is 'no plausible rationale for a distinction between mergers and other corporate transactions.'"[215]

By and large, Delaware jurisprudence shows that there is no certainty as regards the adoption of a process by which the courts can be prevented from classifying a minority stockholder as a de facto controlling shareholder, and hence disable entire fairness review.[216] While the *Tesla* decision may be less surprising as regards the court's refusal to dismiss, given that the board engaged in "no formal process" (such as forming a special committee when deciding on the controller's proposal to acquire a company that he controlled at an allegedly unfairly high price), it is nonetheless instructive with regard to the circumstances that were taken into account in support of the conclusion that Elon Musk's status was that of a controlling shareholder.[217] Even where there are some procedural safeguards within the board process, it is far from predictable whether entire fairness review will

212. *M & F Worldwide Corp.*, 88 A.3d at 646.

213. *Id.* at 645–46 ("If, after discovery, triable issues of fact remain about whether either or both of the dual procedural protections were established, *or if established were effective*, the case will proceed to a trial on which the court will conduct an entire fairness review.") (emphasis added).

214. *Id.* (citing Kahn v. Tremont, 694 A.2d 422, 429 (Del. 1997)).

215. Rosenberg & Lewis-Reisen, *supra* note 183, at 10 (further explaining that "[s]ince then, the *Lynch* entire-fairness standard has been applied to controlling-shareholders' management-services agreements, loans, non-competition payments, and third-party 'brokering' payments"). *See*, *e.g.*, *In re* Ezcorp. Inc. Consulting Agreement Derivative Litig., C.A. No. 9962-VCL, 2016 Del. Ch. LEXIS 14, at *33 (Del. Ch. Jan. 25, 2016) (ruling that the entire fairness standard of review applied to the challenged consultant agreements which involved self-dealing by a controlling shareholder).

216. *See* Weinstein et al., *supra* note 197.

217. *See supra* notes 166, 187, 189, 196, 198 and accompanying text.

actually be disabled. In point of fact—as happened in *Oracle*—the court may well find the controller's "outsized influence" over the company to be so potent as a matter of fact as to allow the conclusion that a majority of the board, and of the special committee charged with negotiations, is not independent.[218] Hence, the most effective way of avoiding the entire fairness review is, arguably, to meet the *M & F Worldwide* dual-approval procedural devices. However, this would essentially require the controller to relinquish control voluntarily and "give up his voting power by agreeing to a non-waivable majority-of-the-minority condition,"[219] to ensure that the process of negotiation and approval replicates a third-party transaction as far as possible. When considered from the perspective of an activist, the ability of minority shareholders to veto certain transactions as a consequence of compliance with the requirements of *M & F Worldwide* can be viewed as a pathway for activism in controlled companies. As has been noted, within the context of M&A transactions,

> [e]ven if most minority shareholders lack the ability to gather information and closely analyze the suggested deal terms, the use of a legal rule that incentivizes controllers to provide minority holders with veto power over conflicted transactions allows activist shareholders to extract a higher premium in going-private transactions (usually suspected to be conducted at a depressed price) to the benefit of *all* shareholders.[220]

VI. ASSESSING THE CORPORATE GOVERNANCE EFFECTS OF THE MARKET FOR CORPORATE INFLUENCE AT DE FACTO CONTROLLED COMPANIES

As has been shown above, the market for corporate influence[221] at de facto controlled companies, or at any rate, at companies actually dominated by a large influential stockholder, can sometimes be so powerful as to result in a situation whereby the majority of seats on the board shifts from directors appointed by the controlling shareholder to activist-appointed directors, without any change in corporate ownership. Such an outcome may result from the concurrence of a variety of complementary conditions, including specifically: (i) the presence of a de facto dominant shareholder holding a relatively low equity stake—granting even less than, say, 25% of the voting rights, depending on the circumstances; (ii) a significant level of

218. *In re* Oracle Derivative Litig., C.A. No. 2017-0337-SG, 2018 Del. Ch. LEXIS 92, at *58 (Del. Ch. Mar. 19, 2018) (concluding that Oracle co-founder and 28% stockholder Lawrence Ellison's influence over board members was such as to result in "a majority of the Oracle board—including two out of three members of the Special Committee that approved the acquisition—lack[ed] independence").

219. *See M & F Worldwide*, 88 A.3d at 638, 642 (citing Kahn v. Lynch Commc'n Sys., 638 A.2d 1110, 1117 (Del. 1994)).

220. Kastiel, *supra* note 110, at 100 (emphasis in original).

221. *See* Cheffins & Armour, *supra* note 3, at 59.

institutional investors in the ownership of the company; (iii) the applicability of legal rules that encourage influence-based activist strategies—specifically, minority shareholders' board representation rights; and (iv) the ability of an activist's proposals to attract sufficient voting support, in particular from larger institutional fellow shareholders, rendering it likely that the dominant shareholder's voting power may be overwhelmed as a consequence of the inherent possibility of disputing de facto control.[222] The latter condition builds on the teaming up phenomenon[223]—the factual convergence of mainstream institutional investors' votes in support of activists' proposals—as a lever for successful activist intervention: in fact, this phenomenon "seems to be developing into a broader market trend."[224] Importantly, teaming up is a phenomenon to be kept distinct from that of a shareholder coalition based on voting agreements that grant the coalition collectively a substantive, and durable, voting power which may even grant control over the company. The distinctive feature of teaming up is precisely that, being a form of soft, non-organized shareholder collaboration, voting convergence is spontaneous, and occasional, since it does not rest upon any agreement entered into by the shareholders.

It is questionable whether the market for corporate influence is efficient at de facto controlled companies in terms of its corporate-governance effects. All other things being equal, the particular ownership structure of the target company—whether widely held, de jure controlled or de facto controlled—might not plausibly be expected to be a neutral factor as regards the efficiency of the corporate-governance structure brought about following successful activist intervention. An outcome such as that in the Telecom Italia case is at odds with the roles ordinarily played by, and the usual balance of powers between, majority and minority shareholders, with unexpected corporate-governance effects.

In order to assess the potential corporate-governance effects of activism against the particular background of the company's ownership structure, a helpful starting point may be to draw a distinction between de jure and de facto corporate control as regards the intensity of a controller's opportunistic incentives and the relationship of these incentives with board representation rights granted to minorities.

In general terms, it may be argued that board representation achieved as a consequence of successful activist initiatives enhances oversight of any incentives on the part of the controller to extract private benefits, and helps to reduce potential value diversion to the benefit of the controlling

222. *See supra* Part IV.
223. *See* Gilson & Gordon, *supra* note 26, at 897–98.
224. Ringe, *supra* note 96, at 419.

shareholder.[225] Compared to de jure controlled companies, board representation at de facto controlled companies is theoretically an even more potent tool for curbing controller opportunism because the controller's exposure to private incentives is higher.[226] Even under a one-share-one-vote regime, de facto control can be based on a relatively small equity stake, as may be the case where the largest shareholder is surrounded by a number of very-small fellow shareholders who are either passive or unlikely to form a coalition with the potential to overwhelm the controller's voting power. In the resulting concentrated-ownership structure, it is unlikely that cash-flow rights and control rights will be bundled together tightly enough to align the controller's interests adequately with those of other investors, and thus moderate the control agency cost.[227] De facto controlling shareholders are exposed to a greater incentive to extract private benefits than de jure controlling shareholders: the smaller the controller's equity stake and cash flow rights, "the more she can divert from others—and thus the higher her incentive to divert."[228]

This would theoretically suggest that—especially at de facto controlled companies—minority shareholders should be granted protection through regulatory devices allowing them to appoint some directors to the board to render insiders more accountable.

However, under certain conditions, the exercise of such minority rights may lever the contestability of de facto control and bring about outcomes which can most probably be regarded as unintended—or, at least, unexpected—consequences of the grant to minority shareholders of the right to have a voice in board elections. Similar outcomes can render the corporate governance structure even less efficient than in situations involving de facto control.

The market for influence usually leads an activist to secure one or more seats on the board, while maintaining its status as a minority.[229] Minority board representation challenges entrenched boards or the controlling shareholder. It "can often lead to the replacement of significant corporate

225. *See* Bernard Black & Reinier Kraakman, *A Self-Enforcing Model of Corporate Law*, 109 HARV. L. REV. 1911, 1947 (1996) (promoting minority shareholder representation on the board based on mandatory cumulative voting as a means by which to render it likely "that a minority of directors is truly independent of management and . . . that these directors will owe affirmative loyalty to the shareholders who elect them").

226. *See* Zohar Goshen & Assaf Hamdani, *Corporate Control and Idiosyncratic Vision*, 125 YALE L.J. 560, 591 (2016) ("The higher the controller's share of cash-flow rights, the lower her incentive to expropriate the minority.").

227. *Id.* at 592–94 (2016) (arguing that the concentrated-ownership structure actually provides a middle-ground solution to management agency costs, as compared to dispersed-ownership and dual-class structures).

228. *Id.* at 591 n.103 (explaining that assuming equity is issued at a ratio of one share to one vote, due to the interplay between control rights and cash flow rights, a relevant shareholder's incentive to expropriate the minority also depends on the degree of ownership concentration).

229. *See, e.g.*, Edelman et al., *supra* note 26, at 1411.

managers such as the CEO or CFO."[230] Moreover, minority board representation can improve self-dealing oversight, particularly in situations where ex ante independent scrutiny of related-party transactions is required,[231] or incentivized,[232] by the law in order to ensure that the transaction is fair for the company and all of its shareholders. For example, within Italian listed companies, the presence of a minority director appointed by institutional investors based on mandatory slate voting has had a positive impact on the strength of internal procedures for addressing related-party transactions.[233] In particular, "the presence of at least one minority director is indeed associated with adoption of stricter internal codes, not only when minority directors are members of the committee of independent directors vetting internal codes, but also when they merely sit in the board."[234] Indeed, the very reason why mandatory slate voting was originally adopted in Italy for board elections at listed companies was to secure minority board representation as a monitoring tool deployed by active shareholders, in keeping with the view—that has grown predominant at the European level—that institutional investors should be encouraged to act as corporate stewards.[235] Further findings from the Italian context seem

230. Christie, *supra* note 124, at 3.

231. At the European level, SRD II ended up adopting a non-prescriptive stance regarding the process to be adopted in relation to related-party transactions. Article 9(c)(4) vests the Member States with broad discretion in this respect, as they are required to "ensure that material transactions with related parties are approved by the general meeting or by the administrative or supervisory body of the company according to procedures which prevent the related party from taking advantage of its position and provide adequate protection for the interests of the company and of the shareholders who are not a related party, including minority shareholders," and without the participation of the director or the shareholder who is a related party. *See* SRD II, *supra* note 105, at Art. 9(c)(4). However, some Member States—amongst which Italy: see *supra* note 162 and accompanying text—adopted wide-ranging regulations on related-party transactions, including detailed provisions involving independent directors in the decision-making process for related party transactions and, in some cases, empowering dissenting minorities to prevent the transaction. On the Italian regime for related party transactions see Strampelli, *supra* note 115, at 144–45; *see also infra* Part III. References to the UK and French regimes are provided by Enriques et al., *supra* note 169, at 157.

232. As is notably the case under Delaware law, see *supra* Part V.

233. *See* Marcello Bianchi, Angela Ciavarella, Luca Enriques, Valerio Novembre & Rossella Signoretti, *Regulation and Self-Regulation of Related Party Transactions in Italy - An Empirical Analysis* 25 (Eur. Corp. Gov. Inst. (ECGI), Finance Working Paper No. 415/2014, 2014), https://ssrn.com/abstract=2383237. It should be noted that under Italian law, Consob Regulation No. 17221 on related party transactions introduced both stricter procedural requirements and heightened disclosure obligations, however leaving some freedom to the board of directors in drawing the individual company's internal code: in fact, the board is allowed to opt-up or opt-down from some of the provisions set forth in the regulation as defaults. *See supra* note 162 and accompanying text.

234. *See* Bianchi et al., *supra* note 233, at 25 (also finding that, to the contrary, the degree of board independence, as measured by the percentage of independent directors sitting on the board, does not have an impact on the strictness of such internal codes).

235. *See* Marco Ventoruzzo, *Empowering Shareholders in Directors' Elections: A Revolution in the Making*, 8 EUR. CO. & FIN. L. REV. 105, 141 (2011); Strampelli, *supra* note 115, at 135–36; *see also infra* Part III.

to support the hypothesis that non-executive minority directors reduce principal-principal agency costs associated with controllers' potential self-dealing, and positively affect firm value, "even in presence of factors (uncertainty about future financial results and high information asymmetry) that might exacerbate the risk of hold-up by minority shareholders."[236] Thus, "the benefits associated to the active monitoring role by the independent minority directors outweigh the costs of potential frictions within the board . . . ."[237]

However, the rise of activist shareholders, coupled with increased regulatory and market pressure on mainstream institutional investors for more active stewardship and engagement[238] and, as a consequence, increased voter turnout at (European) shareholders' meetings, have proven to help turn slate voting—conceived of as a regulatory tool for protecting minority institutional investors—into a potent device for challenging boards and de facto controlling shareholders in a potentially disruptive manner.[239]

236. Nicola Moscariello, Michele Pizzo, Dmytro Govorun & Alexander Kostyuk, *Independent Minority Directors and Firm Value in a Principal–Principal Agency Setting: Evidence from Italy*, J. MGMT. GOVERNANCE 18–19 (2018), https://doi.org/10.1007/s10997-018-9421-0.

237. *Id.*

238. For Europe, see Council Directive 2017/828, Recitals (14)–(18), 2017 O.J. (L 132) (emphasizing the need for effective and sustainable shareholder engagement to "ensur[e] a more long-term approach by listed companies" and strongly encouraging asset managers and institutional investors to perform a stewardship function and exercise shareholder rights by requiring them—on a comply-or-explain basis—to publicly disclose their investment strategies and engagement policies, including through voting, and to publicly report on the implementation thereof, including a description of the votes cast). A similar bend towards promoting institutional investor engagement is also present in the United States, where starting from 1998, federal regulatory responses to weak institutional investors' voting incentives had the effect of changing institutions' pattern of voting. *See* Jill. E. Fisch & Simone M. Sepe, *Shareholder Collaboration* 21–22 (U. of Penn., Inst. for Law & Econ., Research Paper No. 18-22; Eur. Corp. Gov. Inst. (ECGI), Law Working Paper No. 415/2018, 2018), https://ssrn.com/abstract=3227113 (noting that "[b]oth investors and issuers are participating in a growing number of private initiatives aimed at promoting board-shareholder collaboration on a variety of issues and, in particular, corporate governance matters"; specifically, reference is made to initiatives such as the 2014 "Shareholder-Director Exchange Program (SDX)" and the 2017 "Investor Stewardship Group (ISG)"); Edelman et al., *supra* note 26, at 1395–97.

239. It is worth noting that in the practice of slate voting, institutional investors usually submit "short slates" of director nominees to be voted on at the shareholders' meeting. *See* Simone Alvaro & Filippo Annunziata, *Shareholdings of Alternative Investment Funds in Listed Companies and in Banks: A Legal Perspective* 15 (Consob, Legal Research Paper No. 17, 2018), http://www.consob.it/documents/46180/46181/lp17.pdf/2ca235bc-17a1-4bda-9efb-569d9ff361b8 (emphasizing the fact that UCITS (Undertakings for Collective Investment in Transferable Securities) funds submitting short slates of director nominees can have some unexpected corporate governance consequences, as illustrated in a number of cases where those lists "obtained the relative majority of votes, overruling the list submitted by the . . . majority shareholders, but did not obtain the majority of directors precisely because it was composed of a number of candidates less than half of the number of directors to be appointed"); Strampelli, *supra* note 115, at 135–36. Traditional institutional shareholders do not submit long slates of director nominees in order to avoid qualifying as a controlling shareholder: in fact, the regulatory framework for acquisition of major holdings or control in European listed companies applicable to traditional UCITS funds—

Against this backdrop, hedge fund board representation is viewed as "a potential solution to the problem of shareholder-manager agency costs" at widely held corporations.[240] Similarly, hedge fund minority board representation helps to reduce majority-minority shareholder agency costs at de jure controlled companies.[241] By definition, where there is de jure control, any board representation granted to activists, e.g., through slate voting systems, can only be *minority* representation, given that the controller's uncontestable voting power will always secure the majority of the board seats for controller-appointed directors.[242]

The same does not always apply for de facto controlled companies, where the circumstances mentioned above lead activist-appointed directors to secure a majority of the board seats.[243] In general terms, activist minority board representation is also beneficial at de facto controlled companies. However, *majority* board representation that is premised on a small equity stake held by the appointing activist in conjunction with the presence of a much larger, but disempowered, shareholder can arguably result in an inefficient corporate governance structure. In fact, the disempowerment of the de facto controller does not result either from a shift of corporate control, or from any change in the allocation of control and cash-flow rights agreed upon between that shareholder and minority stockholders; instead, by leveraging minority rights and the teaming up phenomenon, the activist can secure a better deal in terms of (de facto) control rights without paying the price of building up a corresponding stake in terms of cash-flow rights.[244]

---

but not to alternative funds reserved to professional investors (AIFs, such as hedge funds)—prevents mutual UCITS funds from acquiring or exercising control (or significant influence) over investee companies in order to limit risk concentration. *See* Simone Alvaro & Filippo Annunziata, *Shareholdings of Alternative Investment Funds in Listed Companies and in Banks: A Legal Perspective* 14 (Consob, Legal Research Paper No. 17, 2018), http://www.consob.it/documents/46180/46181/lp17.pdf/2ca235bc-17a1-4bda-9efb-569d9ff361b8. This, in turn, helps explain why hedge funds may submit long, or even full, slates of director nominees to shareholder vote.

240. Christie, *supra* note 124, at 3.

241. *See* Bebchuk & Hamdani, *supra* note 109, at 1277 (arguing that, to limit controllers' opportunism, public investors should have "some degree of influence" over the appointment of some "enhanced-independence directors" who would "lack the incentives produced by the controller's decisive influence over the directors' appointment and retention and . . . have some incentives that flow from making the directors accountable to public investors"). In particular, public investors should be empowered to determine or at least substantially influence the election or retention of these directors. *Id.*

242. *See* Goshen & Hamdani, *supra* note 226, at 600 (noting that "[c]ontrollers' voting power enables them to appoint any candidate they wish to the board").

243. *See supra* Part IV.

244. *See* Goshen & Hamdani, *supra* note 226, at 560 ("challenging the prevailing model of controlling shareholders as essentially opportunistic actors" and contending that "corporate law for publicly traded firms with controlling shareholders"—where cash flow rights and control rights are bundled together—"should balance the controller's need to secure her idiosyncratic

Therefore, the ordinary balance of powers between minority and majority shareholders can actually be reversed. Minority activist shareholders are turned (at least in the short run) into stockholders that can dictate the strategic direction of the firm and, potentially, exert substantial influence over the board of directors.[245] Conversely, the largest shareholder becomes largely disempowered at the board level despite maintaining the same proportion of voting rights it had before losing control over the board, and is thus constrained to a monitoring role ordinarily performed by minorities.[246]

Peculiar as it may be, such a situation is likely to result in instability at the corporate-governance level. First, potentially conflicting idiosyncratic visions at the board level in terms of business strategies might prevent the business from running smoothly. As directors appointed by different shareholder groups can have different priorities, this factor raises concerns about the board's cohesiveness.[247] In itself, this concern applies anytime the board includes minority-elected directors. However, the peculiar setting of a *majority* of directors appointed by a minority shareholder facing a minority of directors appointed by a stockholder still retaining the majority of voting rights might enhance the potential for conflicts within the board. Second, activist majority board representation still does not ensure that the views of a number of fellow shareholders will converge when voting on matters other than corporate elections in such a way as to continue to offset the largest shareholder's voting power. In reality, the presence of a shareholder that still retains both minority board representation and the largest share of voting power, so as to credibly threaten replacement of the board, might hinder the implementation of any business strategies announced by the activist. Furthermore, were any midstream changes to the business strategies announced at corporate elections to be introduced, mainstream institutional investors might withdraw support from the board and enhance the seriousness of the threat of replacement.

At the same time, it might not be an option for the activist to force through its agenda by positively exerting substantial influence over corporate decision-makers. This is because the activist could be considered a de facto controlling shareholder,[248] thus resulting in the additional costs associated with controlling shareholder status. Those costs could perhaps be relatively limited in terms of the potential controller self-dealing litigation costs, given that "hedge funds are, to a much greater extent than mutual funds, free from the most significant potential sources of conflicts of

---

vision against the minority's need for protection," and hence that paying heed to the rights of the controlling shareholders is important).

245. *See supra* Part IV.

246. *See supra* Part IV.

247. *See* Black & Kraakman, *supra* note 225, at 1949; Strampelli, *supra* note 115, at 126.

248. *See supra* Part V.

interest."[249] However, they cannot be excluded and remain a factor to be reckoned with.[250] Moreover, further categories of cost associated with the controller status must be taken into account, such as those—an examination of which falls outside the scope of this Article—arising as a result of accounting and tax regulation.

At the end of the day, the activist might not be able, as a matter of fact, to exert an influence as substantial as might appear at a first glance; similarly, the largest shareholder might not be as disempowered as at first may seem. The truth is that mainstream institutional investors, whose votes crucially allowed the activist to win control over the board of directors, are bound to remain pivotal even in the aftermath of the successful activist intervention.

In general terms, the largest shareholder might be expected to operate actively as a disciplinary force, since the threat of replacement should mitigate the risk of and disincentivize the activist from acting in a manner that runs contrary to the interests of the largest shareholder.[251] However, the largest shareholder's interests are not necessarily aligned with those of minority institutional investors.[252] Arguably, had the controller's interests been aligned with those of the minority shareholders, institutional investors would not have been so likely to have supported the activists' candidates for directors. Hence, monitoring by public investors remains essential within the corporate governance structure under consideration.

In addition, it must not be forgotten that the activist still qualifies as a "small-minority" shareholder in terms of its cash flow rights—at any rate, significantly smaller than the largest shareholder.[253] This factor exposes the activist to greater incentives to extract private benefits than the largest shareholder.[254] This is not to say that the empowered activist would necessarily take advantage of its influence in order to pursue business strategies that meet selfish interests to the detriment of long-term performance, or that further other opportunistic objectives. It may well be that the activist will remain committed—also due to reputational

249. Edelman et al., *supra* note 26, at 1409 ("[I]n contrast to mutual funds, hedge funds do not sell products to the target firms whose shares they hold. Unlike government pension funds, hedge funds are not subject to extensive political control. As a result, hedge funds are in a good position to monitor corporate boards."); Kahan & Rock, *supra* note 3, at 1067, 1071.

250. *See* Kahan & Rock, *supra* note 3, at 1071 (explaining that hedge funds might influence a decision at the company to improve the value of its position at another portfolio company in a way that does not align with the interests of other shareholders, and illustrating further "hedging-related conflicts").

251. Lucian A. Bebchuk & Kobi Kastiel, *The Perils of Small-Minority Controllers* 9 (Eur. Corp. Gov. Inst. (ECGI), Working Paper No. 434, 2018), https://ssrn.com/abstract=3128375.

252. *See* Kastiel, *supra* note 110, at 118–19.

253. In reference to the non-coinciding case of dual-class-company controllers, see *id.* at 2 (defining a "small-minority" stake as one below 15% of equity capital, a "very-small-minority" as below 10%, and a "tiny-minority" stake as below 5%).

254. *See* Goshen & Hamdani, *supra* note 226, at 591.

considerations[255]—to pursuing "constructivist" strategies.[256] Nonetheless, the activist's heightened exposure to opportunistic incentives calls, once again, for effective institutional investor monitoring.

It is naturally the case that the teaming up phenomenon may serve "as an additional check on the validity and long-term viability of the activists' plans."[257] In effect, the activist

> must convince fellow shareholders that their ideas are beneficial for the entirety of the shareholders, including the typically long-term oriented pension funds. But this step additionally amounts to a de facto "vetting process," whereby checks and balances are created: if and insofar as activists need to convince other funds that their strategic plans are beneficial for the company as such (and do not create idiosyncratic benefits for the hedge fund), this process mitigates the potential extraction of short-term private benefits and ensures that activism is channeled into mutually beneficial activities.[258]

However, for such a system of checks and balances to make good on the promise of a long-term focus and value creation, effective institutional shareholder scrutiny must occur not only when the activist seeks institutions' voting support, but also after the successful activist intervention. It is however questionable whether mainstream institutional investors should be expected to perform an effective gatekeeping function; in fact, whether fundamentally passive, or "rationally reticent,"[259] investors will actually act as active stewards is still open to debate.

Institutional investors, especially passive investors that cannot exit strategically,[260] are often looked upon as actors with few incentives to invest in stewardship and limited resources to engage with investee companies.[261] Regulation itself would encourage institutions "to outsource oversight of the corporations in their portfolios to activist hedge funds and proxy advisory firms such as ISS," or, at any rate, to act as poor gatekeepers, being "themselves measured and compensated by short-term,

---

255. *See supra* note 28 and accompanying text.

256. *See* Fisch & Sepe, *supra* note 238, at 21–22.

257. Ringe, *supra* note 96, at 419.

258. *Id.* at 420.

259. *See* Gilson & Gordon, *supra* note 26, at 895 (defining rational reticence as institutions' inclination to not make proposals themselves but instead supportively respond to other investors' proposals as a consequence of the costs incurred from actively engaging with investee companies, which, owing to their business model, reduces returns while fueling other competitors' free-riding, hence disincentivizing active conduct).

260. Quasi-indexers can be viewed as the most loyal shareholders, since they remain committed in their investments over the long term; passive investors are the largest category of investors. *See*, *e.g.*, Alessio Pacces, *Exit, Voice and Loyalty from the Perspective of Hedge Funds Activism in Corporate Governance*, 9 ERASMUS L. REV. 199, 208 (2016).

261. *See* Edward B. Rock, *Institutional Investors in Corporate Governance*, *in* THE OXFORD HANDBOOK OF CORPORATE LAW AND GOVERNANCE 373–74 (Jeffrey N. Gordon & Wolf-Georg Ringe eds., 2018).

quarterly portfolio performance, and . . . generally agents and subject to misaligned incentives."[262]

This negative view of institutional investors as monitors may be overstated. Nevertheless, the fact remains that active stewardship is a costly endeavor that cannot easily be aligned with investors' prevailing business models—primarily based on asset diversification and, as a consequence, portfolio fragmentation—and incentive structures.[263] The inadequate incentives hypothesis points to a number of factors which characterize the industry structure as the primary explanation for traditional institutions' insufficient levels of serious engagement: the highly competitive structure of the market for money managers, which pressures towards lowering costs; rational apathy and the free rider problem; institutions' revenue model which, being typically a percentage of assets under management, pushes towards increasing funds' size and complexity; asset managers' perverse incentives associated with a fund's relative performance, which improves where underweighted portfolio companies perform badly; the enduring conviction that being involved in corporate governance reduces the resources to be better employed in selecting investments in order to increase fund performance—and portfolio managers' compensation; and various conflicts of interests asset managers are faced with.[264] In spite of their decisive role in providing support to successful activist campaigns, it is therefore unclear whether institutional investors, especially passive investors, interact adequately with activists.[265] Most notably, passive investors mainly focus on issues (such as environmental, social and governance (ESG) issues)

> requiring low-cost interventions although they refrain from engaging in high-cost governance activities such as monitoring of M&A or presenting slates of candidates for election to the board of directors. Consequently, given the collective action problems facing the investment industry, active fund managers have no more incentive to invest in stewardship than

262. Lipton, *supra* note 94.

263. *See* Giovanni Strampelli, *Are Passive Index Funds Active Owners? Corporate Governance Consequences of Passive Investing*, 55 SAN DIEGO L. REV. 803, 819–20 (2018).

264. Rock, *supra* note 261, at 373–74.

265. *See* Alessio M. Pacces, *Hedge Fund Activism and the Revision of the Shareholder Rights Directive* 14–16 (Eur. Corp. Gov. Inst. (ECGI), Law Working Paper No. 353/2017, 2017), https://ssrn.com/abstract=2953992 ("[I]ndex fund managers do not benefit from firm-specific screening. Because their income depends on the size of their portfolio, they choose low-cost voting policies that investors appreciate overall, including best practices in corporate governance.") Hence, whether they are the right arbiters for the choice between the opposing views of the hedge funds and the incumbent management largely depends on the particular context. *Id.*

passive investors do because investment does not lead to any significant improvement in their relative performance.[266]

The fact that, over the last few years, large institutional investors committed to strengthening their in-house governance and engagement departments, and dedicated to collecting firm-specific information, might certainly have reduced their criticized reliance on proxy advisory services—the accurateness of which remains unclear, given the substantial lack of transparency in this respect[267]—and helped to increase independent monitoring over investee companies.[268] In effect, the number of engagements with investee companies performed by larger investors is high.[269] Not less importantly, however, the number of such engagements is limited when compared to the number of their portfolio companies.[270] Moreover, stewardship teams "rarely engage with companies concerning business related strategies, as this would give rise to significant costs."[271] Hence, where activist intervention is motivated by disagreement about the company's strategy, "the strategy proposed by hedge funds in opposition to the incumbent management is particularly difficult to evaluate," since it entails an "entrepreneurship question that indexed funds, with their typically small stakes in a particular company, do not have the expertise and the incentives to answer."[272]

Therefore, it seems to be quite unclear whether institutional investors, especially passive investors, have any incentive to scrutinize the activist proposals adequately,[273] and will actually "operate as an important safeguard when activist proposals may not be in the best interest of the company"[274] and, especially, exert valuable and continuous oversight over influential corporate decision-makers once the supported activist intervention succeeds. Moreover, considering that institutional investors are hedge funds' "main source of investment capital," institutions may have "a

266. Strampelli, *supra* note 263, at 835 (further highlighting the paradoxical consequence that the rise of investors focused on long-term value creation, such as passive index funds, may not result in an effective and exhaustive system of checks and balances between the different company organs and different stakeholders, especially in relation to operations more likely to impinge upon the value of the company or its long-term perspectives).

267. See most recently James R. Copland, David F. Larcker & Brian Tayan, *The Big Thumb on the Scale: An Overview of the Proxy Advisory Industry* 7 (Rock Ctr. for Corp. Governance at Stan. U. Closer Look Series: Topics, Issues and Controversies in Corporate Governance No. CGRP-72; Stan. U. Graduate Sch. of Bus., Research Paper No. 18-27, 2018), https://ssrn.com/abstract=3188174 (providing a comprehensive review of the proxy advisory industry and the debate over proxy advisors' influence on institutional clients' voting behavior, corporate choices, and voting outcomes).

268. *See*, *e.g.*, Fisch & Sepe, *supra* note 238, at 15.

269. *See* Strampelli, *supra* note 263, at 824.

270. *Id.*

271. *Id.* at 825.

272. Pacces, *supra* note 260, at 210–11.

273. Strampelli, *supra* note 263, at 840.

274. *See* Christie, *supra* note 124, at 5.

second interest in supporting hedge fund activism beyond the returns that they generate in any particular company by voting in favor of activists' agendas—a direct return on their investments in the hedge fund themselves."[275] As a consequence, where the activist proposal is value-maximizing of its interest in the firm, but value-decreasing for the firm overall, the institution might be incentivized to provide voting support to maximize its investment in the fund instead of the value of the firm.[276]

Of course, the dubious effectiveness of institutional investor monitoring is not specific to de facto controlled companies, but equally concerns widely held corporations as well. It seems, however, at companies in which control is contestable, this factor can exacerbate the potential negative corporate-governance effects of successful activist intervention.

Against this background, enhanced board independence obviously becomes even more crucial, in that the board should act as "an independent arbitrator" deciding whose views better serve the company's interests.[277] However, despite meeting the (formal) requirements for board composition as regards independence, directors and managers might still be subject to biased influence from influential shareholders—whether an activist or the largest shareholder[278]—even though any director, once elected, is bound to pursue the interests of the company as a whole, and not those of any of its particular shareholders.[279] In effect, the prevalent regulatory trend towards a

275. Edelman et al., *supra* note 26, at 1417.

276. *Id.* at 1418. *But see* Rock, *supra* note 261, at 383 (noting that since major institutional investors only invest in hedge funds after significant due diligence, this investment process "provides some assurance to the general investment public of the activists' bona fides").

277. Sharfman, *supra* note 7, at 822 (discussing the link between board independence and the ability of hedge funds to create long-term value, and arguing that "[a]n activist hedge fund can create long-term value at a public company if the Board has enough independence to act as an impartial arbitrator deciding between the advice provided by executive management and the activist hedge fund").

278. *See*, *e.g*., Luca Enriques, *Related Party Transactions: Policy Options and Real-World Challenges (With a Critique of the European Commission Proposal)*, 16 EUR. BUS. ORG. L. REV. 1, 18–19 (2014) (noting that even where a director is elected with the involvement of minority shareholders, "substantial independence is not guaranteed, as that is mainly a function of an individual's assertiveness, ability not to succumb to boardroom biases, and reputational and career concerns"); Edward B. Rock, *MOM Approval in a World of Active Shareholders* 8 (NYU Law and Econ., Research Paper No. 18-02; Eur. Corp. Gov. Inst. (ECGI), Law Working Paper No. 389/2018, 2018), https://ssrn.com/abstract=3122681 (noting in the context of majority-of-minority approval of related-party transactions that "[t]he 'disinterested' directors on the ISC [(Independent Special Committee)] are ultimately elected by the controlling shareholder and thus may not be genuinely disinterested"). For a similar view, see also Bianchi et al., *supra* note 233, at 8 (explaining that "the veto power of independent directors for all transactions regardless of their size can be ineffective to protect minority shareholders from harmful RPTs [(Related Party Transactions)] if directors do not act independently in practice"). For Delaware jurisprudence in relation to de facto control see *supra* notes 190–194 and accompanying text.

279. *See* Piergaetano Marchetti, Gianfranco Siciliano & Marco Ventoruzzo, *Dissenting Directors*, 18 EUR. BUS. ORG. L. REV. 659, 670–71 (2017) (noting that "it is inevitable that directors feel a stronger 'affection' for the shareholders that have contributed more to their election"); Christie, *supra* note 124, at 14 (highlighting that "[a]ctivist appointed directors,

formal approach to director independence mainly relies on independence in appearance and "does not adequately consider the fact that independence also touches upon a director's behavior, and that the absence of personal, business and financial links with the company, managers and—if applicable—controlling shareholders is only a rough proxy for independence."[280] Moreover, as has been noted by Professors Fisch and Sepe, "the emphasis placed on independence requirements in current rules governing the board appointment process does sacrifice expertise requirements. The result is that most independent directors lack the firm-specific human capital, knowledge and skills of executive directors and tend instead to be 'generalists.'"[281] Therefore, while board independence can help, in that it might mediate between potentially opposing views regarding the business strategies pursued, this factor does not overcome the need for effective institutional investor oversight.

CONCLUSION

If, as many commentators predict, activism is here to stay,[282] it is likely to increasingly target de facto controlled companies and companies with a large, dominating blockholder; as a matter of fact, de facto control is widespread in the European corporate landscape, and appears to be on the rise in the United States. Consequently, the corporate-governance effects of activism at de facto controlled companies appear to be a factor to reckon with. Overall, the interplay between activism and de facto control—where the regulatory framework grants substantial minority-empowering rights, especially as regard board representation—can give room to instability, or at least inefficiency, at the corporate-governance level following successful activist intervention. In such cases, much will depend on the role played by mainstream institutional investors and on the effectiveness of their stewardship function: an area of research in which further investigation,

---

whether they are unaffiliated with the hedge fund or are the hedge fund managers themselves, still have fiduciary duties to the company and cannot blindly pursue the activist agenda to the detriment of the long-term success of the company").

280. Strampelli, *supra* note 115, at 119 (emphasizing the need for incentives designed to nudge truly independent conduct by directors); *see also* Yaron Nili, *Out of Sight, Out of Mind: The Case for Improving Director Independence Disclosure*, 43 J. CORP. L. 35, 53–56 (2017) (arguing that the current approach to director independence—one that is focused on a set of criteria and subsequent certification by the board of directors—is of an empty nature).

281. Fisch & Sepe, *supra* note 238, at 16.

282. *See, e.g.*, Joel Slawotsky, *Hedge Fund Activism in an Age of Global Collaboration and Financial Innovation: The Need for a Regulatory Update of United States Disclosure Rules*, 35 REV. BANKING & FIN. L. 275, 279 (2015) (noting that some developments—including "the sheer size of capital available to hedge funds, the globalization of financial markets, new investment vehicles (such as derivatives), the rise of global cooperation among large funds and 'wolf-pack' tactics . . . are likely to further strengthen activism as a popular strategy among large investors"); Paul Rose & Bernard S. Sharfman, *Shareholder Activism as a Corrective Mechanism in Corporate Governance*, 2014 BYU L. REV. 1015, 1020 (2014).

both empirical and theoretical, is needed. At de facto controlled companies, there is a risk for successful activist intervention to bring about a situation of concentrated ownership characterized by both the disadvantages of not having a tightly controlling shareholder (e.g., in terms of its higher commitment to the firm and its entrepreneurial vision, which can potentially benefit all investors) as well as those associated with contestable control (in terms of the weak alignment of the interests of influential shareholders and public shareholders). Moreover, the positive or negative consequences of activism targeting de facto controlled companies go hand in hand with the very debate concerning the positive or negative corporate effects of hedge fund activism, which is as yet unresolved although—as most recently argued by Professor Roe[283]—the hedge-fund contributed stock-market short-termism's impact on corporations, workers, and savers might be overstated.[284]

By showing the potential negative implications for corporate governance of activism at de facto controlled companies associated with, amongst other factors, the usage of regulatory tools ensuring minority shareholder board representation, this Article attempts to contribute to framing the debate into ongoing shareholder-empowerment in the United States against the particular background of possible interplay between activism and de facto control. If comparative examination matters when considering reform,[285] this Article warns to potential unexpected corporate governance consequences of activism at de facto controlled companies within a regulatory environment that ensures shareholder board representation. In such context, the proposals by Professors Anabtawi and Stout as to the need for reexamining conventional notions of shareholder duties in such a way as to render the rules of loyalty duties—traditionally applied to officers and directors and, sometimes, controlling shareholders—applicable to activist minority investors might appear less radical than at first sight.[286]

Finally, this Article potentially complements the skeptical view of shareholder engagement and the regulatory and self-regulatory tendency—which is apparent in the EU and on the rise in the United States—towards

283. *See* Mark J. Roe, *Stock Market Short-Termism's Impact* 1, 4 (Eur. Corp. Gov. Inst. (ECGI), Law Working Paper No. 426/2018, 2018), https://ssrn.com/abstract=3171090 (showing that "every major predicted consequence from the short-term argument either has not been shown (where is there a discernible economy wide hit to R&D?), is false (cash is not draining out and the stock market is not shunning long-term firms), or is better explained otherwise (capital expenditures are down even where stock markets are less important)," and therefore arguing that "the calamitous form of the stock-market-driven short-termist argument needs to be reconsidered, recalibrated, and, quite plausibly, rejected").

284. *See supra* Part I.

285. *See* Nili, *supra* note 25, at 211.

286. *See* Iman Anabtawi & Lynn Stout, *Fiduciary Duties for Activist Shareholders*, 60 STAN. L. REV. 1255, 1256 (2008); *supra* Part II.

the positive promotion of institutional investor engagement with investee companies, while at the same time failing to adequately address the issue of the costs of such engagement as the major obstacle to active stewardship. The risk of incentivizing engagement by institutions in unitary terms without also adopting regulatory strategies that favor a reduction in engagement-related costs[287] is that it may induce institutions to support hedge fund activist intervention, and neglect taking part in adequate monitoring. At weakly controlled companies, this can enhance dubious corporate-governance effects.

287. *See* Strampelli, *supra* note 263, at 845–851 (outlining potential regulatory strategies aimed at stimulating more active involvement by passive investors by favoring a reduction in engagement-related costs, and favoring, in particular, an approach aimed at promoting a redistribution of engagement costs between active and passive institutional investors by incentivizing collective engagement). Specifically, overcoming possible collective action problems by facilitating collective engagement could foster more effective involvement by mainstream non-activist institutions' in the corporate governance of investee companies, as engagement costs would be shared between the investors that collectively undertake engagement initiatives in non-routine issues, such as proxy contests, or M&A and related-party transactions. *Id.* Collective engagement could also incentivize institutional investors to adequately scrutinize activists' proposals, which would render interaction between activist and non-activist investors more effective. *Id.*