

## **WORLDWIDE HEDGE FUND ACTIVISM: DIMENSIONS AND LEGAL DETERMINANTS**

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In recent years, activist hedge funds have spread from the United States to other countries in Europe and Asia, but not as duplicates of the American practice. Rather, there is a considerable diversity in the incidence and the nature of activist hedge fund campaigns around the world. What remains unclear, however, is what dictates how commonplace and versatile hedge fund activism will be in a particular country. This Article addresses this question by pioneering a new approach to understanding the underpinnings and the role of hedge fund activism, following activist hedge funds as they select a target company that presents high-value opportunities for engagement (entry stage), accumulate a nontrivial stake (trading stage), then determine and employ their activist strategy (disciplining stage), and finally exit (exit stage). The Article then identifies legal parameters for each activist stage and empirically examines why the incidence, objectives, and strategies of activist hedge fund campaigns differ across countries. The analysis is based on 432 activist hedge fund campaigns during the period of 2000–2010 across 25 countries. The findings suggest that the extent to which legal parameters matter depends on the stage that hedge fund activism has reached. Mandatory disclosure and rights bestowed on shareholders by corporate law are found to dictate how commonplace hedge fund activism will be in a particular country (entry stage). Moreover, the examination of the activist ownership stakes reveals that ownership disclosure rules have important ramifications for the trading stage of an activist campaign. At the disciplining stage, however, there is little support for the conjecture that the activist objectives and the employed strategies are a reflection of the shareholder protection regime of the country in which the target company is located.

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## INTRODUCTION

Shareholder activism is a long-standing feature of corporate governance. Yet it is only since the 2000s that it has swept through the corporate landscape, receiving a big boost from activist hedge funds and other shareholder activist funds that are able to influence the conduct of corporate affairs with small, non-controlling stakes.<sup>1</sup> Hedge funds investing in shareholder activism have a history of about two decades: they first appeared in the United States in the aftermath of the “deal decade” of the 1980s and moved to the forefront in the mid-2000s before dropping significantly during the 2008 financial crisis, but since 2012 they have been thriving again.<sup>2</sup>

Among the reasons accounting for the flourish of hedge fund activism in the years after the financial crisis is the fact that investor cash has flown back into the hedge fund sector and activist managers have amassed their own cash reserves fueled by rising stock prices and cheap debt.<sup>3</sup> As a result, activist hedge funds have grown in size and are now more able to take significant positions in big companies and pressure for changes in business strategy or leadership.<sup>4</sup> Characteristically, a columnist emphasized in June 2013 that “[n]o company is too large for hedge fund activism.”<sup>5</sup> Recent targets of activist hedge funds include large American

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1. The practitioners of this brand of shareholder activism are not a homogenous group. “Activist hedge fund” is a term of art and there are a growing number of investors, other than hedge funds, that have emerged prepared to engage in hedge-fund-style shareholder activism. For the purposes of this study, the term activist hedge fund is used as a generic one that includes a variety of investment vehicles, which all share a common feature: they build up sizeable stakes in order to influence the conduct of corporate affairs. On the nature of this brand of shareholder activism, see *infra* text with accompanying notes 22–38.

2. See, e.g., Michael J. de la Merced, *Taking Recipes From the Activist Cookbook*, N.Y. TIMES, Dec. 11, 2014, at F10 (citing data from FactSet indicating that about 281 activist hedge fund campaigns targeting U.S. companies have been announced in 2014—the greatest amount in at least five years).

3. Emily Chasan & Maxwell Murphy, *Activist Investors Go Big*, WALL ST. J., Oct. 1, 2013, at B6.

4. According to data from HFR Inc., at the end of 2012, U.S. activist funds had \$65.5 billion under management, which is the highest in a decade. In 2003, they had \$11.8 billion. Anupreeta Das & Sharon Terlep, *Activist Fights Draw More Attention*, WALL ST. J. (Mar. 19, 2013), <http://www.wsj.com/articles/SB10001424127887324392804578360370704215446>. In 2013, the upward trend continued as U.S. activist hedge funds were estimated to hold nearly \$100 billion in assets under management. David A. Katz & Laura A. McIntosh, *Corporate Governance Update: Shareholder Activism in the M&A Context*, 251 N.Y. L.J. 5 (2014).

5. Jonathan Shapiro, *Hedge Funds’ Time Has Come Again*, AUSTL. FIN. REV., June 7, 2013, at 23.

companies such as Apple, Hess, Procter & Gamble, Air Products, PepsiCo, and eBay.<sup>6</sup> Recent years have seen some activist hedge fund campaigns targeting big companies outside the United States too. Activist hedge fund investor Daniel Loeb's Third Point accumulated a sizeable stake in Sony Corp., the Japanese electronics maker, and pushed for change, while The Children's Investment Fund ("TCI") took a stake in French aerospace company EADS in an attempt to force it to sell its stake in Dassault Aviation.<sup>7</sup>

In addition, despite first appearing to be unsympathetic to the interests of the shareholders as a class, hedge fund activism is increasingly gaining in reputation.<sup>8</sup> A columnist in *The Economist* observed similarly that activist shareholders have turned "from villains into heroes."<sup>9</sup> At the same time, hedge fund activism is getting growing support from large institutional investors, many of which are now teaming up with activist hedge funds to jointly launch activist campaigns.<sup>10</sup> This change in institutional investors' attitudes is driven, at least in part, by the activist sector's robust returns; according to a Citigroup report, activist hedge funds have generated nearly 20 percent annual returns since 2009, outperforming traditional hedge funds and many markets.<sup>11</sup>

Recent evidence addressing the long-standing debate of whether activist hedge funds do more harm than good to the target firm and its other shareholders has also contributed to the change in how activist hedge funds

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6. David Benoit, *New Push to Throw Assets Overboard*, WALL ST. J., Feb. 19, 2014, at C1; Ben Fox Rubin, *Carl Icahn Pushes Apple on Buyback*, WALL ST. J., Oct. 2, 2013, at B8.

7. Dan McCrum, *Activists Keep Fighting Despite Setbacks*, FIN. TIMES, Aug. 17, 2013, at 12.

8. Compare James Saft, *In Praise of Activist Investment*, REUTERS (Aug. 14, 2013), <http://www.reuters.com/article/2013/08/14/us-column-activistinvestors-saft-idUSBRE97D17I20130814> (explaining the benefits of activist hedge funds), with Andrew Willis, *Corporate Raiders Now Wearing the White Hat*, GLOBE & MAIL, Aug. 18, 2005, at B16 (contending that activist managers no longer greatly affect stock price by just showing up).

9. M.B., *How Activist Shareholders Turned from Villains into Heroes*, ECONOMIST (Feb. 17, 2014), <http://www.economist.com/blogs/economist-explains/2014/02/economist-explains-12>.

10. For instance, in November 2012, California State Teachers' Retirement System (CalSTRS) cooperated with activist Relational Investors LLC to call for diversified manufacturer Timken Co. to split its steel and bearings businesses into separately-traded companies, while in August 2011, Canadian pension fund Ontario Teachers' Pension Plan together with U.S. hedge fund Jana Partners pushed McGraw-Hill to break up. Randy Diamond, *CalSTRS Takes Bold Step in Governance*, PENSIONS & INVS., Apr. 29, 2013, at 4.

11. See David Gelles, *Activism Is Going Global, Citi Warns Clients*, N.Y. TIMES DEALBOOK (Oct. 31, 2013), [http://dealbook.nytimes.com/2013/10/31/activism-is-going-global-citi-warns-clients/?\\_php=true&\\_type=blogs&\\_r=0](http://dealbook.nytimes.com/2013/10/31/activism-is-going-global-citi-warns-clients/?_php=true&_type=blogs&_r=0) (warning clients that shareholder activism has spread globally to all types of companies).

are perceived by the investing public and the popular press. Many empirical studies report that activist hedge fund campaigns generate abnormal stock returns, particularly around the announcement of the activist event, but the evidence is more mixed where longer term operating performance of the company is evaluated post hedge fund activism.<sup>12</sup> There is also some recent empirical evidence suggesting that hedge fund activism, at least as of 2007, is able to achieve not only its investment objective of profiting from shareholder activism, but also provides a form of discipline, especially against the agency problems associated with free cash flow, and creates improved long-term performance.<sup>13</sup> As for the alleged “dark-side” of hedge fund activism, empirical evidence suggests that “activist hedge funds are not short-term in focus”; they “do not often use equity decoupling techniques”; “they seldom seek control”; and, in most cases, they “are not mainly hostile to incumbent management.”<sup>14</sup>

Taken together, the existing empirical literature coheres with views expressed by academic proponents of the promising corporate governance role of activist hedge funds.<sup>15</sup> Whether activist hedge funds will continue

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12. See generally Alon Brav et al., *Hedge Fund Activism: A Review*, 4 FOUNDS. & TRENDS FIN. 185 (2009) (examining hedge fund activism in the United States between 2001 and 2006 and analyzing its possible value); John C. Coffee, Jr. & Darius Palia, *The Impact of Hedge Fund Activism: Evidence and Implications* (Eur. Corp. Governance Inst. (ECGI), Law Working Paper No. 266/2014) (providing an excellent review of the empirical literature on hedge fund activism). For post-crisis hedge fund activism, see CNV Krishnan et al., *Top Hedge Funds and Shareholder Activism* (Vanderbilt Univ. Law School, Law & Econ. Working Paper No. 9/2015, 2015) (examining activist hedge fund campaigns in the United States between 2008 and mid-2014, and finding that activist hedge funds, especially those involved in the largest interventions in terms of aggregate market capitalization, generate positive announcement-period abnormal stock price returns).

13. See Lucian A. Bebchuk et al., *The Long-Term Effects of Hedge Fund Activism*, 115 COLUM. L. REV. (forthcoming June 2015) (finding improved operating performance of companies following activist interventions).

14. Dionysia Katelouzou, *Myths and Realities of Hedge Fund Activism: Some Empirical Evidence*, 7 VA. L. & BUS. REV. 459, 460 (2013).

15. JONATHAN R. MACEY, CORPORATE GOVERNANCE: PROMISES KEPT, PROMISES BROKEN 248, 272 (2008) (arguing that activist hedge funds together with private equity funds are increasingly seen as “the great, shining beacon of hope on an otherwise bleak landscape” which can “fill the governance gap created by the passive credit-rating agencies, the moribund market for corporate control, the rational ignorance in shareholder voting, and the captured directors and self-interested management”); Alon Brav et al., *Hedge Fund Activism, Corporate Governance, and Firm Performance*, 63 J. FIN. 1729, 1730, 1774 (2008) (perceiving activist hedge funds as “informed monitors” and describing hedge fund activism as “a new middle ground between internal monitoring by large shareholders and external monitoring by corporate raiders”); Marcel Kahan & Edward B. Rock, *Hedge Funds in Corporate Governance and Corporate Control*, 155 U. PA. L. REV. 1021, 1047 (2007) (hoping that activist “hedge funds may act ‘like real owners’ and provide a check on management discretion”); Paul Rose & Bernard S. Sharfman, *Shareholder Activism as a*

to deliver on their promise to provide more disciplined monitoring of management remains to be seen, but there is a growing consensus that activist hedge funds are here to stay. Therefore, understanding the underpinnings of hedge fund activism is crucial.

The ways in which activist hedge funds employ their monitoring activities are surely a function of market variables. For instance, empirical evidence shows that the performance, size, and ownership structure of the target company are important factors that can influence an activist hedge fund campaign.<sup>16</sup> An additional market consideration is the market depth—in other words, the liquidity of shares in the particular market—which enables an activist hedge fund to profit by acquiring a significant stake in a target firm without a significant price impact.<sup>17</sup> Although market factors are of critical importance to the emergence and development of an activist campaign aimed at a company, the effort required to begin engaging with specific companies in any particular country implies that there will need to be a generally attractive institutional legal framework before activist hedge funds begin their firm-specific research.

To the best of my knowledge, this Article is the first to systematically examine whether “law” is conducive to an activist hedge fund campaign.<sup>18</sup>

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*Corrective Mechanism in Corporate Governance*, 2014 BYU L. REV. (forthcoming 2015), available at <http://ssrn.com/abstract=2324151> (suggesting hedge fund activism may act as a corrective mechanism in corporate governance).

16. See *infra* notes 27–30 and accompanying text.

17. Previous economic literature shows that deep markets—markets with a fair amount of liquidity (non-speculative) trading—facilitate outside investors in concealing their trades behind liquidity trading and building up a sizeable share with profit. See Ernst Maug, *Large Shareholders as Monitors: Is There a Trade-Off between Liquidity and Control?*, 53 J. FIN. 65 (1998) (finding liquid stock markets increase effectiveness of corporate governance); Thomas H. Noe, *Investor Activism and Financial Market Structure*, 15 REV. FIN. STUD. 289, 308 (2002) (showing that increasing liquidity always increases firm value, even in the case of investors with no toehold stake); Andrei Shleifer & Robert W. Vishny, *Large Shareholders and Corporate Control*, 94 J. POL. ECON. 461, 475–76 (1986) (examining pre-takeover trading by large shareholder and showing that a large shareholder can assemble a large block shares only if there is a scope of anonymous trading). For the impact of firm liquidity on mainstream shareholder activism, see Oyvind Norli et al., *Liquidity and Shareholder Activism*, 28 REV. FIN. STUD. 486 (2015) (using a hand-collected sample of contested proxy solicitations and shareholder proposals as occurrences of shareholder activism in the United States and determining that stock liquidity improves shareholders’ incentives to monitor management). But see John C. Coffee, Jr., *Liquidity Versus Control: The Institutional Investor as Corporate Monitor*, 91 COLUM. L. REV. 1277 (1991) (suggesting that liquidity discourages shareholder activism); Amar Bhidé, *The Hidden Costs of Stock Market Liquidity*, 34 J. FIN. ECON. 31 (1993). In the context of hedge fund activism, see Brav et al., *supra* note 15, at 1754 (finding that target firms exhibit higher trading liquidity than comparable firms in their sample).

18. The question of law’s relation to hedge fund activism largely depends on how law is defined for the purposes of analysis. Two important caveats need to be made in this

In taking up this challenge, it pioneers a new approach of understanding the brand of shareholder activism associated with activist hedge funds, describing an activist hedge fund's campaign as a sequence of four stages: an activist hedge fund manager first selects a target company that presents high-value opportunities for engagement (*entry stage*); it accumulates a nontrivial stake (*trading stage*); it then determines and employs its activist strategy (*disciplining stage*); and, finally, it exits (*exit stage*).<sup>19</sup> While the entry and trading stages will also be present in other forms of value investing, the readiness to take a hands-on role and lobby for changes (disciplining stage) is the crucial additional dimension to hedge fund activism. Breaking the activist process into a sequence of four stages allows for a more fine-grained understanding of the legal factors conducive to an activist hedge fund campaign.

The motivation for this study is the variations of the incidence, nature, and evolution of worldwide hedge fund activism. As activist hedge funds in the United States were successful in generating above-market rates of return for the funds and their investors, they turned to other markets in Europe and Asia. Where activist hedge funds have spread from the United States to other markets, they have not emerged as a duplicate of the American practice; rather there is considerable diversity in the incidence and magnitude of hedge fund activism around the world. Data that I have compiled on instances of shareholder activism by hedge funds and similarly structured collective investment vehicles from 2000 through 2010 in 25 countries—other than the United States—provide a helpful way of tracking the emergence of hedge fund activism and testing the implications of cross-country legal differences on the incidence and nature of activist

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respect. First, this study only examines the likely impact of corporate and securities laws which targeted companies are subject to. Therefore, laws governing collective investment vehicles and their likely impact on hedge fund activism remain out of the scope of this study. Second, the focus is on formal (substantive) law rather than on legal institutions. Informal rules, non-legal mechanisms of corporate governance, the company's own constitution, or enforcement actions are also crucial to hedge fund activism's rise and evolution. Yet, the focus on formal law, and more specifically on shareholder protection law and disclosure rules, is an attempt to more clearly define the scope of analysis and harness the power of the previously constructed legal indices that are used in the empirical analysis of Part IV of this Article.

19. For the third stage of an activist hedge fund campaign, I use the term "disciplining" rather than the more common term "monitoring" because effective oversight requires more than monitoring incumbent management; it requires doing something about poor performance. See also Edward B. Rock, *The Logic and (Uncertain) Significance of Institutional Shareholder Activism*, 79 GEO. L.J. 445, 453 (1991) (using the term "discipline," instead of "monitor," "to refer to the activities, or alternatively the oversight, of a sole owner or a large individual owner who is not also a manager").

hedge fund campaigns. The resulting data are combined with legal indices to test which legal rules (if any) matter for hedge fund activism.

The wider purpose of this Article is, on the one hand, to provide a general understanding of the forces that shape the development of worldwide hedge fund activism and expand the empirical base for the study of the relationship between law and areas of economic and corporate governance activity. On the other hand, this analysis has a normative dimension. Knowing how the worldwide phenomenon of hedge fund activism is determined makes it possible to suggest new directions for policymakers concerned with the role of law in promoting hedge fund activism and shareholder activism more generally. If, for instance, it were found that shareholder rights, such as the nomination and election of directors, matter for the effectiveness of hedge fund activism, advocates of activist hedge funds would be encouraged to demand empowerment of the shareholder rights vis-à-vis the incumbents. However, increasing shareholder power would be desirable only if activist hedge funds could operate to improve corporate performance and value. As previous empirical analysis indicates, hedge fund activism does in fact have such consequences.<sup>20</sup>

The rest of the Article proceeds as follows. Part I describes the analytical framework for approaching the relationship between law and hedge fund activism and introduces an activist hedge fund campaign as a sequence of four stages. Part I also brings the long line of research on the relationship between law and economic activity into sharp focus and examines how the so-called “leximetric”<sup>21</sup> coding techniques can be useful in the study of the legal determinants of worldwide hedge fund activism.

Part II uses the four stages of an activist hedge fund campaign as a heuristic to identify the legal factors that are most likely to influence the emergence and evolution of worldwide hedge fund activism. In particular, Part II suggests that three sets of legal rules, which activist hedge funds’ targets are subject to, critically affect the incidence and magnitude of global hedge fund activism: mandatory disclosure rules, ownership disclosure rules, and law protecting shareholder rights. The latter set of rules include the legal rules governing the leeway activist hedge funds have to utilize shareholder decision-making procedures to influence corporate policy and governance, exercise a veto over board initiatives, elect and remove directors, and bring shareholder-driven litigation.

The next two Parts are empirical in nature. Part III describes the sample and presents fresh data on the geography and the insurgents of the

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20. See *supra* notes 12–13 and accompanying text.

21. See *infra* note 54 and accompanying text (defining “leximetric” and the technique).



worldwide hedge fund activism phenomenon. Part IV empirically investigates the implications of cross-country legal differences on worldwide activist hedge fund campaigns, drawing upon Part II's theoretical assessments. The findings suggest that the extent to which country-level legal attractions are a determinant of global hedge fund activism depends on the stage that hedge fund activism has reached. I find that at the entry stage of an activist campaign, activist hedge funds tend to target companies incorporated in countries with stronger disclosure and shareholder regimes. Moreover, examination of the activist ownership stakes reveals that activist hedge funds tend to amass bigger stakes in countries with higher ownership thresholds. The evidence, however, shows that other parameters of the ownership disclosure rules—such as the breadth of the definition of the stake that triggers the disclosure obligation and the deadline within which the investors should report to the competent authorities after crossing the relevant threshold—have somewhat weaker ramifications for the trading stage of an activist campaign. Finally, the data on the disciplining stage of an activist hedge fund campaign provide little indication that the activist objectives and the employed strategies are a reflection of the shareholder protection regime of the country in which the target company is located. This might suggest that while a minimum protection of minority shareholder rights is a necessary condition for the activist hedge funds' entry to the activist arena, subsequent choices of the activist objectives and strategies are, at least in part, endogenous to the ways in which the legal infrastructure affects hedge fund activism.

The concluding part summarizes and offers avenues for future empirical investigation of the impact of international regulatory differences on the incidence and effectiveness of hedge fund activism, and shareholder activism more generally.

## I. SETTING THE SCENE

### A. *Hedge Fund Activism: A Four-Stage Analytical Framework*

Previous literature identifies several key elements of the brand of shareholder activism associated with activist hedge funds and illustrates how it differs from previous forms of shareholder activism by institutional investors, as well from interventions designed to achieve control of the targeted companies. Focusing on activism directed at U.S. companies, Professors Marcel Kahan and Edward Rock have thoughtfully explained that “hedge fund activism is strategic and ex ante [rather than incidental and ex post]: hedge fund managers first determine whether a company

would benefit from activism, then take a position and become active.”<sup>22</sup> Professors Brian Cheffins and John Armour employ the adjectives “offensive” and “defensive” to distinguish between shareholder activism by conventional institutional investors (e.g., mutual funds and pension funds) and shareholder activism by activist hedge funds.<sup>23</sup> The key difference between these two forms of shareholder activism is the existence (defensive activism) or not (offensive activism) of a pre-existing stake in the target company.

However, having an initial endowment in a target company does not automatically render activism “defensive” in nature.<sup>24</sup> In some exceptional cases, activist hedge funds might already have a small shareholding in a company before deciding to actively lobby for changes and, thus, hedge fund activism is not always “ex ante.”<sup>25</sup> Also, the term “offensive” activism implies a confrontational posture; whereas many of the activist hedge funds are not high-profile activist investors and generally do not seek publicity.<sup>26</sup>

This suggests that the style of shareholder activism in which hedge funds and other shareholder activist funds engage has two defining features. First, it presupposes an equity stake as the departure point which is accumulated *proactively*; that is activist hedge funds either do not have a pre-existing stake in the target company or they have a small one which they quickly increase when they decide to adopt a hands-on strategy. Secondly, it aims to effect change in the policies of the targeted companies in order to extract value. The distinguishing feature of this brand of shareholder activism from other forms of engagement with portfolio companies lies in its proactive nature: activist hedge funds initiate changes rather than merely reacting to events of underperformance or deficient management. It is also helpful at this stage to distinguish between activist interventions and passive acquisitions of shares by otherwise activist funds (See Figure 1, below). The former—hedge fund activism—can be thought of as involving a four-pronged strategy approach: *entry, trading,*

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22. Kahan & Rock, *supra* note 15, at 1069.

23. Brian R. Cheffins & John Armour, *The Past, Present, and Future of Shareholder Activism by Hedge Funds*, 37 J. CORP. L. 51, 56 (2011).

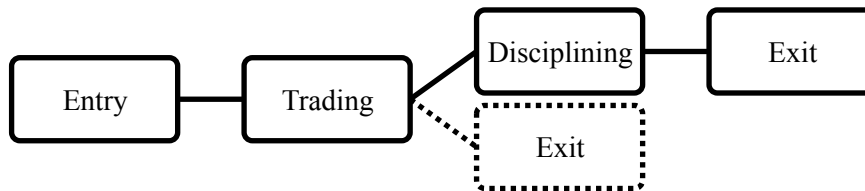
24. Katelouzou, *supra* note 14, at 467.

25. For example, in the TCI’s campaign in J-Power, the Japanese electric power company: “TCI . . . changed the purpose of its holding in its filing with the Japanese regulator, from one of ‘pure investment’ to an ‘investment to receive a capital return as a shareholder and submit important proposals to members of the board or to the annual shareholders’ meeting as the situation warrants.” Michiyo Nakamoto, *TCI Calls on J-Power to Triple Dividend*, FIN. TIMES, Mar. 13, 2007, at 28.

26. For empirical evidence, see *infra* notes 196–197 and accompanying text.

*disciplining*, and *exit*. The latter involves profitable stock-picking, to which value investors aspire, without recourse to a hands-on approach.

Figure 1: The four stages of an activist hedge fund campaign



A typical activist hedge fund campaign starts with the selection of a target company that presents high-value opportunities for engagement (*entry stage*). Activist hedge funds search for undervalued and underperforming companies.<sup>27</sup> Choosing a target company that fails to fulfill its potential and thus likely to deliver better shareholder returns is a necessary pre-condition for the activist hedge fund's entry decision. Yet it is not a sufficient one. Instead, hedge fund activism is intimately linked to the ownership structure of the target company. A dispersed ownership structure is more appealing to activist hedge funds at the entry stage of an activist campaign, whereas the existence of controlling blocks in the target company constitutes a "structural" barrier to shareholder activism by activist hedge funds if the controlling shareholders are unwilling to support the activist campaign.<sup>28</sup> A friendly block-holder in the target company aside, it will be more difficult for a hedge fund to pursue an activist campaign in a company with shareholders who control a sufficiently large block of votes to veto unwelcome activists. However, the emerging patterns of activist hedge fund campaigns in jurisdictions such as Italy, France, and Germany, where ownership concentration is substantial even in large publicly-listed companies,<sup>29</sup> suggest that an activist hedge fund could

27. See Robin M. Greenwood & Michael Schor, *Investor Activism and Takeovers*, 32 J. FIN. ECON. 362, 365 (2009) (finding that about half—47.9% and 45.5%, respectively—of the activist events in their sample involved hedge funds recognizing that the target company was undervalued and engaging in management to maximize firm value); Brav et al., *supra* note 15, at 1729.

28. See Martin de Sa'Pinto, *Laxey-daisical Governance or Saurer Grapes?*, HEDGEWORLDNEWS, Aug. 30, 2006 (mentioning hedge fund's ability to accumulate 26% of the target's shares).

29. For a systematic analysis of ownership in Western Europe, see Mara Faccio &

buy into a company with concentrated ownership structure in certain exceptional circumstances.<sup>30</sup>

After an activist hedge fund identifies a potential target where it anticipates that feasible changes can increase shareholder returns, it starts to accumulate its ownership stake (*trading stage*).<sup>31</sup> Activist hedge funds usually purchase a sizeable stake in the target company through the open market.<sup>32</sup> Previous economic literature shows that, in equilibrium, an active intervention is only worth the cost when an investor owns a large stake. This is because the gains that he or she can accrue from the increase in shareholder returns depend on the size of his or her stake.<sup>33</sup> Yet for investors with no toehold stake in the firm, such as activist hedge funds, shareholder activism is not monotonically related to the size of shareholdings.<sup>34</sup> Indeed, anecdotal evidence suggests that sometimes activist hedge funds intervene even with tiny ownership stakes, while empirical studies point out that, although hedge fund activism does not

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Larry H. P. Lang, *The Ultimate Ownership of Western European Corporations*, 65 J. FIN. ECON. 365 (2002) (finding that 54% of European firms have only one controlling owner). For the ownership structure of East Asian countries, see Stijn Claessens et al., *The Separation of Ownership and Control in East Asian Corporations*, 58 J. FIN. ECON. 81 (2000) (finding that more than two-thirds of the firms in their sample were controlled by a single shareholder).

30. See 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 (2013) (suggesting that activist hedge funds invest in companies with concentrated ownership when they are able to take advantage of the several different rights provided by the law and company bylaws for the protection of minority shareholders, such as the right to elect a director in a company that mandates board representation for minority shareholders); see also Cheffins & Armour, *supra* note 23, at 68 (suggesting that another possibility where hedge fund activism is likely to be deployed, despite the lack of dispersed ownership, is where there is a special class of shares upon which the controlling shareholder's power is based and the activist lobbies for the company to normalize the share structure).

31. For the purpose of simplicity, I assume here that an activist hedge fund has no pre-existing stake. *Contra supra* notes 24–25 and accompanying text.

32. For empirical evidence in the United States, see Nicole M. Boyson & Robert M. Mooradian, *Intense Hedge Fund Activists* 3, 30 (Feb. 23, 2010) (unpublished manuscript), available at <http://ssrn.com/abstract=1571728> (finding from a total of 272 hedge fund-target pairs, only 57 funds purchased any of their shares using a method other than an open market purchase, such as private placement or conversion of preferred stock or debt).

33. See, e.g., Shleifer & Vishny, *supra* note 17, at 468 (arguing that the presence of a large shareholder is a necessary condition for the occurrence of value-increasing takeovers); Charles Kahn & Andrew Winton, *Ownership Structure, Speculation, and Shareholder Intervention*, 53 J. FIN. 99, 109–110 (1998) (showing that, in the case of activists with initial endowment, larger stakes increase the expected value of the initial shares of the activist and the activist's trading profits and, hence, encourage intervention).

34. Noe, *supra* note 17, at 303, 308.

generally involve controlling blocks, it does involve large minority blocks with the median maximum activist blocks being around 10 percent.<sup>35</sup>

After accumulating a sizeable stake, an activist hedge fund announces a change in the firm's corporate policy or governance that it believes is value-enhancing and then tries to get that change carried out (*disciplining stage*). An activist hedge fund does not necessarily formulate a set of demands for the first time at the disciplining stage; already at the entry stage, it identifies valuable improvements in the firm's policy through independent research, while it assesses various firm-specific parameters that are likely to influence its entry to a particular target company. At the disciplining stage, however, an activist makes its investment intents known to the incumbents either privately via letter writings or meetings, or publicly through regulatory filings (e.g. 13D filings in the United States) or press reports. Under this definition, the disciplining stage starts with the communication of the activist hedge fund's demands to the target company, followed by the various tactics an activist hedge fund employs in order to prod the incumbents to conform to its demands.

The entry and trading stage will be present in stock-picking too. But the readiness to take a hands-on role and lobby for changes (disciplining stage) is the crucial additional dimension to hedge fund activism. It is also noteworthy that even if a hedge fund has an activist reputation, this does not mean that it engages actively with all the companies in which it invests. Rather, it is possible that activist hedge funds sometimes buy up shares for purely investment purposes without prompting any specific changes.<sup>36</sup> This type of investment is what I term as stock-picking and does not qualify as hedge fund activism.

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35. See Brav et al., *supra* note 15, at 1747 (reporting that the median initial (maximum) percentage stake that a hedge fund takes in the target is 6.3% (9.5%), but finding that hostile engagements exhibit larger ownership stakes in target firms); Nicole M. Boyson & Robert M. Mooradian, *Corporate Governance and Hedge Fund Activism*, 14 REV. DERIVATIVES RES. 169, 177 (2011) (documenting that the mean initial (maximum) percentage ownership by activist hedge funds in target companies is 8.8% (12.4%)); Greenwood & Schor, *supra* note 27, at 362 (reporting a 9.8% average initial ownership in their sample); Katelouzou, *supra* note 14, at 490 (reporting that the median minimum and maximum held by activist hedge funds in her sample is 4.9% and 10%, respectively).

36. For example, Atlantic Investment Management, a New York-based hedge fund, typically accumulates stocks in undervalued companies, keeps a low profile, and exits at a profit. In egregious times, however, the fund engages in public disputes. The former strategy—stock-picking—includes investments in French Groupe Zodiac, German Rheinmetall, and Italian Prysmian, while the latter one—hedge fund activism—involves activist campaigns in Japanese Dai Nippon Printing Co and Dutch TNT (data on file with the author).

Finally, an activist hedge fund exits in order to realize the gains of its disciplining activities (*exit stage*). Empirical research on hedge fund activism targeting U.S. companies by Professors Alon Brav, Jian Wei, Frank Partnoy, and Randall Thomas illustrates that activist hedge funds usually exit through selling in the open market. They found, based on a sample of 1,049 hedge fund–target pairs between 2001 and 2006, that selling in the open market is the predominant form of activist hedge funds’ exit, accounting for two–thirds of all completed cases in their sample, while other indicia of exit include the sale, merger or liquidation of the target company.<sup>37</sup> Lastly, activist hedge funds are not necessarily short–term investors; rather in the majority of cases the activist holding periods are in the range of one year or longer.<sup>38</sup>

*B. Theoretical Underpinnings of Law and Economic Activity*

Activist hedge funds invest in specific companies rather than whole markets, but the effort required to start engaging with specific companies in any particular country implies that there will need to be a generally attractive institutional legal framework before activist hedge funds begin their firm–specific research. The idea of a link between systemic legal factors and shareholder activism traces back to the 1990s when a number of American scholars identified various regulatory obstacles that discourage conventional institutional investors, such as pension funds and mutual funds, from engaging in shareholder activism.<sup>39</sup> In the context of hedge–fund–style activism, Professors Brian Cheffins and John Armour investigate potential systemic factors by introducing the idea of a “market for corporate influence” in which activist hedge funds are the main

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37. Brav et al., *supra* note 15, at 1747–79.

38. See Katelouzou, *supra* note 14, at 479 (reporting that 73.6% of the hedge funds in her sample remain in the target company for more than one year).

39. In the United States, see Lucian A. Bebchuk, *The Case For Increasing Shareholder Power*, 118 HARV. L. REV. 833 (2005) (arguing that shareholders face legal barriers in the exercise of their voting rights, and taking a more active stance by proposing specific legal rules to enhance shareholder empowerment); Lucian A. Bebchuk, *The Myth of Shareholder Franchise*, 93 VA. L. REV. 675 (2007); Bernard S. Black, *Shareholder Passivity Reexamined*, 89 MICH. L. REV. 520 (1990) (explaining that a complex web of legal barriers and legal risks pose an important impediment to shareholder activism in the United States); Alfred F. Conard, *Beyond Managerialism: Investor Capitalism*, 22 U. MICH. J.L. REFORM 117 (1988) (discussing some of the barriers U.S. federal securities regulation imposes on shareholder action); Mark J. Roe, *Political and Legal Restraints on Ownership and Control of Public Companies*, 27 J. FIN. ECON. 7 (1990) (describing legal barriers which restrict financial institutions from holding large equity blocks and from networking the small blocks they do own). Outside the United States, see Paolo Santella et al., *Legal Obstacles to Institutional Investor Activism in the EU and in the US*, 23 EUR. BUS. L. REV. 257 (2012) (identifying several legal obstacles to institutional investor activism in the form of voting).

practitioners.<sup>40</sup> They identify factors that shape the “supply” and “demand” side of the market for corporate influence and in so doing they explain the past, present and future level of hedge fund activism in the United States.<sup>41</sup> In particular, they suggest that legal rules governing the shareholder rights are among the factors that shape the “supply” side of the market for corporate influence, while compulsory disclosure and regulation of collective investment vehicles have an impact on the “demand” side of this market.<sup>42</sup>

The idea that law is essential to hedge fund activism and other corporate governance arrangements echoes the “law and finance” theme of scholarship. The relationship between law and economic activity has long been a subject of considerable debate in economic and legal circles, which goes back to Max Weber and Friedrich von Hayek.<sup>43</sup> In the 1970s, law and society scholars drew on these theories to conclude that there is a causal relationship running from law to economic activity impacting national developmental policies in developing countries.<sup>44</sup> In recent years, a group of prominent financial economists produced a burgeoning empirical research, known as the “law and finance” literature.<sup>45</sup> Professors Raphael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer, and Robert Vishny were the first to show that a country’s legal tradition determines differences in economic outcomes, such as patterns of shareholder ownership and stock market development.<sup>46</sup> They promulgated a line of greatly influential literature, which links various legal rules, such as legal support for shareholders’ rights, with numerous spheres of economic and non-economic activity.<sup>47</sup>

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40. Cheffins & Armour, *supra* note 23, at 61.

41. *Id.* at 61-75.

42. *Id.*

43. MAX WEBER, *ECONOMY AND SOCIETY: AN OUTLINE OF INTERPRETIVE SOCIOLOGY* (1968) (asserting that the “rationality” of law in Western countries—that is, its highly differentiated, consciously constructed, general and universal character—helped explain why capitalism first arose in Europe); FRIEDRICH A. HAYEK, *THE ROAD TO SERFDOM* (1944) (suggesting that countries with legal systems based on common law better promote economic activity than those with civil law systems).

44. See generally Tom Ginsburg, *Does Law Matter for Economic Development? Evidence from East Asia*, 34 L. & SOC’Y REV. 829, 831–34 (2000) (providing a review of the law and development scholarship).

45. For a review of the law and finance literature, see Rafael La Porta et al., *The Economic Consequences of Legal Origins*, 46 J. ECON. LITERATURE 285 (2008); Mathias Siems & Simon Deakin, *Comparative Law and Finance: Past, Present and Future Research*, 166 J. INST. & THEORETICAL ECON. 120 (2010).

46. Rafael La Porta et al., *Law and Finance*, 106 J. POL. ECON. 1113 (1998); Rafael La Porta et al., *Legal Determinants of External Finance*, 52 J. FIN. 1131 (1997).

47. See, e.g., Simeon Djankov et al., *Courts*, 118 Q.J. ECON. 453 (2003) (constructing

The importance of legal institutions for market activity has also been underscored by the new institutional economics, from the perspective of which adequate and effective protection and enforcement of property rights underpin well-functioning markets.<sup>48</sup> The quality of enforcement has also been a central consideration in the law and finance literature,<sup>49</sup> and its importance has been emphasized by legal scholars who suggest that the impact of the legal system depends not only on substantive rules governing investor protection (law on the books), but also on procedural rules and regulators' enforcement capabilities (law in action).<sup>50</sup>

Contemporary research on comparative corporate governance also embraces the idea that law plays a role in corporate governance—an idea that stems from the agency theory.<sup>51</sup> Under agency theory, corporate law fulfils a functionalist role in constraining the agency costs arising from conflicts between the shareholders (principals) and the managers (agents).<sup>52</sup>

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an index of the efficiency of court proceedings and finding that procedural formalism in dispute resolution is higher in civil law countries than in common law countries); Simeon Djankov et al., *The Regulation of Entry*, 117 Q.J. ECON. 1 (2002) (examining the regulation of entry of start-up companies in 85 countries); Rafael La Porta et al., *Agency Problems and Dividend Policies Around the World*, 55 J. FIN. 1 (2000) (shedding light on payout across 33 countries and finding that stronger shareholder rights are associated with higher dividend payouts). However, the alleged one-way relation from law (cause) to economic activity (effect) promulgated by the law and finance literature was challenged by many legal scholars, who provided alternative hypotheses on the institutional determinants of economic activity. See, e.g., CURTIS MILHAUPT & KATHARINA PISTOR, *LAW AND CAPITALISM: WHAT CORPORATE LAW CRISES REVEAL ABOUT LEGAL SYSTEMS AND ECONOMIC DEVELOPMENT AROUND THE WORLD?* (2008) (viewing the relation between law and market activity as a dynamic one, referring to the degree of centralization of a legal system, and describing the functions that law plays in support of market activity and the political economy of law production as reasons why the legal systems differ to each other); Katharina Pistor, *Legal Ground Rules in Coordinated and Liberal Market Economies*, in *CORPORATE GOVERNANCE IN CONTEXT: CORPORATIONS, STATES AND MARKETS IN EUROPE, JAPAN AND THE U.S.* (Klaus Hopt et al. eds., 2005) (suggesting that differences across legal systems largely correspond to the differences between liberal and coordinated market economies); Mark Roe, *Political Preconditions to Separating Ownership from Corporate Control*, 53 STAN. L. REV. 539 (2000) (emphasizing the centrality of politics to financial market development).

48. See generally John N. Drobak, *Law & the New Institutional Economics*, 26 WASH. U. J.L. & POL'Y 1 (2008); Douglass North, *Institutions, Ideology, and Economic Performance*, 11 CATO J. 477 (1991).

49. See, e.g., La Porta et al., *Law and Finance*, *supra* note 46, at 1140–45.

50. See, e.g., Daniel Berkowitz et al., *Economic Development, Legality, and the Transplant Effect*, 47 EUR. ECON. REV. 165 (2003); Katharina Pistor et al., *The Evolution of Corporate Law: A Cross-Country Comparison*, 23 U. PA. J. INT'L L. 791 (2003).

51. On the theoretical underpinnings of the “law matters” thesis, see Alessio M. Paces, *How Does Corporate Law Matter?: ‘Law and Finance’ and Beyond*, in *DOES LAW MATTER? ON LAW AND ECONOMIC GROWTH* (Michael Faure and Jan Smits eds., 2011), available at <http://ssrn.com/abstract=2260340>.

52. This view reflects many dispersed ownership systems, such as the United Kingdom and the United States, but it overlooks the role of other stakeholders and is less suitable to



Methodological advances, such as legal indices that code legal rules, are making it possible to study how, and which, law matters for economic outcomes. The first of these indices—the anti-director rights index—has proved provocative in many ways and was widely used as a measure of shareholder protection, but at the same time it has been widely criticized for coding errors and inaccuracies in certain values, to name just but a few of its defects.<sup>53</sup> Instead, the so-called “leximetric” analysis of legal data provides a theoretically and empirically more grounded approach in exploring the variation across legal and regulatory regimes of different countries and across time.<sup>54</sup>

Overall, in the last two decades the effect of law on economic activity has been resurged by the law and finance scholarship and has been captured—statistically, at least—by legal indices and econometric analysis. This testing, by way of quantification, is not limited to law and finance, but it can assist other types of corporate governance research. This topic is deferred until Part IV, where legal indices are used to capture whether law is facilitative of hedge fund activism and some preliminary empirical results are presented and discussed. But, let us first conceptualize the legal settings of hedge fund activism in the next Part.

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other legal systems, such as Germany, which deviate from an exclusive focus on shareholders. See Ruth V. Aguilera & Gregory Jackson, *The Cross-National Diversity of Corporate Governance: Dimensions and Determinants*, 28 *ACAD. MGMT. REV.* 477 (2003). An alternative view is to see the corporation not only as a legal, but also as a social institution. See John Buchanan et al., *Empirical Analysis of Legal Institutions and Institutional Change: Multiple-Methods Approaches and Their Application to Corporate Governance Research*, 10 *J. INSTITUTIONAL ECON.* 1 (2014).

53. The anti-director rights index (ADRI) was developed by a group of four financial economists and contained six variables (“proxy mail allowed,” “shares not blocked before the meeting,” “cumulative voting,” “oppressed minority,” “pre-emptive rights to new shares,” and “percentage of share capital to call a special shareholder meeting”) that were intended to capture how strongly the legal system of a country favors minority shareholder protection against the board of directors and managers. On the ADRI, see La Porta et al., *Law & Finance*, *supra* note 46, at 1126–34. For an overview of the shortcomings of the ADRI and a comparison with alternative leximetric indices, see Dionysia Katelouzou, *A Leximetric Approach to Comparative Corporate Governance: The Case of Hedge Fund Activism*, 9 *J. COMP. L.* 43 (2015).

54. See, e.g., Priya P. Lele & Mathias Siems, *Shareholder Protection: A Leximetric Approach*, 7 *J. CORP. L. STUD.* 17 (2007) (borrowing the term “leximetrics” from Robert D. Cooter and Tom Ginsburg, *Leximetrics: Why the Same Laws are Longer in Some Countries than Others* (Univ. Ill. Law & Econ. Research Paper No. LE03-012, 2003), available at <http://ssrn.com/abstract=456520>).

## II. LEGAL FOUNDATIONS OF HEDGE FUND ACTIVISM AND THEORETICAL IMPLICATIONS

This Part examines whether and how law is facilitative of hedge fund activism. The analysis provided here does not aim to be a comprehensive comparison of corporate law across different jurisdictions. Instead, it draws upon Part I's four-stage analytical framework of hedge fund activism and investigates which legal variables are likely to make a greater contribution to the different stages of an activist hedge fund campaign. To make this idea compelling, however, particular national corporate laws must be addressed. In the course of the analysis in this Part, therefore, I provide examples from different jurisdictions as to how corporate law variables are critical for the emergence of hedge fund activism. Future research could extend this analysis into full-fledged comparisons of the legal parameters affecting hedge fund activism across different regulatory regimes. Let's now turn to how corporate law supports the first stage of an activist hedge fund campaign.

### A. *The Entry Stage: The Role of Mandatory Disclosure*

We have seen above that at the first stage of an activist campaign—the entry stage—activist hedge funds need to identify a potential target company that presents high value opportunities for engagement.<sup>55</sup> In selecting a target company, an activist hedge fund must assess what the company would be worth following its activist engagement. This assessment requires extensive information on the financial statements and governance arrangements of the target company and incurs high costs if the information is not made freely available.<sup>56</sup> Also, when up-to-date, accurate, and relevant information about a potential target is available to the market, less unsystematic risk will be involved in the activist's assessment of whether its entry to a company is worth pursuing, and less expected gain will be necessary to motivate an activist hedge fund to undertake an activist campaign.<sup>57</sup>

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55. See *supra* notes 27–30 and accompanying text.

56. At the entry stage, an activist hedge fund faces the costs associated with collecting information, identifying the potential candidate target, and assessing the value of the target company and the risks associated with the activist engagement (search costs). On the costs of an activist hedge fund campaign, see Cheffins & Armour, *supra* note 23, at 62–64.

57. Merritt B. Fox, *Required Disclosure and Corporate Governance*, 62 LAW & CONTEMP. PROBS. 113, 120–21 (1999) (making a similar point for the way mandatory disclosure influences the potential bidders in the market for corporate control); Merritt B. Fox, *Securities Disclosure in a Globalizing Market: Who Should Regulate Whom*, 95 MICH. L. REV. 2498, 2547–48 (1997).

Mandatory disclosure requirements imposed on publicly-listed companies have, therefore, a role to play at the entry stage of an activist campaign. Although information disclosure operates independently of activist hedge fund campaigns, financial reporting via annual accounts and periodic reports can help the activists' target selection by providing a comprehensive picture of the target's performance and enabling the insurgents to form a better judgment of the value of the firm, its securities, and its future prospects.<sup>58</sup> For example, mandated forward-looking financial information might help an activist to assess the expected return on its investment.<sup>59</sup> In addition to its impact on the entry stage of an activist campaign, periodic financial reporting can also help an activist hedge fund in the exercise of its governance powers at the disciplining stage of an activist campaign because it enhances the accountability for and the transparency of the target company.<sup>60</sup>

Mandatory disclosure can also serve to reduce agency losses that arise from information asymmetries between insiders (e.g., directors and managers) and outside activist hedge funds, as the latter are likely to be much less well-informed than the insiders with regard to the operating performance or the governance arrangements of the target company, for example.<sup>61</sup> Suitable tailored disclosure requirements, such as disclosure of

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58. For a comparison of the mandatory disclosure regimes across six countries (France, Germany, Italy, Japan, the United Kingdom, and the United States), see Gerard Hertig et al., *Issuers and Investor Protection*, in *THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH* 281–89 (Reinier Kraakman et al. eds., 2009). Most countries also have a set of mandatory disclosure requirements at the initial offering stage. However, for activist hedge funds, initial public offering disclosure is likely to be of minimal importance, since they usually buy common stock on the open market and rarely invest in initial public offers (IPOs) of securities. For empirical evidence suggesting that IPOs are not a popular method for activists to invest, see Boyson & Mooradian, *supra* note 32, at 30 (reporting that activist hedge funds in the United States accumulate common stock through IPOs in just 13 out of 457 cases in their sample).

59. *Contra* Hertig et al., *supra* note 58, at 284 (suggesting that projective data account for only a tiny fraction of mandatory disclosure across jurisdictions).

60. For the dual objective of disclosure rules at the E.U. level (protection of investors and protection of shareholders), see THE HIGH LEVEL GROUP OF COMPANY LAW EXPERTS, *REPORT OF THE HIGH LEVEL GROUP OF COMPANY LAW EXPERTS ON A MODERN REGULATORY FRAMEWORK FOR A COMPANY LAW IN EUROPE* 33–34 (2002).

61. See generally Fox, *Required Disclosure*, *supra* note 57, at 118–19; Merritt B. Fox, *Civil Liability and Mandatory Disclosure*, 109 COLUM. L. REV. 237, 258 (2009); Paul G. Mahoney, *Mandatory Disclosure as a Solution to Agency Problems*, 62 U. CHI. L. REV. 1047 (1995) (introducing the “agency cost model” as an alternative efficiency justification for mandatory disclosure in securities markets and suggesting that the principal purpose of mandatory disclosure is not to enhance price accuracy, but rather to address certain agency problems that arise between corporate promoters and investors, and between corporate managers and shareholders).

executive compensation and self-dealing,<sup>62</sup> can provide useful benchmarks that might help activist hedge funds evaluate potential agency conflicts and uncover companies requiring corporate governance improvements.

Indeed, in the course of their activist campaigns, hedge funds often criticize the targets of their activism for poor disclosure practices. Such attempts are usually an adjunct to broader activism focusing on corporate governance or capital changes—such as when Pirate Capital, a Connecticut-based hedge fund, put pressure on Intrust to provide more thorough disclosures disclosure to investors as part of its broader attempt to push for a share buyback,<sup>63</sup> or when Elliott Associates L.P. criticized Hess Corp. for opaque disclosure, among other corporate governance failures, and filed a proxy statement nominating five members to the Hess board.<sup>64</sup>

### *B. The Trading Stage: Ownership Disclosure Rules*

Following the entry stage of an activist campaign, an activist hedge fund starts to build its ownership stake.<sup>65</sup> In addition to the impact of target firm liquidity on the profitability of activist trading,<sup>66</sup> rules requiring large shareholders to disclose their holdings can further impair the trading benefits, and, hence, deter hedge funds from proactive stake-building.

The focus of this Section is on the impact of four different aspects of ownership disclosure on the trading stage of hedge fund activism: (1) the initial triggering threshold percentage for disclosure; (2) the breadth of the definition of the stake that triggers the disclosure; (3) the deadline within which the activist(s) should report to the competent authorities after crossing the relevant threshold; and (4) the scope of the disclosure obligation, while it also considers the effect of acting-in-concert legislation on the ability of activist hedge funds to amass a sizeable stake.

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62. See, e.g., Luca Enriques et al., *Related-Party Transactions*, in *THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH* 158 (Reinier Kraakman et al. eds., 2009) (analyzing the differences in disclosure of managerial compensation across five countries).

63. Lori McLeod, *Intrust Pushed for Share Buyback: Evaluating Its Options*, NAT'L POST, Oct. 6, 2005, at 12 (describing how Pirate Capital pressed Intrust for a share buyback).

64. Hess Corp., Proxy Statement Pursuant to Section 14(a) of the Securities and Exchange Act of 1934 (Schedule 14A) (Apr. 4, 2013) (filed by Elliott Associates, L.P. et al.).

65. See *supra* notes 31–35 and accompanying text (describing the share acquisition process at the trading stage in detail).

66. See *supra* note 17 and accompanying text (noting that activists may acquire relatively large blocks of liquid shares trading in “deep markets” with little impact on share price).

### 1. Initial Ownership Thresholds

Most jurisdictions now have rules requiring investors to disclose their holdings whenever they cross some specified thresholds. In the United States, section 13(d) of the Securities Exchange Act of 1934 (hereinafter “Exchange Act”) and the related Securities and Exchange Commission’s (SEC) rules require disclosure of transactions that result in anyone becoming the beneficial owner of more than 5 percent of a public company’s stock.<sup>67</sup> In the European Union, the Transparency Directive<sup>68</sup> requires disclosure about major shareholdings where the proportion of voting rights reaches, exceeds, or falls below eight triggering thresholds ranging between 5 and 75 percent.<sup>69</sup> E.U. Member States remain free to adopt further thresholds, including lower ones, such as a 3 percent threshold in the United Kingdom or a 2 percent threshold in Italy.<sup>70</sup>

While enhanced transparency resulting from lower thresholds may facilitate the entry stage of an activist hedge fund campaign by giving the insurgent a clearer picture of the ownership structure of the target company,

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67. 17 C.F.R. § 240.13d-1(a) (2015). Certain types of investors who invest passively can instead file a more abbreviated Schedule 13G form. 17 C.F.R. § 240.13d-1(b) (2015). In addition, disclosure may also be required under Section 13(f) of the Exchange Act, while all institutional investment managers must report their shareholdings quarterly on Form 13F. 17 C.F.R. § 240.13f-1 (2015).

68. 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 [hereinafter “Transparency Directive”] (amended by Council Directive 2013/50/EU, 2013 O.J. (L 294) 13).

69. The relevant thresholds are at 5%, 10%, 15%, 20%, 25%, 30%, 50% and 75%. *Id.* art. 9, at 47.

70. It also noteworthy that in several countries, like France and Italy, public companies can set lower thresholds for notification of major shareholdings in their own articles of association. The law may specify the lowest threshold, as in France, for example, where it can be set at 0.5%. See *Commission Report on More Stringent National Measures Concerning Directive 2004/109/EC on the Harmonisation of Transparency Requirements in Relation to Information about Issuers whose Securities are Admitted to Trading on a Regulated Market*, at 26, SEC (2008) 3033 final (Dec. 10, 2008) [hereinafter *Commission Report on Transparency Directive*] (citing the French threshold and noting that Belgium specifies 1% as the lowest threshold). In recent years, several E.U. Member States have lowered the initial disclosure threshold from 5% to 3% or 2%, generating a policy debate on setting a lower initial disclosure threshold at 3% at the E.U. level. See *Commission Staff Working Document, The Review of the Operation of Directive 2004/109/EC: Emerging Issues*, at 14 & Annex 8, SEC (2009) 611 (May 27, 2010) (describing the lowering of the initial Directive threshold in some E.U. Member States and noting that the European Parliament and some experts are in favor of a 3% threshold).

lower initial thresholds may act as a brake on the activist's stake-building. When activists buy shares in the open market, the share price of the target company increases, but they can hide their presence so that it is profitable to them to buy shares.<sup>71</sup> However, the possibility of secret trading is restricted as there is an upper limit upon which an activist hedge fund must declare the amount of shares it owns to comply with ownership disclosure rules.<sup>72</sup> The maximum size of the ownership stake an activist hedge fund can purchase anonymously without disclosure, therefore, puts an upper limit to the benefits it can earn from an activist campaign, since the activist's post-disclosure gains must in effect be shared with the market.

In addition to its negative impact on activist trading, mandatory ownership disclosure can serve as an initial warning to the target's management, but may also signal other investors to enter the target company. A relevant high initial threshold enables an activist hedge fund to conceal its presence from the incumbents, who may be unable to judge whether the activist has voting power in the company. Adding to its limiting impact is the fact that ownership disclosure can also enable the target's management to respond to the activist threat, for example, by mounting defensive measures.<sup>73</sup> As a result, an activist hedge fund is expected to build a stake in a target company as discretely as possible,

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71. Empirical studies in the United States show that 13D filings by activist hedge funds are associated with significant price effects. *See, e.g.*, April Klein & Emanuel Zur, *Entrepreneurial Shareholder Activism: Hedge Funds and Other Private Investors*, 64 J. FIN. 187 (2009) (finding that target share price tends to increase around the date of the initial Schedule 13D filing and positive returns continue in the subsequent year for activist hedge funds and other private investors).

72. *See* Cheffins & Armour, *supra* note 23, at 64 (defining the percentage of shares owned as an upper limit on the benefits that an activist shareholder may capture and noting that the increase in share price that occurs when an activist shareholder's stake is made public is an additional constraint).

73. A recent example is Hologic Inc., a U.S. diagnostics and surgical products maker that adopted a one-year shareholder rights plan (exercisable if a person or group acquired 10% or more of the company's common stock) after activist investor Carl Icahn unveiled his 12.63% stake in the firm. *See* Joseph Walker & Tess Stynes, *Icahn Takes Stake in Hologic*, WALL ST. J. (Nov. 21, 2013), <http://www.wsj.com/articles/SB10001424052702304337404579211802051987232> (detailing Hologic's decision to adopt a poison pill in response to Icahn's disclosure of his holding). The potential role of poison pills as a defense against shareholder activists in the United States has recently been advanced by the Delaware Court of Chancery's decision to uphold the Sotheby's poison pill, which was challenged by Daniel Loeb's Third Point. *Third Point LLC v. William F. Ruprecht*, No. 9469-VCP, 2014 WL 1922029, at \*6–10 (Del. Ch. May 2, 2014), *available at* <http://courts.delaware.gov/opinions/download.aspx?ID=205180> (citing evidence suggesting that Third Point intended to take the firm private for authorization of poison pill). For a discussion of this decision, see John C. Coffee, *Hedge Fund Activism: New Myths and Old Realities*, 251 N.Y. L.J. 5 (2014) (theorizing that the poison pill is "losing its blocking power" and recommending the shortening of the ten-day reporting window under Section 13(d)).

primarily to avoid the burden associated with notification of major shareholdings, but also for reasons of anonymity. For this type of investor, the higher the disclosure threshold the better, because a higher threshold will increase the proportion of the benefits the potential activist can expect to capture if it chooses to amass an ownership stake in a company and engage in monitoring activities.

## 2. The Definition of the Stake that Triggers Disclosure and “Hidden Ownership”

In addition to the threshold percentage for disclosure, the breadth of the definition of the ownership stake that triggers disclosure is likely to matter for the trading stage of an activist hedge fund campaign. Until recently, disclosure requirements—in European countries as well as in the United States—were triggered by shareholdings carrying voting rights, rather than economic positions that do not carry voting rights. However, financial derivatives and other synthetic transactions have increasingly enabled investors to separate the economic risk of owning shares of a public company from the ability to vote those shares, a phenomenon which has been coined as “hidden ownership.”<sup>74</sup> In the context of hedge fund activism, hidden ownership can be used in order to circumvent disclosure requirements and stealthily acquire sizeable ownership stakes without alerting the market. While stake-building through hidden ownership can reduce the acquisition costs and increase the amount of benefits that can be internalized by an activist hedge fund, it might distort corporate governance by keeping the activist’s intents unknown from the incumbents.<sup>75</sup>

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74. The concept of hidden (morphable) ownership has been developed by Professors Henry T.C. Hu and Bernard Black in several related articles. *See generally* Henry T.C. Hu & Bernard Black, *The New Vote Buying: Empty Voting and Hidden (Morphable) Ownership*, 79 S. CAL. L. REV. 811 (2006) (establishing the notion of “new vote buying” as the decoupling of economic ownership of shares from voting rights); Henry T.C. Hu & Bernard Black, *Equity and Debt Decoupling and Empty Voting II: Importance and Extensions*, 156 U. PA. L. REV. 625 (2008) (expanding upon Hu and Black’s earlier work on morphable ownership and promoting a disclosure-based response to related problems).

75. *See* Eugenio de Nardis & Matteo Tonello, *Know Your Shareholders: The Use of Cash-Settled Equity Derivatives to Hide Corporate Ownership Interests*, DIRECTOR NOTES: THE EUR. SERIES (The Conference Bd., New York, N.Y.), July 2010, available at <http://ssrn.com/abstract=1648526> (enumerating various market and corporate governance distortive effects of hidden ownership). *But see* Soumyadri Chattopadhyaya, *The Effectiveness of Being Invisible: Hedge Funds, Hidden Ownership and Corporate Governance*, 8 EUR. CO. & FIN. L. REV. 305 (2011) (underscoring the benefits of hidden ownership for activist hedge funds and arguing against mandatory disclosure of economic-only ownership).

In response to a debate sparked by publicized cases of undisclosed stake-building (not only by activist hedge funds), regulators in several European countries have imposed both general disclosure and takeover-specific disclosure to limit the phenomena of hidden ownership in the last several years.<sup>76</sup> On the other side of the Atlantic, however, the 13D requirements do not seem to directly capture hidden ownership.<sup>77</sup> Yet the impact on hedge fund activism of any expansion of the disclosure requirements to include financial derivatives ultimately depends on the incidence of undisclosed activist stake-building. Although any data are surely partial given that hidden ownership is not mandatorily disclosed with the exception of some recent regulatory changes, the available empirical findings suggest that activist hedge funds do not resort to hidden ownership as often as their opponents claim.<sup>78</sup> Correspondingly, the impact

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76. For example, in 2009, the U.K. ownership disclosure rules were amended to require investors to disclose all major long positions, in respect of any financial instrument (either physical or cash-settled) they hold directly or indirectly, with financial instruments being defined broadly to include transferable securities, options, futures, swaps, forward rate agreements, and any other derivative contracts. *See* FSA HANDBOOK, §§ 5.3.1-5.3.2 (2015) [hereinafter “U.K. Disclosure and Transparency Rules” or “DTR”] (imposing broad disclosure requirements on U.K. listed firms). France, Germany, and Switzerland have also expanded their disclosure regimes to address issues arising from hidden ownership. *See generally* Maiju Kettunen & Wolf-Georg Ringe, *Disclosure Regulation of Cash-Settled Equity Derivatives: An Intentions-Based Approach*, 2 LLOYD’S MAR. & COM. L.Q. 227, 238 (2012) (calling the United Kingdom a “forerunner[] in preventing [cash-settled equity derivative] abuse” and noting that France, Germany, and Switzerland have followed suit).

77. Rule 13d-3(a) of the Exchange Act provides that a beneficial owner is any person who directly or indirectly has voting power or investment power over the security, while beneficial ownership of shares also includes “the right to acquire beneficial ownership . . . within sixty days, including . . . [t]hrough the exercise of any option [or] warrant.” 17 C.F.R. § 240.13d-3(a), (d)(1)(i) (2014).

It is also noteworthy that the litigation battle arising in 2008 between the CSX Corporation and two activist hedge funds, The Children’s Investment Fund Management (TCI) and 3G Capital Partners, gave no clear answer regarding the disclosure requirements of hidden ownership. The two activist hedge funds circumvented the disclosure requirements under Section 13(d) of the Exchange Act through cash-settled total return equity swaps and sought to wage a proxy contest over the U.S. railroad company. On appeal, the Second Circuit did not reach any agreement concerning whether and under what circumstances the long party to a cash-settled total return swap will be deemed to beneficially own shares for the purposes of Section 13(d). *See* CSX Corp. v. The Children’s Inv. Fund Mgmt., 654 F.3d 276, 281–82 (2d Cir. 2011) (identifying the disagreement regarding beneficial ownership and limiting the majority opinion to the issue of group formation). However, Judge Winter, in a lengthy concurring opinion, discussed this issue in some depth. His view was that, without an agreement between the long and short parties permitting the long party to acquire or vote the counterparty’s hedge position, cash-settled total return swaps do not render the long party a beneficial owner with a potential disclosure obligation under Section 13(d). *Id.* at 288–89 (Winter, J. concurring).

78. *See* Hu & Black, *Equity and Debt Decoupling*, *supra* note 74, at 659–81 (studying 42 known or rumored instances of hidden ownership worldwide, though not necessarily as a



of an extended disclosure regime catching economic ownership on hedge fund activism is unlikely to be dramatic.

### 3. Time Window of Disclosure Obligations

The deadline within which the investors should report to the competent authorities after crossing the ownership thresholds for notification might also affect the profitability of activist trading.<sup>79</sup> As the reporting deadline becomes more stringent, there is less scope for secret trading and, in turn, it is more costly for activist hedge funds to accumulate a sizeable stake. If an activist is forced to disclose its shareholding in the target too soon, its toehold and its ensuing profit will be smaller and hedge fund activity will be consequently reduced. In addition, a short time window for ownership disclosure may serve to increase the time available to the incumbents to prepare the defensive steps permitted.

Indeed, empirical evidence on both sides of the Atlantic confirms that activist hedge funds often hide their investments as long as possible. A

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part of an activist hedge funds campaign); Katelouzou, *supra* note 14, at 498 (collecting data on the publicly-reported instances of decoupling of economic and voting ownership outside the United States and reporting that activist hedge funds have used hidden ownership techniques to enforce their activist role in 13 out of 432 activist campaigns studied).

79. In the United States, the 13D Schedule must be filed within 10 days of passing the 5% holding. 17 C.F.R. § 240.13d-1 (2014). Since 2010, corporate directors and their advocates have lobbied the Securities Exchange Commission (SEC) to shorten the disclosure time-window from ten days to only one, aiming at shrinking the share blocks that activist investors can acquire. See Letter from Wachtell, Lipton, Rosen & Katz to Elizabeth M. Murphy, Secretary, U.S. Sec. & Exch. Comm'n (Mar. 7, 2011), *available at* [www.sec.gov/rules/petitions/2011/petn4-624.pdf](http://www.sec.gov/rules/petitions/2011/petn4-624.pdf) (requesting that the SEC shall "propose amendments to shorten the reporting deadline and expand the definition of beneficial ownership under the reporting rules"). However, the SEC has yet to take action on this matter. See Liz Hoffman, *SEC Unlikely to Touch 13(D) Stock-Buying Window*, WALL ST. J. MONEYBEAT (Oct. 2, 2014, 4:55 PM), <http://blogs.wsj.com/moneybeat/2014/10/02/sec-unlikely-to-touch-13d-stock-buying-window/> (reporting that SEC Commissioner Daniel Gallagher said the "agency is unlikely to move anytime soon to tighten" the disclosure time window).

In the European Union, the Transparency Directive sets a stricter deadline, as the acquirer should notify the issuer as soon as possible after reaching the threshold, but no later than four days. Transparency Directive, *supra* note 68, art. 12, § 2, at 48. The Transparency Directive also imposes a subsequent time window of three trading days within which the target company must announce the acquisition to the public. *Id.* at art. 12, § 6, at 48. Several E.U. Member States have imposed even shorter deadlines for investors' announcement on major holdings. For example, in the United Kingdom, U.K. acquirers shall be disclosed to the company and the U.K. Financial Services Authority (FSA) within no later than two trading days. See DTR, *supra* note 76, § 5.8.3 (setting the deadline for non-U.K. issuers at four trading days and the deadline for all other issuers at two trading days).

recent study of Schedule 13D filings by activist hedge funds between 1994 and 2007 in the United States found that it is common for activist hedge funds to use the opportunity not to disclose immediately upon crossing the 5% threshold.<sup>80</sup> However, the same study did not find evidence that activists who make full use of the ten-day period prior to disclosure accumulate larger stakes than those who disclose more quickly after crossing the 5% threshold.<sup>81</sup> A study on hedge fund activism in Germany similarly reports that activist hedge funds intentionally delay notifications in order to facilitate further acquisitions of ownership stakes.<sup>82</sup> However, the authors of this study pointed out that the market reaction is not different for timely and delayed disclosures and suggested that the disclosure per se is more important than the time window of disclosure.<sup>83</sup>

#### 4. Intentions-Related Disclosure

Another aspect of the mandatory ownership disclosure regime that might affect the trading stage of an activist campaign is whether or not the activist hedge fund should disclose its intentions when it reports its holdings. In the United States, investors acquiring more than 5 percent of any class of securities of a publicly-listed company must file with the SEC if they have an interest in influencing the management of the company, with the underlying purpose being to alert other shareholders to a potential change of control.<sup>84</sup> In the European Union, the Transparency Directive is silent on this issue.<sup>85</sup> However, some E.U. Member States impose

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80. Lucian A. Bebchuk et al., *Pre-Disclosure Accumulations by Activist Investors: Evidence and Policy*, 39 J. CORP. L. 1, 10–11 (2013) (reporting that in over 40% of the public disclosures studied activist hedge funds take advantage of the ten-day window, with nearly 20% filing on the tenth day).

81. *Id.* at 12.

82. Peter Weber & Heinz Zimmermann, *Hedge Fund Activism and Information Disclosure: The Case of Germany*, 19 EUR. FIN. MGMT. 1017 (2013) (suggesting that the small risk of getting fined for delayed announcement and the low fines that must be paid upon conviction may explain the violation of disclosure procedures).

83. *Id.* at 1048.

84. 17 C.F.R. § 240.13d-101 (2015). In particular, Item 4 of Schedule 13D requires the filer to disclose any “plans or proposals” he/she has with respect to the target issuer, which may or will result in, among others, a change in the board of directors, a liquidation, a merger, a sale of material assets of the issuer, a change of the issuer’s corporate or business structure, or a change of the issuer’s charter or bylaws. *Id.*

85. On the content of the disclosure, see Transparency Directive, *supra* note 68, art. 12, § 1, at 48 (identifying four categories of disclosure information); *see also* Roberta S. Karmel, *Reform of Public Company Disclosure in Europe*, 26 U. PA. J. INT’L ECON. L. 379, 393–98 (2005) (comparing the disclosure regimes of the E.U. to the U.S. regime).

additional disclosure obligations for large investors in relation to the objectives pursued by their investment.<sup>86</sup>

The extended information duties resulting from intentions-related disclosure could discourage the brand of shareholder activism associated with activist hedge funds, since the activist's underlying strategy at the trading stage focuses on the acquisition of a toehold shareholding in the target company. The activist can manage this toehold without revealing the object of its intended campaign. The counterargument might be that if an investor with an activist reputation accumulates a sizeable stake in a company and this is disclosed, everyone knows what is going on without a declaration of intent. In addition, intentions-related disclosure obligations may not always be counterproductive for activist hedge funds. Activist campaigns need publicity: activist hedge funds often make their agenda public via press releases and engage in a public dialogue with the incumbent directors, which not only puts further pressure on the target company but also influences other shareholders. Correspondingly, an intentions-related disclosure may offer activists the publicity they need in order to profit from their monitoring activities. Some studies have also shown that the investment purpose may strongly influence the targets' stock price reaction,<sup>87</sup> and without intentions-related disclosure it might be

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86. For example, in France any investor crossing the 10% or 20% threshold of capital or voting rights must declare the objectives to be pursued in the next 12 months, declaring, among others, whether he/she is acting alone or jointly and whether he/she envisages making further acquisitions or acquiring a controlling interest in the company. *See* Code Commerce [C. Com.] art. L. 233-7 VII c (Fr.) (mandating intentions-related reporting in France).

Germany has also recently adopted a new law (the so-called Risk Limitation Act) according to which investors exceeding the 10% threshold are required to disclose their objectives. Investors are, in particular, requested to disclose whether the acquisition is for the purpose of implementing strategic objectives or achieving trading profits, whether they intend to acquire further voting rights in the following 12 months, whether they intend to exercise any influence, or whether they seek a material change in the capital structure or dividend policy of the company. *See generally Commission Report on Transparency Directive, supra* note 70, at 28 (identifying the German legislation and similar French disclosure obligations).

Some jurisdictions employ a further technique and permit the company to trigger a disclosure obligation in relation to the intentions of the beneficial owners. *See, e.g.,* Companies Act, 2006, c. 46, Part 22 (U.K.) (permitting public U.K. companies to request intentions-related disclosures from shareholders who are interested in the company's shares or were interested in the company's shares at any time within three years prior to the request).

87. *See* Klein & Zur, *supra* note 71, at 209-11 (finding that the market reacts more favorably when the activist hedge fund seeks board representation, buys more stock with the intention of buying the whole firm, or expresses concern over the corporate governance practices of the target company).

more difficult for the market to assess the value of an activist hedge fund campaign.<sup>88</sup>

### 5. Acting-in-Concert Legislation

In addition to ownership disclosure rules, tight rules on acting-in-concert may introduce an important barrier to the trading stage of an activist campaign. An activist hedge fund can team up with other managers (usually hedge funds) and form a “wolf-pack,” where each of the participants purchases a share of the target’s equity, which is below the threshold prompting a major shareholder’s disclosure obligation.<sup>89</sup> A wolf-pack allows activist hedge funds to circumvent disclosure rules and to secretly acquire or build upon sizeable stakes without triggering a strong upward price adjustment. While not all jurisdictions subject all forms of cooperation to mandatory disclosure, regulators have generally made the wolf-pack technique subject to disclosure.<sup>90</sup>

Before concluding this Section, it is important to note that the mandatory bid rule, which requires the acquirer to make a tender offer to all the shareholders once it has accumulated a certain percentage of the

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88. See Weber & Zimmermann, *supra* note 82, at 1020 (discussing German regulations and disclosure requirements for activist hedge funds).

89. See Dirk A. Zetzsche, *Challenging Wolf Packs: Thoughts on Efficient Enforcement of Shareholder Transparency Rules* (Ctr. for Bus. & Corporate Law, Working Paper CBC-RPS No. 0044/09, 2010), available at <http://ssrn.com/paper=1428899> (proposing new shareholder transparency rules to battle secret acquisition strategies).

90. Under U.S. securities regulation, a wolf-pack may account for deemed beneficial ownership under Section 13(d) of the Exchange Act. Specifically, any two or more activist funds will be considered as one aggregated filing group if they have *agreed* to act together “for the purpose of acquiring, holding, voting or disposing” of the shares. 17 C.F.R. § 240.13d-5(b) (2014). Shares held via swaps or other financial instruments may also meet the requirements of an “agree[ment] to act together.” *Id.* This was the case in *CSX v. TCI*, where the court ruled that TCI, which held a large stake of up to 14% indirectly based on swap agreements, was acting in concert with another hedge fund, 3G, and formed a “group.” *CSX Corp. v. The Children’s Inv. Fund Mgmt.*, 654 F.3d 276, 279 (2d Cir. 2011). Therefore, 3G was required to disclose its collaborative activities. *Id.*

In Europe, shares held in wolf-packs may meet the percentage tests used in disclosure rules. For the purposes of the shareholder transparency rules, the notification requirements apply to cases of an “agreement” which “obliges” to adopt “by concerted exercise of the voting rights, a lasting common policy towards the management of the issuer in question.” Transparency Directive, *supra* note 68, art. 10(a), at 47. Shares held via financial instruments may also meet the requirements of the acting-in-concert test. *Id.* art. 13, at 49.

Furthermore, some E.U. Member States, for example Germany and France, have widened the “acting in concert” situation, which triggers the notification duty under the Transparency Directive. See *Commission Report on Transparency Directive*, *supra* note 70, at 27.

shares,<sup>91</sup> is likely to have an additional impact upon the stake-building of activist wolf-packs. Although activist hedge funds almost never make takeover bids and rarely come close to owning stakes large enough to trigger the mandatory bid rule, a wolf-pack of activist hedge funds which reaches the mandatory bid threshold may find itself subject to an obligation to make a general offer.<sup>92</sup> In the European Union, the current definition of acting in concert provided by the Takeover Directive gives wide discretion to E.U. Member States as to the meaning of control. Discretion is given to such an extent that it allows E.U. Member States to adopt definitions that establish limits to concerted shareholder action.<sup>93</sup> For example, while under the U.K. City Code on Takeovers and Mergers, a wolf-pack will trigger a bid requirement only if the participating activists request a general meeting to consider a “board control-seeking” resolution or threaten to do so.<sup>94</sup> Other E.U. Member States, like Germany and France, have

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91. In the European Union, anyone acquiring control of a listed company is required to make an offer addressed to all holders of securities for all their holdings at a price at least equal to the highest price paid in the period preceding the acquisition, unless an exemption or a discount on price is granted by the supervisory authority. Directive of the European Parliament and of the Council on Takeover Bids 2004/25, 2004 O.J. (L 142) 12 (EC) [hereinafter “Takeover Directive”], art. 5, at 17.

However, the mandatory bid rule is not part of U.S. takeover regulation. For an excellent account of the differences in takeover regulation between the United Kingdom and the United States, see John Armour & David A. Skeel, Jr., *Who Writes the Rules for Hostile Takeovers, and Why?—The Peculiar Divergence of U.S. and U.K. Takeover Regulation*, 95 GEO. L.J. 1727 (2007) (discussing the regulatory differences for hostile takeovers between the United States and the United Kingdom).

92. For details on the particular thresholds across the E.U. Member States, see Takeover Directive, *supra* note 91, at Annex 2 (requiring mandatory bids for acquisition of 30% of voting rights in Austria, Belgium, Cyprus, Germany, Finland, Ireland, Italy, the Netherlands, Spain, Sweden, United Kingdom; and for one-third of the voting rights in Portugal, Slovakia, Luxemburg and France). It is noteworthy that Denmark and Italy have recently lowered their mandatory bid thresholds, so that a tender offer needs to be made once the bidder has accumulated one-third of the company’s equity. See Marc Goergen et al., *Corporate Governance Convergence: Evidence from Takeover Regulation Reforms In Europe*, 21 OXFORD REV. ECON. POL’Y 243, 250, 255 (2005).

93. Takeover Directive, *supra* note 91, art. 2.1.d, at 15:

[P]ersons acting in concert shall mean natural or legal persons who cooperate with the offeror or the offeree company on the basis of an agreement, either express or tacit, either oral or written, aimed either at acquiring control of the offeree company or at frustrating the successful outcome of a bid.

94. THE PANEL ON TAKEOVERS AND MERGERS, THE CITY CODE ON TAKEOVERS AND MERGERS (THE CODE) Note 2 to Rule 9.1, at 133–4 (11th ed. 2013), available at <http://www.thetakeoverpanel.org.uk/wp-content/uploads/2008/11/code.pdf>.

A resolution will be normally classified as “board control seeking” if there is a “relationship” between the activist shareholders and the proposed directors. Absent a

introduced ambiguous definitions of acting in concert which might arguably lead to a certain degree of uncertainty and deter activist hedge funds from concerted action.<sup>95</sup>

### C. *The Disciplining Stage: Shareholder Rights*

In this Section, the emphasis turns to the impact of the legal environment on the third stage of an activist campaign—the disciplining stage. The intensity and effectiveness of the activist hedge funds’ actions at the disciplining stage depend decisively on what pressure they can bring to bear as shareholders. However, exercising the rights bestowed on shareholders by corporate law is not necessarily the typical form of hedge fund activism. Activist hedge funds often use behind-the-scenes negotiations, approach the target management through letters and meetings, or use the media to publicly articulate their demands.<sup>96</sup> All these strategies involve unilateral decision-making on the part of target management and do not involve any use of formal shareholder rights on the part of the activist(s). Yet a shareholder-friendly regulatory framework is likely to have an indirect impact on behind-the-scenes or public, but informal, negotiations with the incumbents by giving an activist hedge fund a powerful negotiation advantage at the private stage. A commentator (in the United Kingdom) remarked that “[t]he detailed legal rules governing the holding and conduct of meetings of shareholders can . . . be significant if it comes to a public fight.”<sup>97</sup> In other words, the more shareholder-friendly the regulatory framework is, and therefore the more likely an activist hedge fund’s public campaign is to be successful, the more powerful the private pressure an activist hedge fund can put on a target. The legal rules

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relationship, the U.K. Takeover Panel will look at the number of directors to be appointed or replaced compared with the size of the board. Further, on the meaning of a board-control seeking resolution, see *id.*

95. See Santella et al., *supra* note 39, at 280.

96. For empirical evidence on the strategies employed by activist hedge funds, see *infra* notes 196–197 and accompanying text.

More recently, activist investors have used social media to support activist campaigns, especially in the United States. For instance, Carl Icahn first used Twitter to express his concern over Dell Inc.’s buyout in 2013, and also made extensive use of Twitter in his proxy contest for eBay Inc. Reacting to this growing use of social media, the SEC staff issued new guidance in April 2014 on the use of social media in proxy contests. See, e.g., *Social Media and Proxy Contests*, LEGAL MONITOR WORLDWIDE, Jul. 10, 2014 (discussing shareholder activists’ use of social media); U.S. SEC. & EXCH. COMM’N, COMPLIANCE AND DISCLOSURE INTERPRETATIONS OF SECURITIES ACT RULES (2015), available at <http://www.sec.gov/divisions/corpfin/guidance/securitiesactrules-interps.htm>.

97. PAUL L. DAVIES, GOWER AND DAVIES’ PRINCIPLES OF MODERN COMPANY LAW 425 (8th ed. 2008).

determining the activist hedge fund decision-making power is, therefore, of major importance.

The rest of this Section examines three sets of rules that are likely to empower the insurgent(s) in constraining the board's discretion at the disciplining stage of an activist hedge fund campaign. The first set of rules concerns the extent to which activist hedge funds can utilize the shareholder decision-making procedures to influence the incumbents and exercise a veto over board initiatives. In challenging the incumbents' decisions, however, the right to elect the board of directors and, when necessary, to take remedial action in the form of board dismissals and election of new directors is by far the most persuasive tool for activist shareholders. Finally, activist hedge funds occasionally resort to shareholder-driven litigation to accelerate an activist campaign. Takeover rules might also have an impact on the disciplining stage of an activist campaign; previous empirical studies suggest, however, that activist hedge funds rarely intend to take control of the target companies with a takeover bid, for example.<sup>98</sup> Therefore, the influence of the takeover rules, if any, on hedge fund activism, remains out of the scope of this study.

#### 1. Shareholder Decision-making Power

The brand of shareholder activism associated with hedge funds has serious consequences for the policies of the target company, ranging from cash payouts to the sale of the target company at a premium following the activist campaign, and from governance overhauls to direct governance participation on the target board.<sup>99</sup> Although activist hedge funds most often call for a board decision rather than for a decision of the shareholders through the general meeting, it is the threat of shareholder intervention that motivates the board to act.<sup>100</sup> Thus, the questions of how legal regimes facilitate shareholder participation and what formal rights shareholders have that maximize their influence in general meetings shape the core of the analysis in this Section.

Modern company laws oblige public companies to organize a general meeting at least once a year, while special meetings are called when

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98. Brav et al., *supra* note 15, at 1745; Katelouzou, *supra* note 14, at 493 (reporting that activist hedge funds seek to launch a takeover bid only in 4.2% and 3.9% of the studied samples, respectively).

99. See, e.g., William W. Bratton, *Hedge Funds and Governance Targets*, 95 GEO. L.J. 1375, 1405 (2007) (analyzing the effects that hedge funds have on their targets).

100. For empirical evidence, see Katelouzou, *supra* note 14, at 486 (reporting only 64 formal shareholder proposals out of the 883 activist strategies examined).

unusual circumstances arise and particular decisions (e.g., merger) need to be ratified by shareholders.<sup>101</sup> When the general shareholder meeting is convened by the board, the main protection for the shareholders lies in the information about the agenda made available to them in advance of the meeting<sup>102</sup> and the length of the required notice.<sup>103</sup> For example, timely and detailed information on the precise context of proposals for resolutions may assist activists in taking an active part in shareholder meetings and voting down a management resolution.<sup>104</sup> However, empirical evidence suggests that activist hedge funds rarely vote against management proposals unless an activist campaign is underway.<sup>105</sup>

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101. *See, e.g.*, Companies Act, 2006, c. 46, §§ 336–40 (U.K.) (promulgating the requirements of an annual meeting); DEL. CODE ANN. tit. 8 § 211 (2001) (requiring annual shareholder meetings).

102. *See, e.g.*, Companies Act, 2006, c. 46, §§ 311, 311A (U.K.), as amended by Article 10 of The Companies (Shareholders' Rights) Regulations 2009/1632 (requiring disclosure to shareholders prior to the annual meeting). In Delaware, an agenda has to be attached only for cases of special meetings, but the shareholders have the right to inspect corporate records. *See* DEL. CODE ANN. tit. 8 § 220, 222(a) (2001). Further, on the shareholder information rights under U.S. state laws, see FRANKLIN A. GEVURTZ, CORPORATION LAW 212–21 (West 2nd ed. 2010). In both countries, the annual accounts are sent out along with the notice of the meeting. *See* Companies Act 2006, c. 46, §§ 423–436 (U.K.) (requiring companies to send notice and information of the meeting to shareholders); 17 C.F.R. § 240.14a-3(b) (2014) (requiring corporations to disclose information to shareholders).

103. *See, e.g.*, Companies Act, 2006, c. 46, §§ 307A (U.K.), as amended by Article 9(2) of The Companies (Shareholders' Rights) Regulations 2009/1632 (requiring 21 days' notice in the case of an annual general meeting or 14 days' notice in other cases). In the United States, the time limit for calling a general meeting is 10 days. *See* DEL. CODE ANN. tit. 8 § 222(b) (2001) (promulgating general meeting guidelines). A special procedure requires a motion to be made under SEC Rule 14a-8, in good time. For ordinary general meetings, shareholder proposals must be submitted 120 days before proxy statements are sent out. 17 C.F.R. § 240.14a-3(b) (2014); *see also* MATHIAS M. SIEMS, CONVERGENCE IN SHAREHOLDER LAW 97 (2008) (examining the differences in the time limits and information about the agenda in six countries: China, France, Germany, Japan, the United Kingdom, and the United States).

104. Alternatively, an activist may simply make its views on an item which has already been on the agenda known to other shareholders in advance of the meeting, thereby hoping to encourage other shareholders to attend the meeting, in person or by proxy, and support those views. *See, e.g.*, Directive of the European Parliament and of the Council on the Exercise of Certain Rights of Shareholders in Listed Companies, 2007/36, 2007 O.J. (L 184) 17 (EC), art 6, at 21 and Companies Act 2006, c. 46, §§ 314–316 (U.K.) (empowering shareholders to circulate statements on agenda items). It is unlikely, however, that this right, if available, can be of any use for activist hedge funds which seek to proactively influence the incumbents' strategy and not simply express their opinions to their fellow shareholders.

105. *See* Katelouzou, *supra* note 14, at 486 (reporting that 47 out of the 883 activist tactics studied included events in which the hedge fund voted down the incumbents' resolution(s)).



Rather than voting down a management resolution, activist hedge funds often seek to add a shareholder proposal to the agenda of a meeting that the board has already called.<sup>106</sup> In such cases, the threshold share requirement for shareholders to be able to add an item to the agenda, which is typically 5 percent of the registered capital,<sup>107</sup> is likely to matter for an activist campaign. How easily activist hedge funds can get across the percentage threshold and add an item to the agenda depends, however, on the size of the company; activist hedge funds can easily get across the percentage threshold in small companies, but owning 5 percent in a very large company takes a serious amount of investment.

Alternative criteria for requiring a resolution to be placed on the agenda are also sometimes established, such as the 100-member requirement under the U.K. Companies Act 2006.<sup>108</sup> This requirement is increasingly seen as a viable option for placing shareholder resolutions in large public companies. In 2002, for instance, Laxey Partners bought 2 percent of British Land stock through 100 nominee accounts and placed motions on the agenda of the annual general meeting.<sup>109</sup> More recently, in 2011, the British hedge fund used a similar tactic in its activist campaign to reform Alliance Trust, namely it split its 1.3 percent ownership stake in

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106. *Id.*

107. *See, e.g.*, Companies Act, 2006, c. 46, §§ 338(3)(a) and 338A(3)(a) (U.K.), as amended by Article 17 of The Companies (Shareholders' Rights) Regulations 2009/1632 (barring shareholders with insufficient equity from proposing agenda items).

However, lower thresholds are found, for instance, in the United States at 1%. *See* 17 C.F.R. § 240.14a-8(b)(1) (2014) (allowing a shareholder with a 1% stake to make proposals). Despite the relevant low threshold for adding an item into the agenda of a meeting under Rule 14-a8(b) of Regulation 14A, securities regulation associated with the system of proxy voting has various ramifications for activist hedge funds targeting American companies. While any shareholder may collect proxies for matters relating to the general meeting under Rule 14a-7, he/she must bear the costs. By contrast, holders of 1% of the company's shares for at least one year may place shareholder proposals on the company's proxy statement without incurring any costs under Rule 14a-8. *See* 17 C.F.R. § 240.14a-8 (2014) (promulgating the right of shareholders to propose agenda items).

108. *See* Companies Act, 2006, c. 46, §§ 338(3)(b), 338A(3)(b) (U.K.), as amended by Article 17 of The Companies (Shareholders' Rights) Regulations 2009/1632 (support "[f]rom at least 100 members who have a right to vote at the meeting and hold shares in the company on which there has been paid up an average sum, per member, of at least £100" is required). *See also* 17 C.F.R. § 240.14a-8(b)(1) (2014) (allowing shareholder proposals from those with holdings of at least \$2,000 market value).

109. *See* Norma Cohen, *Laxey Throws Down Gauntlet to British Land*, FIN. TIMES, Apr. 30, 2002, at 24 (noting the use of the 100-member requirement). In this case, the activist fund took advantage of section 376 of the previous Companies Act 1985, which similarly allowed a group of 100 shareholders to place an item on the agenda of a company's annual meeting. This right is now found in Companies Act 2006, c. 46, §§ 338(3)(b) and 338A(3)(b) (U.K.).

Alliance Trust between 100 different nominee accounts and placed resolutions at the annual general meeting to force a share buyback.<sup>110</sup> Similarly, in 2007 the activist fund Efficient Capital Structure bought 0.0004 percent of Vodafone stock, set up 100 nominee accounts in order to achieve the threshold, and placed a resolution at the company's annual general meeting calling for the Vodafone's holding in Verizon Wireless to be spun off.<sup>111</sup>

In addition to the right to add an item to the agenda, the power of shareholders to call for a special general meeting (calling right), when available,<sup>112</sup> provides an additional weapon to activist hedge funds in challenging the incumbents. Indeed, anecdotal evidence suggests that activist hedge funds outside the United States frequently avail themselves of the calling rights, which are generally linked to a 5 percent ownership threshold, and request special general meetings, proposing, among others, the replacement of the target company directors. For instance, Paulson & Co, a New York-based fund, holding a 19 percent stake in Algoma, one of Canada's largest steel-makers, asserted the right provided by Canadian law to request a special shareholder meeting in November 2005 at which it proposed the replacement of the majority of the board of directors and a

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110. See Miles Costello, *Bramson's Triumph Inspires Laxey to Do the Same; Activist Investor Demands Reform at Alliance Trust*, TIMES (LONDON), Feb. 8, 2011, at 35 (discussing activist shareholders' use of the 100-member requirement).

111. See Helen Johnson, *Shareholder Activism in The Retail Sector*, MONTAQ BUS. BRIEFING, Jul. 16, 2009 (reporting that meeting the 100-members requirement was said to cost the Efficient Capital Structure £78,500, but accumulating 5% of Vodafone would have cost £4.1bn); Cassell Bryan-Low & Jason Singer, *Agitation at Vodafone Shows Activists Can Be Small or Big*, WALL ST. J., Jun. 8, 2007, at C1.

112. See, e.g., Companies Act, 2006, c. 46, § 303 (U.K.), as amended by Article 4 of The Companies (Shareholders' Rights) Regulations 2009/1632:

The directors are required to call a general meeting once the company has received requests to do so from—(a) members representing at least the required percentage of such of the paid-up capital of the company as carries the right of voting at general meetings of the company (excluding any paid-up capital held as treasury shares); or (b) in the case of a company not having a share capital, members who represent at least the required percentage of the total voting rights of all the members having a right to vote at general meetings.

In the United States, however, the board of directors has the power to call special meetings and shareholder callings rights can be granted only in the charter or bylaws. See DEL. CODE ANN. tit. 8 § 211(d) (2001) (stating “[s]pecial meetings of the stockholders may be called by the board of directors or by such person or persons as may be authorized by the certificate of incorporation or by the bylaws.”). In practice, companies' charter or bylaws rarely entitle shareholders to call special meetings. See, e.g., Sofie Cools, *The Real Difference in Corporate Law between the United States and Continental Europe*, 30 DEL. J. CORP. L. 697, 732 (2005) (arguing that the absence of a mandatory minimum percentage of share capital to call an extraordinary shareholders' meeting in Delaware law makes it more difficult for shareholders to call an extraordinary meeting).

cash-payout.<sup>113</sup> On the other side of the Atlantic, in the United Kingdom, activist hedge funds often assert their calling rights provided by the Companies Act 2006 and call special general meetings. Prominent examples include the boardroom coup at Wyevale Garden Centers in December 2005 following a general meeting forced by Laxey Partners, a British hedge fund with a nearly 29 percent ownership stake in Wyevale;<sup>114</sup> and the special general meeting called by JO Hambro, an activist fund, together with Morley Fund Management and Insight Investment Management to replace the non-executive chairman of SkyePharma,<sup>115</sup> among others.

For the activist hedge fund activity related to shareholder meetings, what matters is not only what quantitative preconditions have to be set for passing a resolution of the general meeting in order for it to be binding in principle on all shareholders or for initiating a special general meeting, but also what competences the general meeting has in contradistinction to management. Routine business decisions generally fall within the exclusive authority of the board of directors.<sup>116</sup> However, shareholders' meetings have certain powers to initiate resolutions or veto decisions that fundamentally reallocate power among the firm's participants. For instance, activist shareholders targeting British companies can instruct the board to sell the company or amend the articles of association even if the incumbents disagree, provided that the issue is properly noticed and is approved by more than 75 percent of voting shares.<sup>117</sup> Of course, even when the insurgent(s) has the reserve power to direct the board to take, or

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113. See Mara Lemos Stein, *Canadian Law Makes Activist Plays Easier than in U.S.*, HEDGE FUND TRADES, Dec. 5, 2005.

114. Jenny Davey, *Executive Sacked for a Pinch Takes Over as Head of Wyevale*, TIMES (LONDON), Dec. 23, 2005, at 45.

115. Andrew Jack, *Rebel Investors in SkyePharma Seek Chairman's Control*, FIN. TIMES, Feb. 16, 2006, at 20.

116. DEL. CODE ANN. tit. 8 § 141(a) (2001). See The Companies (Model Articles) Regulations, 2008, S.I. 2008/3229, Part 2, ¶ 3 (U.K.) [hereinafter "U.K. Model Articles"] (holding directors responsible for the management of the company's business).

117. See U.K. Model Articles, *supra* note 116, Schedule 3, ¶ 4 (describing the shareholders' reserve power); Companies Act 2006, c. 46, § 314, ¶¶2a to b and § 338, ¶¶3a to b (U.K.) (stating that companies are required to circulate shareholder statements and proposed resolutions whenever asked by shareholders representing at least 5% of voting rights or by 100 shareholders). See also *id.* § 283 (showing that 75% consent by the majority is needed for special resolutions to pass).

By contrast, in the United States, shareholders can only veto fundamental changes, including charter amendments or mergers, after such changes have been proposed by the board of directors. DEL. CODE ANN. tit. 8 § 242(b)(1) (2001). The code states the rules that must be followed to make charter amendments, mergers and consolidation, and (dissolution). *Id.* §§ 251(c), 275(b).

refrain from taking, specified action, as is the situation in the United Kingdom, it is rather uncommon for activist hedge funds to overrule the board in this way.<sup>118</sup> A supermajority vote is hard to come by and, more to the point, a simple majority is enough in the United Kingdom, as we will see in the next Section, to remove the board of directors.

## 2. Appointment and Removal of Directors

A central tenet of an activist hedge fund campaign is the threat or actual use of the shareholder rights to elect and remove corporate directors. Empirical evidence from activist hedge fund campaigns on both sides of the Atlantic indicates that activist hedge funds often channel their campaigns into battles at the general meeting to replace the target's board with the insurgents' nominees, who would look on the activist demands more favorably.<sup>119</sup>

In general, shareholders have the authority to elect and remove directors. Although the board of directors proposes the company's slate of nominees, in most jurisdictions, a qualified minority of shareholders can contest the board's slate by placing additional nominees on the agenda of the shareholders' meeting.<sup>120</sup> Legally-protected board representation for minority shareholders in countries like Italy might further enhance the

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118. See Maggie Urry, *Rebels Court Rock Shareholders*, FIN. TIMES, Jan. 8, 2008, at 21 (describing a rare instance of exercising this right in the case of the joint activist campaign of SRM Global and RAB Capital in Northern Rock). The two hedge funds, holding more than 17% of Northern Rock's shares, requested a special general meeting and placed resolutions to restrict the board's ability to issue shares and sell assets without explicit approval from shareholders. *Id.*

119. See Klein and Zur, *supra* note 71, at 213, 215 (finding that a total of 40% of the hedge fund campaigns involved an actual (12%) or threatened (28%) proxy contest over the election of directors); Brav et al., *supra* note 15, at 1743 (finding that activist hedge funds actually waged proxy fights to gain board representation in 13.2% of the total activist events in their sample); Katelouzou, *supra* note 14, at 488 (reporting that in 54 of the 883 activist tactics studied, the hedge fund used formal voting challenges to the tenure of elected directors).

120. See U.K. Model Articles, *supra* note 116, Schedule 3, art. 20 (stipulating the default rule in the United Kingdom that any shareholder can present his/her own board candidates in advance of the meeting).

However, in the United States, insurgents must instead solicit their own proxies and distribute their own solicitations to contest the company's slate of nominees. Although federal rules limit proxy access, the bylaws of Delaware corporations may provide for individuals nominated by a shareholder to be included in the corporate ballot under certain conditions. DEL. CODE ANN. tit. 8 § 112 (Supp. 2009). Also, following the 2010 amendments to Rule 14a-8, shareholders are permitted to submit proposals that relate to nomination or election of a company's board of directors or procedures for such nomination or election. 17 C.F.R. § 240.14a-8 (2014).

shareholders' control over the appointment process.<sup>121</sup> Empirical evidence reveals, however, that activist hedge funds have not yet fully taken advantage of the legally-protected board representation for minority shareholders in Italy, and have only rarely nominated minority-appointed directors for the board of directors and the board of statutory auditors.<sup>122</sup>

The law can achieve a similar result on a broader scale by mandating cumulative or proportional voting rules.<sup>123</sup> Cumulative voting allows shareholders to cast all their votes in director elections for a single director. Cumulative voting generally acts as a safeguard for shareholders by ensuring that those who hold a significant minority of shares can elect a candidate of their choosing to the board, and is seen by corporate governance reformers and mainstream institutional investors as a mechanism to improve shareholder representation on boards. However, although shareholder proposals that require cumulative voting for the election of directors have been popular among mainstream institutional investors,<sup>124</sup> activist hedge funds have not frequently lobbied for cumulative voting in the course of their campaigns.<sup>125</sup>

More often, however, activist hedge funds take advantage of shareholder-led nomination committees, when available, and actively engage in the nomination process.<sup>126</sup> A prominent example is Cevian Capital, the largest activist investor in Europe. As part of its activist agenda, the investment firm secures seats on boards or nomination committees and plays an active part at the board level.<sup>127</sup> Cevian Capital

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121. Erede, *supra* note 30, at 350–53.

122. *Id.* at 359, 365–67.

123. See generally Enriques et al., *The Basic Governance Structure: The Interests of Shareholders as a Class*, in *THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH* 91 (Reinier Kraakman et al. eds., 2009) (compiling the availability of cumulative voting across six countries: France, Germany, Japan, Italy, the United Kingdom, and the United States).

124. See Stuart L. Gillan & Laura T. Starks, *The Evolution of Shareholder Activism in the United States*, 19 *J. APPLIED CORP. FIN.* 55, 57 (2007) (finding that adopting cumulative voting has consistently been among the top three shareholder proposals by institutional investors in the United States).

125. In a rare example of hedge fund activism directed at cumulative voting, Luminus Management, a New York-based fund holding 8% of Transalta's shares, put forward four shareholder proposals relating to the amendment of the articles of association to provide for cumulative voting. Scott Haggett, *TransAlta Says Board to Study Shareholder's Demands*, *REUTERS NEWS* (Dec. 17, 2007), <http://www.reuters.com/article/2007/12/17/transalta-luminus-idUSN1739876820071217>.

126. See, e.g., Richard Mine, *Model Management; Scandinavia*, *FIN. TIMES*, Mar. 21, 2013, at 34 (discussing the availability of nomination shareholder committees in Nordic countries).

127. Alistair Barr, *Cevian Carves Profitable Niche in Europe*, *MARKETWATCH* (Nov.

has taken board representations and agitated for changes at Lindex, Skandia, Volvo, and Swedbank, to name a few of its targets.<sup>128</sup>

Some countries further empower the shareholders to remove a director by a simple majority at any time. For instance, in the United Kingdom, an activist hedge fund or a group of activists representing at least 5 percent of the voting share capital can call a special meeting and put forward an ordinary resolution to remove any or all directors at any time during their term without cause.<sup>129</sup> The removal power exercisable by ordinary majority can be a powerful inducement to the target company's directors to follow the line of action preferred by an activist hedge fund, because if the target company's directors choose not to follow the shareholders' views, they can be removed by ordinary majority. To put it simply, if the incumbents do not initiate the changes an activist hedge fund perceives as value-enhancing, the activist will try to replace the board with one that will make the changes. Professor Lucian Bebchuk has further suggested that "because management knows that shareholders have the power to replace the board, management generally will not neglect shareholder interests to begin with, and shareholders will not need to exercise their replacement power."<sup>130</sup> This is why sometimes just the threat that the activist hedge fund will replace the board is enough to make the incumbents comply with the activist's demands.

### 3. Litigation

So far we have analyzed the opportunities activist hedge funds have to intervene directly in the management of the company by securing the passing of resolutions binding the company (governance rights) and by

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10, 2010), <http://www.marketwatch.com/story/cevia-carves-profitable-niche-in-europe-2010-11-19>.

128. Charles Fleming, *Icahn, Gardell Team Up to Take 4% Stake in Metso*, WALL ST. J., May 25, 2005, at C4; David Ibison, *Boost for Cevian over Volvo Fight*, FIN. TIMES, Oct. 25, 2006, at 25; Barr, *supra* note 127.

129. Companies Act, 2006, c. 46, §§ 168, 303 (U.K.). By contrast, in Delaware, only directors of a non-staggered board can be removed by shareholders without cause. DEL. CODE ANN. tit. 8 § 141(k) (2001). In a non-staggered board, the whole board has a one-year term and is subject to reelection at each annual general meeting. By contrast, in a staggered board, only one third of the directors are up for reelection. However, boards are staggered in the majority of U.S. companies, in which case the default rule of Delaware corporate law is that the directors can only be removed for cause. *Id.* See the leading case *Ralph Campbell v Loew's Inc.*, 134 A.2d 565 (Del. 1957), which describes what amounts to "cause." More importantly, whether the board is staggered or not, shareholders in Delaware cannot themselves call a special meeting to vote out board members, unless there are specific provisions in the corporate charter. See *supra* note 112 and accompanying text.

130. Bebchuk, *The Case for Increasing Shareholder Power*, *supra* note 39, at 851.

removing members of the board so as to surmount their resistance (removal rights). In addition to resorting to the governance and removal rights, an alternative route for an activist hedge fund to implement its objectives is to threaten or actually pursue litigation on behalf of the company against the alleged wrongdoing directors (derivative claims). This strategy is sometimes an essential part of activist hedge fund campaigns targeting U.S. companies—as when Cardinal Capital Management filed a derivative lawsuit for breach of fiduciary duty against the board of directors of Hollinger International,<sup>131</sup> or when activist hedge fund Costa Brava filed several derivative claims against Telos Corporation.<sup>132</sup>

However, outside the United States, filing a suit alleging a breach of fiduciary duties by directors and officers is not a preferable way for activist hedge funds to put pressure on the incumbents. Consider, for example, the statutory derivative claim introduced in the United Kingdom by the Companies Act 2006.<sup>133</sup> While the new regime has been envisaged as “provid[ing] another tool for use by activist shareholders to push for change at under-performing companies,”<sup>134</sup> the incentives for activists to bring such actions are still weak.<sup>135</sup> An activist hedge fund “has little financial incentive to sue on behalf of the company, because the return to [the activist] will be, at most, a percentage of the recovery which reflects the percentage of the shares of the company [the activist] holds.”<sup>136</sup>

While recourse to derivative litigation is unlikely to be a cost-effective tactic, activist hedge funds sometimes get involved in legal disputes with their targets when other activist strategies fail to yield the desired results. Examples include Implenla, a Swiss construction group, where Laxey Partners took legal action in an attempt to raise its share of

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131. Barbara Shecter, *Hollinger Executives Accused of “Diverting Hundreds of Millions”: Shareholder Lawsuit*, NAT’L POST, Jan. 3, 2004, at 1.

132. See Marr Kendra, *Telos Prevails After 3 Years of Battling Shareholder*, WASH. POST, Apr. 21, 2008, at D01 (stating that after a lawsuit was filed on behalf of the shareholder, more than half the board of directors stepped down).

133. Companies Act 2006, c. 46, §§ 260–269 (U.K.).

134. Arad Reisberg, *Derivative Claims Under the Companies Act 2006: Much About Nothing?*, in RATIONALITY IN COMPANY LAW: ESSAYS IN HONOUR OF D.D. PRENTICE 17 (John Armour & Jennifer Payne eds., 2009) (explaining in depth the new regime of derivative claims in the United Kingdom and assessing its impact).

135. Compare *Wallersteiner v Moir* (No 2), (1975) 2 W.L.R. 389 (showing that an activist hedge fund in the United Kingdom which decides to bring a derivative claim must not only pay its own legal costs, but also bears the risk of being ordered to pay the defendant directors’ costs subject to the possibility of gaining indemnity from the company), with *GEVURTZ*, *supra* note 102, at 407–70 (showing that the risk an activist hedge fund runs by losing the suit is less severe in the United States where contingency fees are available).

136. DAVIES, *supra* note 97, at 609.

voting rights and forced Implenia into mediation talks;<sup>137</sup> or Stork, a Dutch industrial group, where hedge funds Centaurus Capital and Paulson Co. filed a court complaint after Stork issued preference shares to the Stock Foundation to dilute the activists' stake ahead of a special meeting called by the two hedge funds.<sup>138</sup>

Activist hedge funds also resort to litigation in the context of mergers & acquisitions as blocking acquirers (trying to block the deal as shareholders of the potential acquirer) or blocking bidders (trying to block the deal or improve the terms as shareholders of the potential target).<sup>139</sup> For instance, Paulson Co., a New York activist hedge fund, objected to the 31 Canadian dollars per share bid paid for Deer Creek Energy Ltd. by Total SA, and launched a court action under so-called dissenter's rights to seek a higher price.<sup>140</sup> Meanwhile in the Netherlands, a group of minority shareholders, led by Centaurus Capital Ltd, a British activist hedge fund, used litigation, along with other tactics, to fight the Swedish Tele2's offer for Versatel, the Dutch telecommunications company.<sup>141</sup> Finally, activist hedge funds can invoke their appraisal rights, namely the right to exit at a fair price if they do not approve the contested transaction, when these are available. Anecdotal evidence suggests that activist hedge funds, especially in the United States, often challenge the liquidation value as determined by the board of directors, and if they are unable to obtain better terms they threaten to file a statutory appraisal action.<sup>142</sup> One of the most recent, high-profile appraisal rights cases involved Carl Icahn's campaign against the Dell going-private transaction in which the threat of invoking appraisal rights was one of the several factors that led to a higher buyout price.<sup>143</sup>

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137. *Implenia Shares Fall, Laxey Exerts Pressure*, REUTERS, July 23, 2007.

138. Ian Bickerton, *Hedge Funds Try to Block Stork Foundation's Vote*, FIN. TIMES, Jan. 6, 2007, at 17.

139. For empirical evidence on this type of hedge fund activism, see Katelouzou, *supra* note 14, at 492–98.

140. Claudia Cattaneo, *Fight Over Deer Creek Deal*, NAT'L POST, Sept. 1, 2006, at FP1.

141. Ian Bickerton, *Versatel Under Renewed Attack*, FIN. TIMES, Feb. 7, 2007, at 21.

142. See, e.g., Kahan & Rock, *supra* note 15, at 1038–39; Kaja Whitehouse and David Enrich, *Investors Tapping Arcane Law to Win Bigger Merger Payouts*, DOW JONES NEWS SERV., Feb. 5, 2007, available at Factiva, Doc. No. DJFHFT0020070720e3250013g (citing examples of the use of statutory appraisal actions in activist campaigns in the United States). For the potential use of the appraisal right from activist hedge funds in Italy, see Elisabetta Bellini, *Hedge Fund Activism in Italy*, 9 J. CORP. L. STUD. 201, 226 (2009).

143. Stephen M. Davidoff, *Exercising appraisal rights as a fresh form of shareholder activism*, INT'L N.Y. TIMES, Mar. 6, 2014, at 16.



#### *D. Theoretical Implications*

The analysis provided so far has considered whether and how law facilitates the different stages of an activist hedge fund campaign, taking input from press and documentary sources. Suppose that the legal rules I proposed above matter for hedge fund activism. What results might one expect on the incidence and nature of hedge fund activism across different countries?

One set of hypotheses involves the incidence and magnitude of worldwide hedge fund activism. At the entry stage of an activist campaign, the preceding analysis suggests that a higher number of activist campaigns should be expected in countries with stronger mandatory disclosure of firm-specific information.<sup>144</sup> The underlying rationale is that mandatory disclosure rules increase share price accuracy and address corporate governance agency problems, and by providing more public information, they can assist activist hedge funds in finding their targets. We have also seen that a defining feature of the disciplining stage of hedge fund activism is the formal or informal use of shareholder rights to enhance shareholder value.<sup>145</sup> A shareholder-friendly regulatory framework should arguably foster the incidence of hedge fund activism because of its impact on the disciplining stage of an activist campaign. Another channel through which shareholder rights can affect the activist hedge funds' intervention decision is by protecting minority shareholders and disciplining managerial behavior. This protective function of shareholder rights reflects the law and finance literature which links the legal protection of minority shareholder rights with dispersed share ownership and robust capital markets.<sup>146</sup> Correspondingly, all else being equal, activist hedge funds are likely to choose target companies incorporated in countries with stronger disclosure and shareholder protection regimes.

At the trading stage of an activist campaign, we have seen that strict disclosure duties on significant holdings (either with having lower thresholds, shorter time windows, or catching non-voting economic positions and activist intentions) may limit the expected returns for

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144. See *supra* text with accompanying notes 52–61 (showing the impact of mandatory disclosure on the number of activist campaigns).

145. See *supra* notes 96–130 and accompanying text (examining the formal use of shareholder rights to enhance shareholder value in the voting context and in connection with the removal of directors, and the informal exercise of these rights in behind-the-scenes negotiations and public articulation of activist demands through the media).

146. See *supra* notes 45–47 and accompanying text (providing an overview of the law and finance literature).

prospective activists.<sup>147</sup> For example, one would expect an activist to build up a larger stake in the United States, where the initial threshold is 5 percent, than in the United Kingdom, where an activist can engage in secret trading and conceal its presence from the incumbents up to 3 percent.

Finally, with respect to the disciplining stage, the activist hedge funds' choice of objectives and strategies might be a reflection of the shareholder protection regime of the country in which the target company is located. As seen above, a defining feature of the disciplining stage of hedge fund activism is the use of shareholder rights to enhance shareholder value—meaning legal rules governing the scope of the shareholder decision-making procedures that activist hedge funds have at their disposal to influence the corporate policy and governance, to exercise a veto over board initiatives, to elect directors, and to bring a suit alleging managerial wrongdoing.<sup>148</sup> Correspondingly, all else being equal, one would expect that the nature of the stated objectives and the aggressiveness of the employed strategies would depend decisively on what pressure activist hedge funds could bring to bear as shareholder.

The next two Parts of this Article present some preliminary empirical evidence that addresses these hypotheses based on a hand-collected dataset of activist hedge fund campaigns.

### III. HAND-COLLECTED DATASET OF ACTIVIST HEDGE FUND CAMPAIGNS

#### A. *Activism Sample and Data Collection*

In this Article, I extend the original dataset of activist hedge fund campaigns of 17 countries between January 1, 2000 and December 31, 2010 to 25 countries.<sup>149</sup> The geographic area chosen represents a range of developed (Australia, Canada, France, Germany, Italy, Japan, the Netherlands, Spain, Sweden, Switzerland, and the United Kingdom) and developing/emerging (Argentina, Brazil, Chile, China, Czech Republic, India, Malaysia, Mexico, Pakistan, South Africa, Latvia, Russia, Slovenia, and Turkey) countries. The countries vary along several important

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147. See *supra* notes 65–95 and accompanying text (discussing four different aspects of ownership disclosure related to hedge fund activism and the impact each has at the trading stage).

148. See *supra* notes 99–142 and accompanying text (examining how specific shareholder rights can empower activist hedge funds in constraining the incumbents' discretion).

149. Katelouzou, *supra* note 14, at 473.

dimensions, including the strength of their investor protection, their financial development, their legal traditions, and their ownership patterns.

The selected geographic area had a great impact on the data collection. While empirical studies on hedge fund activism directed at U.S. companies are based on the detailed information disclosed by the Schedule 13D filings,<sup>150</sup> data on hedge fund activism outside the United States are much harder to obtain and the sources vary enormously. There is no uniform regulatory threshold requiring public disclosure of block holdings across my sample countries, and, therefore, it is not possible to identify the first purchase based, for example, on a 5 percent block-holder definition. Also, unlike the United States, the sampled countries (except for Germany and France since 2008) do not require investors to disclose what goals they are pursuing with their stake building.<sup>151</sup> The activist interventions and the related data have therefore been collected from two resources: the Dow Jones Factiva—an online database of business news—and regulatory filings for the countries whose filings are available in Factiva.<sup>152</sup>

The data collection comprised a four-step procedure.<sup>153</sup> As a first step, data were hand-gathered from press reports available from Factiva using the following search requests as inputs: “hedge fund” and “shareholder” and “activist” for each of the 25 countries in the sample. Factiva searches revealed a large number of potential activist interventions, for which the names of the target company and the funds involved were recorded. In a second step, I filtered out cases where the investor was not an activist hedge fund. To identify which of the funds can be classified as activists, for the purposes of my analysis, I searched the internet for the websites of these funds and news articles describing them. In most cases, I was able to filter out pension funds, individuals, regular companies, trusts, and private equity/venture capital funds. For the remaining cases, I relied on Factiva and used the following search requests as input: “(name of the fund)” within the same paragraph “activist fund.” This screening yielded a second case list, including 131 activist hedge funds in the broad sense. Thirdly, I conducted a fresh news search in Factiva using the hedge fund and target company names as keywords, to identify further aspects of the activist campaigns, such as the activist hedge funds’ stated objectives and

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150. See, e.g., Brav et al., *supra* note 15, at 1736–37 (discussing the importance of Schedule 13D filings for empirical data).

151. See *supra* notes 84–87 and accompanying text (detailing the process in the United States, the E.U, France, Germany, and the United Kingdom).

152. See Katelouzou, *supra* note 14, at 474 n.60 (describing the Dow Jones Factiva database).

153. See *id.* at 474–76 (describing the collection process in detail).

strategies. Sometimes, extensive searches on high-profile cases shed light on other activist interventions. These cases were recorded and separate searches (using the hedge fund and target company names as keywords) were undertaken.

These three rounds of Factiva searches yielded a list of 934 activist fund-target pairs. An activist campaign can include more than one hedge fund-target pair when a consortium of two or more activist funds, otherwise known as a wolf-pack, intervenes in the same target company.<sup>154</sup> From this case list, I excluded events where the activist hedge fund simply acquired a stake without putting any kind of pressure on the target (based on the reported hedge funds' objectives and strategies), or where the primary purpose of the activist hedge fund was to engage in merger arbitrage. The final sample is comprised of 432 activist campaigns sponsored by 129 activist hedge funds. The sample involves 408 unique companies and 494 hedge fund-target pairs.

Information about activist hedge funds' stake holdings has been collected from hedge fund-related press reports and from targets' annual reports. Regulatory filings on "significant holdings" have also been taken into consideration for the countries whose filings are available in Factiva. I further checked the accuracy of the activist ownership stakes, taking into consideration information on the sampled firms' ownership structures from ORBIS/BvD—a global database of companies with data on descriptive information, financials, news, annual reports, ownership, and mergers and acquisitions. Finally, I conducted extensive news searches in Factiva to identify the stated objectives and the employed strategies for each activist hedge fund campaign. Because each activist hedge fund campaign may have more than one objective, the sample is comprised of 946 stated objectives and 883 activist strategies. The difference in numbers between the stated objectives and the employed strategies is due to the fact that hedge funds often employ a single strategy to achieve more than one objective.

### *B. The Incidence and Magnitude of Worldwide Hedge Fund Activism*

From the outset of this Article, I have noted that geographical variations in the incidence and magnitude of hedge fund activism across countries form the main motivation for studying the role of law in facilitating hedge fund activism. Hedge fund activism originated in the United States and then spread out to other countries in Europe and Asia.

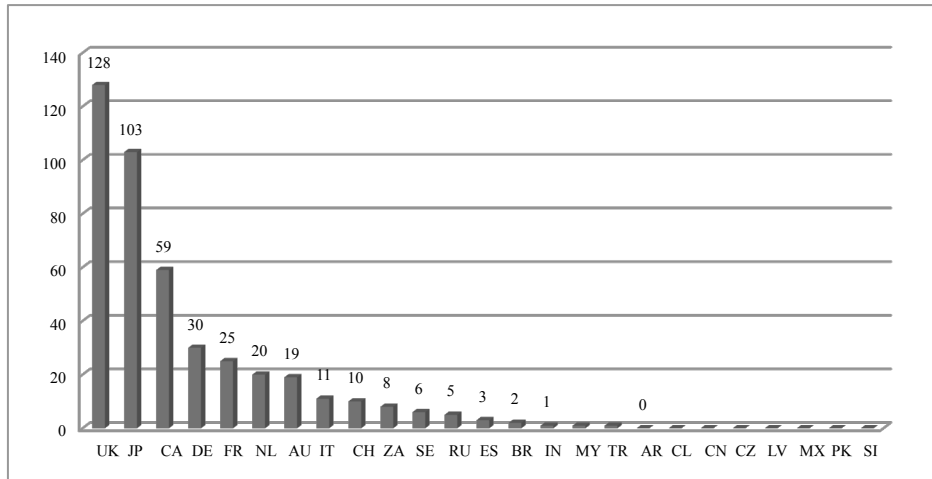
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154. I define an activist campaign as being launched by a "wolf-pack" when there is a group of activists who explicitly or implicitly engage with the board and exercise influence.

Although the U.S. market still has the greatest concentration of activist hedge funds and activist campaigns, there are many well-documented activist hedge fund interventions outside the United States.<sup>155</sup>

Figure 2 breaks down the empirical findings by target country. U.K. and Japanese firms dominate the sample, making up 53.47 percent of the total targets. There are four other countries with at least 20 interventions: Canada, Germany, France, and the Netherlands. Within Europe, U.K. companies are by far the dominant targets of activist hedge funds. Figure 2 shows that almost 53.8 percent of European activist campaigns target U.K. companies. German companies are the second, much smaller, targets of activist hedge funds in Europe.

Figure 2: Activist Hedge Fund Campaigns by Target Country



Note: the following abbreviations are used: AR (Argentina), AU (Australia), BR (Brazil), CA (Canada), CH (Switzerland), CL (Chile), CN (China), CZ (Czech Republic), DE (Germany), ES (Spain), FR (France), IN (India), IT (Italy), JP (Japan), LV (Latvia), MX (Mexico), MY (Malaysia), NL (Netherlands), PK (Pakistan), RU (Russian Federation), SE (Sweden), SI (Slovenia), TR (Turkey), UK (United Kingdom), ZA (South Africa)

The 432 activist campaigns were launched by 129 activist hedge funds. The 54 different funds with three or more engagements are listed in Appendix 1. These interventions are spread across the following countries: Australia, Brazil, Canada, France, Germany, India, Italy, Japan, the

155. See *supra* note 7 and accompanying text (providing examples of hedge fund activism in Canada, Japan, France, the Netherlands, and the United Kingdom).

Netherlands, Russia, South Africa, Spain, Sweden, Switzerland, Turkey, and the United Kingdom, although they are highly concentrated in a handful of countries.<sup>156</sup>

In the case list, there are some well-known activist hedge funds that have received wide public attention. Examples include The Children's Investment Fund ("TCI"), set up in 2004 by Chris Hohn;<sup>157</sup> the Hermitage Fund, set up in 1996 by William Browder, which has built its reputation on its highly public engagements with Russian state-linked oil and gas companies;<sup>158</sup> and the U.S. fund Steel Partners, founded by Warren Lichtenstein in 1990.<sup>159</sup> Steel Partners has been particularly active in Japan, until 2008, through Steel Partners Japan Strategic Fund, a joint venture with Boston-based Liberty Square Asset Management LLC, which was formed in 2002 as a special purpose investment vehicle to actively invest in undervalued stocks in Japan.<sup>160</sup> The list also includes other funds that engage in shareholder activism, hedge-fund style. Examples of traditional value-oriented fund managers, but with "offensive" activist stances, include Brandes and Tweedy Browne.<sup>161</sup> Although mutual funds are not technically hedge funds, Franklin Mutual Advisers is also included in the sample, because it behaves like any other activist fund in that it builds up sizeable stakes proactively in order to influence the conduct of corporate affairs.<sup>162</sup> Appendix 1 also includes some of the raiders of the 1980s who have been resurfaced as activist funds, such as Guy Wyser-Pratte, Vincent Bollore, Tito Tettamanti (Sterling Investment Group), and Ron Brierley (Guinness Peat Group).<sup>163</sup>

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156. See *supra* fig. 2.

157. Jenny Anderson, *A Hedge Fund With High Returns and High-Reaching Goals*, N.Y. TIMES (Nov. 13, 2006), available at [http://www.nytimes.com/2006.11.13/us/13hedge.html?pagewanted=all&\\_r=0](http://www.nytimes.com/2006.11.13/us/13hedge.html?pagewanted=all&_r=0).

158. Georgina Leslie, *Emerging Markets: Russia's Crusader*, GLOBAL INVESTOR (May 1, 2002), available at <http://www.globalinvestormagazine.com/Article/2228217/Search/Results/Emerging-Markets-Russias-Crusader.html?Keywords=emerging+markets%3a+russia%27s+crusader>.

159. See Jason Singer, *With '80s Tactics, U.S. Fund Shakes Japan's Cozy Capitalism*, WALL ST. J., Apr. 15, 2004, at A1 (discussing Steel Partner's activist investments in Japan).

160. *Id.*

161. See e.g. Craig Karmin & Vanessa Fuhrmans, *Bayer Meeting: View of Holder Activism*, WALL ST. J., Apr. 26, 2001, at C1 (examining the activist campaign of Tweedy Browne in Bayer AG, the German chemical and pharmaceutical giant); James Boxell, *Brandes cuts its final links with BAE Systems*, FIN. TIMES (Oct. 5, 2005), available at <http://www.ft.com/cms/s/0/04c56f88-353c-11da-9e12-00000e2511c8.html#axzz3a2tbnLTa> (discussing how Brandes, the US value investor, is adopting an increasingly activist stance in the UK).

162. See *supra* notes 24–26 and accompanying text.

163. See, e.g., *Raiders in the healing arts*, FIN. TIMES, Jun. 27, 1998, at 1 (discussing how the so-called corporate raiders of the 1980s and 1990s, including Guy Wyser Pratte, are

Clearly, no single activist fund dominates the sample: Laxey Partners is the most active hedge fund with 28 interventions, which comprises 5.67% of all activist campaigns, while Steel Partners and the Murakami Fund follow with 27 and 24 interventions, respectively.<sup>164</sup> Though the activist campaigns were launched by 129 different activist hedge funds, there were a few hedge funds that predominated. The top ten activist hedge funds launched 37.1 percent of the activist events, while the top twenty launched 51.7 percent of the events studied.<sup>165</sup>

But why do activist hedge funds invest in particular countries, such as the United Kingdom and Japan? Do national differences in corporate law explain the different patterns in hedge fund activism? The next Part addresses these questions and correspondingly examines how domestic, corporate, and securities laws may influence activist hedge funds as they find a potential target company and decide whether to buy shares and launch an activist campaign.

#### IV. SOME PRELIMINARY EMPIRICAL EVIDENCE

In this Part, I make an empirical assessment and provide some preliminary comparative evidence with respect to the effect on worldwide activist hedge fund campaigns of three sets of legal rules: mandatory disclosure, ownership disclosure rules, and rights bestowed on shareholders by corporate law (which, in this context, means the legal rules governing the scope activist funds have to utilize the shareholder decision-making procedures to influence the corporate policy and governance, to exercise a veto over board initiatives, to elect and remove directors, and to bring shareholder-driven litigation).

Before proceeding, I need to stress that because I focus only on activist hedge fund campaigns drawn from press reports, my analysis is limited to an empirical assessment of the legal dynamics of the publicized activist hedge fund campaigns, while behind the scenes negotiations and other informal activist attempts are probably under-represented in my sample. Another caveat is that to account for how well different legal

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increasingly transforming to activist shareholders); Aaron O. Patrick, *Bollore Focuses on Advertising as His New Game*, WALL ST. J. Jul. 1, 2006, at B1 (calling Vincent Bollore as “Carl Icahn with a French accent”); Andrea Felsted, *Activist investors lift Amey holding*, FIN. TIMES Nov. 28, 2002, at 27 (discussing the activist campaign of Tito Tettamanti’s Sterling Investment Group in Amey plc); *Brierley the raider rides back in style*, THE SUN. TIM., Aug. 2, 1998, available at Factiva Doc. No. st00000020010927du82007fo (explaining Sir Ron Brierley’s transformation from a corporate raider to a shareholder activist).

164. See *infra* app. 1.

165. See *infra* app. 1.

systems protect certain rights, I draw on the work of previous legal indices of shareholder protection and disclosure rules.<sup>166</sup> A central methodological tenet of legal indices is that legal rules can be coded. All legal indices involve the reduction of a complex institutional reality to a summary form—a variable coded with a number—which allows for statistical analysis. Yet any empirical study devised to test the influence of legal rules inevitably captures only a part of the differences between legal systems.<sup>167</sup> Diligent numerical coding, however, provides a fruitful basis for analyzing comparative corporate governance phenomena across a large number of countries in a very accessible, statistical form.

#### A. *The Entry Stage*

The empirical evidence presented in Part III of this Article reveals a considerable diversity in the incidence of activist campaigns around the world: U.K. and Japanese companies are the prominent targets among the activist campaigns studied, while activist hedge funds engage in oversight activities less often in Continental Europe and developing countries. The preceding analysis suggests that, all else being equal, activist hedge funds are likely to target companies incorporated in countries with stronger disclosure and shareholder protection regimes.

To gauge whether the number of activist campaigns (*ACTIVISM*) differs significantly by the strength of the mandatory disclosure and shareholder protection, Table 1 computes (independent two-tailed) t-test and Mann-Whitney U-test statistics.<sup>168</sup> *ACTIVISM* counts how often activist hedge funds target companies incorporated in the 25 sampled countries between 2000 and 2010.<sup>169</sup> These tests are relevant to a

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166. See *supra* notes 53–54 and accompanying text.

167. On the merits and limitations of the legal indices to account for differences of legal systems, see Katelouzou, *supra* note 53.

168. I use a two-tailed test to test my hypotheses for robustness reasons. An alternative possibility could be the use of a one-tailed test. However, the one-tailed test can only test the effect in one direction disregarding the possibility of a relationship in the other direction. Thus, the use of one-tailed tests artificially increases the power of the test (*i.e.*, the probability of rejecting the null hypothesis gets higher).

The t-test is a parametric test for testing the equality of means and is based on the normality assumption of the population. The Mann-Whitney U-test, also known as Wilcoxon rank sum test, is a non-parametric test for testing the equality of the medians. Given the non-normality of the variable of interest—*ACTIVISM*—the parametric assumptions underlying the t-test may not hold. The Mann-Whitney U-test is often used to guard against this possibility. This test is robust in small samples and does not impose strong assumptions on the distributional properties of the data. In the present context, the results of the non-parametric test are thus more reliable than those of the parametric t-test.

169. See *supra* notes 149–55 and accompanying text.



preliminary empirical assessment of the legal parameters affecting the entry stage of an activist hedge fund campaign. As a measure of how stringent the mandatory disclosure rules are, I use the prospectus disclosure index (*DISCL*) of the law and finance literature and I divide the sample into two regimes: *Low DISCL* and *High DISCL*.<sup>170</sup> *DISCL* is a measurement of six substantive elements of a country's strength of disclosure requirements: (1) prospectus; (2) insiders' compensation; (3) ownership by large shareholders; (4) inside ownership; (5) contracts outside the normal course of business; and (6) transactions with related parties.<sup>171</sup> The cut-off between these two regimes is the median value of *DISCL* (=0.625).<sup>172</sup> I classify the countries with a value of *DISCL* greater than the median of 0.625 as *High DISCL* regimes, while the rest of the countries are classified as *Low DISCL* regimes. Consistent with what is expected, the *High DISCL* countries have higher mean values of *ACTIVISM* than the *Low DISCL* countries; the t-test statistics reveal that the difference in mean *ACTIVISM* between the *High DISCL* (36.5) and the *Low DISCL* (6.2) countries is statistically significant at less than the 10 percent level ( $p=0.066$ ). The difference in median *ACTIVISM* between the *High DISCL* and *Low DISCL* countries is also statistically significant at less than the 5 percent level ( $p=0.023$ ).

As a measure of the level of shareholder protection (*SP*) in the sampled countries, I use the 30-country shareholder protection index, which has been constructed under a project on "Law, Finance and Development" at the Centre for Business Research (CBR) in the University of Cambridge.<sup>173</sup> The 30-country CBR index codes the level of shareholder protection over the period of 1990–2013 and is comprised of

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170. See Rafael La Porta et al., *What Works in Securities Laws?*, 61 J. FIN. 1 (2006) (devising the prospectus disclosure index). *DISCL* is, however, a fairly weak proxy for legal rules on periodic disclosure, as it is constructed so as to reflect the agency problems between prospective investors in an initial offering and the "promoter" who offers shares for the sale, and it is not necessarily a proxy for post-offering disclosure rules. Unfortunately, reliable international data on post-offering periodic disclosure are not available. Thus, for the time being, I must rely on *DISCL* as a rough proxy for mandatory disclosure requirements.

171. *Id.* at 5–11.

172. To calculate the median value of *DISCL* in my sample, I used La Porta's data on "disclosure requirements" (*DISCL*). See *id.* at 15–16, tbl III.

173. See John Armour et al., *Shareholder Protection and Stock Market Development: An Empirical Test of the Legal Origins Hypothesis*, 6 J. EMPIRICAL LEGAL STUD. 343 (2009) (relying on a previous CBR index which coded the shareholder protection rules for twenty countries). See also Centre for Business Research, *Project: Law, Finance, and Development*, U. CAMBRIDGE, <http://www.cbr.cam.ac.uk/research/research-projects/completed-projects/law-finance-development> (last visited April 15, 2015) (explaining the variables and the coding methods involved).

the following ten variables: (1) “powers of the general meeting for de facto changes”; (2) “agenda setting power”; (3) “anticipation of shareholder decision facilitated”; (4) “prohibition of multiple voting rights (super voting rights)”; (5) “independent board members”; (6) “feasibility of director’s dismissal”; (7) “private enforcement of director duties”; (8) “shareholder action against resolutions of the general meeting”; (9) “mandatory bid”; and (10) “disclosure of major share ownership.”<sup>174</sup> To construct *SP*, I calculate the arithmetic mean (average) of the aggregate score of the ten variables between 1999 and 2009 for each of the 25 countries in my sample.<sup>175</sup>

To test the impact of the shareholder protection rules on the incidence of hedge fund activism, I divide the sample into two regimes: *High SP* and *Low SP*. The cut-off between *High SP* and *Low SP* is the median value of *SP* (=5.641). As expected, Panel B of Table 1 reports that the *High SP* countries have a higher number of activist campaigns than the *Low SP* countries. The t-test statistic reveals that the difference in mean *ACTIVISM* between the *High SP* (29.62) and the *Low SP* (3.92) countries is statistically significant at less than the 5 percent level ( $p=0.049$ ). The difference in median *ACTIVISM* between the *High SP* and *Low SP* countries is also statistically significant at less than the 5 percent level ( $p=0.035$ ).

**TABLE 1: LEGAL RULES’ EFFECT ON THE INCIDENCE OF HEDGE FUND ACTIVISM**

This table reports key statistics (number (N), mean, and standard deviation) for the dependent variable, *ACTIVISM*, by disclosure and shareholder protection regime. Panel A divides the sample into two regimes—*High DISCL* and *Low DISCL*—and reports the t-statistics for the average differences and the Mann-Whitney U-test rank statistics, which is asymptotically normal, for the median differences. Countries with a value of *DISCL* that is greater than the median of value of *DISCL* for each sample are classified as *High DISCL* regimes, while those with a value of *DISCL* that is less than or equal to the median of *DISCL* for each sample are classified as *Low DISCL* regimes.

174. On the 30-country CBR shareholder protection index, see Dionysia Katelouzou & Mathias Siems, *Disappearing Paradigms in Shareholder Protection: Leximetric Evidence for 30 Countries, 1990-2013*, 15 J. CORP. L. STUDIES (forthcoming 2015).

175. The CBR shareholder protection index, however, does not code Australia. Therefore, to measure shareholder protection in Australia, I rely on a study by Helen Anderson, Michelle Welsh, and Ian Ramsay, which employs the same variable definition and coding definition as the CBR index. See Helen Anderson et al., *Shareholder and Creditor Protection Indices Australia 1970-2010* (Melbourne Legal Studies Research Paper No. 641, 2011), available at <http://ssrn.com/abstract=2163809>.

Panel B examines the difference in the number of activist campaigns by shareholder protection (*SP*). Countries with a value of *SP* that is greater than the median value of *SP* for each sample are classified as *High SP* regimes, while those with a value of *SP* that is less than or equal to the median of *SP* for each sample are classified as *Low SP* regimes. Panel B reports the t-statistics for the average differences and the Mann–Whitney U-test rank statistics, which is asymptotically normal, for the median differences.

Panel A: <i>ACTIVISM</i> by Disclosure ( <i>DISCL</i> )								
	High <i>DISCL</i>			Low <i>DISCL</i>			T-test	Mann–Whitney U-test
	N	Mean	Sd	N	Mean	Sd		
<i>ACTIVISM</i>	10	36.5	45.246	10	6.2	10.358	2.064*	2.280**
Panel B: <i>ACTIVISM</i> by Shareholder Protection ( <i>SP</i> )								
	High <i>SP</i>			Low <i>SP</i>			T-test	Mann–Whitney U-test
	N	Mean	Sd	N	Mean	Sd		
<i>ACTIVISM</i>	13	29.62	41.947	12	3.92	6.186	2.183**	2.158**

\*\*\* significant at the 1 percent level; \*\* significant at the 5 percent level; \* significant at the 10 percent level.

### B. *The Trading Stage*

At the trading stage of an activist campaign, we have seen that several aspects of the disclosure rules on significant holdings limit the expected returns of prospective activists and have a chilling effect on the trading benefits of an activist campaign.<sup>176</sup> To examine the impact of ownership disclosure rules on activist trading, I begin by describing the size of the activist ownership stakes across my sample countries. Table 2 reports the mean and median maximum and minimum percentage of the activist

176. See *supra* notes 65–95 and accompanying text.

ownership blocks in the sample countries with more than ten activist campaigns (by location of the target company). Evidently, there are big cross-country differences; activist hedge funds in Italy build small stakes (around 2 percent), whereas in the United Kingdom and Canada they build relatively large ones. Also, in some countries—such as Canada, France, Germany, and Italy—the minimum (both mean and median) ownership stake falls under the triggering disclosure threshold.<sup>177</sup> This might suggest that activist hedge funds try to remain behind the public scenes, at least at the beginning of their campaigns. Unsurprisingly, activist hedge funds accumulate quite large ownership stakes in Canada, perhaps because they can trade secretly up to the 10 percent triggering threshold.<sup>178</sup>

**TABLE 2: MINIMUM AND MAXIMUM OWNERSHIP STAKES (%) HELD BY ACTIVIST HEDGE FUND**

The table presents the minimum (Column 1) and maximum (Column 2) ownership activist stakes (%) by hedge fund–target pairs. I calculated the ownership activist stake on the basis of hedge fund–target pairs to account for the presence of wolf–packs. Information about hedge funds’ stake holdings was collected from three sources: the hedge funds’ related press reports, the targets’ annual reports, and regulatory filings on “significant holdings” (for the countries whose filings are available in Factiva). Of the 494 hedge fund–target pairs, 55 are excluded due to unavailability of ownership data. Some of these unreported cases involve wolf–packs, in which there is no information for each participating fund’s stake, although the total ownership for a group is recorded.

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177. The initial disclosure threshold is set at 10% in Canada, 5% in Germany and France, and 2% in Italy for the period studied (2000–2010). *See infra* note 180 and accompanying text.

178. It is noteworthy that in March 2013 the Canadian Securities Administrators (CSA) proposed, among other changes intended to provide greater transparency about significant holdings, to lower the reporting threshold from 10% to 5%. However, in October 2014, the CSA announced that it will not be moving forward with the proposed reform. *See CSA Notice 62-307 Update on Proposed Amendments to Multilateral Instrument 62-104 Take-Over Bids and Issuer Bids, National Instrument 62-103 Early Warning System and Related Take-Over Bid and Insider Reporting Issues and National Policy 62-203 Take-over Bids and Issuer Bids*, CANADIAN SEC. ADM’RS (Oct. 10, 2014), [http://www.osc.gov.on.ca/en/SecuritiesLaw\\_csa\\_20141010\\_62-307\\_proposed-admndments-multilateral-instrument.htm](http://www.osc.gov.on.ca/en/SecuritiesLaw_csa_20141010_62-307_proposed-admndments-multilateral-instrument.htm).

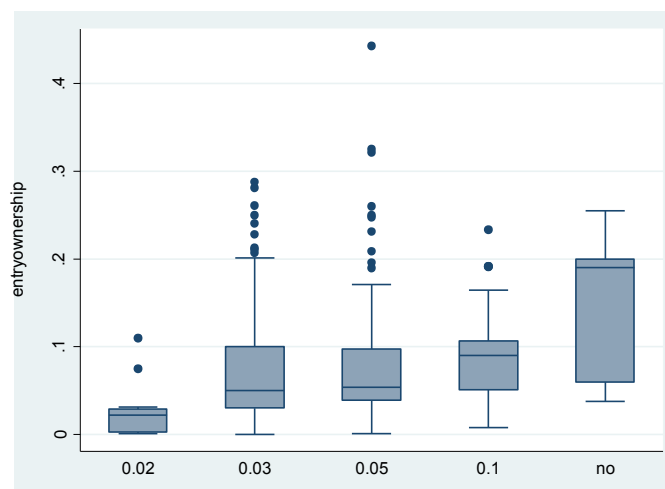
	Minimum Ownership		Maximum Ownership	
	(1)	(2)	(1)	(2)
	Mean	Median	Mean	Median
<b>Australia</b>	6.71%	6.38%	12.04%	12.57%
<b>Canada</b>	8.39%	8.61%	13.07%	12.10%
<b>France</b>	4.06%	3.00%	9.08%	10.03%
<b>Germany</b>	3.53%	2.92%	6.44%	5.68%
<b>Italy</b>	1.84%	1.97%	2.90%	2.23%
<b>Japan</b>	6.57%	5.00%	12.54%	10.00%
<b>Netherlands</b>	5.97%	5.12%	9.50%	9.95%
<b>Switzerland</b>	6.78%	6.70%	13.78%	9.45%
<b>UK</b>	8.43%	4.50%	13.11%	10.93%
<b>All Countries</b>	6.10%	4.93%	11.54%	10%

A counterargument is that these findings could be driven by the initial thresholds necessitating public disclosure of share ownership. To put it simply, it may well have been that the press coverage was driven by the disclosure rules, with reporters finding out about the interventions from the public disclosures. Correspondingly, the press was finding out about instances of hedge fund activism in Italy that would have stayed below the radar in Canada, meaning that the size of the average stake I found for Canada would have been larger than the one I found for Italy. However, in one-third of the activist campaigns studied, the filing is not the market's first news of the activist ownership block; rather, the insurgent(s) accumulate an entry ownership stake which remains below the triggering ownership threshold.<sup>179</sup> In 4 (out of 12) campaigns, the entry activist ownership stake remains below 2 percent; in 35 (out of 166) campaigns it

179. A notable example is the Knight Vinke's investment in the Italian oil company Eni SpA, where in 2009 Knight Vinke, having accumulated an ownership stake below 1%, publicly pressured Eni to break up. See Vincent Boland Knight, *Vinke Urges Eni Break Up*, FIN. TIMES, Sept. 30, 2009, available at <http://www.ft.com/cms/s/0/92f124b8-adf2-11de-87e7-00144feabdc0.html#axzz3UN3ucaXP>. Note that, in Italy, hedge funds are subject to the same disclosure requirements generally applicable to any investor with a shareholding higher than 2%, and then crossing or falling below 5%, 10%, 15%, 20%, 25%, 30%, 35%, 40%, 45%, 50%, 66.6%, 75%, 90%, 95%. See Erik Vermeulen, *Beneficial Ownership and Control: A Comparative Study—Disclosure, Information and Enforcement* (OECD Corporate Governance Working Paper, No. 7, 2013), available at <http://dx.doi.org/10.1787/5k4dkhwckbzv-en>.

remains below 3 percent; in 63 (out of 204) campaigns it remains below 5 percent; and in 30 (out of 52) campaigns it remains below 10 percent, when the triggering thresholds are 2, 3, 5, and 10 percent, respectively.<sup>180</sup> The boxplots in Figure 3 below confirm that activist hedge funds tend to amass lower thresholds in countries with lower initial ownership disclosure thresholds. The median entry ownership stake of activist hedge funds is 2.22, 5, 5.38, and 9.02 percent, respectively, in countries with 2, 3, 5, and 10 percent initial notification thresholds, respectively; whereas in countries with no disclosure obligations, the average entry ownership stake is 19 percent. However, the median entry activist ownership stakes do not trigger notification of major shareholder rules in countries with a 10% triggering disclosure threshold.

Figure 3: Activist Hedge Funds' Entry Ownership Stakes by Initial Disclosure Threshold



180. Italy has the lowest initial disclosure threshold (2%) among my sample countries. The United Kingdom applies a 3% threshold throughout the period studied, whereas Germany and Switzerland in 2007 and Spain in 2009 decreased the 5% initial disclosure threshold to 3% (in line with the U.K. regime). Australia, Brazil, France, Japan, the Netherlands, and Sweden apply a 5% threshold throughout the period studied. Malaysia replaced the previous 2% threshold with a 5% one in 2001, whereas Russia increased the initial 5% disclosure threshold to 25% in 2003, but decreased it again to 5% in 2006. Turkey is the only country in my sample that did not require any disclosure of major share ownership until 2002, when it introduced a 5% initial disclosure threshold. Finally, Canada applies a 10% threshold. For a detailed explanation of the relevant disclosure thresholds, as well as explanations and references to the relevant provisions of law, see Centre for Business Research, *supra* note 173.

To further gauge whether activist hedge funds build up smaller entry stakes in countries with more stringent ownership disclosure thresholds, Table 3 computes a one-way ANOVA test.<sup>181</sup> The average entry ownership stake of activist hedge funds is 2.9, 6.9, 7.3, and 9 percent in countries with 2, 3, 5, and 10 percent initial notification thresholds, respectively. The difference in the average entry ownership stakes is statistically significant for the natural logarithm of *ENTRYOWNER* at the 1 percent level.<sup>182</sup>

**TABLE 3: OWNERSHIP DISCLOSURE RULES' EFFECT ON ACTIVIST OWNERSHIP STAKES**

Columns 1 to 4 of this Table present the sample size and the average entry ownership stake of activist hedge funds when the triggering ownership threshold is 2, 3, 5, and 10 percent, respectively. Column 5 presents the sample size and the average entry ownership stake of activist hedge funds when there are no ownership disclosure obligations. The ownership disclosure measure (*OWNERDISCL*) equals 1 if shareholders who acquire at least 2 percent of the companies' capital have to disclose it; equals 0.75 if this concerns 3 percent of the capital; equals 0.5 if this concerns 5 percent; equals 0.25 if this concerns 10 percent; and equals 0 when there is no disclosure obligation.<sup>183</sup> To construct *OWNERDISCL*, I take into account the threshold percentage of disclosure at the first year of investment for each activist campaign. I assign one score for each of the 494 hedge fund–target pairs. Column 3 presents the one-way ANOVA test. The dependent variable (*ENTRYOWNER*), which represents the ownership that activist hedge funds build up when they begin investing in their target companies, does not meet the

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181. I use one-way analysis of variance (ANOVA) because I have one categorical independent variable (*OWNERDISCL*) and one continuous dependent variable (*ENTRYOWNER*). The one-way analysis of variance is used to test the claim that three or more population means are equal. This is an extension of the two independent sample t-tests. For definitions of the variables, see Table 4.

182. However, the one-way ANOVA test does not test that one mean is less than another, only whether they are equal or at least one is different. This is why future empirical research needs to test whether this difference really exists, and if yes, whether it is attributable to other factors—although there might be some evidence to support the claim that there is a difference in the mean of activist ownership stakes across the five disclosure regimes.

183. This definition is preferable to the one used in the CBR shareholder protection index (Variable 10), as it accounts for differences between countries with a 2% and a 3% ownership threshold. See *supra* notes 174-175 and accompanying text. For a detailed analysis of the evolution of ownership disclosure between 1995 and 2005 based on Variable 10 of the CBR index, see M.C. Schouten & M.M. Siems, *The Evolution of Ownership Disclosure Rules Across Countries*, 10 J. CORP. L. STUDIES 451 (2010) (analyzing the development of ownership disclosure between 1995 and 2005).

normality assumption. This is why I compute the one-way ANOVA test with the dependent variable being the natural logarithm of *ENTRYOWNER*.

	OWNER DISCL =1		OWNER DISCL =0.75		OWNER DISCL =0.5		OWNER DISCL =0.25		OWNER DISCL =0		One-way ANOVA
	(1)		(2)		(3)		(4)		(5)		(6)
<i>ENTRY OWNE R</i>	N	Mea n	N	Mea n	N	Mea n	N	Mea n	N	Mea n	
	1	0.02	16	0.06	20	0.07	5	0.09	5	0.14	8.767**
	2	9	6	9	4	3	2	0		9	*

As for the maximum ownership stakes of the 494 hedge fund–target pairs studied, in only 10 does the insurgent surpass the corresponding mandatory bid thresholds, while in the 95th percentile, activist hedge funds hold 28.76 percent of the target company. Even more interestingly, different patterns arise across countries depending on the actual thresholds that trigger a mandatory bid.<sup>184</sup> For instance, in the United Kingdom, where the mandatory bid threshold is 30 percent, there are 24 activist maximum ownership positions between 25 and 29.99 percent. Even when activist hedge funds form wolf–packs, they rarely find themselves subject to an obligation to make a general offer.<sup>185</sup> In Canada, however, where the mandatory bid threshold is 20 percent, the activist hedge funds studied tend to acquire stakes below 20 percent, which are evidently smaller than their counterparts in the United Kingdom. Surprisingly, perhaps, activist hedge funds in the Netherlands, where there is no mandatory bid threshold, never surpass 30 percent, while there is only one activist hedge fund accumulating an ownership stake of more than 20 percent in a Dutch company. These findings should be read in light of the activist hedge funds’ general aversion to acquiring corporate control.<sup>186</sup> From the 883 activist hedge fund strategies studied, only 37 involve takeover bids,<sup>187</sup>

184. See *supra* notes 91–92 and accompanying text (describing when an acquirer must make a tender offer to all shareholders (mandatory bid rule) and the frequency of such an occurrence).

185. In my sample, none of the two wolf–packs targeting U.K. companies triggered the mandatory bid rule, despite the participating activist hedge funds together carrying more than 30% of the company’s voting rights. (Data on file with the author).

186. See Cheffins & Armour, *supra* note 23, at 58–60 (distinguishing between the market for corporate control and the market for corporate influence, and suggesting that activist hedge funds are associated with the latter).

187. See Katelouzou, *supra* note 14, at 497 (explaining characteristics of hedge fund



while empirical evidence on hedge fund activism in the United States—where the would-be-acquirers can bid as small or as large of a percentage of the target company as they wish<sup>188</sup>—shows that even in the absence of a mandatory bid rule, activist hedge funds rarely attempt to take over the targeted company.<sup>189</sup>

In addition to ownership disclosure rules, we have seen that tight rules on acting-in-concert may introduce an additional barrier to the trading stage of an activist campaign.<sup>190</sup> Data on how often activist hedge funds have avoided being treated as a “group” for purposes of disclosure regulations are very difficult to obtain. In the United States, Thomas Briggs collected data on hedge fund activism during a 20-month period and reported that thirteen out of the 52 campaigns he studied involved some kind of pack activity.<sup>191</sup> In their clinical study on activist engagement by the Hermes Focus Fund, Professors Marco Becht, Julian Franks, Colin Mayer, and Stefano Rossi also provide some data about behind the scenes shareholder collaboration.<sup>192</sup> The sample studied here provides a window through which to examine the impact of acting-in-concert legislation in a wide range of countries. From the total 432 activist campaigns studied, 50 appear to involve a form of wolf-pack, while four campaigns involve two different wolf-packs formed from different activist hedge funds and/or different time periods. From the total 54 wolf-packs, only 6 have been caught by acting-in-concert legislation and subjected to filing requirements, while the other 48 involve activist funds mutually supportive but separate filers or other coalitions reported in the press.<sup>193</sup>

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activism based on empirical evidence).

188. The 1986 Williams Act—the main federal law governing public takeover bids (or tender offers)—does not impose a mandatory bid rule. Pennsylvania, Maine, and South Dakota, however, have “control share cash-out” laws triggered at 20%, 25% and 50%, respectively. See Klaus J. Hopt, *European Takeover Reform of 2012/2013—Time to Re-Examine the Mandatory Bid*, 15 EUR. BUS. ORG. REV. 143, 168 (2014).

189. See, e.g., Brav et al., *supra* note 15, at 1743 (summarizing the occurrence of different hedge fund tactic categories).

190. See *supra* notes 92–95 and accompanying text (discussing when activist hedge funds team up with other hedge funds and the benefits of these arrangements for the hedge funds involved).

191. Thomas W. Briggs, *Corporate Governance and the New Hedge Fund Activism: An Empirical Analysis*, 32 J. CORP. LAW 681, 698 (2007).

192. Marco Becht et al., *Returns to Shareholder Activism: Evidence from a Clinical Study of the Hermes U.K. Focus Fund*, 22 REV. FIN. STUD. 3093 (2009).

193. Data on file with the author.

### C. *The Disciplining Stage*

After accumulating a sizeable stake, the insurgent(s) announces a change in the firm's policy it believes as value-enhancing and then tries to get that change carried out (disciplining stage). The overarching goal of activist hedge funds is superior risk-adjusted returns. In the course of their campaigns, however, they state a variety of objectives, which can be sorted into three broad groups: corporate governance activism, corporate management activism, and corporate control activism. I use the term corporate management activism to describe activist campaigns with the aim of determining capital, operational, and strategic changes that are necessary for improving firm performance. Corporate governance activism includes activist events launched in the name of corporate governance best practices on matters including board independence, executive compensation, and anti-takeover defenses. Lastly, corporate control activism encompasses not only attempts to direct the affairs of the target firm replacing the majority of the board members, but also attempts to facilitate control transactions, such as mergers and sales of the company to third parties and interventions where the activist makes an offer to buy the target.

Data that I have compiled on the stated objectives of activist hedge fund campaigns provide a helpful way of examining whether hedge fund activism operates similarly across different countries.<sup>194</sup> Table 4 (Panel A) breaks down the activist objectives in the three broad categories of activism (corporate governance, corporate management, and corporate control) by target country. Overall, the review of the stated objectives suggests that in my sample countries, as in the United States, activist hedge funds engage with incumbent management intent on bringing about changes in corporate strategy and financial structure to enhance returns to shareholders; in almost 41.2 percent of the stated objectives, hedge funds tried to force a capital-related or an operational change (corporate management activism). This should not be striking if we take into account that maximization of shareholder value is paramount for activist hedge funds. Corporate governance activism is also quite popular, making up 30.1 percent of the activist objectives, while engagement in transfers of control is the activist hedge funds' stated objective in 28.7 percent of the total sample. The prominence of corporate management activism is evident in most of the countries studied, with the exception of Canada where the majority of the activist objectives (36.1 percent) relate to corporate control activism.<sup>195</sup>

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194. Katelouzou, *supra* note 14, at 491–95.

195. The relatively high frequency of corporate control activism in Canada is probably due to the fact that U.S. hedge funds launch U.S.-style proxy fights in Canadian companies. For an account of hedge fund activism targeting Canadian companies, see Brian R. Cheffins,

Also, in France, Australia, and Switzerland, most of the activist objectives relate to corporate governance changes.<sup>196</sup>

To test whether these cross-country differences in the activists' stated objectives are attributed to cross-country differences in the protection of shareholder rights, Table 4 (Panel B) groups the countries by their shareholder protection regime in *High SP* and *Low SP* countries.<sup>197</sup> Evidently, there is a common pattern across the two groups: activist hedge funds engage more often in corporate management activism. From the 741 stated objectives of the activist campaigns targeting companies located in *High SP* regimes, 41.7 percent fall within the corporate management camp, while corporate governance and corporate control objectives amount to 30.5 and 27.8 percent, respectively. The proportion of corporate management activism is slightly lower in *Low SP* countries (39.5 percent), while activist hedge funds engage more often with corporate control transactions in *Low SP* countries (30.8 percent). The chi-square test suggests, however, that there is no statistically significant association between the shareholder protection regime and the stated objective. That is, the activist stated objectives are not attributable to differences in the shareholder protection regime.

**TABLE 4: ACTIVIST OBJECTIVES AND SHAREHOLDER PROTECTION RULES**

Panel A reports the summary of activist hedge funds' stated objectives by country. The sample includes 946 stated objectives across 432 activist campaigns. The difference in numbers is due to the fact that in each hedge fund-target pair the hedge fund can have multiple objectives. Panel B reports key statistics for the dependent variable, *OBJECTIVE*, by shareholder protection regime. *OBJECTIVE* is a categorical variable, which equals 1 if the stated objective of hedge fund activism is directed to improvements of corporate management (corporate management activism); equals 2 if the stated objective of hedge fund activism is directed to improvements of corporate governance (corporate governance activism); and equals 3 if the stated objective of hedge fund activism is directed to

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*Hedge Fund Activism Canadian Style* 47 U. B.C. L. REV. 1 (2014) (describing the role of hedge fund activism in Canadian corporate governance).

196. The relatively high frequency of corporate governance activism in Australia, France, and Switzerland is likely due to the relatively high number of activist campaigns seeking minority board representation and ousting of key executives without acquiring control of the company (9, 16, and 8, respectively). Further on this category of activism, see Katelouzou, *supra* note 14, at 492, 494–95 (classifying the corporate governance-related stated objectives of activist hedge funds into nine sub-categories).

197. Countries with less than five-stated activist objectives are omitted (*i.e.*, Spain, Turkey, Brazil, India, and Malaysia).

changes in corporate control (corporate control activism). Countries with a value of *SP* that is greater than the median value of *SP* for each sample are classified as *High SP* regimes, while those with a value of *SP* that is less or equal to the median of *SP* for each sample are classified as *Low SP* regimes. *N* is total number of the variables of interest observed in each shareholder protection regime. Countries with less than 5 stated objectives are omitted. Panel B also reports chi-square test statistics for the dependent variable, *OBJECTIVE*.

<b>Panel A: Activist Hedge Funds' Stated Objectives by Country</b>						
	<b>Corporate Management</b>		<b>Corporate Governance</b>		<b>Corporate Control</b>	
	<b>N</b>	<b>%</b>	<b>N</b>	<b>%</b>	<b>N</b>	<b>%</b>
<b>All Countries</b>	390	41.23%	285	30.13%	271	28.65%
<b>UK</b>	122	44.53%	76	27.74%	76	27.74%
<b>Japan</b>	112	51.38%	54	24.77%	52	23.85%
<b>Canada</b>	47	32.64%	45	31.25%	52	36.11%
<b>Germany</b>	27	40.30%	13	19.40%	27	40.30%
<b>France</b>	14	25.93%	24	44.44%	16	29.63%
<b>Netherlands</b>	20	45.45%	9	20.45%	15	34.09%
<b>Australia</b>	8	25.00%	14	43.75%	10	31.25%
<b>Switzerland</b>	10	35.71%	12	42.86%	6	21.43%
<b>Italy</b>	8	40.00%	8	40.00%	4	20.00%
<b>Russia</b>	6	31.58%	13	68.42%		
<b>South Africa</b>	4	21.05%	11	57.89%	4	21.05%
<b>Sweden</b>	8	47.06%	5	29.41%	4	23.53%

<b>Panel B: OBJECTIVE by Shareholder Protection (SP)</b>				
	<b>High SP</b>		<b>Low SP</b>	
	<b>N</b>	<b>%</b>	<b>N</b>	<b>%</b>
<b>OBJECTIVE (=1)</b>	309	41.70%	77	39.50%
<b>OBJECTIVE (=2)</b>	226	30.50%	58	29.70%
<b>OBJECTIVE (=3)</b>	206	27.80%	60	30.80%
<b>Chi-square test (Low SP vs. High SP)</b>	0.691			

Activist hedge funds use a range of strategies to pursue their stated objectives, founded upon the ownership of a sizeable, though non-controlling, stake. In a previous study, I presented evidence on activist hedge fund strategies across 17 countries between 2000 and 2010.<sup>198</sup> The 883 activist strategies studied had an escalating degree of hostility against the target company, from meetings and letter writings (gentle activism), to public criticism and shareholder resolutions or board representation without publicly-reported management confrontation (soft activism), to efforts to replace the board or to take control of the company (aggressive activism).<sup>199</sup>

Since I have examined 432 activist campaigns, but 883 activist strategies, from which 270 are assigned as aggressive activism, it is useful to investigate the aggressiveness of each activist campaign. Table 5 (Panel A) provides evidence on the aggression of global activist hedge fund's campaigns and confirms that activist hedge funds are not mainly aggressive, as the majority of activist campaigns involve only gentle and/or soft tactics (237 out of 432 activist campaigns). Panel A also reports that there is considerable congruence between the activist strategies, with solely aggressive campaigns being the minority across all the sample countries. However, in several aspects in terms of coverage and emphasis there are some cross-country differences. For instance, the overwhelming majority of activist campaigns in Japan (74.76 percent) involve only gentle and/or soft tactics, while the corresponding percentage is 72.7 and 53.1 percent in Italy and the United Kingdom, respectively. On the other hand, more aggressive tactics are adopted in Switzerland, France, and Germany, where

198. Katelouzou, *supra* note 14, at 484.

199. *Id.* at 485–86.

the overwhelming majority of activist campaigns involve at least one aggressive tactic (80, 68, and 63.3 percent, respectively).

Panel B of Table 5 groups the countries by shareholder protection in *High SP* regimes and *Low SP* regimes.<sup>200</sup> The aggressiveness of the activist hedge funds' campaigns is measured in two categories (0: gentle/soft, 1: aggressive). Evidently, there is a common pattern across the two groups: activist hedge funds mainly use gentle/soft approaches. The proportion of gentle and/or soft strategies in *High SP* and *Low SP* regimes amounts to 53.1 and 55.3 percent, respectively. Although there is a small difference in favor of the *Low SP* countries, the chi-square test shows that this difference is not statistically significant.

**TABLE 5: ACTIVIST STRATEGIES AND SHAREHOLDER PROTECTION RULES**

Panel A reports the aggressiveness of each activist campaign in my sample by country. The sample includes 883 activist strategies across 432 activist campaigns. In order to examine the aggressiveness of each activist campaign, I split the activist campaigns into two groups: those that include only gentle and soft tactics and those that include at least one aggressive tactic. I track the evolution of each campaign using information from press reports. Panel B reports key statistics for the dependent variable, *AGGRESSION*, by shareholder protection regime. *AGGRESSION* is a dummy variable, which equals "0" if the activist hedge fund employs only gentle/soft tactics and equals "1" if the activist employs mixed (both gentle/soft and aggressive) or solely aggressive tactics. Countries with a value of shareholder protection, or "*SP*", that is greater than the median of value of *SP* for each sample are classified as *High SP* regimes, while those with a value of *SP* that is less than or equal to the median of *SP* for each sample are classified as *Low SP* regimes. "N" is the total number of the interest variables observed in each shareholder protection regime. Panel B also reports the chi-square test statistics for the dependent variable, *AGGRESSION*.

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200. Countries with less than five activist campaigns are omitted (*i.e.*, Brazil, India, Malaysia, Spain and Turkey).

<b>Panel A: Activist Hedge Fund Campaigns by Aggression</b>				
	<b>Gentle/Soft</b>		<b>Aggressive</b>	
	N	%	N	%
All Countries	237	54.86%	195	45.14%
UK	68	53.13%	60	46.88%
Japan	77	74.76%	26	25.24%
Canada	28	47.46%	31	52.54%
Germany	11	36.67%	19	63.33%
France	8	32.00%	17	68.00%
Netherlands	11	55.00%	9	45.00%
Australia	8	42.11%	11	57.89%
Italy	8	72.73%	3	27.27%
Switzerland	2	20.00%	8	80.00%
South Africa	6	75.00%	2	25.00%
Sweden	4	66.67%	2	33.33%
Russia	1	20.00%	4	80.00%
<b>Panel B: <i>AGGRESSION</i> by Shareholder Protection (<i>SP</i>)</b>				
	<b>High <i>SP</i></b>		<b>Low <i>SP</i></b>	
	N	%	N	%
<i>AGGRESSION</i> (=0)	180	53.10%	47	55.30%
<i>AGGRESSION</i> (=1)	159	46.90%	38	44.70%
Chi-square test (Low <i>SP</i> vs. High <i>SP</i> )	0.132			

#### *D. Summary of Empirical Findings*

Drawing together the preliminary empirical findings presented in this Part, one can arrive at a precursory conclusion: the extent to which law matters depends on the stage that hedge fund activism has reached. *Ceteris paribus*, the number of activist hedge fund campaigns is larger in countries

with stronger mandatory disclosure and shareholder protection regimes (entry stage). Of these two legal variables, however, shareholder protection has a more significant effect on the incidence of worldwide hedge fund activism.

At the trading stage of an activist campaign, activist hedge funds acquire smaller entry ownership stakes in countries with lower initial disclosure thresholds. The empirical data studied also reveal that other parameters of the ownership disclosure rules—such as the acting-in-concert legislation and the mandatory bid rule—have somewhat weaker ramifications for the trading stage of an activist campaign.

Finally, at the disciplining stage of an activist campaign, shareholder protection seems to have little explanatory power, as the activist stated objectives and employed strategies are not attributable to differences in the shareholder protection regime. This suggests that while a minimum protection of the shareholder rights is a necessary condition for the activist hedge funds' entry to a target company, subsequent choices of the activist objectives and strategies are, at least in part, endogenous to the ways in which the legal regimes affect hedge fund activism. Because activist hedge funds pursue activism as a profit-making strategy, they choose a target company and amass a sizeable stake only when the anticipated benefits from intervention outweigh the costs associated with the different stages of an activist campaign. Activist hedge funds, therefore, state the objectives and resort to the strategies that enable them to make profits from activism irrespective of the shareholder rights afforded to them.

#### CONCLUSION AND FUTURE RESEARCH

Triggered by the differences in the incidence, magnitude, and nature of worldwide hedge fund activism, this Article has provided a theoretical and empirical framework for understanding the legal parameters underpinning the monitoring role that activist hedge funds can play and how effectively they can play it. On the theoretical side, this Article introduces an activist hedge fund campaign as a sequence of four stages: entry, trading, disciplining, and exit. This four-stage framework serves as a heuristic device to identify a number of legal factors likely to determine the emergence and evolution of worldwide hedge fund activism. On the empirical side, this Article expands the empirical base for the study of the relationship between law and hedge fund activism in two ways: first, it tracks the emergence of worldwide hedge fund activism on the basis of a hand-collected dataset on activist hedge fund campaigns between 2000 and



2010 across 25 countries; and second, it draws upon legal indices provided by the law and finance scholarship and leximetric coding techniques to capture whether law is facilitative of hedge fund activism.

The empirical findings of Part IV show that international differences in the scope of mandatory disclosure rules and ownership disclosure rules are among the factors that shape the entry and trading stage of activist hedge fund campaigns across countries, respectively. More importantly, 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, in this context, 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. I find that the frequency of activist hedge fund campaigns increases with the extent to which the rights of shareholders are protected from managerial discretion. However, the data with respect to the disciplining stage of activist hedge fund campaigns provide little support that the activist objectives and the employed strategies are a reflection of the shareholder protection regime of the country in which the target company is located. Though it may appear paradoxical, the preliminary findings of this study suggest that while a minimum protection of the shareholder rights is a necessary condition for the activist hedge funds' entry, subsequent choices of the activist objectives and strategies are, at least in part, endogenous to the ways in which the legal regimes affect hedge fund activism.

Worldwide hedge fund activism, however, is not a mere reflex of the legal parameters studied in this Article. One may adduce extra-legal factors explaining the differences in the incidence, nature, and outcomes of hedge fund activism across countries. Such factors include, but are not limited to, the performance, size, and ownership structure of the target company, as well as the nature of the influential activities and domicile of the insurgent. Future research will aim to test the impact of those additional factors on the different stages of an activist hedge fund campaign by multivariate empirical means. It is important to consider empirical data from a multitude of countries—both before and after the 2008 financial crisis—to understand why the incidence and magnitude of hedge fund activism differs around the world and whether hedge fund activism will be a permanent feature of corporate governance. Although further empirical research is required to shed light on the complex interplay between hedge fund activism and law, this study reinforces, rather than undercuts, the perception that law matters to worldwide hedge fund activism, mostly by

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vindicating shareholder rights as a determinant of the differences in the incidence and prevalence of hedge fund activism across the world.

## APPENDIX 1

*HEDGE FUND TARGET PAIRS BY HEDGE FUND AND GEOGRAPHY*

The table in this appendix reports the frequency distribution of hedge funds–target pairs by hedge fund and geography in the hand–collected dataset between January 1, 2000 and December 31, 2010. Only the hedge funds with three or more engagements are listed. It should be noted that the hedge funds involved in wolf–packs get credited individually. My sample includes 432 activist campaigns, but 494 hedge fund–target pairs.<sup>201</sup>

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201. For the abbreviations, see *supra* Figure 2. The following abbreviations are also used: MC (Monaco), SG (Singapore), and VG (Virgin Islands).

Rank	Activist Funds (Location)	AU	BR	CA	CH	DE	ES	FR	JP	IN	IT	MY	NL	RU	SE	TU	UK	ZA	Total
1	Laxey Partners (UK)	1			5								2				20		28
2	Steel Partners (US)							25									1		26
3	Murakami Fund (JP)							24											24
4	Hermes Focus Fund (UK)					5	1			1			3				13		23
5	Wyser Pratte (US)					8	7						1						16
6	Guinness Peat (UK)	3															12		15
7	Centaurus Capital (UK)					2	1	4		1			5				1		14
8	Crescendo Partners (US)			14															14
9	J O Hambro (UK)				1												12		13
10	The Children's Investment Fund (TCI) (UK)	1	1			2			2	1			2				1		10
11	Amber Capital (US)							3			4		2						9
12	Cevian Capital (UK/SE)					2									6		1		9



Rank	Activist Funds (Location)	AU	BR	CA	CH	DE	ES	F	JP	IN	IT	MY	NL	RU	SE	TU	UK	ZA	Total
25	Atlantic Investment Management (US)							1	3				1						5
26	Audley Capital (UK)			1		2											2		5
27	Carrousel Capital (UK)	2															3		5
28	Hermitage Capital (UK)													5					5
29	Knight Vinke (MC)							1		1			1				2		5
30	Mellon/Fursa (US)					1		1	1				1				1		5
31	Perpetual (AU)	5																	5
32	Polygon Investment (UK)							1									4		5
33	Cycladic Capital (UK)					1		1									2		4
34	GoldenPeaks Capital (CH)				3												1		4
35	Jana Partners (US)		2										2						4



Rank	Activist Funds (Location)	AU	BR	CA	CH	DE	FR	JP	IN	IT	MY	NL	RU	SE	TU	UK	ZA	Total	
48	Greenlight Capital (US)			1				1									1	3	
49	Harbinger Capital (US)	1							1								1	3	
50	Knox D'Arcy (UK)																3	3	
51	Salida Capital (CA)			3														3	
52	Sterling Investment Group (UK)				2												1	3	
53	Tweedy Browne (US)					2		1										3	
54	West Face Capital (CA)			3														3	
	Other (1 or 2 engagements)	6	0	29	1	9	1	6	12	0	2	1	4	1	0	0	28	0	99
	<b>Total</b>	<b>20</b>	<b>2</b>	<b>62</b>	<b>12</b>	<b>43</b>	<b>3</b>	<b>32</b>	<b>103</b>	<b>1</b>	<b>13</b>	<b>1</b>	<b>29</b>	<b>6</b>	<b>7</b>	<b>1</b>	<b>150</b>	<b>9</b>	<b>494</b>