

Fordham Journal of Corporate & Financial Law

Volume 24, Number 1

2019

Article 6

Curb Your Enthusiasm: The Rise of Hedge Fund Activist Shareholders and the Duty Of Loyalty

Soo Young Hong*

*J.D. Candidate, Fordham University School of Law, 2019

Copyright ©2019 by the authors. *Fordham Journal of Corporate & Financial Law* is produced by The Berkeley Electronic Press (bepress). <https://ir.lawnet.fordham.edu/jcfl>

Curb Your Enthusiasm: The Rise of Hedge Fund Activist Shareholders and the Duty Of Loyalty

Soo Young Hong

Abstract

Shareholder activism has been a growing problem in the corporate world, creating numerous dilemmas for the board of directors of companies. Activist shareholders can unsettle a company, pressuring the directors to make decisions according to the course of business the activists would prefer, and thus interfering with the traditional role of directors as the decision-makers of a company. With this new development in the business world, legal scholars have been debating if this activism needs to be controlled and, if so, what measures can be taken to reach a balance. This Note examines the traditional corporate principles such as the shareholder primacy theory and the principle of “one share, one vote,” evaluating the benefits and the costs of adhering to these theories amidst the changing landscape in the business and legal world. This Note then proposes that the traditional concept of the duty of loyalty can be applied to activist shareholders, much like it has been applied to the directors and majority shareholders in the past, based on a fact-by-fact analysis.

KEYWORDS: Hedge Fund Activist Shareholders, Duty of Loyalty, Shareholder Activism, Activist Hedge Funds

CURB YOUR ENTHUSIASM: THE RISE OF HEDGE FUND ACTIVIST SHAREHOLDERS AND THE DUTY OF LOYALTY

*Soo Young Hong**

ABSTRACT

Shareholder activism has been a growing problem in the corporate world, creating numerous dilemmas for the board of directors of companies. Activist shareholders can unsettle a company, pressuring the directors to make decisions according to the course of business the activists would prefer, and thus interfering with the traditional role of directors as the decision-makers of a company. With this new development in the business world, legal scholars have been debating if this activism needs to be controlled and, if so, what measures can be taken to reach a balance. This Note examines the traditional corporate principles such as the shareholder primacy theory and the principle of “one share, one vote,” evaluating the benefits and the costs of adhering to these theories amidst the changing landscape in the business and legal world. This Note then proposes that the traditional concept of the duty of loyalty can be applied to activist shareholders, much like it has been applied to the directors and majority shareholders in the past, based on a fact-by-fact analysis.

TABLE OF CONTENTS

INTRODUCTION	194
I. TRADITIONAL PRINCIPLE OF “ONE SHARE, ONE VOTE” AND ITS EVOLUTION	196
II. SUPPORTERS AND OPPONENTS OF SHAREHOLDER ACTIVISM	202
A. Proponents	202
B. Critics	206
III. FIDUCIARY DUTY OF LOYALTY	209
A. Traditional Principle	210
B. Duty of Loyalty Revamped – Anabtawi and Stout Version	212

* J.D. Candidate, Fordham University School of Law, 2019.

C. Additional Narrowing of this Duty.....	214
CONCLUSION.....	217

INTRODUCTION

Given the billions of dollars in investments that hedge funds are able to bring in, the business world closely tracks these funds and the transactions they make. Recently, a relatively new class has emerged in the hedge fund landscape: “activist hedge funds.” Activist hedge funds pursue profits, not only through the regular mechanisms of a hedge fund, but by aggressively taking a role in directing the business strategies and activities in which they invest. These activists often utilize their position as shareholders to push a company’s board of directors into making a decision that may change the nature of the company substantially and, perhaps, harmfully.

Take, for example, the tense battle between activists Starboard Value and Carl Icahn over Newell Brands, best known for producing Yankee Candles and Sharpies.¹ Starboard Value sought to overthrow the whole board of directors, while Icahn wanted to replace some members with those of his choice.² The corporation appeared to be sandwiched between the wishes of two activists clashing with one another. Demands from assertive activists like Carl Icahn typically garner Wall Street’s attention. Throughout the process of writing this Note, weekly New York Times Dealbook email alerts detailed his latest move.³ Similarly, several years ago, Bill Ackman of Pershing Square made headlines after attempting, and ultimately failing, to replace the chief executive officer (CEO) of JCPenney and overhaul its business to transform it into a more upscale department store.⁴ His recent activist effort also included a five-year

1. Lindsay Fortado, *Starboard Value Launches Proxy Fight at Newell Brands*, FIN. TIMES (Apr. 4, 2018), <https://www.ft.com/content/9824dc92-3848-11e8-8eee-e06bde01c544> [<https://perma.cc/T5NX-VA7N>].

2. *Id.*

3. The period covered is primarily February and March of 2018.

4. Matteo Tonello, *The Activism of Carl Icahn and Bill Ackman*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (May 29, 2014), <https://corpgov.law.harvard.edu/2014/05/29/the-activism-of-carl-icahn-and-bill-ackman/> [<https://perma.cc/UHZ9-QC6Z>].

campaign against Herbalife; the hedge fund mogul is currently suffering substantial losses after his endeavors fell apart.⁵

These reports by the financial press and the attention they receive are problem-inducing. They distract the directors who must spend significant time, energy, and money issuing public statements and other forms of responses to the press.⁶ This can become a wasteful allocation of funds by the corporation, which, in turn, directly impacts the gains of its shareholders. Because many of these activists like Carl Icahn and Bill Ackman are highly subject to public scrutiny, the noise created by the media can also distract shareholders by clouding their judgment on what is truly in the best interests of the corporation. Furthermore, there is no guarantee that the publicity will have a positive effect. If the media attention hurts the corporation's image, its stock prices could drop, causing direct harm to the shareholders. Public agitation is just one way in which minority shareholders (with less than fifty percent ownership interest), who actively pursue an agenda against the board of directors, can hurt the interests of the remaining body of shareholders. Their activism could be controlled using a particular principle of corporate law: by imposing a duty of loyalty on them.

Part I of this Note discusses the traditional corporate law principle of “one share, one vote,” as well as the reasons and costs underlying this principle. This section will also discuss how the concept has evolved as hedge funds have taken a more aggressive role in shaping corporate governance. Part II outlines the dynamic dialogue in which a number of legal scholars—namely, Lucian Bebchuk, Iman Anabtawi, and Lynn Stout—have evaluated the advantages and disadvantages of this activism. Part III argues that hedge fund activist shareholders should be bound by a manifest duty of loyalty to the corporation and other shareholders when they push for a company to break up, take extreme measures against

5. The New York Times Dealbook Brief for March 1, 2018 had a section titled “End of an era for Bill Ackman.” For more information about his campaign, see Matthew Goldstein, *Ackman Ends His 5-Year Fight with Herbalife*, N.Y. TIMES (Feb. 28, 2018), <https://www.nytimes.com/2018/02/28/business/dealbook/ackman-herbalife-pershing-square.html> [<https://perma.cc/AG7F-HGJB>].

6. See James McRitchie, *Directors Prepare for Shareholder Activism*, CORP. GOVERNANCE (Jan. 28, 2016), <https://www.corpgov.net/2016/01/directors-prepare-for-shareholder-activism/> [<https://perma.cc/Q4HM-EWDC>] (“It is argued that companies are frequently spending money on distractions, while core functions and operations suffer. Activists talk to former employees, customers, competitors. Directors prepare for shareholder activism by doing much the same.”).

company valuation, or burden the board of directors to act quickly in implementing expensive defense measures against activist campaigns. Courts should also hold the duty of loyalty against these shareholders, much like how traditional corporate law binds directors and controlling shareholders. This Note suggests several situations where a fact-driven analysis applying the duty of loyalty could help curtail this form of shareholder activism.

I. TRADITIONAL PRINCIPLE OF “ONE SHARE, ONE VOTE” AND ITS EVOLUTION

One of the most fundamental building blocks of traditional corporate law is the idea of “shareholder franchise.”⁷ The shareholder primacy theory is a widely established doctrine in this area of law, taking the view that the foremost goal of a corporation is to promote shareholder interests, namely to maximize its profits so that the surplus distributed to the shareholders also increases.⁸ This theory prioritizes shareholder wealth, leading to a maximized surplus, and greater social utility.⁹

This shareholder primacy theory sets up the traditional separation of ownership and management in corporate law. The structure involves three sets of players, listed in order of descending control: the shareholders, the board of directors, and the officers.¹⁰ Shareholders express their interest in the corporation and its governance by purchasing share(s) and gain votes in accordance with the number of shares bought.¹¹ The shareholders have the power to elect the board of directors who make efficient business decisions.¹² As this Note will argue, however, shareholder activism demonstrated by aggressive hedge fund investors disturbs this process.

Tied to the shareholder primacy theory is the idea of “one share, one vote,” that “each unit shall have the same power of control over the organization.”¹³ Thus, a shareholder who has just a single share in a

7. Grant M. Hayden & Matthew T. Bodie, *One Share, One Vote and the False Promise of Shareholder Homogeneity*, 30 CARDOZO L. REV. 445, 447-48 (2008).

8. *Id.* at 473 (citing FRANK H. EASTERBROOK & DANIEL R. FISCHER, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* 35-39 (1991)).

9. *Id.* at 465.

10. *Id.*

11. *Id.* at 463.

12. *Id.* at 470 (citing Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547, 548 (2002)).

13. *Id.* at 446-47.

company still has the same procedural right as another shareholder who may possess fifty shares in the same company. An analogous concept can be found in the American political system with the operating principle that one citizen gets one vote in their exercise of the democratic process.¹⁴ Similarly, each share is equivalent to each vote that the shareholder can exercise, so that the shareholder's voting power is directly related to their financial interest in the company.¹⁵ This means that, although each shareholder has the same procedural right as one another, their substantive rights may vary; as long as a share is owned, a shareholder will be able to vote (procedural right), but the weight of that vote would be less than another shareholder owning more shares. Thus, the number of shares owned effectively determines one's substantive rights.¹⁶

The presumption behind this theory, in order for it to operate perfectly, is that the shareholders have "similar if not identical"¹⁷ interests. Since the voting scheme is structured so that each share has the same voting weight, disproportionate voting power creates distorted interests.¹⁸ Unlike the democratic system, shareholders buy their ownership votes and thus have distorted substantive rights and economic interests, especially between minority and majority shareholders.¹⁹ As Professors Grant Hayden and Matthew Bodie write in their Article, each shareholder's "interests and preferences in a corporate election" demonstrate the number of shares that a shareholder owns and reflect the percentage of the residual (i.e., how much of the whole that particular shareholder owns).²⁰ Activist minority shareholders with a small stake, however, are disturbing this process since they push the company to take actions that benefit themselves for the sake of majority shareholder interests, without having to bear agency costs.

Based on this scheme, there are some benefits to the "one share, one vote" ideal. Theoretically, all shareholders have an equal incentive to reduce agency costs, leading to a more efficient corporate governance process.²¹ Furthermore, if the shareholders pursue similar interests, they

14. *Id.*

15. *Id.* at 448.

16. *Id.*

17. *Id.* at 499 (citing EASTERBROOK & FISCHER, *supra* note 8, at 70).

18. *Id.* at 475.

19. *Id.* at 477.

20. *Id.* at 499.

21. *Id.* (citing Shaun Martin & Frank Partnoy, *Encumbered Shares*, 2005 U. ILL. L. REV. 775, 776 (2005)).

will ultimately share the same goals for the company and can reduce the likelihood of having a “war zone of competing preferences.”²² These benefits, of course, run on the presumption that all shareholders are identical—the lack of competing preferences would foster an efficient decision-making process.

The reality, however, is that all shareholders are not equal—at least, not in terms of their interests. Different competing interests may emerge depending on how much control a shareholder has over the corporation. For example, the difference in the influence a controlling shareholder or a minority shareholder can wield in a company’s decision-making process can be substantial. As Hayden and Bodie note, the major upside of belonging to the majority is that one gets to enjoy the benefit of control while agency costs are lowered.²³ Another problem that the authors point out is that not every shareholder’s voting power and interest in the profits are equivalent.²⁴ A shareholder with greater voting power does not always have as great a stake in the profits, whereas someone with less voting power may have a greater interest in the residual.²⁵

Two additional potential conflicts hinder the “one share, one vote” ideal in practice. First, shareholders might not all agree on what wealth maximization means for a particular company.²⁶ Perspectives on wealth maximization might vary depending on whether the shareholder focuses on the long-term or the short-term.²⁷ With the passage of time, “uncertainties multiply” and shareholder primacy is rendered meaningless.²⁸ Moreover, “one share, one vote” is not the “timeless and natural” voting structure it once was.²⁹ Second, the diversity of

22. *Id.* at 499.

23. *Id.* at 477.

24. *Id.* at 480–81.

25. *Id.*

26. *Id.* at 493.

27. *See id.*

28. *See id.*

29. *Id.* at 463 (citing Colleen A. Dunlavy, *Social Conceptions of the Corporation: Insights from the History of Shareholder Voting Rights*, 63 WASH. & LEE L. REV. 1347, 1356 (2006)). Moreover, “one share, one vote” is not a required structure; some companies offer alternative voting structures. *See* Marco Becht & J. Bradford Delong, *Why Has There Been So Little Block Holding In America?*, in A HISTORY OF CORPORATE GOVERNANCE AROUND THE WORLD: FAMILY BUSINESS GROUPS TO PROFESSIONAL MANAGERS 613, 653–57 (Randall K. Morck ed. 2005) (noting that the number of dual or multi-class share corporations listed on the New York Stock Exchange more than doubled from 1994 to 2001).

shareholders creates a diversity of interests. That is, a shareholder with a diversified portfolio is more interested in their overall investment success rather than in the success of one particular company; in contrast, a shareholder heavily invested in one company is likely to be more vigilant about that particular company's success.³⁰ Furthermore, there may be a difference between the interests of a controlling shareholder and a minority shareholder and conflict may arise; Hayden and Bodie maintain that "[i]t is the power of a 'controlling' interest that drives the law and economics of shareholder voting."³¹ But as the landmark case *Kahn v. Lynch Communications System, Inc.* demonstrates, a minority shareholder can also have control, despite an ownership percentage that is less than fifty percent, based on how much influence it can wield on the board of directors.³²

In most cases, individual shareholders of a publicly-traded company have little motivation to stay involved in corporate matters, since the shares they own are often insignificant.³³ Individually, their shares do not produce sufficient voting power to sway the decision-making process; thus, they take a more passive role because it is unlikely that they will influence corporate policy. As such, the cost of being involved in the corporate affairs outweighs the potential benefit of their shareholder interest.³⁴ As Professors Anabtawi and Stout explain, "[w]hen the largest single [shareholder] interest amounts to but a fraction of one percent—the case in several of the largest American corporations—no stockholder is in the position through his holdings alone to place important pressure upon the management."³⁵ Dispersed ownership was a common phenomenon in public companies and, traditionally, directors and officers have been at the forefront of dictating corporate policy in these firms.³⁶

There have been instances, however, where individual shareholders grouped together to form a controlling interest—large enough to vote out

30. *Id.* at 493.

31. Hayden & Bodie, *supra* note 7, at 474.

32. 638 A.2d 1110 (Del. 1994) (holding that a 43.3-percent shareholder has a controlling or dominating interest and has the power to influence the votes of non-controlling shareholders).

33. Hayden & Bodie, *supra* note 7, at 474–75 (citing DEL. CODE ANN. tit. 8 § 228).

34. Iman Anabtawi & Lynn Stout, *Fiduciary Duties for Activist Shareholders*, 60 STAN. L. REV. 1255, 1257–58 (2008).

35. *Id.* at 1274–75 (quoting ADOLPH A. BERLE & GARDINER C. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* 84 (1933)).

36. *Id.* at 1258.

the incumbent board.³⁷ After some time and recent developments in the realm of finance, the rise of “institutional investors” is changing the shareholder landscape.³⁸ Anabtawi and Stout explain that “[i]nstitutional investors—typically pension funds and mutual funds—aggregate the savings of millions of individuals into enormous investment portfolios that buy stock in public companies. As a result, institutional investors can take far larger positions in particular companies than most individual investors ever could.”³⁹ Such institutional investors include high-profile business entities like Blackstone.

Most institutional investors want to maintain a diversified investment portfolio.⁴⁰ They owe a fiduciary duty to their clients to make money for them.⁴¹ The activist hedge funds, however, diverge from this path because their aim is not to diversify their portfolios.⁴² Rather, their strategy is “to take large positions in as few as two or three companies and then demand that those companies pay special dividends, launch massive stock buyback programs, sell assets, or even put themselves on the auction block in order to add ‘shareholder value.’”⁴³ Because the companies they invest in are not as diversified as conventional mutual funds, such companies are strategic, and this investment style can lead to conflict of interest concerns.⁴⁴ For instance, a conflict of interest can occur when they want to seat someone on the board who is associated with the fund or some other company of which the hedge fund is a shareholder.⁴⁵

Depending on the situation, they may also employ the “wolf pack” strategy to pressure management into following the course of action proposed by the activists.⁴⁶ Investment strategies utilized by hedge funds

37. Hayden & Bodie, *supra* note 7, at 474–75.

38. *Id.* at 487.

39. Anabtawi & Stout, *supra* note 34, at 1275.

40. *Id.* at 1278.

41. See Craig C. Martin & Matthew H. Metcalf, *The Fiduciary Duties of Institutional Investors in Securities Litigation*, 56 BUS. LAW. 1381, 1404 (2001) (“Institutional investors . . . have five affirmative fiduciary duties[.]. First, the fiduciary must act solely in the interest of the plan participants and beneficiaries and for the exclusive purpose of benefitting the plan’s participants.”).

42. Anabtawi & Stout, *supra* note 34, at 1279.

43. *Id.*

44. See generally Simon Wong, *Barriers to Effective Investor Engagement*, FINANCIAL TIMES (Jan. 15, 2012, 3:54 AM), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1989455 [<https://perma.cc/D84J-4B63>].

45. *Id.*

46. Anabtawi & Stout, *supra* note 34, at 1279.

generally produce short-term gains and make it unlikely that an activist shareholder will pursue an agenda purely for the interest of the overall corporation with an eye toward long-term benefits.⁴⁷ This power play creates “a new genre of public company shareholder that is aggressive, wealthy, and eager to play a role in setting corporate policy.”⁴⁸ The tendency of these activists to be aggressive in their proposals makes one skeptical that they are doing it for reasons other than self-interest (i.e., to generate profits for their hedge funds).⁴⁹ They often push for substantial changes in a very short period of time.⁵⁰

Professors Anabtawi and Stout demonstrate this dynamic by illustrating a scenario where a hedge fund invests in a large block of shares in a troubled biotech company.⁵¹ The hedge fund investor, attempting to raise the stock price, presses management to sell the company, except that there is no buyer willing to pay the premium until a large health sciences corporation announces that it wants to acquire the firm.⁵² Then, “the hedge fund buys [ten percent] of the common stock of the possible acquirer,” becoming a shareholder in the potential acquirer and obtaining the right to vote.⁵³ The hedge fund also hedges its shares in the acquirer and informs the board of the acquirer that if any of the directors veto the purchase of the biotech company, the hedge fund will use its shareholder power to start a proxy contest to remove the director or directors that vetoed the transaction.⁵⁴ There is an eerie feeling of self-dealing that pervades the scenario described. Even though the biotech company faced difficulties, the activist investor did not pursue the actions

47. See *Long-Termism Versus Short-Termism: Time for the Pendulum to Shift?*, INSTITUTIONAL INV. (June 13, 2016), <https://www.institutionalinvestor.com/article/b14z9m xp09dnn5/long-termism-versus-short-termism-time-for-the-pendulum-to-shift> [<https://perma.cc/6SVK-YKWH>] (“Lastly, the rise of and prominent role played by “activist” investors is seen as further evidence of secular trends encouraging short-term behaviors at the expense of long-term thinking.”).

48. Anabtawi & Stout, *supra* note 34, at 1279.

49. See *Long-Termism Versus Short-Termism*, *supra* note 47 (“Activist funds buy shares, get board seats, and then employ their strategy to unlock value from the company. More often than not, unlocking value entails some form of financial engineering that drives up the share price and ultimately allows the activist fund to profit from its initial investment.”).

50. Anabtawi & Stout, *supra* note 34, at 1291.

51. *Id.* at 1258–59.

52. *Id.*

53. *Id.* at 1259.

54. *Id.* at 1259.

above to improve the well-being of the corporation, but rather for the hedge fund to make profits and, thus, hedge its shares. It is possible that the acquisition resulted in the purchase of shares at a premium, but if there was a possibility of having a larger premium or a higher price in the long run, then the rest of the shareholders lost out on that opportunity and did not have the chance to make an informed decision. This situation, creating an eerie feeling of self-dealing, is a problem and, thus, the duty of loyalty should apply to a hedge fund investor.

II. SUPPORTERS AND OPPONENTS OF SHAREHOLDER ACTIVISM

There are various schools of thought among the legal academia community as to whether the rise of hedge fund activism in the shareholder context is a problem and whether any measures should be taken to curb it. This section attempts to delineate the major arguments of leading scholars.

A. PROPONENTS

Professor Lucian Bebchuk asserts that the aggressive approach taken by hedge fund shareholders is actually beneficial to a corporation, and that the board of directors should not be granted with greater insulation.⁵⁵ He argues that shareholder power should increase generally, not only regarding the power to replace directors.⁵⁶ Bebchuk makes a distinction between two categories of corporate decisions: 1) “rules-of-the-game” decisions, which are those similar to classic shareholder powers, including the power to amend the charter and the power to change the company’s state of incorporation;⁵⁷ and 2) “game-ending” decisions, such as the decisions to merge, sell assets, or dissolve the company.⁵⁸ This Note focuses on the latter type of decision-making, as this is what hedge fund activists tend to push the board to do.

In his discussion of rule-of-the-game decisions, Bebchuk primarily argues that the law should be changed to permit provisions in corporate charters that grant intervention power to shareholders.⁵⁹ The Delaware

55. Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833, 836 (2005).

56. *Id.*

57. *Id.* at 836–37.

58. *Id.* at 837.

59. *Id.* at 841.

General Corporation Law provides the general rule that any director or the entire board may be removed by a majority vote of shareholders.⁶⁰ According to Bebchuk, the current shareholder franchise includes only the power to veto, a “negative power,” as opposed to “the power to initiate rule changes.”⁶¹ Under his proposal, shareholders would have the authority to intervene in specific business decisions only if the charter were drafted to specifically include this power.⁶² In his view, shareholders should have the power to initiate, in addition to the power to veto, because the power to veto does not maximize shareholder value.⁶³ The power to initiate would allow shareholders to intervene if they deem that the board is not seizing lucrative opportunities, such as selling the company to a potential acquirer.⁶⁴ Bebchuk explains his reasoning for such a proposed regime: “In publicly traded companies with dispersed ownership, the interests of management do not fully overlap with those of shareholders, and management thus cannot be automatically counted on to take actions that would serve shareholder interests.”⁶⁵ As such, one primary reason behind the push for greater shareholder independence and power is a concern for agency costs, specifically the costs of having management make decisions on behalf of the shareholders.

One wonders, however, if these agency costs are truly reduced in the context of shareholder activism; how does one guarantee that a shareholder activist speaks for most shareholders? Management, on the other hand, might be more likely to speak for most shareholders; there is the basic presumption that a manager will prioritize the interests of the corporation as the principal consideration in their decision-making process (when not acting in their own self-interest), “with a view towards maximizing corporate profit and shareholder gain.”⁶⁶ Additionally, most shareholders are not involved in the day-to-day operations of the company; even the activist shareholder, who may be business-savvy, is

60. DEL. CODE ANN. tit. 8, § 141(k) (2018).

61. Bebchuk, *supra* note 55, at 862.

62. *Id.* at 865.

63. *Id.* at 862.

64. *Id.* at 840.

65. *Id.* at 850.

66. Melvin A. Eisenberg, *The Duty of Good Faith in Corporate Law*, 31 DEL. J. CORP. L. 1, 8 (2006).

not heavily involved in the fine details of the operations.⁶⁷ Under the current corporate scheme, corporate boards of directors are elected by shareholders, thus owing a fiduciary duty to them.⁶⁸ On the flip side, if directors are not upholding shareholder interests or the shareholders are dissatisfied, there is always the possibility of being voted out.⁶⁹ For this structure to work effectively, the assumption is that the board of directors would be objective in their decision-making and endeavor to generate shareholder value, i.e., to maximize the profit of the company.⁷⁰ Because many directors are now compensated in the form of stock options, they are shareholders as well, which, in practice, should incentivize them to promote the overall shareholder interest—not just their own.⁷¹

Bebchuk also addresses counterarguments that those who support management insulation are likely to make—mainly, the critique of short-term horizons.⁷² He writes:

Supporters of management insulation might also worry that shareholder-initiated proposals might be motivated by considerations other than the enhancement of long-term share value. Some shareholders, it might be argued, have special interests or a social agenda, and might consequently favor changes that serve their own agenda but not long-term shareholder value.⁷³

Bebchuk rebuts this view favoring management insulation by pointing out that changes need to be made by the majority of shareholders and that “[a] proposal that seeks to advance special interests or an activist agenda at the expense of shareholder value would have no meaningful chance of obtaining majority support.”⁷⁴ In addressing the special category of institutional investors that follow high-turnover strategies,

67. *Principles of Corporate Governance*, BUS. ROUNDTABLE 5 (2012) http://www.ecgi.org/codes/documents/brt_cgov_principles_27mar2012_en.pdf [<https://perma.cc/K4KQ-99UB>].

68. Bebchuk, *supra* note 55, at 851.

69. August Jackson, *Does a Corporation Owe Fiduciary Duty to Shareholders?*, HOUS. CHRON., <https://smallbusiness.chron.com/corporation-owe-fiduciary-duty-shareholders-70243.html> [<https://perma.cc/NHT8-9TVW>] (last visited Dec. 30, 2018).

70. *Principles of Corporate Governance*, *supra* note 67, at 30.

71. *Id.* at 25.

72. Bebchuk, *supra* note 55, at 883.

73. *Id.* at 883.

74. *Id.* at 883–84.

Bebchuk argues that their preferences of charter provisions might align with those of long-term shareholders and would not lead to a conflict.⁷⁵

Based on this expansion of the shareholders' ability to make "rules-of-the-game" decisions, Bebchuk argues that shareholders should also have the right to make "game-ending" decisions—meaning, the ability to intervene in specific business decisions—to the extent they are granted by the charter under the proposed regime.⁷⁶ This Note questions whether there would be a need for a board of directors, since the dichotomy between management and ownership is often blurred.

Nonetheless, Bebchuk notes several advantages under the proposed scheme of increasing shareholder authority in the decision-making process. First, the intervention power would allow shareholders to react more actively to tender offers, namely, to make a counter-offer.⁷⁷ Second, shareholders would be in a better position to pursue their interests in the case of management's possible informational advantage.⁷⁸ The board of directors and corporate officers may have a leg up on access to nonpublic information about the company, such as the company's investments and projections in growth and value, that might be essential in business decisions such as mergers and acquisitions.⁷⁹ Bebchuk argues that it would be a balancing test for shareholders: (1) in recognizing this informational advantage; and (2) in that the management, equipped with such information, may oppose certain transactions for self-serving reasons.⁸⁰ For example, management will inherently oppose decisions that terminate the company—even though it might be the best alternative for shareholders—because management will be unemployed or, at the very least, substantially lose their control and the benefits that may come with that control.⁸¹ Bebchuk's biggest overall concern seems to be that even if management has greater insulation from shareholder action, there is no guarantee that they will always act in the best interests of the shareholders.⁸²

75. *Id.* at 884.

76. *Id.* at 892, 895.

77. *Id.* at 897.

78. *Id.* at 893-94.

79. *Id.* at 893.

80. *Id.* at 894.

81. *Id.* at 898.

82. *Id.* at 910.

B. CRITICS

Leading scholars that oppose greater shareholder intervention, for which Bebchuk advocates, include Iman Anabtawi and Lynn Stout.⁸³ They first address the concern of short investment horizons that many institutional investors are prone to seek.⁸⁴ Due to the hyperactive nature of hedge funds and their potential to turn over their portfolios several times in a fiscal year, activist shareholders often pressure management to “pursue policies that raise share price in the short term but fail to help the company, and even harm it, in the long run.”⁸⁵ There are three strategies commonly employed by activist hedge funds to increase the stock price without enhancing business operations: 1) sell the company, 2) pay special dividend or stock repurchase, or 3) produce short-term earnings (but jeopardize long-term results).⁸⁶

Professor Stephen Bainbridge also disagrees with Bebchuk’s approach to shareholder activism.⁸⁷ Bainbridge first argues that if the corporate governance structure were as problematic as some scholars argue, the scheme would not have survived this long without undergoing a major revamping, and the U.S. economy has not suffered as a result of the alleged flaws in governance systems.⁸⁸

Bainbridge’s main argument lies in the recognition that “limited shareholder voting rights is corporate law’s majoritarian default.”⁸⁹ To begin, Bainbridge points out that every organization invokes a method of collecting individual preferences into a group decision.⁹⁰ This implies that some agency costs are inevitable because the board of directors, rather than individual shareholders, makes business decisions. Bainbridge writes further:

That we choose not to eliminate agency costs by eliminating the board’s power of fiat suggests that vesting discretion in directors’ hands has substantial values. A complete theory of corporate governance thus requires balancing the virtues of discretionary fiat

83. See generally Anabtawi & Stout, *supra* note 34.

84. *Id.* at 1290-91.

85. *Id.*

86. *Id.* at 1291-92.

87. Stephen M. Bainbridge, *Response to Increasing Shareholder Power: Director Primacy and Shareholder Disempowerment*, 119 HARV. L. REV. 1735, 1735 (2006).

88. *Id.* at 1739.

89. *Id.* at 1744.

90. *Id.* at 1745.

against the need to ensure that such power is used to further the interests of shareholders.⁹¹

This Note agrees with Bainbridge's point and takes the position that Bebchuk's proposal tips the balance between the rights of shareholders and the board of directors to the side of shareholders. For instance, Bainbridge mentions a key doctrine of corporate law—the business judgment rule—and agrees with Bebchuk that it is an insulating instrument for the board of directors.⁹² Unlike Bebchuk, however, Bainbridge does not view this negatively, because “corporate law must strive to balance authority and accountability”⁹³—some freedom must be given to the board of directors to efficiently run a company.

Following this line of thought, Bainbridge explains why he opposes expansive shareholder voting rights.⁹⁴ He writes that “[a]ctive investor involvement in corporate decision-making seems likely to disrupt the very mechanism that makes the widely-held public corporation practicable: namely, the centralization of essentially nonreviewable decision-making authority in the board of directors.”⁹⁵

This power play between the management and the shareholders is further complicated by a relatively new phenomenon called empty voting. Henry Hu and Bernard Black, leading scholars on this topic, begin with the presumption that the right to vote is the foundation of shareholder power.⁹⁶ Hu and Black identify a trend where hedge funds and other businesses decouple ownership and voting power by having more votes than shares; they call this new trend “empty voting” because “the votes have been emptied of an accompanying economic stake.”⁹⁷ Thus, voting rights are greater than the net number of shares owned by a particular shareholder.⁹⁸

One way empty voting occurs is through the share lending market, in which an investor (often a hedge fund) allows another entity to borrow

91. *Id.* at 1747.

92. *Id.*

93. *Id.* at 1748.

94. *Id.* at 1749.

95. *Id.*

96. Henry T. C. Hu & Bernard Black, *The New Vote Buying: Empty Voting and Hidden (Morphable) Ownership*, 79 S. CAL. L. REV. 811, 814 (2006).

97. *Id.* at 815.

98. *Id.*

the investor's shares in a corporation.⁹⁹ There is a lack of disclosure requirements and, thus, it is difficult to monitor who owns how many shares.¹⁰⁰ Hu and Black note that "it is no accident" that hedge funds are often involved in this market.¹⁰¹ For example, a hedge fund might own seven million shares in a pharmaceutical company, Company T.¹⁰² Another pharmaceutical company, Company M, agreed to buy Company T in a stock merger, but Company M's stock price drops when the merger is announced.¹⁰³ The hedge fund then buys 9.9-percent shares of Company M in an effort to ease obtaining shareholder approval for the merger.¹⁰⁴ The hedge fund, however, hedges its shares, meaning that while its voting ownership was 9.9-percent, its economic ownership is zero.¹⁰⁵ Ultimately, the situation was such that the more Company M paid for the target, the more the hedge fund profited.¹⁰⁶

As Hayden and Bodie point out, vote selling disrupts the shareholder franchise and is another form of disproportionate voting: the right to control (over the board) is detached from the right to (and the economic interest in) the residual.¹⁰⁷ The authors further provide a possible motivation for a shareholder to lend their voting right to someone else: "money coupled with ignorance."¹⁰⁸ Financial institutions figured out a way to make profit by leasing their shares for a fee while still having the nominal status of shareholder and, thus, the right to company profits.¹⁰⁹ These financial institutions have nothing to lose by hedging their shares; in fact, there is more to gain, as there is an opportunity to make money through share lending and receive a residual from their status as shareholders.¹¹⁰ This enterprise seems completely unfair to other shareholders, especially if they have genuine and legitimate interests in

99. *Id.* at 816.

100. *Id.* at 815-16.

101. *Id.* at 819.

102. *Id.* at 816.

103. *Id.*

104. *Id.*

105. *Id.*

106. *Id.*

107. Hayden & Bodie, *supra* note 7, at 475-76 (citing EASTERBROOK & FISCHER, *supra* note 8, at 74 ("Separation of shares from votes introduces a disproportion between expenditure and reward.")).

108. *Id.* at 485.

109. *Id.*

110. *Id.*

the corporation and the wealth the company is expected to generate and distribute.

This Note concerns practices like empty voting in which the shareholder franchise is significantly distorted. The shareholder-empty voter is exercising the vote even though their interest is not aligned with that of a conventional shareholder—that is, to maximize corporate profits so the shareholder would also get a larger piece of the pie.¹¹¹ The different economic interest and reduced stake in the success of the corporation might increase the tendency of the empty voter to vote without prioritizing the interests of the corporation.¹¹² Thus, the empty voter could theoretically participate in decisions that would harm the corporation and, as a result, harm the interests of other shareholders. With regard to the “one person, one vote” analogy, just as a citizen has the right to vote and ideally make an informed decision about an issue that impacts the country or state, a shareholder has a right to vote because he or she owns shares and ideally cares enough about the corporation and its well-being.¹¹³ With empty voting, however, it seems that the ownership interest goes away, at least for the period of time that the shares are “borrowed.”¹¹⁴ This Note is concerned with this phenomenon, predominantly practiced by hedge funds, and suggests that this could be a situation that triggers a duty to other shareholders. Since the interests of shareholders could be directly in conflict with one another, the “empty voter,” by partaking in the shareholder enterprise, should not act in ways that only benefit them by using the shares to make profits. Empty voting would pose a threat when activists contemporaneously shake things up and hedge their shares, thus, exerting an influence without sharing the stakes. To other shareholders who actually have economic interests at stake, this empty voting exercise would be unfair.

III. FIDUCIARY DUTY OF LOYALTY

This section will delve into the duty of loyalty. The Note will first explain the traditional version of the doctrine, as it stands in corporate law today. Then, the Note will argue that this duty should be broadened to address the problems discussed above.

111. *Id.* at 484, 495.

112. *Id.* at 477.

113. *See* Hayden & Bodie, *supra* note 7, at 452, 470.

114. Hu & Black, *supra* note 96, at 814.

A. TRADITIONAL PRINCIPLE

The traditional corporate doctrine of the duty of loyalty lies in the duty owed by a corporation's board of directors to its shareholders. This duty requires management to prioritize the interests of the company and the shareholders above management's interests.¹¹⁵ Several scenarios can trigger this duty, such as transactions that result from unfair self-dealings.¹¹⁶ If a shareholder sues the board of directors for a breach of the duty of loyalty and a disinterested board of directors approved the associated transaction, courts apply a "business judgment rule" standard of review.¹¹⁷ During litigation, the plaintiff must first demonstrate that the alleged transaction was tainted by self-interest.¹¹⁸ Then, the board of directors has the burden to show that the transaction was intrinsically fair.¹¹⁹ There are two components or possibilities of demonstrating fairness: fair price and fair dealing.¹²⁰

There have been cases finding that controlling shareholders owed a duty of loyalty as well.¹²¹ These scenarios usually involved majority shareholders because courts often deem a shareholder to be controlling only when they "exert 'actual control' over the corporation."¹²² Here, it seems that actual control is reflected by having more than fifty percent ownership of the shares; in other words, the actual number of shares that leads to voting power influential enough to sway the board triggers the duty.¹²³ As Anabtawi and Stout note, courts refuse to immediately apply the duty of loyalty to shareholders owning less than a majority share, and

115. Anabtawi & Stout, *supra* note 34, at 1263.

116. *Id.* at 1264.

117. *See* *Cooke v. Oolie*, No. CIV. A. 11134, 2000 WL 710199, at *11 (Del. Ch. May 24, 2000) (holding that the court analysis begins with a presumption of business judgment rule).

118. *Weinberger v. UOP, Inc.*, 457 A.2d 701, 703 (Del. 1983) ("it is first the burden of the plaintiff attacking the merger to demonstrate some basis for invoking the fairness obligation").

119. *Id.* at 710 ("When directors of a Delaware corporation are on both sides of a transaction, they are required to demonstrate their utmost good faith and the most scrupulous inherent fairness of the bargain.").

120. *Id.* at 711.

121. *See, e.g.*, *Carr v. New Enter. Assocs.*, 2018 WL 1472336, at *1, 22 (Del. Ch. Mar. 26, 2018) ("This right must yield, however, when a corporate decision implicates a controller's duty of loyalty.").

122. Anabtawi & Stout, *supra* note 34, at 1269 (citations omitted).

123. *Id.*

instead look to the specific circumstances of the case to decide whether the defendant had enough shares to replace the board.¹²⁴ Current case law does not seem to comment upon shareholders that hold a significantly smaller number of shares, but may still have enough influence over the board.

One common scenario where the controlling shareholders exercise their power, and possibly breach their fiduciary duty, is the context of “freeze-out” mergers. A “freeze-out” merger occurs when minority shareholders are forced to sell their stocks at substantially low prices because the acquirer is another entity owned solely by the controlling shareholder.¹²⁵ *Kahn v. Lynch Communications Systems, Inc.*¹²⁶ illustrates this scenario. The court held that Alcatel controlled Lynch, even though Alcatel only owned forty-three percent of Lynch’s shares, because Alcatel dominated Lynch’s corporate affairs.¹²⁷ The court further found that the parent-subsidary scheme was an example of a situation in which the controlling shareholder was on both sides of the transaction.¹²⁸ The resulting self-dealing was unfair, leading courts to apply a heightened standard of “intrinsic fairness” to examine situations like freeze-out mergers.¹²⁹ In the recent case *In re Tesla Motors, Inc. Stockholder Litigation*, however, the Delaware Chancery Court found that Elon Musk, the largest shareholder of the company (owning 22.1-percent of common stock),¹³⁰ was a controlling shareholder.¹³¹ The court considered circumstantial evidence, including Musk’s past behavior, his current status at the company, and public statements the company made about Musk regarding his influence on Tesla’s business decisions.¹³² Despite Musk’s minority ownership, these factors are relevant to the analysis of activist shareholders.¹³³ If one were to define control based on how much influence a shareholder can exert on the company, then it would be more likely that an activist shareholder be deemed a controlling shareholder.

124. *Id.*

125. *Id.* at 1266.

126. 638 A.2d 1110 (Del. 1994).

127. *Id.* at 1114.

128. *Id.* at 1115.

129. Anabtawi & Stout, *supra* note 34, at 1271-72.

130. *In re Tesla Motors, Inc. Stockholder Litig.*, 2018 WL 1560293, at *2 (Del. Ch. Mar. 28, 2018).

131. *Id.* at *19.

132. *Id.* at *2, *16.

133. *Id.*

This would align with the traditional corporate law doctrine of applying a duty of loyalty to a controlling shareholder.

The duty of loyalty is also found in the context of closely held corporations. Courts often hold that shareholders in a closely held corporation owe fiduciary duties to one another.¹³⁴ The classic case illustrating this rule is *Donahue v. Rodd Electrottype Company*.¹³⁵ In this case, the court established three characteristics of a closely held corporation.¹³⁶ First, there are only a few number of shareholders.¹³⁷ Second, the shareholders participate heavily in management; in other words, there is no clear line between ownership and management.¹³⁸ Third, there is no ready public market for a discontented shareholder to sell their shares.¹³⁹ The disadvantageous position of the minority shareholder makes it easy for the majority to threaten the minority's interests.¹⁴⁰ Anabtawi and Stout draw parallels between the majority domineering the minority in a closely held corporation and the activist shareholder in that both "majority" groups, despite not possessing over fifty percent of the outstanding shares, exert control over the minority:

When a single shareholder's actions determine the outcome—when an activist successfully extracts greenmail, or a hedge fund with a five percent stake casts the deciding vote in a hotly-contested merger—that minority activist, like the minority shareholder in *Smith v. Atlantic Properties*,¹⁴¹ has exercised "ad hoc" control and triggered latent loyalty duties.¹⁴²

B. DUTY OF LOYALTY REVAMPED – ANABTAWI AND STOUT VERSION

With the traditional duty of loyalty underpinning the types of situations outlined above, Anabtawi and Stout propose that the law of fiduciary duty should apply to self-serving shareholders and their

134. *Donahue v. Rodd Electrottype Co. of New England, Inc.*, 328 N.E.2d 505, 517 (Mass. 1975).

135. *See generally id.*

136. *Id.* at 511.

137. *Id.*

138. *Id.*

139. *Id.*

140. *Id.*

141. 422 N.E.2d 798 (Mass. App. Ct. 1981).

142. Anabtawi & Stout, *supra* note 34, at 1298.

opportunistic behaviors.¹⁴³ They identify the “underlying disease” as shareholder optimism, and suggest that all shareholders owe latent duties to the corporation and other shareholders.¹⁴⁴ According to these scholars, there are two advantages of using this strategy.¹⁴⁵ First, the traditional fiduciary duty of loyalty principle will be more aligned with the changing landscape of shareholder activism, offering the possibility of a more flexible resolution.¹⁴⁶ Second, their reinterpretation of shareholder fiduciary duty will not conflict with the emerging school of thought that shareholder democracy is an important tool to curb managerial misbehavior.¹⁴⁷

Anabtawi and Stout propose that fiduciary duties should apply when certain shareholders have the power to direct a particular corporate decision to their liking.¹⁴⁸ By broadening the definition of control, they argue that this duty applies, not only to controlling shareholders, but also to minority shareholders who can sway a single transaction in a way in which they become the but-for cause.¹⁴⁹ They also expand upon the scope of duty of loyalty scenarios to, not only freeze-out mergers and closely held corporations, but also to situations involving self-dealing, in which the breaching shareholder excludes other shareholders from enjoying the benefit they reap from said breach.¹⁵⁰ Anabtawi and Stout frame the analysis in the following way:

[A] broad-brush approach that mirrors the flexible approach typically taken in duty of loyalty cases involving corporate officers and directors. Rather than trying to identify isolated instances which shareholder conflicts arise, our approach instead asks the larger question typically asked in director and officer fiduciary duty cases: Does the shareholder have any material economic interest, in any form, that is different from other shareholders’ interests in the matter?¹⁵¹

143. *Id.* at 1260.

144. *Id.* at 1294-95.

145. *Id.* at 1260.

146. *Id.*

147. *Id.*

148. *Id.* at 1295.

149. *Id.*

150. *Id.* at 1295-96.

151. *Id.* at 1299.

Veering from this framework, this Note argues that, instead, the approach should apply in specific instances where the activist alarms a company when they propose that a board makes a corporate decision that can ultimately change the nature of the business, thus harming the shareholder enterprise. As argued by Anabtawi and Stout, the primary factor in determining that duty of loyalty should apply is whether the shareholder exerts enough pressure to sway the board of directors, not whether a shareholder is able to vote a majority of the company's outstanding shares.¹⁵²

When analyzing a shareholder's duty of loyalty, there is a close focus on the motive underlying a shareholder's action.¹⁵³ Much of the case law deals with a conflict of interest that "clearly and affirmatively harms the corporation or other shareholders."¹⁵⁴ With the rise of hedge fund activists, however, the harm is not always immediate or apparent.¹⁵⁵ Thus, Anabtawi and Stout suggest a reinterpretation of the loyalty principle to include situations when a shareholder promotes a certain transaction that yields a personal benefit to that shareholder and that shareholder only.¹⁵⁶

C. ADDITIONAL NARROWING OF THIS DUTY

At the crux of this quagmire of shareholder activism is the question of when hedge fund activists should be bound to this duty of loyalty. This Note, based on the author's observations from current events, comes up with three particular, though not exclusive, instances when the duty should apply: (1) when the shareholder activist proposes that a company break up, (2) when extreme measures are taken to weaken company valuation, and (3) when the activist unreasonably burdens a board of directors to act quickly and to put on costly defense measures against activist campaigns. For instance, when Carl Icahn tried to break up the insurance company AIG, the board of directors had to vehemently fight against him.¹⁵⁷ Icahn threatened a proxy fight unless the board agreed to break up the company.¹⁵⁸ The hedge fund activist reasoned that AIG was

152. *See id.* at 1297.

153. *Id.* at 1263.

154. *Id.* at 1299.

155. *Id.* at 1301.

156. *Id.* at 1309.

157. Stephen Gandel, *AIG Settles with Activist Carl Icahn*, FORTUNE (Feb. 11, 2016), <http://fortune.com/2016/02/11/aig-carl-icahn-2/> [<https://perma.cc/9KFH-BAGL>].

158. *Id.*

better off not being a “too-big-to-fail” institution because the regulatory costs that come with the label can be reduced.¹⁵⁹ Icahn’s reasoning is not the easiest to follow because the insurance industry is heavily regulated to begin with. Moreover, the only reason a company like AIG can survive through the downs and recover is exactly because it is “too big to fail.”

Nonetheless, the board had to use significant resources—mostly money and time—to prepare proxy materials to persuade other shareholders not to agree with Icahn. The battle lasted for months and ended in a “settlement.”¹⁶⁰ AIG created two board seats: one for another activist who rallied with Icahn and the other for the managing director of Icahn Capital, the enterprise chaired by Carl Icahn.¹⁶¹ Although two seats were given, it was not entirely a bad loss for the company; it was an addition—not a replacement—of seats, and the company did not plan on changing its course of business strategy.¹⁶²

In light of such events, courts should hold the duty of loyalty against these shareholders, similar to the way in which traditional corporate law has bound directors and controlling shareholders. The duty of loyalty is appropriate because activists are often incentivized by the possibility of making quick profits; thus, their short-term gain can potentially harm the company and its remaining body of shareholders. The nature of the hedge fund business is generally characterized by volatile business strategies and a great deal of risk. With the combination of emphasizing short-term gains and volatile investment strategies, hedge fund shareholders are less likely to propose what is best for the company in the long-term. Especially if the demand involves a change in the nature of the business, their plan might differ substantially from the interests of the remaining shareholder body. Couple this tendency with the possibility of empty voting and the problem gets bigger.

If a hedge fund shareholder engages in activism and contemporaneously lends its shares, the activist shareholder is infringing on the rights of other shareholders on potentially multiple levels. First, it is using its voting power when its economic stake does not match the vote ownership; thus, the exercise of such power seems unfair to other shareholders who hold on to their shares and engage in the voting process as part of their shareholder rights. Second, despite the possibility of

159. *Id.*

160. *Id.*

161. *Id.*

162. *Id.*

having zero net ownership of shares, hedge fund activists may push the board to replace some or all of its members or, as often happens, to split up the company. Breaking the company apart seems intuitively contrary to the communal shareholder interest. Why would shareholders buy stock in a company they want to break up in the first place? Last but not least, a hedge fund activist is often not the controlling shareholder. With dispersed ownership as a hallmark of public companies, it is difficult to possess majority ownership of shares. However, just because the number of shares owned and the percentage of residual reflected from the ownership are far removed from the numbers to be a controlling shareholder, that does not mean that the minority shareholder yields no influence. Take, for example, one of the more recent endeavors by Carl Icahn: his vehement opposition to the Xerox-Fuji merger.¹⁶³ Icahn himself did not own more than fifteen percent of shares in Xerox, yet he was able to command considerable attention and buzz in the news and the business world.¹⁶⁴

The soundness of these proposals is another matter, but the fact that these high-profile hedge fund activists can cause a great deal of commotion, both within and outside of the attacked corporation, calls for a needed mechanism that can curb their enthusiasm so as not to harm other shareholders' interests. The high-profile status of activists, notably Carl Icahn, causes public agitation, but also creates a lot of distraction for both managers and shareholders. The board may feel forced to defend itself by responding to public statements, costing a lot of time, energy, and money. This can be problematic in two ways. First, the money used would come from the corporation, which disgruntled shareholders would view as waste (and courts may agree if lawsuits are brought). Second, the time spent defending against such activists takes time away from the directors running the business. Furthermore, media "hype" can cloud the judgment of other shareholders and, if the press attention is negative, stock prices can drop, which would directly harm shareholder interests. Applying the duty of loyalty works as a policy matter as well. A lot of hedge fund activists are disturbing the corporate tranquility, not just in one company, but several at the same time. The aggregate effect of these activities could lead to an unstable landscape in the corporate world.

163. See Shawn Tully, *Paper Jam! How Carl Icahn And a Billionaire Partner Blocked Xerox's Merger with Fujifilm*, FORTUNE (May 21, 2018), <http://fortune.com/2018/05/21/carl-icahn-blocked-xerox-merger-fujifilm/> [<https://perma.cc/N4PM-4PM8>].

164. *Id.*

Courts' interpretations of the duty of loyalty in this light would allow for two possibilities. First, the possibility that the board of directors would sue activists hopefully curtails frivolous activist efforts. This is a less expensive measure because the threat of litigation can shape activist conduct by setting a standard, even before an activist shakes up the company. In the case where the board brings a suit, the court should engage in a balancing test between the activist's proposal and the board's reluctance to follow it. Courts should focus on the motives behind the proposal (e.g., to break up a company) and then attempt to weigh the potential benefits the activist stands to gain against proposed benefits to other shareholders. Second, the duty allows other shareholders to sue for damages to their interests in a company. Like the threat of a board taking action, these private suits may curb activist efforts because litigation is expensive and any press attention might negatively impact the hedge fund's, and the activist's, image and business. Although there is some concern about floodgates opening in shareholder litigation, it is not a significant problem because plaintiffs would have to articulate rather concisely what "bad act" an activist shareholder committed that resulted in some harm—direct or indirect—to the board of directors or other minority shareholders.

CONCLUSION

Shareholder franchise is one of the doctrines at the heart of American corporate law. The "one share, one vote" principle is a quintessential foundation to the operation of shareholder franchise. Nevertheless, with the shareholder ecosystem changing as a result of new trends in the financial world, such as hedge fund activism, the traditional principle needs to adjust accordingly. Keeping in alignment with the traditional concept of the duty of loyalty—often applied to self-dealing boards of directors, controlling shareholders engaging in unfair transactions, and closely held corporations—this Note argues that the duty of loyalty should extend to hedge fund activist shareholders who agitate companies in seeking to replace the board or split up the company. Hedge fund shareholders prevalently hedge their shares and participate in empty voting, which destroys the sanctity of the "one share, one vote" principle. Due to these activities, the volatile nature of the business, and the power of influence by many high-profile hedge funds, including the investors who head them, courts should be open to the application of the duty of

loyalty in a fact-driven analysis when a board of directors or another minority shareholder brings suit.