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Barbarians Inside the Gates: Raiders, Activists, and the Risk of Mistargeting

ABSTRACT. This Article argues that the conventional wisdom about corporate raiders and activist hedge funds—raiders break things and activists fix them—is wrong. Because activists have a higher risk of mistargeting—mistakenly shaking things up at firms that only appear to be underperforming—they are much more likely than raiders to destroy value and, ultimately, social wealth.

As corporate outsiders who challenge the incompetence or disloyalty of incumbent management, raiders and activists play similar roles in reducing "agency costs" at target firms. The difference between them comes down to a simple observation about their business models: raiders buy entire companies, while activists take minority stakes. This means that raiders are less likely to mistarget firms underperforming by only a slight margin, and they are less able to shift the costs of their mistakes onto other shareholders. The differences in incentives between raiders and activists only increase after acquiring their stake. Raiders have unrestricted access to nonpublic information after acquiring ownership of a target company, which allows them to look under the hood to determine whether changing the target's business strategy is truly warranted. Activists, by contrast, have limited information and face structural conflicts of interest that impair their ability to evaluate objectively what's best for the target company.

This insight has profound implications for corporate law and policy. Delaware and federal law alike have focused on keeping raiders outside the gates, but they ignore the real threat: activists that are already inside. This Article proposes reforms to both state and federal law that would equalize the regulation of raiders and activists.

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INTRODUCTION

Activist investor Bill Ackman was supposed to save JCPenney. His handpicked Chief Executive Officer (CEO) Ron Johnson, the architect of Target's turnaround, announced a bold new strategy: "fair and square pricing."[1] No more discounts or clearance, just great prices every day of the year.[2] The results were disastrous and almost immediate. Revenue fell by a quarter, the stock price cratered by 60%, and thousands of employees lost their jobs.[3] "Penney had been run into a ditch when he took it over," Columbia Business School Professor Mark Cohen said of Johnson, "But, rather than getting it back on the road, he's essentially set it on fire."[4] Nor is that the only high-profile failure by an activist investor in recent years. After nagging Sony for years to spin off entire divisions,[5] Dan Loeb of Third Point finally threw up his hands and sold out two years ago.[6] And when Carl Icahn initially reported a position in Netflix in 2012, he pushed for a sale to a third-party strategic buyer, calling the young company a "great acquisition candidate,"[7] only to be later proven wrong about its standalone potential.

1. James Surowiecki, *The Turnaround Trap*, NEW YORKER (Mar. 18, 2013) [hereinafter Surowiecki, *Turnaround*], https://www.newyorker.com/magazine/2013/03/25/the-turnaround-trap [https://perma.cc/FM4N-VXCR]; *see* James Surowiecki, *When Shareholder Activism Goes Too Far*, NEW YORKER (Aug. 14, 2013) [hereinafter Surowiecki, *Too Far*], https://www.newyorker.com/business/currency/when-shareholder-activism-goes-too-far [https://perma.cc/RFD2-BJ3J].

2. *See* Surowiecki, *Turnaround*, *supra* note 1.

3. *Id.*

4. *Id.* JCPenney arguably never recovered from the Johnson disaster, filing for bankruptcy in 2020. *See* Maria Chutchian, *J.C. Penney Rescue Deal Approved in Bankruptcy Court*, REUTERS (Nov. 9, 2020, 11:16 PM), https://www.reuters.com/article/us-jc-penney-bankruptcy/j-c-penney-rescue-deal-approved-in-bankruptcy-court-idUSKBN27Q0FB [https://perma.cc/53U2-J96Y].

5. Alex Weprin, *Dan Loeb Renews Push to Break Up Sony, yet Praises Leadership*, HOLLYWOOD REP. (Jan. 30, 2020, 5:18 PM), https://www.hollywoodreporter.com/news/dan-loeb-renews-sony-break-up-push-praises-leadership-1275238 [https://perma.cc/V44L-LD66]; Surowiecki, *Too Far*, *supra* note 1.

6. *See* Svea Herbst-Bayliss & Makiko Yamazaki, *Hedge Fund Third Point Sells ADRs in Sony: SEC Filings*, REUTERS (Aug. 18, 2020, 8:40 PM), https://www.reuters.com/article/us-thirdpoint-sony/third-point-sells-sony-adrs-still-owns-large-amount-of-tokyo-stock-idUSKCN25F03T [https://perma.cc/QY78-HLRA].

7. Paul Bond, *Netflix Under Attack: Why Carl Icahn Could Force a Sale*, HOLLYWOOD REP. (Nov. 15, 2012, 2:00 AM), https://www.hollywoodreporter.com/tv/tv-news/netflix-sale-why-carl-icahn-390666 [https://perma.cc/RBJ8-8EMG]; *see also* Netflix, Inc., Schedule 13D (Form SC 13D) (Oct. 24, 2012), https://www.sec.gov/Archives/edgar/data/921669/000092846412000262/nflxsc13d103112.htm [https://perma.cc/6PFA-TQ9A] (filed by Icahn Capital LP) (stating, in Icahn's disclosure of his position in Netflix, that he believed the company "may hold significant strategic value for a variety of significantly larger companies").

After Icahn failed to bring about a sale, Netflix excelled on its own, with its stock price rising by over 1,700% over the following decade.[8] These stories cut against the conventional view of shareholder activists as scrappy visionaries with the pluck and acumen to turn around ailing corporate giants.[9]

What these cases have in common is a shareholder activist who enters the corporate scene with a plan to make things better and instead makes (or almost makes) things much worse. The very name—*shareholder activists*—evokes the image of faithful foot soldiers in the battle for efficiency and shareholder value. By contrast, their ugly cousins—*corporate raiders*—evoke greedy Wall Street fat cats: Gordon Gekko screaming into a phone and ruining somebody's life.[10] But as the examples of JCPenney, Sony, and Netflix show, sometimes the image fails to match the reality.

This Article argues that the conventional wisdom—corporate raiders break things and activist hedge funds fix them—is wrong. Activists are no better than raiders; if anything, they are likely worse. Because, as we argue, activists have a higher risk of *mistargeting*—mistakenly shaking things up at firms that only *appear to be* underperforming—they are much more likely than raiders to destroy value and, ultimately, social wealth.[11] This insight has important implications for the law and policy of control contests. Delaware and federal law alike have

8. *See Netflix, Inc. Common Stock (NFLX) Historical Data*, NASDAQ, https://www.nasdaq.com/market-activity/stocks/nflx/historical [https://perma.cc/5LLM-DDGN] (reporting closing prices of $9.94 on October 26, 2012 and $186.98 on July 8, 2022). This remains true even after Netflix's recent drop in stock price from a high of $691.69 in November 2021. *Id.*

9. *See, e.g.*, Frank Partnoy & Steven Davidoff Solomon, *What CEOs Get Wrong About Activist Investors*, HARV. BUS. REV. (May 1, 2018), https://hbr.org/2018/05/what-ceos-get-wrong-about-activist-investors [https://perma.cc/7K95-YJLX] (arguing that managers should view activists "as a source of potential value").

10. *See* WALL STREET (20th Century Fox 1987).

11. There are no direct empirical studies measuring what we describe as mistargeting. However, there are conflicting studies on whether hedge-fund activists increase firms' value in the long run. For instance, one study finds that, despite some value creation in the short term, "[f]ewer than half of all activist targets experience positive long-term returns," Ed deHaan, David Larcker & Charles McClure, *Long-Term Economic Consequences of Hedge Fund Activist Interventions*, 24 REV. ACCT. STUD. 536, 538-40 (2019), while another study finds that, on average, targeted firms improve in value, Alon Brav, Wei Jiang, Frank Partnoy & Randall Thomas, *Hedge Fund Activism, Corporate Governance, and Firm Performance*, 63 J. FIN. 1729, 1749 (2008). A recent study concludes that activists may even *decrease* long-term performance at firms that are not acquired following the activist's intervention. Andrew C. Baker, The Effects of Hedge Fund Activism 26-33, 32 fig.12 (Oct. 2021) (unpublished manuscript), https://andrewcbaker.netlify.app/publication/baker_jmp/Baker_JMP.pdf [https://perma.cc/BC4J-QQUQ] (finding "some evidence that activists may tend to . . . decreas[e] the long-run performance of the typical targeted firm that remains independent").

focused on keeping raiders outside the gates, but they ignore the real threat: activists already inside. We thus propose equalizing the regulation of raiders and activists.[12]

The distinction between raiders and activists comes down to a simple observation about their differing business models. Raiders typically acquire 100% of the target's stock at a significant premium above market.[13] By contrast, activists need only buy a relatively small block of shares to push their reforms through via the proxy-voting process.[14] As a result, raiders have a much higher hurdle rate—the rate of return they need to make a target worth their substantial investment.[15] Moreover, as potential 100% owners of the target's stock, raiders cannot shift risk onto other parties, further incentivizing them to invest more in information and take only prudent risks.[16] On the other hand, activists buy

12. This Article does not address the role of a new type of activist facilitating environmental and social changes, as exemplified by the activist fund Engine One's proxy fight with Exxon Mobil pushing Exxon to reduce its carbon footprint. *See* Matt Phillips, *Exxon's Board Defeat Signals the Rise of Social-Good Activists*, N.Y. TIMES (June 9, 2021), https://www.nytimes.com/2021/06/09/business/exxon-mobil-engine-no1-activist.html [https://perma.cc/VAX3-LJX9]. Instead, we focus on the more "traditional" types of activist hedge funds focused on financial returns.

13. *See* sources cited *infra* note 51 and accompanying text. By the term "raiders," we mean individuals or entities who try to acquire the target company despite objections from the company's board of directors (i.e., "hostile" acquirers), whether for financial or strategic reasons. Today, private-equity firms frequently play this role (often with the acquisition dressed up as a friendly one), but strategic acquirers, such as large firms who seek to integrate the target company's technology into the acquirer's existing business, can also be raiders.

14. *See* April Klein & Emanuel Zur, *Hedge Fund Activism* 1 (N.Y.U. Pollack Ctr. for L. & Bus. Working Paper, No. CLB-06-017, 2006) [hereinafter Klein & Zur, *Hedge Fund Activism*], https://ssrn.com/abstract=1291605 [https://perma.cc/4WGP-NRT4] (defining hedge-fund activism as a hedge fund purchasing an initial stake of five or more percent with the purpose of influencing management decisions); *cf.* April Klein & Emanuel Zur, *Entrepreneurial Shareholder Activism: Hedge Funds and Other Private Investors*, 64 J. FIN. 187, 187 (2009) ("[W]e define an entrepreneurial activist as an investor who buys a large stake in a publicly held corporation with the intention to bring about change and thereby realize a profit on the investment."). A recent study reports that "[t]he median initial (maximum) percentage stake that a[n activist] hedge fund takes in the target is 6.6 (9.4) percent," while "[t]he inter-quartile range of [activist] hedge funds' initial stakes ranges from 5.4 to 9.8 percent, and the 75th percentile of the maximum ownership falls below 15 percent." Alon Brav, Wei Jiang & Rongchen Li, *Governance by Persuasion: Hedge Fund Activism and Market-Based Shareholder Influence* 29 (Eur. Corp. Governance Inst., Finance Working Paper No. 797/2021, 2022), https://ssrn.com/abstract=3955116 [https://perma.cc/ZNP7-WY24]. By contrast, raiders acquire controlling stakes. *Id.* ("These features distinguish the activist hedge funds from the corporate raiders in the 1980s who sought to obtain full control such that they can dictate firm policy as well as internalize all the benefits from their intervention.").

15. *See* discussion *infra* Section I.A.

16. *See* discussion *infra* Sections I.A, III.A.1, III.A.3.

smaller blocks, allowing for a much lower hurdle rate and an ability to shift some of the cost of mistakes onto other shareholders.[17] They are thus much more likely to try to shake things up at corporations that are underperforming by only a slight margin.

The differences in the incentives of raiders and activists only increase after acquiring their stake. Raiders have unrestricted access to nonpublic information once they acquire 100% ownership, whereas activists have restricted access due to the securities laws and other restrictions.[18] After completing an acquisition and looking under the hood, a raider can always decide to maintain the company's existing business strategy, thereby preserving social wealth that an activist would have destroyed. Moreover, as repeat players whose success in future campaigns depends on their credibility and reputation,[19] activists face structural conflicts that impede their ability to evaluate a target company's business objectively even when they can obtain confidential information.[20] For these reasons, we argue, activists are much more likely to try to "fix" something that is not broken.

The mistargeting risk rests on the idea that investors cannot always accurately identify the true value of the firms they buy into, and when they mistakenly undervalue these firms, they create an opportunity for raiders and activists to (mis)target these firms. There are at least two reasons why outsiders might fail to perceive the true value of a publicly traded firm. The first is market mispricing. A company that lags behind its peers may be poorly run, or it may be engaged in an innovative business plan that is hard for investors to understand and value.[21] Investors may also systemically undervalue long-term gains over

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17. *See* discussion *infra* Sections I.A., III.A.1, III.A.3.

18. *See infra* note 123.

19. *See generally* C.N.V. Krishnan, Frank Partnoy & Randall S. Thomas, *The Second Wave of Hedge Fund Activism: The Importance of Reputation, Clout, and Expertise*, 40 J. CORP. FIN. 296 (2016) (concluding that hedge funds succeed because of reputation-enhancing strategies, rather than target-selection methods); Travis L. Johnson & Nathan Swem, *Reputation and Investor Activism: A Structural Approach*, 139 J. FIN. ECON. 29 (2021) (arguing that reputation effects account for about half of the value activists create for target shareholders).

20. *See* sources cited and accompanying text *infra* notes 135-141.

21. *See* Zohar Goshen & Assaf Hamdani, *Corporate Control and Idiosyncratic Vision*, 125 YALE L.J. 560, 565-66 (2016); *see also* Mustafa Ciftci, *Do Analysts Underestimate Future Benefits of R&D?*, 5 INT'L BUS. RSCH. 26, 35 (2012) (finding that "analysts underestimate earnings long term growth for [research-and-development (R&D)]-intensive firms"); Mark Humphery-Jenner, *Takeover Defenses, Innovation, and Value Creation: Evidence from Acquisition Decisions*, 35 STRATEGIC MGMT. J. 668, 668 (2014) (finding that hard-to-value firms that have antitakeover provisions make acquisitions that generate more shareholder wealth and are more likely to increase corporate innovation); Thomas J. Chemmanur & Xuan Tian, *Do Anti-Takeover Provisions Spur Corporate Innovation? A Regression Discontinuity Analysis*, 53 J. FIN. & QUANTI-

short-term ones, or else might simply be impatient—the "short-termism" problem.[22] Or investors might overreact (or underreact) to new information, leading to temporary mispricing until the market corrects itself.[23] The second reason why investors might misperceive their companies' value is asymmetric information. A company may possess trade secrets or other private, confidential information that it cannot share with the market, causing its stock price to fall short of its true value.[24]

Notably, the mistargeting is a mistake only from the perspective of long-term diversified shareholders, who are either selling their firm to a raider for too low a price or replacing a successful business strategy with a mediocre one upon a campaign of an activist. Whether the reason for the undervaluation is mismanagement or the market's underappreciation of a high-quality company, it is a bargain for a raider and a profit opportunity for an activist.

Because of their all-in business model, corporate raiders are less likely on all fronts to inflict costly mistakes on long-term shareholders. A short illustration shows how activists might destroy shareholder value to a greater extent than raiders. Suppose an economy is comprised of high-quality, low-quality, and average companies. Low-quality and high-quality firms alike appear to "underperform" in the sense that current performance is below some relevant benchmark. But while the low-quality firms actually do underperform because of poor management, the high-quality firms only appear to underperform because they are engaged in hard-to-value, long-term, innovative strategies that will produce gangbuster profits in future periods. For the reasons mentioned above, it is difficult for activists to tell low-quality from high-quality companies. When activ-

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TATIVE ANALYSIS 1163, 1165-66, 1178-86 (2018) (finding evidence that the elimination of anti-takeover protections harms innovation, with especially pronounced effects in firms that are vulnerable to short-term market pressures).

22. *See, e.g.*, Marcel Kahan & Edward B. Rock, *Hedge Funds in Corporate Governance and Corporate Control*, 155 U. PA. L. REV. 1021, 1083 (2007) (discussing and evaluating the scale of the short-termism issue); sources cited *infra* note 106.

23. *See, e.g.*, Aydoğan Alti & Paul C. Tetlock, *Biased Beliefs, Asset Prices, and Investment: A Structural Approach*, 69 J. FIN. 325, 326-27 (2014); Werner F. M. De Bondt & Richard Thaler, *Does the Stock Market Overreact?*, 40 J. FIN. 793, 804 (1985) [hereinafter De Bondt & Thaler, *Does the Stock Market Overreact?*]; Werner F. M. De Bondt & Richard H. Thaler, *Further Evidence on Investor Overreaction and Stock Market Seasonality*, 42 J. FIN. 557, 557 (1987) [hereinafter De Bondt & Thaler, *Further Evidence*]; Kent Daniel, David Hirshleifer & Avanidhar Subrahmanyam, *Investor Psychology and Security Market Under- and Overreactions*, 53 J. FIN. 1839, 1841 (1998). *See generally* Werner De Bondt, *Investor and Market Overreaction: A Retrospective*, 12 REV. BEHAV. FIN. 11 (2020) (reviewing the literature on overreaction, how behavioral insights modify standard asset pricing theory, and the contributions of both to financial theory).

24. *See* Bernard Black & Reinier Kraakman, *Delaware's Takeover Law: The Uncertain Search for Hidden Value*, 96 NW. U. L. REV. 521, 529-34 (2002).

ists target low-quality companies and turn them into average companies by improving management quality, they add value to shareholders and the economy. But when they target high-quality companies and turn them into average companies by shutting down innovation, they *destroy* value. Raiders, by contrast, are less likely to move companies *either* from low-quality to average *or* from high-quality to average. For example, if both high- and low-quality firms underperform relative to their peers by 10%, 20%, or even 50%, a raider that needs 60% upside to turn a profit will pass.[25] Moreover, in the cases that the raider buys the target, the 100% ownership makes it likelier that the mistargeting is discovered and avoided. For this reason, raiders are less likely to destroy shareholder value *or* create it.

That shareholder activists and corporate raiders add value, at least in some cases, is beyond dispute. In particular, activists reduce agency costs (or "agent costs"), the value lost to unfaithful managers who take liberties and expropriate the private benefits of control.[26] Imagine a firm whose CEO mismanages the company for private benefits so that the corporation underperforms relative to its peers by 10%. A raider with a 60% hurdle rate will not go anywhere near this company. But an activist who needs, say, a 7% or 8% return stands to make a buck by firing the CEO, replacing them with a loyal agent, and selling. In a world with only raiders, this CEO will get away with their expropriation, but in a world with activists *and* raiders, they will get the boot.

Moreover, both positive and negative effects ripple across the market. On the one hand, where an activist or a raider can make a buck by firing lazy CEOs who take long afternoon naps and use the company jet for leisure travel, managers across the board are ex ante less likely to do those things.[27] This is a positive externality of shareholder activism.[28] On the other hand, where activists are likely to mistarget firms engaged in profitable but long-term business strategies, CEOs are less likely to take bold positions or invest in projects that fail to yield

25. For a numerical illustration, see *infra* note 59.

26. *See* Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 308 (1976) (defining "agency costs"); Zohar Goshen & Richard Squire, *Principal Costs: A New Theory for Corporate Law and Governance*, 117 COLUM. L. REV. 767, 770 (2017) (introducing the term "agent costs").

27. As one raider observed, managers were less likely to misbehave because "[t]hey knew guys like me would buy the company and throw them out." Nell Mackenzie, *Bosses Are Wary of the Return of the Corporate Raider*, BBC (Jan. 8, 2020), https://www.bbc.com/news/business-50609165 [https://perma.cc/HPY8-6P9T].

28. *See* Nickolay Gantchev, Oleg R. Gredil & Chotibhak Jotikasthira, *Governance Under the Gun: Spillover Effects of Hedge Fund Activism*, 23 REV. FIN. 1031, 1033 (2019) ("Our results show positive spillover effects of activism—as activism threat increases, non-targeted firms with high threat perception are more likely to undertake policy changes mirroring those implemented at the targets.").

immediate returns. This is a negative externality of shareholder activism.[29] While raiders are likely to produce similar externalities, the model presented here suggests these externalities will be significantly lower than the externalities generated by activists.

The critical question is whether activists are doing more economic harm than raiders and, if so, whether we should be more on guard about activists than raiders, conventional wisdom be damned. More specifically, we must examine whether activists create more value by sacking unfaithful managers than they destroy by firing good ones.[30] The latter sum—the value destroyed by mistakenly firing good managers—can be deemed a "principal cost" because it originates with the principal (the shareholder) rather than the agent.[31] Determining the value that activists add requires subtracting the principal costs they create from the agent costs they avoid. Is this net value greater for activists or for raiders? There are no easy answers to these questions, but the long-term course of the market provides some hints.

In particular, market trends suggest that the cost of mistargeting might be higher than the benefits that activists provide, at least under the current regulatory regime. In other words, the principal costs activists generate might exceed the agent costs they reduce—although we do not take a firm position on this issue. While empirical studies assessing whether activists reduce agent costs are equivocal,[32] activists' effects on principal costs are concerning. Start with the financial economist Hendrik Bessembinder's empirical observation that the returns in the stock market are not normally distributed but, instead, are positively

29. *See* John C. Coffee, Jr. & Darius Palia, *The Wolf at the Door: The Impact of Hedge Fund Activism on Corporate Governance*, 41 J. CORP. L. 545, 552 (2016) ("[O]ur primary concern is . . . with the possibility that the increasing rate of hedge fund activism is beginning to compel corporate boards and managements to forego long-term investments (particularly in R&D) in favor of a short-term policy of maximizing shareholder payout in the form of dividends and stock buybacks. This would represent a serious externality, even if private gains resulted.").

30. Activist pressure might be one reason why Chief Executive Officers (CEOs) of publicly traded firms are fired more frequently than CEOs of private firms. *See, e.g.*, Huasheng Gao, Jarrad Harford & Kai Li, Investor Myopia and CEO Turnover: Evidence from Private Firms 2 (Apr. 2013) (unpublished manuscript), https://www.erim.eur.nl/fileadmin/erim_content/documents/Li_April24.pdf [https://perma.cc/HC63-YK57] (arguing, based on a comparison between public-firm and private-firm CEOs, "that, if anything, public firm CEOs appear to be fired too often, as would be predicted by investor myopia in US public firms"); Huasheng Gao, Jarrad Harford & Kai Li, *CEO Turnover-Performance Sensitivity in Private Firms*, 52 J. FIN. & QUANTITATIVE ANALYSIS 583, 584 (2017) ("Given the well-documented concern about public-firm CEO entrenchment, it may at first seem surprising that public-firm CEOs are actually more likely than private-firm CEOs to be fired.").

31. *See* Goshen & Squire, *supra* note 26, at 770 ("Principal costs occur when investors exercise control, and agent costs occur when managers exercise control.").

32. *See* discussion *infra* Section III.B.1.

skewed.[33] A small number of firms account for most of the return in the stock market. Much like a venture-capital fund's portfolio, where the general rule of thumb is that one successful startup compensates for the failure or poor performance of nine other startups,[34] in the stock market it is about one successful firm for every three.[35] This finding suggests that the cost of breaking a high-quality firm is greater than the benefit of fixing three low-quality firms.

Bessembinder's study also found that some 4% of companies have generated all the equity premium in the stock market over the past ninety years.[36] This finding suggests that the ratio is one successful firm out of twenty for the top performers in the stock market. Suppose that even just a quarter of those growth-driving companies (i.e., 1% of all companies) have at some point fit the mold of a company that appeared to underperform but whose long-term vision would eventually lead to explosive growth. If activists had mistargeted these firms because they were not generating optimal short-term results, they would have destroyed a substantial part of the economic growth. Moreover, there is no telling how many companies *would have been* among the four-percenters were it not for mistargeting by activists.

These observations suggest that the law's efforts to lock the gates against corporate raiders while letting hedge-fund activism go relatively unchecked

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33. Hendrik Bessembinder, *Do Stocks Outperform Treasury Bills?*, 129 J. FIN. ECON. 440, 442 (2018).

34. *See Global Startup Ecosystem Report 2019*, STARTUP GENOME 19 (2019), https://startupgenome.com/reports/global-startup-ecosystem-report-2019 [https://perma.cc/YKS3-M4GU] (discussing empirical research showing that only one in twelve startups succeed); Patrick Ward, *Is It True that 90% of Startups Fail?*, NANOGLOBALS (June 29, 2021), https://nanoglobals.com/startup-failure-rate-myths-origin [https://perma.cc/APU7-TQKZ] (discussing the unclear origins of the "'9 out of 10 startups fail' statistic"); Deborah Gage, *The Venture Capital Secret: 3 Out of 4 Start-Ups Fail*, WALL ST. J. (Sept. 20, 2012, 12:01 AM ET), https://www.wsj.com/articles/SB10000872396390443720204578004980476429190 [https://perma.cc/JFZ9-V972] (reporting on comments by Shikhar Gosh, a senior lecturer at Harvard Business School, summarizing his findings that only one venture firm out of four returns any capital to investors).

35. *See* Eric Crittenden & Cole Wilcox, *The Capitalism Distribution*, BLACKSTAR FUNDS (2008), https://invertiryespecular.com/wp-content/uploads/2015/11/thecapitalismdistribution.pdf [https://perma.cc/PZ2H-UZ8B] (observing a panel of 8,054 stocks from 1983-2007 and finding that all of the gains generated by the panel were produced by the best-performing quartile of stocks); *see also* Michael Cembalest, *The Agony and the Ecstasy: The Risks and Rewards of a Concentrated Stock Position*, J.P. MORGAN 6 (2014), https://www.chase.com/content/dam/privatebanking/en/mobile/documents/eotm/eotm_2014_09_02_agonyescstasy.pdf [https://perma.cc/VX4F-BHPR] (finding that, from 1980-2014, only 60% of all stocks had positive returns, just one-third of all stocks outperformed the Russell 3000, and about 7% of all stocks generated "lifetime excess returns more than two standard deviations over the mean").

36. Bessembinder, *supra* note 33, at 441.

should be adjusted.[37] If activists are no better than raiders—and potentially even more harmful—then it would seem the barbarians are already *inside* the gates. The insight that activists are more likely to mistarget companies than their ugly cousins has profound implications for corporate law, which, we argue, should equalize the regulation of raiders and activists. In fact, the main value of hedge-fund activists is not in fixing targets' operations, financing, or governance, but rather in overcoming the barriers created by Delaware's takeover jurisprudence—sidestepping targets' legally permissible defensive measures and facilitating mergers and acquisitions. Our analysis has timely implications for current debates in the courts about how to evaluate corporate efforts to guard against hedge-fund activism.

This Article proceeds in four parts. Part I provides background about how raiders and activists operate; it also introduces the concepts of principal and agent costs. Part II explains the mistargeting hazard and introduces an informal model that shows how the presence of control challenges may either decrease or increase the net sum of principal and agent costs. Part III analyzes the relative effects of activists and raiders on principal and agent costs in light of our model and the available empirical evidence; it concludes that activists are likely to impose greater costs than raiders. Part IV examines the implications of these findings for law and policy. The model presented in this Article suggests that, contrary to conventional wisdom, lawmakers and courts should be more skeptical of hedge-fund activists and avoid providing them with preferential treatment relative to raiders.

I. THE PROMISE (AND THREAT) OF CONTROL CONTESTS

The impact of activists and raiders on agency costs has been widely studied: corporate control contests keep boards and officers honest and hardworking by rewarding their malfeasance with a coup.[38] The drawbacks of corporate control

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37. *See* John Armour, Jack B. Jacobs & Curtis J. Milhaupt, *The Evolution of Hostile Takeover Regimes in Developed and Emerging Markets: An Analytical Framework*, 52 HARV. INT'L L.J. 219, 244-47 (2011) (concluding that the Delaware Supreme Court's acceptance of poison pills forced would-be acquirers "to resurrect the proxy contest" as a means of effectuating a hostile takeover, significantly increasing the difficulty of successfully executing an acquisition).

38. *See, e.g.*, Paul Rose & Bernard S. Sharfman, *Shareholder Activism as a Corrective Mechanism in Corporate Governance*, 2014 BYU L. REV. 1015, 1037 ("The traditional understanding of shareholder activism is that it is a tool of accountability used to minimize agency costs."); Michael C. Jensen, *Agency Costs of Free Cash Flow, Corporate Finance, and Takeovers*, 76 AM. ECON. REV. 323, 328-29 (1986) (arguing that takeovers are "a solution to the problem" of "conflicts of interest between shareholders and managers"); Henry G. Manne, *Cash Tender Offers for Shares—A Reply to Chairman Cohen*, 1967 DUKE L.J. 231, 236-37 (arguing that the threat of raiders encourages managers to manage their companies as efficiently as possible).

contests have received less attention.[39] The term "principal costs" can provide a template for understanding the downsides of control contests. Just as missteps by agents can produce costs, so too can missteps by principals – in this case, activist hedge funds and corporate raiders – burden corporations and shareholders with unnecessary costs.[40] Evaluating whether control challengers help or hinder the performance of their targets, therefore, requires understanding this fundamental tradeoff between agent and principal costs. But, as we will argue, the particular costs and benefits created by control contests differ by the type of control challenger. While activists and raiders pursue the same ends – shifting corporate control – they employ different means and incur different costs in doing so, resulting in a different tradeoff between principal and agent costs. Understanding this essential difference between activists and raiders allows courts and scholars to judge different types of control challenges by the particular costs and benefits each type is likely to impose.[41]

This Part provides background on the promise and threat of control contests. Section I.A describes the roles of activists and raiders in corporate control contests, explaining how, due to the different means they use, activists incur lower costs than raiders when contesting control. Section I.B introduces the vocabulary of principal and agent costs, explaining how the exercise of control by either principals or agents can generate costs.

39. *But see* Martin Lipton, *Takeover Bids in the Target's Boardroom*, 35 BUS. LAW. 101, 104-09 (1979); Leo E. Strine, Jr., *Who Bleeds When the Wolves Bite?: A Flesh-and-Blood Perspective on Hedge Fund Activism and Our Strange Corporate Governance System*, 126 YALE L.J. 1870, 1934-51 (2017); John C. Coffee, Jr., Robert J. Jackson, Jr., Joshua R. Mitts & Robert E. Bishop, *Activist Directors and Agency Costs: What Happens When an Activist Director Goes on the Board?*, 104 CORNELL L. REV. 381, 401-31 (2019).

40. *See* Goshen & Squire, *supra* note 26, at 770.

41. There is literature in corporate law debating the relative efficiency of using *voting* to aggregate shareholder preferences and information (the activists' method relying on "voice") compared with *markets* allowing shareholders to sell their shares (the raiders' method relying on "exit"). This literature is equivocal. *See, e.g.*, Ronald J. Gilson & Alan Schwartz, *Sales and Elections as Methods for Transferring Corporate Control*, 2 THEORETICAL INQUIRIES L. 783, 783 (2001) (arguing that voting is inferior to stock markets); Lucian Bebchuk & Oliver Hart, *Takeover Bids vs. Proxy Fights in Contests for Corporate Control* 3-4 (Nat'l Bureau of Econ. Rsch., Working Paper No. 8633, 2001) (arguing that combining both proxy fights and takeover bids is superior to either mechanism on its own); Yair Listokin, *Corporate Voting Versus Market Price Setting*, 11 AM. L. & ECON. REV. 608, 609-10 (2009) (finding that in "close elections" where the median voter should be nearly indifferent between either outcome, "the price-setting shareholder is far from indifferent," as market value declines in response to management victories).

A. *Raiders and Activists in Corporate Control Contests*

An investor who wishes to change the direction of a widely held corporation can win a control contest in either of two ways. The first strategy, pursued by hostile raiders, is to assemble a control block. Traditionally, raiders have started a raid by buying a toehold stake in the target—typically about 10% of the outstanding shares—on the open market.[42] Then, to build that stake into a majority of shares, the raider makes a tender offer (i.e., an offer made directly to other shareholders to buy their shares).[43] If the offer is successful, the raider will take steps to buy 100% of the shares and then use its voting power to replace the board and implement the raider's own business vision. Alternatively, the raider can decide that the incumbent managers' business vision is fundamentally sound, in which case the raider could leave the managers in place and simply reap the resulting profits. Today, hostile takeovers are frequently dressed up as friendly acquisitions, but they still occur.[44] We discuss corporate raiders in these traditional terms because, as we explain in Part IV, much of the relevant legal doctrine was developed in response to traditional takeover attempts by raiders, and there is an imbalance in how the law has treated raiders and activists.

The second strategy that control challengers follow is to persuade enough shareholders to support the challenger's proposal in a proxy contest. This is the strategy favored by activist hedge funds.[45] Once an activist fund identifies a suitable target, it typically builds up a 5% to 10% equity stake through stock-market purchases.[46] But instead of then making a tender offer, the activist initiates or

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42. *See, e.g.*, Ronald J. Gilson, *Seeking Competitive Bids Versus Pure Passivity in Tender Offer Defense*, 35 STAN. L. REV. 51, 53-54 (1982). Toeholds are less prevalent today. *See* Eitan Goldman & Jun Qian, *Optimal Toeholds in Takeover Contests*, 77 J. FIN. ECON. 321, 326-27 (2005). Nevertheless, for reasons that will become apparent in Part IV, we discuss raiders in traditional terms.

43. Gilson, *supra* note 42, at 53-54 (describing the "traditional approach" for acquirers to "exploit [their] investment in information" by purchasing 10% of the target's stock and then making a tender offer). For more on toeholds, see Rajdeep Singh, *Takeover Bidding with Toeholds: The Case of the Owner's Curse*, 11 REV. FIN. STUD. 679, 679-80 (1998), which describes and evaluates the toehold strategy.

44. *See* Tingting Liu & J. Harold Mulherin, *How Has Takeover Competition Changed Over Time?*, 30 J. APPLIED CORP. FIN. 81, 82 (2019) (finding that "takeover competition has gone underground"). For a recent example of an attempted hostile takeover, see the CoreLogic saga, which began with a hostile takeover attempt by two large blockholders in 2020 and ended with an acquisition of the company by a third-party private-equity fund in 2021. Steve Evans, *CoreLogic to Be Acquired by Stone Point Capital & Insight Partners for $5.89bn*, ARTEMIS (Apr. 30, 2021), https://www.artemis.bm/news/corelogic-to-be-acquired-by-stone-point-capital-insight-partners-for-5-89bn [https://perma.cc/V2TS-9PWJ].

45. *See, e.g.*, Kahan & Rock, *supra* note 22, at 1088-89.

46. *See id.*; Brian R. Cheffins & John Armour, *The Past, Present, and Future of Shareholder Activism by Hedge Funds*, 37 J. CORP. L. 51, 59-60 (2011).

threatens to initiate a proxy contest.[47] When it runs a proxy contest, it asks other shareholders to support its proposal to replace incumbent directors, increase dividends, or force a change in the firm's capital or governance structure.[48] Regardless of the substance of its proposal, the activist operates through the mechanism of shareholder voting.

Of course, these strategies are not mutually exclusive. A challenger might use one strategy in one campaign and another strategy in another campaign—or even both strategies in the same campaign.[49] As we later explore, activists also sometimes push for a third party to acquire the target company.[50] Presently, however, we analyze the strategies separately.

To contest control successfully, a challenger must incur the costs of shifting a target firm from one business strategy to another. A hostile raider's shifting costs commonly include research to identify a target, execution costs (such as hiring advisers and arranging the financing for the acquisition), and the large premium that the raider must offer other shareholders to induce them to tender. The latter two costs will usually increase with the size of a target. Empirical studies indicate that a raider's total shifting costs have generally exceeded 30%—and occasionally more than 50%—of the target's pre-raid market capitalization.[51]

47. Klein & Zur, *Hedge Fund Activism*, *supra* note 14, at 5.

48. *Review and Analysis of 2018 U.S. Shareholder Activism*, SULLIVAN & CROMWELL LLP 27 (Mar. 14, 2019), https://www.sullcrom.com/files/upload/SC-Publication-SandC-MnA-2018-US-Shareholder-Activism-Analysis.pdf [https://perma.cc/UY8Z-5HSX] ("Although board representation remains the most common objective in activist campaigns, it is almost always sought in conjunction with other underlying objectives.").

49. For example, Elon Musk started his engagement with Twitter, Inc. earlier this year by pursuing activist-like tactics, such as seeking board representation, and later announced plans to acquire the company. *See* Todd Olmstead, *Elon Musk Joins Twitter's Board: What It Could Mean for the Social Platform*, WALL ST. J. (Apr. 6, 2022, 7:47 AM ET), https://www.wsj.com/articles/elon-musk-twitter-stock-board-of-directors-explained-11649189318 [https://perma.cc/3DYB-Q2FG] (reporting that Musk joined Twitter's board); Rob Copeland, Rebecca Elliot & Cara Lombardo, *Elon Musk Makes $43 Billion Bid for Twitter, Says 'Civilization' at Stake*, WALL ST. J. (Apr. 14, 2022, 7:48 PM ET), https://www.wsj.com/articles/elon-musk-offers-to-buy-rest-of-twitter-for-54-20-a-share-11649932296 [https://perma.cc/S8VP-F3SX].

Well-known activist hedge funds have also sometimes pursued hostile takeovers. *See, e.g.*, Matt Levine, Opinion, *Bill Ackman Gets into the Hostile Takeover Business*, BLOOMBERG (Apr. 23, 2014, 10:02 AM EDT), https://www.bloomberg.com/opinion/articles/2014-04-22/bill-ackman-gets-into-the-hostile-takeover-business [https://perma.cc/8AH4-MMQW] (describing efforts by activist hedge-fund manager Bill Ackman to acquire Allergan Pharmaceuticals).

50. *See* discussion *infra* Section III.B.1.

51. *See* Michael C. Jensen, *Takeovers: Their Causes and Consequences*, 2 J. ECON. PERSPS. 21, 22 (1988) (noting that the average takeover premium paid to target shareholders was historically about 30%, and by the early 1980s had increased to about 50%); Shaojie Lai & Xialing Pu, Notably, these high costs mean that a raid is worthwhile only if the raider can substantially increase the target's value.

By contrast, an activist hedge fund's shifting costs tend to be much lower, consisting of the research to select a target, the development of an alternative business strategy, the purchase of the 5-10% block of shares at market prices, and the expenses of a proxy fight. One empirical study estimates that the activist's average expenses for a campaign ending in a proxy fight are about $11 million,[52] a price tag that does not appear to vary much with target size.[53] If it is successful, the activist may even be able to get the corporation to reimburse those expenses.[54] Moreover, the activist can incur even lower expenses if it settles with the company—the same empirical study estimates that the "demand negotiations" and "board representation" stages of an activist campaign incur average costs of about $3 million and $2 million, respectively[55]—which happens more often than a full-fledged proxy contest.[56] As with a successful proxy contest, a settlement may provide for partial or full reimbursement of the activist's costs.[57]

Mispricing or Growth? An Empirical Analysis of Acquisition Premium, 37 FIN. RES. LETTERS art. no. 101359, at 2 (2020) (finding an average acquisition offer premium of 41.24% for U.S. public-company targets in cash deals). These acquisition premia do not include research and execution costs, which bring total shifting costs even higher.

52. Nickolay Gantchev, *The Costs of Shareholder Activism: Evidence from a Sequential Decision Model*, 107 J. FIN. ECON. 610, 611, 627 (2013).

53. Nickolay Gantchev does not report his cost estimates as a function of target size, but we note that in what was reportedly "the biggest and most-expensive proxy fight in history," the activist had budgeted $25 million for the contest. David Benoit, *P&G vs. Nelson Peltz: The Most-Expensive Shareholder War Ever*, WALL ST. J. (Oct. 6, 2017, 6:07 PM ET), https://www.wsj.com/articles/p-g-vs-nelson-peltz-the-most-expensive-shareholder-war-ever-1507327243 [https://perma.cc/S9AR-4KKS]. All things considered, that is not much higher than the average. By contrast, acquisition premia do clearly scale with target size, though the *percentage* appears to generally decrease for bigger targets. *See* George Alexandridis, Kathleen P. Fuller, Lars Terhaar & Nickolaos G.Travlos, *Deal Size, Acquisition Premia and Shareholder Gains*, 20 J. CORP. FIN. 1, 5 tbl.2 (2013).

54. *See* DEL. CODE ANN. tit. 8, § 113 (2022) (allowing the corporation's bylaws to "provide for the reimbursement by the corporation of expenses incurred by a stockholder in soliciting proxies in connection with an election of directors"); Joseph E. Gilligan, Asher M. Rubin & James J. Benson, *Preparing for Proxy Contests: Practical Steps Every Company Should Consider*, BLOOMBERG BNA, *reprinted in* HOGAN LOVELLS (Feb. 24, 2014), https://www.hoganlovells.com/~/media/hogan-lovells/pdf/publication/q00281-bna-article-04cm_pdf [https://perma.cc/V45Z-GSED] (describing such frequent reimbursements).

55. Gantchev, *supra* note 52, at 612.

56. *See* Lucian A. Bebchuk, Alon Brav, Wei Jiang & Thomas Keusch, *Dancing with Activists*, 137 J. FIN. ECON. 1, 5 tbl.1 (2020) (analyzing 3,012 activism campaigns between 2000 and 2013 and finding that settlements were more than twice as common as voted proxy contests).

57. *Id.* at 7 n.11.

Therefore, an activist's shifting costs tend to be lower than a raider's, with the difference widening as target size increases.

This differential cost implies that activists have a much lower "hurdle rate," or the minimum percentage improvement in the target's share price necessary to make targeting profitable.[58] And because they have lower hurdle rates than raiders, activists can target a wider range of firms.[59] Put another way, agent costs must reach a minimum level at a firm before targeting the firm is worthwhile, and that threshold is higher for raiders than for activists. Moreover, the advantage that activists have over raiders in policing agent costs will generally increase with the size of the target.

Today, the mainstream view is dimmer on raiders than on activists. This dichotomy is reflected not only in commentary about corporate control contests but also in the law itself. As explained in Part IV, both state and federal law place greater constraints on raiders than activists, as reflected in Delaware case law regulating corporate defenses against control challengers and in the relevant federal securities laws. Meanwhile, scholars have accepted the use of defenses against tender offers, arguing that they may ultimately serve the best interests of

58. Will Kenton, *Hurdle Rate*, INVESTOPEDIA (Sept. 4, 2021), https://www.investopedia.com/terms/h/hurdlerate.asp [https://perma.cc/8PJK-2YEF].

59. As an illustration, consider a target firm whose total market capitalization is $1 billion. Assume that an activist hedge fund can successfully target the firm by acquiring a 10% share block at unaffected, preannouncement market prices and then spending $5 million to win a proxy fight. On these assumptions, the overall value of the target needs to improve by at least $50 million, or 5%, for the activist to turn a profit (assuming that the market prices the firm's shares accurately). By contrast, a hostile raider who pays a 50% premium will have to spend $500 million in addition to the unaffected market price of $1 billion to buy 100% of the shares in a tender offer. Therefore, the raider will have to expect to increase the value of the target by more than $500 million, or 50%, to turn a profit and make the raid worthwhile. If we assume an even larger target, the activist's hurdle rate falls further, but the raider's does not, on the assumption that the activist's shifting costs vary less with the target's size than do the raider's. Importantly, when a raider uses leverage to buy the target, the hurdle rate does not decrease because the leverage adds financial risk on top of the target's business risk. The latter statement is a direct application of the seminal irrelevance of capital structure theorem. *See* Franco Modigliani & Merton H. Miller, *The Cost of Capital, Corporate Finance and the Theory of Investment*, 48 AM. ECON. REV. 261, 291-93 (1958).

shareholders.[60] Some have even expressly advocated for decisions about takeovers to be made instead through direct shareholder votes,[61] while expressing favorable opinions about activists and condemning "anti-activist" defensive measures.[62]

B. Agent and Principal Costs in Corporate Control Contests

The effects that activists and raiders have on principal costs are not as well studied as agent-cost effects. When activists and raiders mistarget firms—selecting targets whose business strategies are ultimately profitable but entail delay or complexity—they destroy shareholder value. Corporate control challenges therefore produce countervailing effects: they reduce agent costs while increasing principal costs. To understand the fundamental tradeoff posed by corporate control challengers, it is crucial first to understand the reasons for mistargeting.

By delegating control to agents, investors expose themselves to agent costs, defined as the costs generated by the divergent goals of agents and principals.[63] Principals hope to maximize profits, while agents hope to maximize their personal gain to the greatest extent possible without being fired. Because the agent captures only a small portion of the firm's cash flows, they may not work as hard as they would otherwise (known as "shirking") and may consume more of the

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60. *See, e.g.*, Marcel Kahan & Edward B. Rock, *How I Learned to Stop Worrying and Love the Pill: Adaptive Responses to Takeover Law*, 69 U. PA. L. REV. 871, 911 (2002) (concluding that the pill "seems to have been transformed into a device that plausibly is in shareholders' interests").

61. Bebchuk & Hart, *supra* note 41, at 1-4 (making this argument through a formal model). *But see* Gilson & Schwartz, *supra* note 41, at 791, 800 (arguing the opposite).

62. *See, e.g.*, Lucian A. Bebchuk, Alan Brav & Wei Jiang, *The Long-Term Effects of Hedge Fund Activism*, 115 COLUM. L. REV. 1085, 1089-91 (2015) (concluding that activist hedge funds produce positive long-term effects); Ronald J. Gilson & Jeffrey N. Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights*, 113 COLUM. L. REV. 863, 867 (2013) (arguing that activists play a valuable role in setting up intervention proposals for consideration by institutional investors); Brav et al., *supra* note 14, at 11 (contending that activist hedge funds are "in a unique position to reduce the agency costs associated with the separation of ownership and control"); Marcel Kahan & Edward B. Rock, *Anti-Activist Poison Pills*, 99 B.U. L. REV. 915, 921-23 (2019) (criticizing and arguing for increased judicial scrutiny of "anti-activist" poison pills); Jeffrey N. Gordon, *Corporate Vote Suppression: The Anti-Activist Pill in* The Williams Companies Stockholder Litigation, CLS BLUE SKY BLOG (Aug. 19, 2021), https://clsbluesky.law.columbia.edu/2021/08/19/corporate-vote-suppression-the-anti-activist-pill-in-the-williams-companies-stockholder-litigation [https://perma.cc/9Q3N-KQYW] (similar).

63. *See* Jensen & Meckling, *supra* note 26, at 308 (developing a formal analysis of agency costs); Goshen & Squire, *supra* note 26, at 770 (developing a theory of both principal and agent costs).

firm's resources in the form of perquisites than they would otherwise (called "diverting").[64] Shirking and diverting reduce the firm's cash flows and, thus, its total value. Together, these can be understood as "conflict costs": the costs arising from the *conflict* between shareholders' and managers' goals.[65] We use the term agent costs—as opposed to the more conventional "agency costs"—to encompass another category as well: "competence costs."[66] These are the costs an honest decision maker incurs in trying to do her best to avoid mistakes and maximize firm value.[67] Competence costs include the costs of acquiring the necessary expertise, the information needed to make optimal decisions, and the residual cost of mistakes.[68] So, for example, when Ron Johnson decided to switch to fair-and-square pricing and caused JCPenney's revenue to collapse, he inflicted competence costs on JCPenney's shareholders.[69]

Control challengers reduce agent costs—both conflict and competence costs—by solving the collective-action problem of multiple diversified investors.[70] Institutional shareholders that dominate the public-equity markets may be "rationally reticent" to invest in policing managerial misbehavior because they capture a relatively small portion of the gains from such activity.[71] Thus, no one shareholder will act because most of the gains from policing management go to free riders who benefit from increased stock prices without contributing to the cost of investing in information and engaging with managers.[72] Activists solve this problem by taking on the burden of disciplining or replacing disloyal or incompetent managers.

But competence and conflict costs are not the sole prerogative of agents. When principals rather than agents generate these costs, they can be deemed "principal costs."[73] One way principals can generate these costs is by firing managers they misperceive as disloyal or incompetent, who are actually loyal and

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64. *See* Jensen & Meckling, *supra* note 26, at 317.

65. *See* Goshen & Squire, *supra* note 26, at 784.

66. *Id.*

67. *Id.* at 785-86.

68. *Id.* at 786-88.

69. *See supra* notes 1-4 and accompanying text.

70. *See* Klein & Zur, *Hedge Fund Activism*, *supra* note 14, at 2 (describing this collective-action problem).

71. Gilson & Gordon, *supra* note 62, at 895.

72. Edward B. Rock, *The Logic and (Uncertain) Significance of Institutional Shareholder Activism*, 79 GEO. L.J. 445, 453-54 (1991).

73. *See* Goshen & Squire, *supra* note 26, at 770-71.

able.[74] By removing these managers and preventing them from carrying out their business strategies, or selecting incompetent managers, principals inflict competence costs on the firm.[75] In the unfortunate example of JCPenney, the fair-and-square-pricing disaster can be understood through the lens of principal costs.[76] Rather than pinning the failure on the CEO, the decision to replace JCPenney's leadership and install Johnson in the first place can be understood as incompetence on the part of Bill Ackman, the hedge-fund manager. Ackman, a principal, inflicted costs on the firm and thus on other shareholders by firing JCPenney's management, or at least by replacing them with Johnson instead of someone else.

This dynamic also produces second-order effects. When the fear of a control contest dissuades other managers from generating agent costs through disloyalty or incompetence, that effect extends to even those firms that activists and raiders have not targeted. To avoid the possibility of a control contest, managers will shirk and divert less than they would without such a threat looming, thereby reducing agent costs even at untargeted firms. This effect is a positive externality created by activists and raiders.[77] By contrast, when the fear of a control contest dissuades other competent and loyal managers from pursuing idiosyncratic, long-term, or complex business strategies, untargeted firms are also affected. The threat of a control contest can strike fear into the hearts of even competent and otherwise loyal managers, who understandably want to keep their jobs; it might also dissuade them from pursuing strategies that could make them the target of a proxy battle or takeover. Principal costs can, therefore, manifest even at firms without an active control contest. These costs are a negative externality created by activists and raiders.[78]

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74. *See id.* at 787-88. These costs can properly be termed "principal competence costs" since they arise not from conflicting motives but from the principal's lack of competence in policing manager behavior. *Id.*; Laurent Bach & Daniel Metzger, The Dark Side of Shareholder Activism: Evidence from CEO Turnovers 6-7 (Apr. 2013) (unpublished manuscript), https://www.eurofidai.org/Bach_2013.pdf [https://perma.cc/K8YU-785P] (finding that strong corporate governance inflicts costs on shareholders by sometimes leading to the departure of value-enhancing CEOs).

75. *See* Goshen & Squire, *supra* note 26, at 786-88.

76. *See supra* notes 1-4 and accompanying text.

77. *See* Gantchev et al., *supra* note 28, at 1033.

78. *See* Coffee & Palia, *supra* note 29, at 574-77 (arguing that the threat of activist engagement is a general deterrent to firm R&D expenditures, even within firms not targeted by activists).

The foregoing analysis suggests that raiders and activists increase principal costs by introducing a risk of mistargeting.[79] The next Part explores this mistargeting hazard in greater detail, setting the stage for an analysis of the different propensities of raiders and activists to mistarget.

II. THE MISTARGETING HAZARD

When Dan Loeb attempted to disrupt a business strategy at Sony that turned out to be profitable, he was engaged in mistargeting.[80] Mistargeting refers to corporate control challenges initiated against firms that are not underperforming. It is important to emphasize, however, that mistargeting is mistaken targeting only from the perspective of the long-term diversified shareholders, who either sell their firm at a discount or exchange a successful business strategy for an average one. From the perspective of a raider, market mispricing leading to undervaluation of a firm represents a bargain, not a mistake.[81] Similarly, from the perspective of an activist, it does not matter if the activist campaign increased the share price by destroying idiosyncratic vision or fixing agency costs—either way, it is a bargain, not a mistake. The mistargeting risk represents a salient category of principal costs introduced by control challengers. This Part explains this mistargeting hazard and its potential effects on principal and agent costs. Section II.A describes two key potential causes of mistargeting: market mispricing and asymmetric information. Section II.B introduces an informal model that shows how mistargeting could cause the presence of control challengers to increase the net sum of principal and agent costs.

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79. Mike Burkart and Samuel Lee offer a model that shows activists are better than raiders at improving firm value, focusing on the free-riding and agency-costs problems after assuming away principal costs. Mike Burkart & Samuel Lee, *Activism and Takeovers*, 35 REV. FIN. STUD. 1868, 1869-72 (2022). We do not dispute that without principal costs (i.e., without mistakes and mistargeting), activists would do more than raiders to improve firm value.

80. *See supra* notes 5-6 and accompanying text.

81. *See* Karen Simonyan, *What Determines Takeover Premia: An Empirical Analysis*, 75 J. ECON. & BUS. 93, 93 (2014) (finding that "takeover premia were affected by market misvaluation: they were higher during periods of investor pessimism and market undervaluation and were lower during periods of investor optimism and market overvaluation"); Alex Edmans, Itay Goldstein & Wei Jiang, *The Real Effects of Financial Markets: The Impact of Prices on Takeovers*, 67 J. FIN. 933, 935 (2012) (showing a strong relationship between a firm being valued below its potential and the probability of it being a takeover target); Ming Dong, David Hirshleifer, Scott Richardson & Siew Hong Teoh, *Does Investor Misvaluation Drive the Takeover Market?*, 61 J. FIN. 725, 752 (2006) (finding empirical support for the hypothesis that "bidders for undervalued targets have an incentive to profit by bidding below true target value").

A. Causes of Mistargeting

There are at least two reasons why control challengers might mistake high-quality firms for low-quality ones. The first has to do with market mispricing. Corporate leaders may simply see something that the market does not ("differences of opinion"),[82] perhaps because the leader has an idiosyncratic vision that others fail to recognize. While these firms underperform now – because it is hard for the market to evaluate their vision – their investments will eventually pay off handsomely. Alternatively, myopic markets might not perceive or properly reward value that will be realized far in the future ("short-termism"), or the market might under- or overreact to new information ("inefficient markets"). The second reason for mistargeting is a lack of information ("asymmetric information"). Laws, regulations, fiduciary duties, and competitive considerations restricting the disclosure of certain types of private information might prevent corporate managers from revealing to potential control challengers why their stock price is sagging.

1. Market Mispricing

The first reason for mistargeting relates to market mispricing, which occurs when the market fails to price the company's stock accurately based on public information. This can occur for several reasons, including a failure to recognize the leader's idiosyncratic vision, short-termism, or over- or underreaction.

Idiosyncratic Vision. Intuitively, it is not hard to imagine that the stock markets might undervalue bold, long-term visions.[83] Suppose a firm invests 7% of its cash flows in research and development (R&D) while its peers in the industry only invest 3%. Are the managers of this outlier firm engaged in a "pet" project wasting corporate resources (i.e., imposing agent costs)[84] or developing a path-

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82. For a model explaining how differences of opinion might emerge, see generally Robert J. Aumann, *Agreeing to Disagree*, 4 ANNALS STATS. 1236 (1976).

83. *See generally* Goshen & Hamdani, *supra* note 21 (developing a theory of corporate control and idiosyncratic vision).

84. For a survey of some of the literature exploring this type of agent cost, see generally Volker Laux & Brian Mittendorf, *Board Independence, Executive Pay, and the Adoption of Pet Projects*, 28 CONTEMP. ACCT. RSCH. 1467 (2011), which suggests that greater board dependence might promote less-frequent adoption of CEO pet projects; Michael C. Jensen, *Agency Costs of Free Cash Flow, Corporate Finance, and Takeovers*, 76 AM. ECON. REV. 323 (1986), which introduces the problem of management overinvestment; Steven Kaplan, *The Effects of Management Buyouts on Operating Performance and Value*, 24 J. FIN. ECON. 217 (1989), which offers evidence suggesting that management buyouts result in operating improvements within target firms breaking innovation that would transform the industry (i.e., executing an idiosyncratic vision)[85]? It is hard to know. But if the market believes that the managers are investing in a "pet" project, the stock price will decline.[86] Depending on the true reality behind the R&D budget, when an activist's campaign to slash R&D expenses is successful, it might have reduced agent costs or inflicted principal costs. It is hard to know because we can rarely observe the counterfactual (i.e., what *would* have happened but for the control challenger's intervention).

Of those rare cases, the story of Henry Ford best illustrates the complexity that a business vision presents for investors in determining reasons for suboptimal firm performance. Ford was competing with hundreds of other entrepreneurs attempting to create a "horseless carriage."[87] But he had a unique vision for car production. Investors controlled the first firm he founded, the Detroit Automobile Company.[88] While the Detroit Automobile Company's investors demanded that cars be immediately produced and sold, Ford insisted on perfecting the design before production. This led to delays, frustration on both sides, and, eventually, the investors' decision to shut down the firm.[89] Ford's second attempt, the Henry Ford Company, was also controlled by investors.[90] Again, after designing a car, Ford resisted investors' pressure and interference, and he did not move directly into production.[91] Eventually, his obstinacy led the investors to replace Ford with Henry Leland, change the company name to the Cadillac Automobile Company, and produce the car Ford designed with great success.[92] This sounds like the classic triumph of shareholder activism reducing agency costs. But this time, we observed the counterfactual. In his third attempt—the Ford Motor Company—Ford insisted on retaining control. This time, with no outside investor interference, Ford transformed his business vision for car design

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by reducing incentives for this type of agency cost; and Scott Richardson, *Over-Investment of Free Cash Flow*, 11 REV. ACCT. STUD. 159 (2006), which finds that strong governance reduces overinvestment.

85. *See* Chemmanur & Tian, *supra* note 21, at 1163 (explaining that antitakeover provisions "help nurture innovation by insulating managers from short-term pressures arising from equity markets").

86. *See* Ciftci, *supra* note 21, at 26 (explaining that analysts underestimate long-term earnings growth in R&D-intensive firms).

87. M. Todd Henderson, *The Story of* Dodge v. Ford Motor Company*: Everything Old is New Again*, *in* CORPORATE LAW STORIES 37, 40 (J. Mark Ramseyer ed., 2009).

88. *Id.*

89. *Id.* at 44.

90. *Id.*

91. *Id.* at 45.

92. *Id.*

and production into one of the great corporate success stories of all time.[93] Although investors made money from firing Ford and appointing Leland, they would have made much more had they been patient and stayed with him.[94] The Ford story illustrates that principal costs—in this case, mistargeting—can still be high even when firm performance apparently improves.

There are, of course, other examples.[95] Apple's firing of Steve Jobs—who then returned to lead it from the brink of failure to the largest publicly traded corporation—also comes to mind.[96] For one recent example, look at Tesla, the electric automaker. In October 2018, when Tesla's share price was about $17 based on today's shares outstanding,[97] David Einhorn, the manager of the hedge fund Greenlight Capital, told his investors that Tesla bore a grim resemblance to Lehman Brothers before its 2008 bankruptcy (a collapse that Einhorn had predicted months earlier).[98] Indeed, some predicted outright that Tesla would file for bankruptcy in 2019,[99] while others speculated about who should replace Elon

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93. *Id.* at 47.

94. Indeed, Ford Motor Company quickly generated "spectacular" returns. *Id.* at 48. Let us offer just one point of comparison: while Cadillac was sold in the early 1900s for $4.75 million, *see* Kenny Norman, *A Detailed Look at the Evolution of Cadillac*, HOTCARS (Jan. 2, 2021), https://www.hotcars.com/a-detailed-look-at-the-evolution-of-cadillac [https://perma.cc/KTF8-ZVK6], Ford bought shares from its investors at an implied valuation of $255 million in 1919; just a few years later, a financial syndicate would value the company at $1 billion. *See* Marc Hodak, The Ford Squeeze-Out (Sept. 11, 2007) (unpublished manuscript), https://ssrn.com/abstract=1011924 [https://perma.cc/2T7M-BGW9].

95. See, for example, other stories about Jack Bogle, who was fired from managing the Wellington Management Company and returned to transform Vanguard into the largest mutual-fund company in America, and Jon Luther, whose investors closed a food chain he managed, Benchmark, only for him to become the turnaround CEO of Popeyes and Dunkin' Donuts. RICK NEWMAN, REBOUNDERS: HOW WINNERS PIVOT FROM SETBACK TO SUCCESS 31-41, 45-52 (2012).

96. *See* Randall Lane, *John Sculley Just Gave His Most Detailed Account Ever of How Steve Jobs Got Fired from Apple*, FORBES (Sept. 9, 2013, 11:32 AM EDT), https://www.forbes.com/sites/randalllane/2013/09/09/john-sculley-just-gave-his-most-detailed-account-ever-of-how-steve-jobs-got-fired-from-apple [https://perma.cc/U4LR-W5T3].

97. Given Tesla's multiple stock splits, we report its prices using values reported by Google Finance as of September 20, 2022. *Tesla Inc*, GOOGLE FIN., https://www.google.com/finance/quote/TSLA:NASDAQ [https://perma.cc/7AZ2-ELAT].

98. Tae Kim, *Einhorn on Tesla: 'Like Lehman, We Think the Deception Is About to Catch Up*,' CNBC (Oct. 5, 2018, 6:51 PM EDT), https://www.cnbc.com/2018/10/05/einhorn-on-tesla-like-lehman-we-think-the-deception-is-about-to-catch-up-to-tsla.html [https://perma.cc/AM9N-3NGD].

99. Mike Guy, *Here's Why Tesla Will Go Bankrupt in 2019*, DRIVE (June 17, 2019, 3:11 AM), https://www.thedrive.com/tech/24261/elon-musk-and-10-billion-of-debt-why-tesla-will-go-bankrupt-in-2019 [https://perma.cc/2PSB-BSJK].

Musk as CEO.[100] The following October, as Tesla delivered a rare third-quarter profit, experts remained "concerned on 2020 momentum/profitability."[101] But by August 2020, Tesla's stock price was over $90.[102] Within another year, it surpassed $200. The market, it seemed, had undervalued Tesla and the investment strategy of its quixotic leader. Those who had perceived Tesla's true value made off handsomely, as the unexpected stock jump minted a new class of millionaires.[103] Had an activist (such as Einhorn) or a raider mistargeted Tesla and sold it for scrap, other Tesla investors may not have enjoyed those profits. Elon Musk's idiosyncratic vision would have remained unrealized. While the strength of the electric-vehicle market is now accepted,[104] other potentially pathbreaking technologies, such as artificial intelligence and gene editing, may still face market skepticism about the ability of firms to realize value from continued R&D on them.[105]

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100. Sam Abuelsamid, *Who Should Replace Elon Musk as Tesla CEO?*, FORBES (Oct. 1, 2018, 8:00 AM EDT), https://www.forbes.com/sites/samabuelsamid/2018/10/01/who-should-replace-elon-musk-as-tesla-ceo [https://perma.cc/8UM2-3MZ9].

101. Paul A. Eisenstein, *Tesla Reported a Surprise Profit—But How Long Can CEO Elon Musk Stay Ahead?*, NBC NEWS (Oct. 24, 2019, 11:12 AM EDT), https://www.nbcnews.com/business/autos/tesla-reported-surprise-profit-how-long-can-ceo-elon-musk-n1071296 [https://perma.cc/XD2V-TPMN] (quoting correspondence from Evercore ISI to Tesla investors).

102. *Tesla Inc*, *supra* note 97.

103. Justin Harper, *Tesla: Soaring Share Price Creates Army of 'Teslanaires,'* BBC NEWS (Dec. 29, 2020), https://www.bbc.com/news/business-55391571 [https://perma.cc/Q74N-H6XE].

104. *See, e.g.*, *Electric Vehicles / Electric Vehicle Market*, FORTUNE BUS. INSIGHTS (Sept. 2021), https://www.fortunebusinessinsights.com/industry-reports/electric-vehicle-market-101678 [https://perma.cc/WE79-WSE8] (forecasting a compound annual growth rate of 24.3% for the global electric-vehicle market in the 2021-2028 period).

105. This can be seen in the broad skepticism about Cathie Wood's innovation fund, ARKK. *See* Abhishek Vishnoi, *Cathie Wood's Strategy Draws More Skeptics as Returns Wane*, BLOOMBERG (Aug. 18, 2021, 11:14 AM EDT), https://www.bloomberg.com/news/articles/2021-08-18/detractors-of-cathie-wood-s-strategy-seem-to-be-growing-each-day [https://perma.cc/8HVT-86GP]. ARKK initially attracted billions of dollars in investment and was "among the best-performing [exchange-traded funds] in the U.S." before "struggl[ing] to maintain momentum amid concerns about lofty prices and accelerating inflation." *Id.* Last year, several hedge funds, including one managed by Michael Burry (made famous by MICHAEL LEWIS, THE BIG SHORT: INSIDE THE DOOMSDAY MACHINE (2010) and THE BIG SHORT (Paramount Pictures 2015)), disclosed short positions in ARKK. Vishnoi, *supra*. Skepticism about the commercial promise of Alphabet Inc.'s subsidiary focused on artificial intelligence, DeepMind, is another example. *See* Gary Marcus, *DeepMind's Losses and the Future of Artificial Intelligence*, WIRED (Aug. 14, 2019, 9:00 AM), https://www.wired.com/story/deepminds-losses-future-artificial-intelligence [https://perma.cc/2CW8-8MXF].

Short-termism. Relatedly, the classic theory of short-termism asserts that stock markets often suffer from myopia: their focus on short-term returns impairs their ability to analyze long-term business plans properly.[106] Under this theory, markets undervalue the profits that long-term investments generate.[107] Such myopia might occur because stock-market investors systematically underestimate the likelihood that long-term business projects will succeed, or apply too high a risk premium because they overestimate the volatility of returns from such projects.[108] The resulting mispricing might persist because investors face limits on arbitrage that prevent the correction of mispricing.[109] In any case, myopic markets might underprice the shares of firms that will generate most of their profits later rather than sooner. Thus, corporate leaders who pursue long-term visions might be replaced before that vision can pan out.[110]

106. *See, e.g.*, Mark J. Roe, *Corporate Short-Termism—In the Boardroom and in the Courtroom*, 68 BUS. LAW. 977, 985-87 & nn.28-41 (2013) (summarizing these arguments and the relevant literature); Patrick Bolton, José Scheinkman & Wei Xiong, *Executive Compensation and Short-Termist Behaviour in Speculative Markets*, 73 REV. ECON. STUD. 577, 577 (2006); Jeremy C. Stein, *Efficient Capital Markets, Inefficient Firms: A Model of Myopic Corporate Behavior*, 104 Q.J. ECON. 655, 655 (1989) [hereinafter Stein, *Myopic Corporate Behavior*]; Jeremy C. Stein, *Takeover Threats and Managerial Myopia*, 96 J. POL. ECON. 61, 62 (1988).

107. *See, e.g.*, Roe, *supra* note 106, at 981, 1005 (discussing the argument that, due to short-termism, "[q]uarterly results trump long-term investment, particularly long-term technological development," but ultimately concluding that "the evidence that financial markets are excessively short-term is widely believed but not proven").

108. *See id.* at 986 ("There is evidence that markets underestimate long-term corporate cash flows. And there is evidence that mispriced public firms invest in line with the time horizons of their major investors." (footnotes omitted)).

109. Andrei Shleifer & Robert W. Vishny, *The Limits of Arbitrage*, 52 J. FIN. 35, 36-37 (1997) (showing that arbitrage by professional investors does not effectively address asset mispricing "in extreme circumstances, where prices are significantly out of line and arbitrageurs are fully invested"); Andrei Shleifer & Robert W. Vishny, *Equilibrium Short Horizons of Investors and Firms*, 80 AM. ECON. REV. 148, 148 (1990) [hereinafter Shleifer & Vishny, *Equilibrium Short Horizons*] (explaining that it is less risky and less costly for asset managers to arbitrage a short-term asset for which mispricing will disappear in the short term than a long-term asset where there is more time for bad news or a wave of pessimism to hit).

110. *See, e.g.*, Martin Lipton & William Savitt, *The Many Myths of Lucian Bebchuk*, 93 VA. L. REV. 733, 745-47, 756-57 (2007) (explaining that corporate leaders face "a choice between maintaining an appropriate long-term focus . . . and the risk of being replaced with new directors answering to short-term investors"); Martin Lipton, *Bite the Apple; Poison the Apple; Paralyze the Company; Wreck the Economy*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Feb. 26, 2013), https://corpgov.law.harvard.edu/2013/02/26/bite-the-apple-poison-the-apple-paralyze-the-company-wreck-the-economy [https://perma.cc/3EZU-Y3J7] (providing a summary of arguments about the "detrimental effect of pressures for short-term performance"); Martin Lipton & Steven A. Rosenblum, *A New System of Corporate Governance: The Quinquennial Election of Directors*, 58 U. CHI. L. REV. 187, 205-13 (1991) (same).

To be sure, if the market valued long-term investments correctly, then actions that harmed a corporation in the long term would immediately reduce its stock price. Critics of the myopic-markets theory doubt that markets systemically undervalue long-term investments or can easily be fooled by such "tricks."[111] But the theory's proponents find support in theoretical models showing that market myopia is possible[112] and empirical evidence that either challenges the efficiency of markets[113] or associates the adoption of short-term strategies with shareholder pressure.[114] Of course, the other side of the debate cites

111. *See, e.g.*, MARK J. ROE, MISSING THE TARGET: WHY STOCK MARKET SHORT-TERMISM IS NOT THE PROBLEM 84-110 (2022) ("Considerable firm-level evidence points to stock market short-termism being no more than minimal.").

112. *See, e.g.*, Stein, *Myopic Corporate Behavior*, *supra* note 106, at 655-56 (using a game-theoretic model); Adam Brandenburger & Ben Polak, *When Managers Cover Their Posteriors: Making the Decisions the Market Wants to See*, 27 RAND J. ECON. 523, 526-27 (1996) (explaining myopia as a function of information asymmetries between managers and shareholders); Simon Grant, Stephen King & Ben Polak, *Information Externalities, Share-Price Based Incentives and Managerial Behaviour*, 10 J. ECON. SURVS. 1, 1 (1996) (exploring how informational asymmetries can lead to myopia); Natalie Mizik, *The Theory and Practice of Myopic Management*, 47 J. MKTG. RSCH. 594, 596 (2010) (discussing myopic management through the frameworks of signaling and information neglect); Shleifer & Vishny, *Equilibrium Short Horizons*, *supra* note 109, at 148.

113. *See, e.g.*, Lynn A. Stout, *The Mechanisms of Market Inefficiency: An Introduction to the New Finance*, 28 J. CORP. L. 635, 653-55 (2003) (reviewing the finance literature challenging the efficient capital markets hypothesis); Victor L. Bernard & Jacob K. Thomas, *Evidence that Stock Prices Do Not Fully Reflect the Implications of Current Earnings for Future Earnings*, 13 J. ACCT. & ECON. 305, 305-08 (1990) (presenting evidence consistent with the view that stock prices fail to fully reflect the implications of current earnings for future earnings).

114. *See, e.g.*, Daniel Ferreira, David Kershaw, Thomas Kirchmaier & Edmund-Philipp Schuster, *Shareholder Empowerment and Bank Bailouts* 1, 15-18 (Eur. Corp. Governance Inst., Working Paper No. 345, 2013) (showing that banks in which managers were more insulated from shareholders were roughly 18 to 26 percentage points less likely to be bailed out during the financial crisis); Leo E. Strine, Jr., *Can We Do Better by Ordinary Investors? A Pragmatic Reaction to the Dueling Ideological Mythologists of Corporate Law*, 114 COLUM. L. REV. 449, 463 n.41 (2014) (citing empirical studies suggesting that direct shareholder democracy might harm long-term corporate value); Brian J. Bushee, *Do Institutional Investors Prefer Near-Term Earnings over Long-Run Value?*, 18 CONTEMP. ACCT. RSCH. 207, 212 (2001) (finding that high levels of transient ownership are associated with an overweighting of near-term expected earnings); Brian J. Bushee, *The Influence of Institutional Investors on Myopic R&D Investment Behavior*, 73 ACCT. REV. 305, 307 (1998) (arguing that a high level of institutional ownership by institutions exhibiting high portfolio turnover, diversification, and momentum trading significantly increases managerial incentives to pursue short-term projects); Tomislav Ladika & Zacharias Sautner, *Managerial Short-Termism and Investment: Evidence from Accelerated Option Vesting*, 24 REV. FIN. 305, 305 (2020) (finding that management with shortened timeframes for performance-based compensation resulted in less real investment by corporations); Kevin J. Laverty, *Economic "Short-Termism": The Debate, the Unresolved Issues, and the Implications for Management Practice and Research*, 21 ACAD. MGMT. REV. 825, 832 (1996) (discussing short-

empirical studies showing that markets are efficient and that shareholder activism improves corporate value in the long run.[115] The empirical battle over short-termism has not yet produced a clear winner.[116] This Article does not take a position on the magnitude of the short-termism hazard. But we think it likely that the hazard exists.

Inefficient Markets. Finally, the market might misprice the target company's stock because the market has over- or underreacted to new information.[117] Prices might deviate from fundamental valuations due to fads, fashion, information

termism as managerial opportunism); John Asker, Joan Farre-Mensa & Alexander Ljungqvist, *Corporate Investment and Stock Market Listing: A Puzzle?*, 28 REV. FIN. STUD. 342, 343-45 (2014) (showing that private firms invest substantially more than public firms, with the gap widening where public firms' share prices are more responsive to earnings news); Alex Edmans, Vivian W. Fang & Katharina A. Lewellan, *Equity Vesting and Investment*, 30 REV. FIN. STUD. 2229, 2231-32, 2239-54 (2017) (presenting evidence that CEOs' concerns about current stock prices lead to reduced investment and arguing that these concerns are more consistent with market myopia than with efficient cuts in investment).

115. *See, e.g.*, Brav et al., *supra* note 11, at 1748-49 (finding that activist hedge funds generate long-term value); Bebchuk et al., *supra* note 62, at 1138 (finding the same); April Klein & Emanuel Zur, *Entrepreneurial Shareholder Activism: Hedge Funds and Other Private Investors*, 64 J. FIN. 187, 188 (2009) (finding that activist targets experience positive abnormal returns and interpreting this finding to "suggest that, on average, the market believes activism creates shareholder value"); Robin Greenwood & Michael Schor, *Investor Activism and Takeovers*, 92 J. FIN. ECON. 362, 362 (2009) (finding that the higher returns of activist targets is driven by a belief that the activists will successfully force a takeover); Roe, *supra* note 106, at 1005 ("Overall, the evidence that financial markets are excessively short-term is widely believed but not proven, and there is much evidence pointing in the other direction."); ROE, *supra* note 111, at 84-110 (evaluating the evidence for and against short-termism and concluding that while "there is some corporate short-termism," it is "small"). For a perspective that "long-term bias" can also impose substantial costs on investors and be every bit as damaging as short-termism, see Michal Barzuza & Eric Talley, *Long-Term Bias*, 2020 COLUM. BUS. L. REV. 104, 104-105.

116. *Compare* Coffee & Palia, *supra* note 29, at 552 (marshalling empirical evidence to explore "the possibility that the increasing rate of hedge fund activism is beginning to compel corporate boards and managements to forego long-term investments (particularly in R&D) in favor of a short-term policy of maximizing shareholder payout in the form of dividends and stock buybacks"), *with* Mark J. Roe & Roy Shapira, *The Power of the Narrative in Corporate Lawmaking*, 11 HARV. BUS. L. REV. 233, 239-44 (2021) (arguing that the "mixed" and "weak" empirical evidence that short-termism causes "economy-wide damage" does not support the "wide belief" that it does so).

117. *See* De Bondt & Thaler, *Does the Stock Market Overreact?*, *supra* note 23, at 799-803 (showing empirically that investors tend to overreact to new information); De Bondt & Thaler, *Further Evidence*, *supra* note 23, at 577-79 (providing additional evidence to support the hypothesis that "investors overreact to short-term . . . earnings movements"); Daniel et al., *supra* note 23, at 1841 (using empirical evidence to show "[t]he market's tendency to over- or underreact to different types of information"); De Bondt, *supra* note 23 (providing a review of the literature on overreaction theories).

bubbles, or crashes.[118] For example, consider the market gyrations that occurred during the beginning of the COVID-19 pandemic. Between mid-February and mid-March 2020, the S&P 500 dropped over 30% amidst fears that the pandemic would devastate the economy.[119] Over the following months, however, the market rebounded, and the S&P 500 ended the year over 10% higher than the earlier pre-pandemic peak.[120] These wild fluctuations, which plausibly reflect market overreaction to new information about the pandemic, gave control challengers an opportunity to buy in cheap and potentially exploit temporary market fears when mounting a control contest.[121]

2. *Asymmetric Information*

Because market prices only reflect public information, the market will underprice the stock of a corporation whose board cannot disclose favorable inside information. During this period of undervaluation, a control contest could cause shareholders to forfeit the corporation's hidden value because they either tender their shares to a raider at too low a price[122] or support an inferior business strategy proposed by an activist hedge fund in a proxy fight. For example, assume that a company knows that lands on which it holds an option sit atop vast and valuable mineral reserves. It might choose to withhold this information because it intends to buy up neighboring land. Investors could mistakenly replace competent managers if an activist targets the company. Managers may have a fiduciary duty *not* to disclose the information to the general public, even when facing a control contest, because doing so would be against the company's best interests. Meanwhile, federal securities law prohibits managers from selectively disclosing the information to just the control challenger, and control challengers

118. *See generally* Colin Camerer, *Bubbles and Fads in Asset Prices*, 3 J. ECON. SURVS. 3 (1989) (summarizing several theories about why asset prices might deviate from intrinsic values).

119. *S&P 500*, S&P GLOB., https://www.spglobal.com/spdji/en/indices/equity/sp-500 [https://perma.cc/5TX3-J82Y].

120. *Id.*

121. *See* Ofer Eldar & Michael D. Wittry, *Crisis Poison Pills*, 10 REV. CORP. FIN. STUD. 204, 241-42 (2021) (finding that during the COVID-19 pandemic, many firms adopted poison pills in response to declines in valuations, and stock prices increased upon their announcements).

122. Bernard Black and Reinier Kraakman analyzed this version of short-termism, called the "hidden value" theory, in the context of the debate over hostile takeovers. *See* Black & Kraakman, *supra* note 24.

might not want to receive nonpublic information because they wish to remain free to trade without risking insider-trading liability.[123]

B. The Mistargeting Model

Imagine once more the stylized market described above with three types of firms: high-quality, low-quality, and average firms. The low-quality firms underperform because their managers are either incompetent or disloyal. However, the high-quality firms also underperform, either because they are pursuing innovative or long-term plans that are hard for the market to price or because they are relying on confidential information that has not yet become public. To outsiders, high-quality and low-quality firms are indistinguishable, as both underperform by about the same margin—say, 10%—relative to the average firms. By contrast, investors can largely tell the average firms from the high- and low-quality firms (because they perform about 11% better).

For example, assume the market has 100 firms, and half of them are average. The others are split between twenty high-quality firms (20% of the total) and thirty low-quality firms (30% of the total). Assume there are two time periods, T1 and T2. At T1, the average firms trade at $1 million, while the high- and low-quality firms both trade at $900,000. However, if time is allowed to run its course, the high-quality firms will be worth $1.1 million at T2, while the market capitalization of the average and low-quality firms remains unchanged.

123. *See* Regulation FD, 17 C.F.R. § 243.100(a) (2022) (prohibiting the selective disclosure of material nonpublic information). Although Regulation FD contains an exemption for cases where the recipient of information "expressly agrees to maintain the disclosed information in confidence," *id.* § 243.100(b)(2)(ii), the risk of insider-trading liability remains, and activists frequently do not wish to enter such agreements because they want to remain free to trade without risking insider-trading liability. *See* Arthur F. Golden, Thomas J. Reid, Laura C. Turano & Daisy Wu, *United States*, *in* SHAREHOLDER ACTIVISM & ENGAGEMENT 88, 91 (Arthur F. Golden, Thomas J. Reid & Laura C. Turano eds., 3d ed. 2018), https://www.davispolk.com/sites/default/files/gtdt_2018-shareholder-activism-engagement.pdf [https://perma.cc/S9RX-5MNZ].

TABLE 1: NO ACTIVISTS OR RAIDERS

	T1	T2
HIGH-QUALITY FIRMS	20 x $900,000 = $18,000,000	20 x $1,100,000 = $22,000,000
LOW-QUALITY FIRMS	30 x $900,000 = $27,000,000	30 x $900,000 = $27,000,000
AVERAGE FIRMS	50 x $1,000,000 = $50,000,000	50 x $1,000,000 = $50,000,000
TOTAL MARKET CAP.	$95,000,000	$99,000,000

Now, however, assume that activists and raiders will target a certain subset of the high- and low-quality firms and turn them into average firms. We might first assume that they have perfect competence and no conflicts: they only target low-quality firms. Assume that they will target twenty low-quality firms. In this case, we would see market value at T2 rise to $101 million instead of $99 million in the normal course, a $2 million improvement (twenty firms, each with a $100,000 improvement). Control contests under these assumptions would be an unmitigated good.

However, a more interesting (and realistic) model is a world with mixed competence. Sometimes activists and raiders will correctly target low-quality firms, and sometimes they will mistakenly target high-quality firms. Suppose that their "accuracy rate" is 60%, meaning that challengers correctly choose low-quality firms 60% of the time out of all the firms they target. Assume that they target twenty-five firms in total. In this scenario, challengers will target ten high-quality firms and fifteen low-quality firms and transform each of them into an average-quality firm. Under the assumptions of this example, these effects roughly cancel each other out in terms of market capitalization, yielding a $99.5 million market capitalization in T2 instead of the $99 million without control challengers.

TABLE 2: ACTIVISTS OR RAIDERS WITH 60% ACCURACY

	T1	T2
HIGH-QUALITY FIRMS	20 x $900,000 = $18,000,000	10 x $1,100,000 = $11,000,000
LOW-QUALITY FIRMS	30 x $900,000 = $27,000,000	15 x $900,000 = $13,500,000
AVERAGE FIRMS	50 x $1,000,000 = $50,000,000	75 x $1,000,000 = $75,000,000
TOTAL MARKET CAP.	$95,000,000	$99,500,000

From this point, we can imagine at least two changes to the model: a change in the relative returns of high- and low-quality firms and a change in the rate of accuracy. First, assume that high-quality firms are fewer in number (with only ten firms) but are also much *higher* quality than before. Now, high-quality firms are growth machines. They underperform at T1, but at T2 they really take off, becoming 400% more valuable than their average peers. That is, at T2, they are worth $5 million. Table 3 shows the outcomes when there are no control challengers.

TABLE 3: GROWTH MACHINES WITH NO CONTROL CONTESTS

	T1	T2
HIGH-QUALITY FIRMS	10 x $900,000 = $9,000,000	10 x $5,000,000 = $50,000,000
LOW-QUALITY FIRMS	30 x $900,000 = $27,000,000	30 x $900,000 = $27,000,000
AVERAGE FIRMS	60 x $1,000,000 = $60,000,000	60 x $1,000,000 = $60,000,000
TOTAL MARKET CAP.	$96,000,000	$137,000,000

Assume, however, that activists and raiders are at work. Suppose they have an 80% accuracy rate, meaning that about one-fifth of the companies they target, on average, are high-quality ones, and they target a total of twenty-five firms. That is, control challengers are even more accurate than before—they will mistarget five high-quality firms and properly target twenty low-quality firms. In this world, however, we can expect activists and raiders to do far more damage than before, even though they usually target the right firms, because the high-quality firms are worth so much more than the average-quality firms. Mistargeting is, therefore, a much more pressing risk.

TABLE 4: GROWTH MACHINES WITH CONTROL CONTESTS

	T1	T2
HIGH-QUALITY FIRMS	10 x $900,000 = $9,000,000	5 x $5,000,000 = $25,000,000
LOW-QUALITY FIRMS	30 x $900,000 = $27,000,000	10 x $900,000 = $9,000,000
AVERAGE FIRMS	60 x $1,000,000 = $60,000,000	85 x $1,000,000 = $85,000,000
TOTAL MARKET CAP.	$96,000,000	$119,000,000

In this world, control contests do more harm than good. Without corporate raiders and shareholder activists, the market would have been worth $137 million, as shown in Table 3. But because control contests create more principal costs than they avert in agent costs, it turned out to be worth $119 million, as shown in Table 4. That $18 million difference represents the principal costs of control contests.

This effect can become even more pronounced with externalities. In the previous scenarios, control challengers targeted only a subset of the high- and low-quality firms, contesting control for only part of these firms. The other part continued doing business without interference. Now suppose that corporate boards and managers of high- and low-quality firms that have not been targeted realize they could nevertheless soon become the target of a control contest. To avoid such a control contest, these incumbents change their companies' business strategies to make them less attractive targets to activists or raiders, such as by cutting R&D, taking on additional debt, and increasing share buybacks. Here, all high- and low-quality firms become average at T2, even though control challengers have targeted only a subset of the firms.

TABLE 5: GROWTH MACHINES WITH CONTROL CONTESTS AND EXTERNALITIES

	T1	T2
HIGH-QUALITY FIRMS	10 x $900,000 = $9,000,000	0 x $5,000,000 = $0
LOW-QUALITY FIRMS	30 x $900,000 = $27,000,000	0 x $900,000 = $0
AVERAGE FIRMS	60 x $1,000,000 = $60,000,000	100 x $1,000,000 = $100,000,000
TOTAL MARKET CAP.	$96,000,000	$100,000,000

In this scenario, control contests destroy even more value. Without activists and raiders in the picture, the market would have grown from $96 million to $137 million. With activists and raiders intervening—but without externalities—the market grows from $96 million to $119 million. Add externalities into the model and control contests even more dramatically dampen economic growth, with the market growing from $96 million to only $100 million.

Depending on the assumptions one makes about which firms generate outsized returns and how likely raiders and activists are to destroy social wealth by mistakenly targeting high-quality firms, control contests can either be a net good or a net evil. More particularly, certain kinds of control contests may be—and, this Article argues, *are*—more likely to result in mistargeting.

This Part analyzed one of the key risks of corporate control contests: the mistargeting hazard. When the challenger gets things right, control contests reduce agent costs by getting rid of bad managers. But control contests can also create principal costs when the challenger gets rid of a good manager who is pursuing mispriced or confidential business strategies. Moving from the general into the particular, the next Part examines how activists and raiders are likely to differ in the extent to which they avoid agent costs and create principal costs.

III. THE COSTS OF RAIDERS AND ACTIVISTS

Compared with corporate raiders who purchase the entirety of their targets' stock at a premium, hedge-fund activists have a relative hair trigger for their decision to get involved. This hair trigger means they are more likely to correct managerial malfeasance before it rises to a staggering level. But it also means they are more likely to mistarget companies. We argue, moreover, that activists are more likely than raiders to destroy social wealth after engaging in mistargeting, even controlling for each control challenger's willingness to intervene. This means that activists are more likely both to get involved and to wrongly cause their targets to abandon sound business strategies when they do get involved.

This Part explores the relative costs of raiders and activists in light of the mistargeting hazard. Section III.A argues that activists are likely to impose greater principal costs than raiders because activists are more likely to engage in mistargeting and, ultimately, to destroy social wealth. Section III.B turns to the available empirical evidence. Empirical studies offer equivocal evidence for the claim that activists increase shareholder value and suggest that any value that activists create is driven primarily by those activist efforts that eventually result in the target company's acquisition. In short, activists create value mainly by opening the door for raiders. As Part IV will explain, this has important implications for law and policy.

A. *Raiders and Activists Compared*

The key difference between the business models of activists and raiders is that an activist acquires a relatively small stake in the target company—generally less than 10%—whereas a raider acquires the entire company. This difference leads to two important results. First, activists are simply more likely than raiders to engage in corporate control contests—warranted or unwarranted. This means that the presence of activists is more likely to lead to both lower agent costs and higher principal costs than would the presence of raiders alone. Second, activists are more likely than raiders to destroy social wealth after engaging in mistargeting, even controlling for their willingness to intervene. This suggests that activists impose greater principal costs than raiders, independent of the greater propensity of activists to engage in control contests.

1. *Propensity to Intervene*

Activists have a greater potential than raiders to both reduce agent costs and increase principal costs due to activists' greater propensity to engage in control contests. As previously explained, activist hedge funds have a lower hurdle rate than corporate raiders.[124] As a result, activists will be willing to target a wider range of firms, even when a firm's apparent underperformance is relatively modest. This means that activists will engage in control contests where raiders would typically sit on the sidelines. When activists target the right companies, that additional engagement will translate into lower agent costs for shareholders and the market. When they target the wrong companies, that additional engagement will translate into higher principal costs for shareholders and the market. Thus,

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124. *See* discussion *supra* Section I.A.

the presence of activists will both reduce agent costs and increase principal costs to a greater extent than would the presence of raiders alone.

Externalities amplify these effects. As previously noted, the presence of activists and raiders in the market can dissuade managers from pursuing strategies that they believe might make them the target of a control contest.[125] The extent to which managers are dissuaded from generating agent costs through disloyalty or incompetence is a positive externality.[126] But the extent to which managers are dissuaded from pursuing idiosyncratic, long-term, or confidential business strategies that would create value is a negative externality.[127] Because activists are willing to target a wider range of firms, the presence of activists in the market will increase both positive and negative externalities more than would the presence of raiders alone.

2. *Likelihood of Destroying Social Wealth*

So far, we have shown that activists are more likely than raiders to engage in control contests because activists have lower hurdle rates. If the contestant's hurdle rate were the only factor that distinguished activists from raiders, the relative impacts of activists and raiders on firm value would depend solely on whether control contests generally increase or decrease the net sum of principal and agent costs. If control contests decreased the net sum of principal and agent costs, then activists would do more to improve firm value than would raiders alone. If control contests increased the net sum of principal and agent costs, by contrast, then activists would reduce firm value more than would raiders alone.

But a careful examination of the different features of activists and raiders suggests that raiders are likely to impose lower principal costs than activists, even controlling for each contestant's hurdle rate. Raiders, compared to activists, are less likely to mistakenly quash idiosyncratic vision or long-term investments and are less likely to destroy value due to market inefficiencies or asymmetric information. First, because raiders buy 100% of the corporation, raiders will receive more information after targeting a firm, meaning they are more likely to understand when a firm is engaged in innovative, long-term, or hard-to-value business plans, as opposed to underperforming for other reasons. Indeed, securities regulations and directors' fiduciary duties may affirmatively prevent the company from sharing confidential information with an activist—even though sharing that information could avert a proxy contest—and the activist may not want to receive such information because it wishes to remain free to trade without

125. *See* discussion *supra* Section I.B.

126. *See* Gantchev et al., *supra* note 28, at 1032-34.

127. *See* Coffee & Palia, *supra* note 29, at 552.

risking insider-trading liability.[128] Unlike activists, once a raider has 100% of the target's shares, the incumbent managers can divulge everything they know to the raider without running afoul of securities laws, fiduciary duties, or other concerns.[129]

Second, once the raider has acquired 100% of the target stock, what is good for the target is also good for the raider. If the raider can be convinced that the business plan will be more profitable over the long term than a strategy of spinoffs or dividends, it will naturally allow the plan to proceed either with the existing board or with its own board.[130] Activists are unlikely to have the luxury of waiting for an idiosyncratic vision or long-term business plan to pay off. Generous estimates of hedge-fund involvement put their median time horizon between one and two years.[131] Moreover, when successful, their methods tend to

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128. *See supra* note 123 and accompanying text (describing the effect of Regulation FD and insider-trading prohibitions).

129. The securities-law prohibition on selective disclosure applies only to public companies, which is not a concern for a raider once it completes the acquisition and takes the target private. Regulation FD, 17 C.F.R. § 243.101(b) (2022) (defining issuers subject to Regulation FD to include those with "a class of securities registered under Section 12 of the Securities Exchange Act of 1934 (15 U.S.C. 78*l*), or . . . required to file reports under Section 15(d) of the Securities Exchange Act"). Meanwhile, there is no risk of insider-trading liability if the raider is the sole shareholder because there is no risk that the raider will engage in prohibited trading. Moreover, buyers can often get confidential information before the acquisition during the due diligence phase by signing a confidentiality agreement, though this can be more complicated if the board resists the takeover.

130. More than 50% of the top executives of target companies keep their jobs in the first year after a takeover. *See* Kenneth K. Martin & John J. McConnell, *Corporate Performance, Corporate Takeovers, and Management Turnover*, 46 J. FIN 671, 674 (1991) (finding that, compared with the normal management turnover rate of about 10%, the turnover rate for top executives rises to 41.9% in the first year following the takeover and 19% in the second year). Even though for our argument it is sufficient that only some managers keep their jobs, a raider can proceed with the existing plan (or some variant of it) even if there is management turnover following the takeover. High rates of CEO turnover following hostile takeovers do not imply that raiders cannot stay the course. Nor would lower rates of CEO turnover following activist engagements compared to hostile takeovers say anything about the capacity for raiders versus activists to stay the course. CEO turnover rates are an equilibrium outcome. That is, they reflect the strategic interactions between the CEO and the activist and the CEO's beliefs about the likelihood that the activist will succeed. A rational CEO who wants to keep her job will avoid dismissal by acceding to the activist's demands if she believes that there is a sufficiently high likelihood that the activist will succeed in a proxy fight—and possibly even if she doesn't think the likelihood is all that high, but she believes that the activist will make her life sufficiently hard that caving in is the rational course of action.

131. Brav et al., *supra* note 11, at 1749 (identifying 369 days as the median duration for the period between Schedule 13D filing and divestment, and 319 days as the median duration in the case of hostile transactions); Alon Brav, Wei Jiang & Hyunseob Kim, *Hedge Fund Activism: A Review*, 4 FOUNDS. & TRENDS FIN. 185, 204 tbl.4.2 (2010) (identifying a 266-day period between Schedule 13D filing and divestment).

involve increasing a company's debt load and distributing its cash.[132] Predictably, these interventions result in a spike in short-term value but often scuttle long-term growth.[133] High debt loads and low cash reserves are likely to hamper innovative business plans that require substantial investments. And realizing the gains of complex business plans that distinguish a firm from its peers is incompatible with the strategy of increasing debt load, distributing cash, and moving on. Thus, even if the activist is convinced that the payout would be greater in the long run, it may be ready to sacrifice that long-term gain for short-term profits. Indeed, the business model of activist hedge funds requires them to generate consistent abnormal short-term returns or risk their investors fleeing to other funds that are generating such returns.[134]

The possibility that an activist might obtain additional information after gaining a seat on the board[135] does not meaningfully narrow the gap between raiders and activists. Even if the activist learns new information that should change an objective observer's opinion, the activist will face structural conflicts that impede it from objectively assessing whether to change the company's business. First, a change in position could hurt the activist's reputation. In waging proxy contests, activists frequently come in hot, penning strongly worded "fight letters" and white papers castigating incumbent management for incompetence, disloyalty, or both.[136] If the activist later changes its tune, it effectively concedes to the market that it was wrong. Especially in cases where the activist takes a hypercritical stance during the proxy contest, a subsequent change in position could damage the activist's credibility in future campaigns.[137] As repeat players,

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132. Klein & Zur, *Hedge Fund Activism*, *supra* note 14, at 5.

133. Mark R. DesJardine & Rodolphe Durand, *Disentangling the Effects of Hedge Fund Activism on Firm Financial and Social Performance*, 41 STRATEGIC MGMT. J. 1054, 1078-79 (2020).

134. *See* Coffee & Palia, *supra* note 29, at 573 ("[H]edge fund managers remained subject to short-term time constraints, because if they did not earn above-market returns as activists, their investors were again likely to switch to other managers who had recently done so.").

135. *See* Assaf Hamdani & Sharon Hannes, *The Future of Shareholder Activism*, 99 B.U. L. REV. 971, 994-97 (2019) (explaining that one of the roles of activist-appointed directors is to provide the hedge fund with access to nonpublic information that will help the fund refine its business plans for the target).

136. *See* Martin Lipton, *Dealing with Activist Hedge Funds and Other Activist Investors*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Jan. 25, 2019), https://corpgov.law.harvard.edu/2019/01/25/dealing-with-activist-hedge-funds-and-other-activist-investors-2 [https://perma.cc/K6NQ-4Q98] (describing strategies used by activist investors); Third Point LLC v. Ruprecht, C.A. No. 9469, 2014 WL 1922029, at *9-14 (Del. Ch. May 2, 2014) (detailing activist hedge-fund manager Daniel Loeb's aggressive criticism of incumbent management in connection with his activist campaign at Sotheby's, through which he intended to "shock and awe" management notwithstanding any "collateral damage" to the board).

137. *See* sources cited *supra* note 19.

activists have strong incentives to avoid such a result.[138] Second, the manager of the activist fund—apart from the fund's investors—may have special incentives to ignore new information. To the extent that the new information suggests that the target company's business plan will take some time to produce results, the fund manager's need to generate consistent, abnormal short-term returns or risk losing the fund's investors will incentivize the manager to ignore the information in favor of short-term results.[139] Moreover, to the extent that the new information suggests that the target company's business plan is riskier than the alternative business strategy proposed by the hedge fund, a risk-averse fund manager may not want to take the gamble, even if a diversified investor would. Unlike a typical investor who can "diversify away" her exposure to a specific company's idiosyncratic risk by investing in an index fund or other diversified portfolio,[140] the fund manager is likely to have both her capital and her career disproportionately tied up in the target company, thereby incentivizing her to be more cautious than a diversified investor would like. In other words, the fund manager may opt for a bird in the hand rather than two in the bush, while diversified shareholders would be willing to wait to see through a riskier strategy.[141]

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138. Although it is theoretically possible that activists could try to develop a reputation for being fair-minded by adjusting their views based on nonpublic information learned after joining the board, we doubt that this is widespread as an empirical matter. To the contrary, anecdotal evidence suggests that activists are likely to continue to stick to their original investment thesis after joining the board, as highlighted by the *PLX* case in which the Delaware Court of Chancery found that activist hedge-fund manager Eric Singer breached his fiduciary duties to the target company after joining its board and continuing to single-mindedly pursue the goal he had originally announced: a sale. *In re* PLX Tech. Inc. S'holders Litig., C.A. No. 9880, 2018 WL 5018535, at *32-47 (Del. Ch. Oct. 16, 2018), *aff'd*, 211 A.3d 137 (Del. 2019). In any event, even if activists may adjust their views in certain situations, they seem less likely than raiders to do so.

139. *See* Coffee & Palia, *supra* note 29 and accompanying text.

140. *See* Richard A. Brealey, Stewart C. Meyers & Franklin Allen, Principles of Corporate Finance 176 (10th ed. 2011) (observing that diversification can eliminate "specific risk"); Jeffrey N. Gordon, *Systematic Stewardship*, 47 J. Corp. L. 628, 629 (2022) ("Risk that pertains to a particular company, so-called 'idiosyncratic' risk, can be diversified away . . . .").

141. Our claim is not that a person's opinions cannot change once she joins the board; it is that the *activist* fund and its manager have special incentives to disregard information learned after joining the board. The possibility that an activist might nominate unaffiliated candidates for the board does not eliminate this problem. A savvy activist will carefully vet its nominees for agreement with its plan.

These same considerations counsel that "books and records" litigation brought under Section 220 of the Delaware General Corporation Law is unlikely to materially narrow the gap between raiders and activists. *See* Del. Code Ann. tit. 8., § 220 (2022) (providing stockholders a statutory right to inspect the "books and records" of a corporation and its subsidiaries for a "proper purpose . . . reasonably related to such person's interest as a stockholder"). Indeed, Nor does a raider's potential use of leverage imply that activists pose a lesser threat than raiders. To be sure, some raiders finance their acquisitions with high levels of debt assumed by the target company, which might make it more difficult to depart from the initial strategy.[142] However, for several reasons, leveraged acquisition will not make raiders more threatening than activists. First, raiders do not necessarily finance their acquisitions with high levels of debt. As we define the term,[143] "raiders" include not only the corporate raiders of the 1980s who relied heavily on "junk" bonds to finance their acquisitions.[144] More typical raiders today would be private-equity firms that execute leveraged buyouts with lower levels of traditional debt and can (and do) maintain innovation.[145] And raiders can also be strategic acquirers who pay with stock in a third of acquisitions.[146] For example, Air Products and Chemicals, Inc.'s hostile bid for Airgas, Inc., which we discuss in Section IV.A, was to be financed primarily with equity,

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an activist-appointed director has even greater informational rights than a mere stockholder has. *See* 1 R. Franklin Balotti, Jesse A. Finkelstein, John Mark Zeberkiewicz & Blake Rohrbacher, Balotti and Finkelstein's Delaware Law of Corporations and Business Organizations § 7.20[G] (4th ed. 2022) (discussing the "separate statutory right" granted to directors "to examine the stock ledger, stocklist, and other corporate records" so long as such examinations are germane to their directorial role). The problem is that the activist has incentives to ignore or minimize the information whether gained through a seat on the board or a books-and-records demand. Instead, the more plausible activist use for books-and-records litigation is as a tool to gain information to use *against* management, such as by revealing managerial malfeasance, in advance of a proxy contest. *See, e.g.*, High River Ltd. P'ship v. Occidental Petrol. Corp., C.A. No. 2019-0403, 2019 WL 6040285, at *4 (Del. Ch. Nov. 14, 2019) (describing the "typical case" in which a stockholder uses Section 220 to "inspect books and records to investigate corporate wrongdoing" and noting that the Court of Chancery has allowed plaintiffs "to use acquired books and records to mount a proxy contest").

142. *See, e.g.*, Brian Ayash, *The Origin, Ownership and Use of Cash Flows in Leveraged Buyouts*, 77 Q. Rev. Econ. & Fin. 286, 294 (2020) (finding that leveraged buyouts reduce investment and growth in target companies).

143. *See supra* note 13 (defining the term "raiders").

144. Even during the 1980s, when most targets were not high-tech corporations, targets that had high levels of R&D before the takeover maintained investment in productive R&D projects after the takeover. *See* William F. Long & David J. Ravenscraft, *LBOs, Debt and R&D Intensity*, 14 Strategic Mgmt. J. 119, 132 (1993).

145. *See generally* Josh Lerner, Morten Sorensen & Per Strömberg, *Private Equity and Long-Run Investment: The Case of Innovation*, 66 J. Fin. 445, 445 (2011) (finding "no evidence that LBOs sacrifice long-term investments," that "LBO firm patents are more cited," and that LBO firms "show no shifts in the fundamental nature of the research, and become more concentrated in important areas of companies' innovative portfolios").

146. *See* Jarrad Harford, Sandy Klasa & Nathan Walcott, *Do Firms Have Leverage Targets? Evidence From Acquisitions*, 93 J. Fin. Econ. 1, 3 (2009) (finding that large acquisitions are paid for with only cash 51% of the time, only common stock 32% of the time, and a mix of equity and cash 17% of the time).

not debt.[147] Second, even where raiders do cause the target company to assume a great deal of debt and paying off the debt might foreclose an attractive business opportunity, a raider can still change course if it can replace the debt with equity financing.[148] It is not uncommon for an acquirer to secure equity financing, of course, and an acquirer may change the equity component of an offer before the deal even closes, as shown by recent events.[149]

In any event, even to the extent that the use of leverage does limit the options available to raiders, that result only brings them closer to activists.[150] It does not mean that activists will preserve social wealth or do so more frequently than raiders.

3. *Cost-Shifting*

Another difference between raiders and activists is that activists can more easily shift their costs onto other shareholders, whereas raiders must buy those shareholders out at a premium. Think of the target firm as a car: activists plan to rent the car, while raiders intend to buy it. The buyer is more likely than the renter to do their best to protect the car. This is partly because the buyer has more at stake as an absolute matter and partly because the renter can shift some costs onto other parties—the dealer and future owners—while the buyer cannot.

This difference in the ability to shift costs has two relevant implications. First, the premium paid out to other shareholders offsets the cost of a mistake by the target's selling shareholders. Although the large premium that raiders must offer limits the range of underperforming firms they can target profitably, it also provides an offsetting benefit by compensating diversified shareholders for mistargeting risk. As discussed in Part II, both raiders and activists might mistarget a firm. Raiders might buy an undervalued firm at a discount, while activists might replace a firm's high-quality strategy with a middling one. A raider, however, at least partly compensates diversified shareholders for this risk

147. *See* Ernest Scheyder, *Air Products Goes Hostile in Bid for Airgas*, REUTERS (Feb. 11, 2010, 8:53 AM), https://www.reuters.com/article/us-airgas-airproducts/air-products-goes-hostile-in-bid-for-airgas-idUSTRE61A2TH20100211 [https://perma.cc/22PJ-S6HU].

148. Indeed, acquirers adjust debt levels following acquisitions. *See, e.g.*, Harford et al., *supra* note 146, at 11.

149. *See* Connor Smith, *Tesla CEO Elon Musk Fine-Tunes His Potential Buy of Twitter*, BARRONS (May 26, 2022, 9:24 AM ET), https://www.barrons.com/articles/tesla-elon-musk-twitter-stock-price-acquisition-51653515821 [https://perma.cc/RUC6-SED5] (describing changes to Musk's financing of his pending acquisition of Twitter, Inc., including his replacement of the margin-loan component with equity financing, resulting in $33.5 billion in equity financing and $13 billion in debt).

150. But not too close, as activists also use leverage, just in a different form: buying options and derivatives.

by paying them a premium for their shares.[151] The compensation will be even greater if the announcement of a tender offer puts the target "in play," drawing other raiders into a bidding contest.[152] Activists face no competition[153] and offer no such compensation, suggesting that they impose higher principal costs on diversified shareholders than raiders do.[154]

Second, the ability of activists to shift their costs onto other shareholders means that activists can benefit even when they mistarget and destroy value, while raiders will generally not destroy value when they engage in mistargeting. Suppose that an activist mistakenly targets a high-quality firm that only appears to be underperforming and then causes it to abandon its high-value business strategy. Even though it has destroyed value, the activist still could benefit to the extent the market perceives the changes caused by the activist as increasing the firm's value—whether due to market mispricing or asymmetric information—and bids up the company's stock price. The activist would then sell its stock for a profit. By contrast, although raiders can also benefit from mistargeting, they are less likely to destroy value. Raiders cannot shift their costs onto others, so they will ultimately refrain from imposing changes in strategy that are likely to decrease shareholder value. While the raider's mistargeting might cause a wealth transfer from other shareholders to the raider, this transfer would not be socially inefficient. The size of the pie would not change even if the allocation of the slices did.

4. *Offsetting Effects of Shareholder Screening*

Shareholders have an incentive to screen bad proposals and so might be expected to curb the risk of mistargeting. If an activist mistargets a shareholder's portfolio firm, the shareholder loses out because long-term returns would have been greater without the control contest. If a raider mistargets a firm, the shareholders may sell for a premium that—although above market—is less than what the firm ultimately turns out to be worth in the long run. Thus, in either case, shareholders have a reason to discern good control contests from bad ones.

151. *See* sources cited *supra* note 51 (reporting average takeover premia).

152. *See* Gilson, *supra* note 42, at 54. This increases the likelihood of the target ending up in the hands of the bidder who values it the most.

153. Hedge-fund activists do not face competition from other activists who offer a better business strategy for the target, as the norm is to follow the first mover.

154. That said, raiders may also take a greater portion of the profits when they successfully improve the performance of an underperforming company. In theory, at least, activists may share a greater portion of those profits with other shareholders. In practice, the sharing of profits with diversified shareholders decreases to the extent that activists form a "wolf pack" by tipping off other hedge funds that buy stock before the activist's involvement is disclosed.

However, while the role of shareholders at first seems promising, capacity and competence limitations cast doubt on their ability to screen control contests.

To begin, because activist hedge funds do not offer shareholders a premium, they give those shareholders even more reason to screen than in the case of raiders. And we can expect that recent market changes have made the screening of activists more effective. Institutional shareholders, who are considered sophisticated, now own a large proportion of the shares of public corporations.[155] Moreover, securities regulation has increased the amount and quality of information disclosed to the market, and market efficiency has also increased over the years.[156] Despite these changes, there are several reasons to suspect that screening still does not prevent mistargeting by activist hedge funds.[157]

First, not all institutional investors invest in information. Most prominently, index funds[158] invest very little in information about the quality of the managers at their portfolio companies.[159] The exchange of information between activists and institutional investors is unlikely to remedy this problem. In mounting a control contest, an activist hedge fund tries to persuade shareholders that the company is mismanaged, not undervalued or mispriced. Thus, an activist is unlikely to provide information that leads investors to oppose the activist's plan. Second, many informed institutions will not hold share blocks that are large enough to justify becoming more informed than the hedge-fund activist.[160] Indeed, it is only because the institutional investor is insufficiently informed, or is committed to an indexing strategy, that it might hold low-quality firms in its portfolio in the first place. Third, some activist funds pursue the "wolf pack" tactic, in which several funds target the same firm, thereby collectively acquiring

155. *See* Gilson & Gordon, *supra* note 62, at 874.

156. *See generally* Jeffrey N. Gordon, *The Rise of Independent Directors in the United States, 1950-2005: Of Shareholder Value and Stock Market Prices*, 59 STAN. L. REV. 1465 (2007) (analyzing the relationship between improved market efficiency and the rise of independent directors).

157. *See generally* Alessio M. Pacces, *Exit, Voice and Loyalty from the Perspective of Hedge Funds Activism in Corporate Governance*, 9 ERASMUS L. REV. 199, 204-11 (2016) (analyzing the capacity of institutional investors to screen activist proposals).

158. Index funds are a passive investment vehicle aiming at replicating a given market index (e.g., the S&P 500 or the NASDAQ 100) by purchasing the securities composing the given index. *See generally* Anna Agapova, *Conventional Mutual Index Funds Versus Exchange-Traded Funds*, 14 J. FIN. MKTS. 323 (2011) (providing an overview of conventional open-ended mutual index funds and exchange-traded funds tracking underlying indices).

159. *See* Lucian Bebchuk & Scott Hirst, *Index Funds and the Future of Corporate Governance: Theory, Evidence, and Policy*, 119 COLUM. L. REV. 2029, 2050-59 (2019) (describing index-fund managers' incentives to underinvest in stewardship and the evidence in support of this theory).

160. *See* Gilson & Gordon, *supra* note 62, at 891-92.

a large share block.[161] Since the pack's members tend to vote together, the "lead wolf" (the fund that initiates the contest) can succeed by persuading a relatively small fraction of the other shareholders to grant their proxies.[162] In other words, even if most unaffiliated shareholders vote *against* the activist, a small number of mistaken shareholders could doom the rest. Finally, self-interested boards who want to avoid losing their seats in a proxy fight may agree to activist demands before other shareholders can give their views. Indeed, most activist campaigns settle before even reaching the proxy-fight stage, with settlements being about twice as common as voted proxy contests.[163]

Notably, shareholder screening cannot improve over time through a learning process, and there is no reputational risk for the activists. After an activist campaign ends, it is unobservable whether the activist reduced agent costs or increased principal costs. Return to our example of the outlier firm investing 7% of cash flows in R&D compared to the 3% of its peers.[164] If the market undervalues the firm because investors mistakenly believe managers are overinvesting in a "pet" project, a successful activist's campaign slashing the R&D budget will increase the share price even if the managers were in fact developing pathbreaking technology.

In addition, shareholders may be particularly poor screeners of activists as opposed to raiders. Activists ask shareholders to vote on a substantive *business question*—whether to replace the board or pursue a particular business strategy. Institutional investors, whose core function is to select investments, do not specialize in making these business decisions. Raiders ask these investors to make an *investment choice*—namely, whether to sell their shares at a particular price. This decision depends on the potential future value of a company, a question that institutional investors *are* supposed to be experts at predicting.[165] At least in

161. *See* Thomas W. Briggs, *Corporate Governance and the New Hedge Fund Activism: An Empirical Analysis*, 32 J. CORP. L. 681, 691 (2007); Coffee & Palia, *supra* note 29, at 549; *see also* Tanja Artiga González & Paul Calluzzo, *Clustered Shareholder Activism*, 27 CORP. GOVERNANCE INT'L. REV. 210, 210 (2019) (describing so-called wolf pack activity as "clustered activism").

162. *See* Coffee & Palia *supra* note 29, at 567.

163. *See* Bebchuk et al., *supra* note 56, at 5.

164. *See* discussion *supra* Section II.A.1.

165. *See, e.g.*, Melvin Aron Eisenberg, *The Legal Roles of Shareholders and Management in Modern Corporate Decisionmaking*, 57 CALIF. L. REV. 1, 7-15 (1969) (discussing the different types of firm decisions in which shareholders should be involved and noting that decisions that require business, rather than investment, skills should generally be left to corporate management rather than shareholders).

theory, then, screening a corporate raid should be easier for these large-scale shareholders than screening an activist proxy contest.[166]

B. The Empirical Evidence

In the previous Section, we considered the likely impacts of raiders and activists on firm value along two dimensions: (1) the relative propensity of raiders and activists to engage in control contests and (2) the likelihood that each contestant will destroy social wealth after engaging in mistargeting, controlling for the propensity to intervene. We argued that, given their greater propensity to contest corporate control, activists are likely to both decrease agent costs and increase principal costs more than would raiders alone.[167] We also argued that, holding constant each contestant's propensity to intervene, raiders are less likely to engage in value-destructive mistargeting and are, therefore, likely to impose lower principal costs.[168]

The foregoing analysis suggests that the relative impacts of raiders and activists on firm value depend on both the aggregate effect of control contests on the net sum of principal and agent costs and the channels through which raiders and activists create or destroy that value. This Section turns to the relevant empirical evidence bearing on these issues.

On the whole, the evidence that activists generally decrease agent costs more than they increase principal costs is equivocal.[169] And to the extent that activists do create long-term value, the evidence suggests that this effect is driven primarily by those activist efforts that eventually result in the target's acquisition.[170] In other words, activists primarily add value not by improving governance and cutting agent costs, but rather by acting as auctioneers and selling off the companies they target to raiders.

Meanwhile, studies show that a small number of firms generate most of the returns in the stock market, suggesting that the loss from breaking a good firm

166. Proxy advisors are unlikely to fully solve this problem and may sometimes even make it worse. *See generally* Andrey Malenko & Nadya Melenko, *Proxy Advisory Firms: The Economics of Selling Information to Voters*, 74 J. FIN. 2441 (2019) (exploring the circumstances under which reliance on proxy advisors' recommendations may lead to less informative voting); David F. Larcker, Allan L. McCall & Gaizka Ormazabal, *Outsourcing Shareholder Voting to Proxy Advisory Firms*, 58 J.L. & ECON. 173 (2015) (finding evidence that stock markets reacted negatively to changes in compensation programs induced by proxy advisors).

167. *See* discussion *supra* Section III.A.1.

168. *See* discussion *supra* Section III.A.2.

169. *See* discussion *infra* Sections III.B.1, III.B.2.

170. *See* discussion *infra* Section III.B.1.

will typically be greater than the benefit from fixing a bad one.[171] Additionally, companies with innovative business strategies that are particularly susceptible to mistargeting appear to drive the bulk of economic growth in the United States.[172] These facts suggest that principal costs—not agent costs—may be the greater threat to shareholder value and the broader economy. Given that raiders are likely to impose lower principal costs than activists, this provides an additional reason to question the value of activists relative to raiders. Overall, this analysis challenges the conventional view that corporate law should keep corporate raiders out while welcoming activists.

1. *Agent Costs in Focus*

If activists do more to decrease agent costs than to increase principal costs, we would expect to see large and durable gains from shareholder activism. Indeed, an implicit premise of most empirical studies on activism is that outperformance of targeted companies over nontargeted companies proves the social benefits of activism.[173]

As a threshold matter, our model provides reason to question this premise because the stock price of a targeted company may increase even where social value is destroyed. When an activist transforms an "underperforming" high-quality firm into an average firm, the stock price will go up, and the activist will show a profit. The social loss from the abandoned business strategy will fall on the long-term shareholders and will not necessarily be captured by the empirical study. To overcome this difficulty, some studies have employed "matching" techniques—comparing targeted firms to a control group of untargeted firms with similar characteristics—and found that targeted firms underperform untargeted

171. *See* discussion *infra* Section III.B.2.

172. *See* discussion *infra* Section III.B.2.

173. *See, e.g.*, Brav et al., *supra* note 14, at 1-2, 47-49 (employing a matching technique to develop a control group of untargeted companies in support of the overall "conclusion that interventions by activist hedge funds lead to improvements in target firms, on average, in terms of both short-term metrics, such as stock value appreciation, and long-term performance, including productivity, innovation, and governance").

firms.[174] However, unobserved differences between the targeted and matched firms may limit the effectiveness of this causal-identification strategy.[175]

In any event, even accepting this premise, the evidence that activists improve shareholder value is equivocal. Empirical studies have indicated that shareholder gains are ephemeral and uncertain. Rather, evidence suggests that the positive returns frequently attributed to hedge-fund activism are largely explained by activists' ability to force a takeover.[176] Thus, the primary value of hedge-fund activists, if any, is to act as an auctioneer for corporate raiders. This insight should color our understanding of the social consequences of activists and raiders.

Studies of stock returns after the announcement that a company is the target of a hedge-fund activist seem to show an initial premium[177] but are split as to whether targets exhibit abnormal long-term gains.[178] Meanwhile, certain stud-

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174. *See, e.g.*, K.J. Martijn Cremers, Erasmo Giambona, Simone M. Sepe & Ye Wang, Hedge-Fund Activism and Long-Term Firm Value 1 (Dec. 13, 2018) (unpublished manuscript), https://ssrn.com/abstract=2693231 [https://perma.cc/V9B7-ZMEM] (finding that targeted firms underperformed nontargeted firms). *But see* Lucian Bebchuk, Alon Brav, Wei Jiang & Thomas Keusch, *The Long-Term Effects of Hedge Fund Activism: A Reply to Cremers, Giambona, Sepe, and Wang*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Dec. 10, 2015), https://corpgov.law.harvard.edu/2015/12/10/the-long-term-effects-of-hedge-fund-activism-a-reply-to-cremers-giambona-sepe-and-wang [https://perma.cc/A6RV-M3T7] (criticizing the study by Cremers et al., *supra*).

175. *See* Pacces, *supra* note 157, at 206-07, 206 n.78.

176. *See* Greenwood & Schor, *supra* note 115, at 362 ("Thus, the returns associated with activism are largely explained by the ability of activists to force target firms into a takeover, thereby collecting a takeover premium.").

177. *See* Klein & Zur, *Hedge Fund Activism*, *supra* note 14, at 4; Brav et al., *supra* note 11, at 1730.

178. *See, e.g.*, DesJardine & Durand, *supra* note 133, at 1055 ("[Q]uestions remain whether the benefits of such interventions by activist hedge funds extend beyond short-term shareholders . . . ."); Baker, *supra* note 11, at 19 & fig.8 (replicating prior analyses and showing that "[d]ifferent modeling assumptions lead to large differences in the estimated change in operating performance around activism events"). *Compare* Bebchuk et al., *supra* note 62, at 1085-91 (presenting evidence that hedge-fund activism has produced long-term gains for shareholders), *and* Brav et al., *supra* note 14, at 5-7 (reviewing prior literature and providing an updated analysis to find empirical evidence that supports the view that hedge-fund activism improves long-term firm performance), *with* DesJardine & Durand, *supra* note 133, at 1078 (finding evidence of short-term gains for shareholders which reversed in later years), deHaan et al., *supra* note 11, at 536 (finding that on a value-weighted basis, activism-related abnormal stock return estimates are not statistically significant and finding no evidence of abnormal postactivism improvements in operating performance), Cremers et al., *supra* note 174, at 1-3 (arguing that selection effects explain prior findings that hedge-fund activism improves firm value), *and* Baker, *supra* note 11, at 26-33, 35-36 (leveraging different econometric methods to find little evidence that activists improve firm operating performance or returns in the long ies are subject to differing interpretations. For example, one study from the international context finds that when the Korea Corporate Governance Fund announced the first activist campaign in Korea, other (nontarget) companies experienced a stock price increase negatively related to governance measures (i.e., the more insulated boards and managers were from shareholder control, the more the company's stock rose in response to the threat of activism).[179] Based on that finding, the authors concluded that activism has a positive wealth effect.[180] But this finding could just as easily be interpreted to yield the opposite conclusion—insulated firms experienced positive abnormal returns because they were harder for activists to harm with value-destructive intervention.

To the extent that activists do create long-term value among target corporations, this effect seems to be driven by those activist efforts that eventually result in the target's acquisition. A study of 980 instances of shareholder activism over thirteen years (most of them from hedge funds) showed that an activist's involvement increases the chance that a corporation will be acquired by 11%.[181] Of the 980 target firms, 226—nearly a quarter—were the subject of an acquisition or an acquisition announcement within eighteen months.[182] These firms far outperformed their peers that were not acquired and indeed were responsible for abnormal returns following the announcement of shareholder activism.[183] Three recent studies came to similar conclusions.[184] This evidence suggests that the

run). *But see* Bebchuk et al., *supra* note 174 (arguing that the conclusions of the study by Cremers et al., *supra* note 174, suffer from a "flawed empirical analysis" and "are inconsistent . . . with a large body of empirical studies by numerous researchers").

179. Dong Wook Lee & Kyung Suh Park, *Does Institutional Activism Increase Shareholder Wealth? Evidence from Spillovers on Non-Target Companies*, 15 J. CORP. FIN. 488, 500 (2009).

180. *Id.* at 503 ("We find that, among non-targets, those companies that grant fewer rights to outside shareholders experience a more positive stock price reaction. . . . Since fewer rights in the hands of the outside shareholders at the present time imply greater room for activism in the future, our findings lend strong support to the positive wealth effect of institutional activism.").

181. Greenwood & Schor, *supra* note 115, at 364, 372.

182. *Id.* at 368.

183. *Id.* at 369-70.

184. deHaan et al., *supra* note 11, at 541 (finding "little evidence that commonly discussed strategy and governance motivations for activist interventions have consistent associations with improvements in shareholder wealth," and "nearly all the positive long-term returns to activist interventions are concentrated among firms that are subsequently acquired"); Edward P. Swanson, Glen M. Young & Christopher G. Yust, *Are All Activists Created Equal? The Effect of Interventions by Hedge Funds and Other Private Activists on Long-Term Shareholder Value*, 72 J. CORP. FIN. art. no. 102144, at 26 fig.7 (2022) (finding that "[a]nnouncement returns are especially large at 17.36% when activists demand a sale of all, or part, of the company," while "ab-stock premium following the announcement of an activist campaign primarily reflects the possibility that the campaign will result in a takeover rather than any governance or operational changes.[185] As one private-equity manager remarked, the role of activists is not stirring things up within their target companies but "teeing up deals," resulting in the target firm "being driven into some form of auction."[186]

This evidence suggests activists play a limited role in reducing agent costs at target firms. If they did play a meaningful role, activists would trigger large-scale governance and operational changes that result in statistically and economically significant changes in accounting metrics or stock price. But this is not the case. Instead, activists generate value primarily by "teeing up deals" for potential acquirers.[187] Especially when compared with principal-cost effects, agent costs are a thin reed on which to rest scholarly and judicial justifications for the role of activists.

2. *Principal Costs in Focus*

How great is the risk (and cost) of mistargeting? If principal costs in the form of mistargeting are the greater threat to shareholder value, it would provide a reason to be more skeptical of activists than raiders, which are less likely to mistarget and destroy social wealth. Due to the fundamental problem of causal inference—we do not observe what would have happened to a targeted firm but for the activist's intervention—it is difficult to draw firm conclusions about the

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normal returns for non-sale demands are" smaller at 3.91% but still "statistically and economically significant"); Baker, *supra* note 11, at 16 & fig.6, 17 fig.7 (finding that positive abnormal returns are "in large measure driven by takeover targets," with value-weighted returns to activism for non-takeover targets being "not much larger than zero" in recent years).

Edward P. Swanson, Glen M. Young, and Christopher G. Yust's finding that activism still produces modest positive returns even when the activist does not demand a sale would be consistent with market expectations that there is still a possibility, however slight, that the activist intervention will result in a sale. Moreover, Andrew C. Baker concludes that activists may even *decrease* the long-term performance of firms that are not acquired following the activist's intervention. Baker, *supra* note 11, at 32 fig.12, 33 ("There is thus some evidence that activists may tend to . . . decreas[e] the long-run performance of the typical targeted firm that remains independent.").

185. *See* Greenwood & Schor, *supra* note 115, at 363 ("Under this hypothesis, the high returns documented around the announcement of activism reflect investors' expectations that target firms will be acquired at a premium to the current stock price."); deHaan et al., *supra* note 11, at 541.

186. Andrew Ross Sorkin, *Will the Credit Crisis End the Activists' Run?*, N.Y. TIMES: DEALBOOK (Aug. 27, 2007, 8:06 AM), https://dealbook.nytimes.com/2007/08/27/will-credit-crisis-end-the-activists-run [https://perma.cc/J8GN-6B4J].

187. *Id.*

net effects of activism on control costs.[188] But two strands of empirical research suggest that we might expect principal costs to be a higher risk than agent costs.

The first strand is the empirical observation that the returns in the stock market are positively skewed.[189] A small number of firms account for most of the return in the stock market, making the cost of breaking a high-quality firm greater than the benefit of fixing a low-quality firm.[190] For example, one report found that a minority of stocks (25%) are responsible for most of the market's gains.[191] In other words, mistargeting one good firm will inflict costs that are higher than the benefits of fixing three bad firms.

Moreover, Hendrik Bessembinder has found that between 1926 and 2016, just 4% of publicly listed companies (1,100 firms out of the 25,332 firms in the study) accounted for *all* net wealth creation.[192] "Beyond these best-performing firms, an additional 9,579 firms (37.81%) created positive wealth over their lifetimes, just offset by the wealth destruction of the remaining 14,661 (57.88% of total) firms."[193] Stripped of this 4% of the top firms, the stock markets in aggregate failed to outperform U.S. Treasury bonds.[194]

However, even disregarding the wealth creation of the top performers, the study shows that only 30.8% of individual common stocks generated lifetime buy-and-hold returns that exceed the performance of the value-weighted portfolio of all common stocks over the matched time intervals, and only 26.1% outperformed the equal-weighted portfolio.[195] In other words, one of three firms created more value than the other two destroyed. This suggests that mistargeting even a small subset of the top-performing companies will result in a substantial social loss, and, more generally, mistargeting one good firm will destroy more value than fixing two bad ones would create.

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188. The fundamental problem of causal inference remains elusive even with sophisticated econometrics and the use of "big data." *See generally* Rocío Titiunik, *Can Big Data Solve the Fundamental Problem of Causal Inference?*, 48 PS: POL. SCI. & POL. 75 (2015) (concluding that the difficulties in identifying causal relationships stem from the lack of a solid research design and a credible theory, rather than the amount of available data).

189. *See* Bessembinder, *supra* note 33, at 440 (highlighting the "important role of positive skewness in the distribution of individual stock returns").

190. *See* Crittenden & Wilcox, *supra* note 35, at 3; *accord* Cembalest, *supra* note 35, at 6.

191. *See* Crittenden & Wilcox, *supra* note 35, at 3.

192. Bessembinder, *supra* note 33, at 441.

193. *Id.* at 456.

194. *Id.* at 441.

195. *Id.* at 445 tbl.2A.

The second strand provides evidence that activism reduces R&D investment at firms, giving credence to the idea that control challenges can deter idiosyncratic vision and long-term investment strategies.[196] Together with the insight

196. *See* Coffee & Palia, *supra* note 29, at 553 (concluding based on a review of the literature that activism results in a decrease in R&D investment); Baker, *supra* note 11, at 37 & fig.15, 39 tbl.3 (finding evidence "consistent with targeted firms lowering investment and increasing payouts").

Some research finds evidence of increased innovation "efficiency" and purports to show that activism also improves innovation "output," as measured by patent counts and citations, notwithstanding the decrease in R&D. *See* Alon Brav, Wei Jiang, Song Ma & Xuan Tian, *How Does Hedge Fund Activism Reshape Corporate Innovation?*, 130 J. FIN. ECON. 237, 238 (2018); Tingfeng Tang, *Hedge Fund Activism and Corporate Innovation*, 85 ECON. MODELING 335, 336 (2020).

However, the studies' relatively short timeframes and chosen measures for innovation output limit their ability to speak to the extent to which activism deters idiosyncratic vision or valuable long-term investment strategies. One study looks only two years beyond the activist intervention, Tang, *supra*, at 342 tbl.5, and the other looks five years beyond the intervention without disentangling the effects by year, Brav et al., *supra*, at 258 tbl.10. The value of many, if not most, valuable idiosyncratic visions and long-term investment strategies is unlikely to become apparent in those short timeframes, especially using the studies' chosen measures for innovation output: patent counts and citations. Patent attorneys advise that it takes years on average just to obtain an issued patent after applying, to say nothing of the years of research that must precede the filing of a patent application. *See, e.g.*, Vic Lin, *How Long Is the US Patent Application Process (How Much Time Does It Take to Get a Utility Patent)?*, PAT. TRADEMARK BLOG, https://www.patenttrademarkblog.com/how-long-us-utility-patent-application-process [https://perma.cc/D5QN-5DNX]; *see also Patents Pendency Data*, U.S. PAT. & TRADEMARK OFF. (July 2022), https://www.uspto.gov/dashboard/patents/pendency.html [https://perma.cc/X2WF-3BPF] (noting that, in July 2022, the three-month rolling average for the time taken from the patent application filing date to the U.S. Patent and Trademark Office's First Office Action was 20.4 months). In addition, R&D can be helpful not only in developing patented technologies, but also for other purposes, such as teaching companies how to assimilate and exploit external information. *See* Wesley M. Cohen & Daniel A. Levinthal, *Innovation and Learning: The Two Faces of R&D*, 99 ECON. J. 569, 593 (1989).

Meanwhile, Alon Brav and his coauthors find that hedge-fund activists reduce technological diversity, Brav et al., *supra*, which presents a tradeoff because technological diversity may have other benefits that the Brav and Tang studies do not capture. *See generally* Cristina Quintana-García & Carlos A. Benavides-Velasco, *Innovative Competence, Exploration and Exploitation: The Influence of Technological Diversification*, 37 RSCH. POL'Y 492 (2007) (presenting evidence that technological diversity benefits innovative competence, with especially strong effects on exploratory innovative capability); Po-Hsuan Hsu, Hsiao-Hui Lee, Shu-Cing Peng & Long Yi, *Natural Disasters, Technology Diversity, and Operating Performance*, 100 REV. ECON. & STATS. 619 (2018) (finding evidence that technological diversity enhances firms' sustainability).

Finally, other research is consistent with the view that public markets have often undervalued idiosyncratic vision and long-term business strategies, though the jury is still out on the magnitude of the short-termism problem. *See, e.g.*, Mustafa Ciftci, Baruch Lev & Suresh Radhakrishnan, *Is Research and Development Mispriced or Properly Risk Adjusted?*, 26 J. ACCT., AUDITING & FIN. 81, 84 (2011) (presenting evidence that short-term undervaluation of R&D is due that firms engaged in innovative investment projects drive most economic growth, these results suggest that activists may inflict more principal costs than they avert in agent costs.

Activists tend to reduce investment expenditure at target firms. For example, John C. Coffee, Jr. and Darius Palia detail how storied chemical company DuPont slashed its R&D spending when faced with a proxy contest by Trian, a prominent activist fund.[197] However, the investment-reduction effect is not limited to target firms. Rather, as Coffee and Palia explain, high-profile campaigns reduce investment expenditures across the market.[198] In other words, a significant effect of hedge-fund activism is to cut back on idiosyncratic investment not producing immediate returns.[199]

The result may be a large, unobserved stifling of economic growth. It is impossible to count the number of companies that have cut back on investments because of the *threat* of shareholder activism. Indeed, empirical studies on hedge-fund activism generally do not attempt to estimate the impact of hedge-fund activism on untargeted firms (i.e., the externalities of activism).[200] However, market trends suggest that the type of investments most likely to be deterred by

to mispricing); David Hirshleifer, Po-Hsuan Hsu & Dongmei Li, *Innovative Originality, Profitability and Stock Returns*, 31 REV. FIN. STUD. 2553, 2594 (2018) (presenting evidence that innovative originality is undervalued by the market); Anne Marie Knott & Carl Vieregger, *Reconciling the Firm Size and Innovation Puzzle*, 31 ORG. SCI. 477, 485-87 (2020) (arguing that large firms are acting rationally in increasing R&D investments). *But see* Roe, *supra* note 106, at 1005 (arguing there is little evidence that short-termism is a pervasive problem); Barzuza & Talley, *supra* note 115, at 112 (arguing that "long-term bias" may be equally problematic).

197. Coffee & Palia, *supra* note 29, at 579 ("DuPont survived (at least for a time) by preempting Trian's strategy—with the result that, whether management wins or loses in the proxy contest, R&D expenditures decline." (footnote omitted)); *see also DuPont (DD): Proxy Contest with Trian Fund Management*, INSTITUTIONAL S'HOLDER SERVS. (Apr. 26, 2015), https://www.isscorporatesolutions.com/file/documents/dupont_ssr.pdf [https://perma.cc/Y7CT-6X9B] (providing a history of Trian's engagement with DuPont).

198. Coffee & Palia, *supra* note 29, at 579-80 ("Even if not targeted, other firms in the same industry will understandably fear becoming the subject of a similar activist intervention and become more likely to take preemptive steps to cut research expenditures."). After Trian's initial engagement with DuPont in 2013, other companies responded to its activist campaign. A *Financial Times* survey in July 2014 noted a "fundamental trend" in this industry that pharmaceutical and household-consumer-products companies are divesting their noncore divisions and "reassessing their portfolios." Scheherazade Daneshkhu, Andrew Ward & Adam Thomson, *Drugmakers Juggle Non-Core Assets*, FIN. TIMES (July 28, 2014), https://www.ft.com/content/94b69be8-1675-11e4-8210-00144feabdc0 [https://perma.cc/KAX7-34TB].

199. Some scholars argue that these two effects are one and the same. Overinvestment, under this theory, is a type of agent cost, which activists reduce by creating an "investment-limiting" effect. Bebchuk et al., *supra* note 62, at 1138.

200. *See, e.g.*, Brav et al., *supra* note 11, at 1755-60 (analyzing the impact of hedge-fund activism on targeted firms, without considering externalities). *But see* Gantchev et al., *supra* note 28, at 1033, 1043-51 (analyzing spillover effects on untargeted firms).

hedge-fund activism drive most economic growth. A recent study reports that activists have increasingly targeted technology and other similar firms, not just aging dinosaurs in manufacturing and similar traditional sectors.[201] Meanwhile, the accounting firm Deloitte reported that, as of 2019, information services were by far the largest contributor to GDP growth,[202] and it will surprise nobody to learn that Silicon Valley's technology ventures are a major driver of economic productivity. These ventures often begin as quixotic startups and require a good deal of idiosyncratic vision and early investment to get off the ground. Together, these trends suggest that most economic growth arises from bold business ideas that may at first elude appreciation by the market. In turn, this suggests that by deterring this type of investment, activists and raiders may create an enormous unobserved drag on the economy in the form of principal costs. For all the reasons mentioned above, activists are much more likely to create this effect.

This Article does not attempt to show that activists are net detrimental overall, but rather that they are *more likely than raiders* to have a detrimental impact overall. The possibility that activists may have a massive and unobserved negative effect on economic growth underscores the potential magnitude of this mistargeting hazard. As we explain in the next Part, this insight has profound implications for corporate law and policy.

IV. IMPLICATIONS FOR LAW AND POLICY

In several ways, state and federal law have privileged corporate efforts to keep raiders outside the gates while applying greater scrutiny to corporate efforts to keep out activists. Our analysis suggests that this pattern is unwarranted. If anything, courts and lawmakers should be more suspicious of activists than raiders, especially when the activist seeks operational or financial changes (as opposed to a sale of the target company).

This Part explores key implications of our analysis for corporate law and policy. Section IV.A addresses Delaware law, focusing on the judicial evaluation of poison pills. Section IV.B turns to the federal securities laws, focusing on the Williams Act and its implementing regulations. At both the state and federal levels, the law has improperly treated raiders as a greater threat than activists. We propose reforms that would equalize the regulation of raiders and activists.

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201. Baker, *supra* note 11, at 11 (reporting that activists have increasingly targeted "firms in the business equipment category, which includes technology firms that produce computers, software, and electronic equipment").

202. *See* Rumki Majumdar & Daniel Bachman, *Changing the Lens: GDP from the Industry Viewpoint*, DELOITTE (July 25, 2019), https://www2.deloitte.com/us/en/insights/economy/spotlight/economics-insights-analysis-07-2019.html [https://perma.cc/V245-4NVG].

A. Delaware Law

In multiple ways, Delaware law has discouraged corporate raiders but encouraged hedge-fund activists. In this Section, we focus on how courts have evaluated the propriety of the so-called "nuclear weapon of corporate governance,"[203] the poison pill. As we explain, the emerging trend in the case law improperly scrutinizes pills designed to defend against activists more closely than pills designed to defend against raiders.

Initially introduced during the heyday of corporate raiding in the 1980s, the poison pill (or "shareholder rights plan") is a corporate device that allows a board of directors to make the purchase of the company's shares beyond a specified threshold prohibitively costly and thereby block hostile takeovers.[204] Specifically, in adopting a pill, a company issues rights to its stockholders that allow them to buy the company's stock at a substantial discount to the prevailing market price.[205] These rights are triggered only if a stockholder buys enough stock to cross a specific ownership threshold of the company's total shares, such as 20%.[206] Importantly, the pill voids any rights issued to the offending stockholder who crossed the threshold so that only other investors may buy discounted shares.[207] This substantially dilutes the offending stockholder's ownership position, making it economically irrational to buy enough stock to cross the threshold in the first place.[208]

A poison pill acts as a powerful defense against an attempt by a corporate raider to acquire the company through an unsolicited tender offer. With a pill in place, the would-be raider must either convince the board to waive the pill or wage a proxy fight and convince other stockholders to vote out the current board. If they win the proxy fight, the new board can "redeem" the pill and allow the acquisition to proceed. In effect, the raider must become an activist.

Soon after the advent of the pill, corporate raiders started attacking it as invalid under Delaware law. The plaintiffs in these cases cast the pill as an unlawful

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203. *In re* Williams Cos. S'holder Litig., C.A. No. 2020-0707, 2021 WL 754593, at *4 (Del. Ch. Feb. 26, 2021).

204. Lucian A. Bebchuk & Robert J. Jackson, Jr., *Toward a Constitutional Review of the Poison Pill*, 114 COLUM. L. REV. 1549, 1570 (2014).

205. *Id.*

206. *Id.*

207. *Id.*

208. *Id.*

device adopted by incumbent directors solely to "entrench themselves in office."[209] That is, the plaintiffs alleged that the corporate directors adopted the pill merely to avoid being replaced with new directors following a takeover. Academics leveled similar criticisms, arguing that the pill impairs the ability of the market for corporate control to check managerial agency costs.[210]

Ultimately, however, the law developed to give well-advised boards virtually unfettered discretion to use pills to block raiders. In 1985, the Delaware Supreme Court first upheld the pill against a legal challenge under the intermediate "proportionality" standard of review set forth in *Unocal Corp. v. Mesa Petroleum Co.*[211] Under *Unocal*'s two-pronged test, as glossed by the Delaware Supreme Court in later cases, "the target board must show (1) that it had 'reasonable grounds for believing a danger to corporate policy and effectiveness existed' . . . and (2) that any board action taken in response to that threat is 'reasonable in relation to the threat posed.'"[212] Although early decisions suggested that there might be some teeth to this standard of review,[213] Delaware courts have since given boards the green light to use the pill to block virtually all unsolicited tender offers designed to lead to a takeover.[214] Meanwhile, academics seem to have also largely acquiesced to the use of pills to defend against tender offers, at least under the right circumstances.[215]

The Court of Chancery's well-known decision in *Air Products & Chemicals, Inc. v. Airgas, Inc.*[216] is instructive on the wide discretion afforded to boards in

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209. Moran v. Household Int'l, Inc., 490 A.2d 1059, 1070 (Del. Ch. 1985), *aff'd*, 500 A.2d 1346 (Del. 1985).

210. *See, e.g.*, Jensen, *supra* note 51, at 41-44.

211. *Moran*, 500 A.2d at 1350, 1357 (citing Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985)).

212. Air Prods. & Chems., Inc. v. Airgas, Inc., 16 A.3d 48, 92 (Del. Ch. 2011) (quoting Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1373 (Del. 1995)).

213. *See Moran*, 500 A.2d at 1354 ("When the Household Board of Directors is faced with a tender offer and a request to redeem the Rights, they will not be able to arbitrarily reject the offer."); City Cap. Assocs. v. Interco Inc., 551 A.2d 787, 797-98 (Del. Ch. 1988) (holding that the board may leave a pill in place "for a period" but "[o]nce that period has closed," the board must allow stockholders to choose whether to accept the tender offer); *see also* Ronald J. Gilson & Reinier Kraakman, *Delaware's Intermediate Standard for Defensive Tactics: Is There Substance to Proportionality Review?*, 44 BUS. LAW. 247, 269-71 (1989) (expressing the hope that there could be "substance" to proportionality review under *Unocal*).

214. *See, e.g.*, *Airgas*, 16 A.3d at 57-58, 94-129, 108 n.410; Bebchuk & Jackson, *supra* note 204, at 1571 (observing that Delaware courts have "adopted a deferential approach to incumbents' use of poison pills" and "during the last twenty years, despite the near-universal use of the poison pill, there has not been a single case in which Delaware law was held to require directors to redeem a poison pill").

215. *See supra* notes 60-61 and accompanying text.

216. 16 A.3d 48 (Del. Ch. 2011).

responding to takeovers. In *Airgas*, the target company, Airgas, had in place both a staggered board and a poison pill, which effectively meant that an acquirer needed to win two consecutive proxy contests in order to effect a hostile takeover.[217] Faced with an unsolicited tender offer for all outstanding shares by a competitor, Air Products, the Airgas board refused to redeem the pill because, in its view, the offered price was too low, leading Air Products and other stockholder plaintiffs to sue for breach of fiduciary duties.[218]

The Court of Chancery ruled for Airgas on all counts.[219] In so ruling, Chancellor Chandler found that "Airgas's stockholder base is sophisticated and well-informed" and that stockholders had access to "essentially all the information they would need to make an informed decision."[220] But the Chancellor held that the allegedly inadequate price offered by Air Products represented a valid threat to corporate policy and that the board had acted proportionally in response to that threat.[221] In holding that Airgas satisfied the first prong, the court accepted Airgas's argument that substantial ownership of its stock by "short-term, deal-driven investors poses a threat to the company and its shareholders," referencing Delaware Supreme Court decisions that allow directors to prefer long-term success over "short-term shareholder profit."[222] The Chancellor also rejected the plaintiffs' argument that the staggered board-poison pill combination was unlawfully "preclusive."[223]

The emerging case law on so-called "anti-activist" poison pills has taken a different turn. With the growth of activism over the past two decades, corporate

217. *Id.* at 55, 57; *see also* Lucian Arye Bebchuk, John C. Coates IV & Guhan Subramanian, *The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence, and Policy*, 54 STAN. L. REV. 887, 899 (2002) ("In combination with an effective staggered board, . . . a pill provides significant antitakeover protection: the pill blocks any stock acquisition beyond the trigger level, and the staggered board forces the bidder to go through two proxy contests in order to gain control of the board and redeem the pill." (footnote omitted)).

218. *Airgas*, 16 A.3d at 55-56.

219. *Id.* at 55-58, 129.

220. *Id.* at 57.

221. *See id.* at 57-58 ("[I]nadequate price [is] a valid threat to corporate policy and effectiveness." (citing Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1384 (Del. 1995))); *see also id.* at 58 ("[D]irectors are not obliged to abandon a deliberately conceived corporate plan for a short-term shareholder profit unless there is clearly no basis to sustain the corporate strategy." (quoting Paramount Commc'ns v. Time, Inc., 571 A.2d 1140, 1154 (Del. 1989))).

222. *Id.* at 57-58, 99, 108-13, 108 n.410, 124 (quoting *Paramount*, 571 A.2d at 1154).

223. *Id.* at 113-22 ("The fact that a combination of defensive measures makes it more difficult for an acquirer to obtain control of a board does not make such measures realistically unattainable, i.e., preclusive." (quoting Versata Enters. v. Selectica, Inc., 5 A.3d 586, 604 (Del. 2010))).

boards and their legal advisers have repurposed poison pills from their antitakeover origins to also guard against activism.[224] These anti-activist pills often have lower ownership thresholds, such as 10% rather than 20%, and unique features designed to address common activist tactics, such as different treatment of activist and passive investors, the inclusion of "synthetic equity" in the definition of ownership, and "acting in concert" provisions that aggregate ownership by multiple hedge funds engaging in consciously parallel behavior (the "wolf pack").[225] Although courts have upheld the use of pills against activists in two cases,[226] the record has been mixed and suggests that Delaware courts are likely to scrutinize pills targeting activists more closely than those targeting raiders.

The Court of Chancery's recent decision in *In re Williams Companies Stockholder Litigation*, which the Delaware Supreme Court summarily affirmed in a short order, is illustrative.[227] Williams is an energy company that owns and operates natural-gas infrastructure assets, such as pipelines and processing facilities.[228] In early 2020, the company entered a period of extreme market turmoil due to the COVID-19 pandemic and a global oil price war.[229] Before 2020, the company's stock price had "traded at a high of $24.04 and had been relatively stable over the preceding months."[230] But soon, "the COVID-19 pandemic and

224. *See generally* Kahan & Rock, *supra* note 62 (providing a comprehensive overview and analysis of anti-activist poison pills).

225. *See* Spencer D. Klein, Michael G. O'Bryan & Joseph Sulzbach, *2020 Poison Pill Recap and Current Trends*, MORRISON & FOERSTER (Feb. 25, 2021), https://www.mofo.com/resources/insights/210224-poison-pill-recap-current-trends.html [https://perma.cc/5ANE-S64A] (explaining recent trends in poison pills). For arguments in support of pills with activist-specific features, including an explanation of wolf-pack behavior, see Coffee & Palia, *supra* note 29, at 601-02; and Guhan Subramanian, *Corporate Governance 2.0*, HARV. BUS. REV. (Mar. 2015), https://hbr.org/2015/03v/corporate-governance-2-0 [https://perma.cc/Q6PH-4A4B]. For a critique of anti-activist features, see Kahan & Rock, *supra* note 62, at 946-69.

226. *See* Yucaipa Am. All. Fund II, L.P. v. Riggio, 1 A.3d 310, 313 (Del. Ch. 2010) (upholding the use of a pill with a 20% ownership threshold against an activist hedge fund on the ground that the activists posed a "threat that the corporation's stockholders would relinquish control through a creeping acquisition without the benefit of receiving a control premium"), *aff'd*, 15 A.3d 218 (Del. 2011); Third Point LLC v. Ruprecht, C.A. No. 9469, 2014 WL 1922029, at *14, 21-22 (Del. Ch. May 2, 2014) (upholding the use of a pill with a 10% ownership threshold, which distinguished between activist and passive investors, against an activist hedge fund, which was initially justified as a defense against "creeping control" and subsequently as a defense against "effective, rather than explicit, negative control").

227. C.A. No. 2020-0707, 2021 WL 754593 (Del. Ch. Feb. 26, 2021), *aff'd sub nom.* Williams Cos. v. Wolosky, 264 A.3d 641 (Del. 2021) (unpublished table decision).

228. *Williams*, 2021 WL 754593, at *2.

229. *Id.* at *4.

230. *Id.*

the ensuing oil price war between Saudi Arabia and Russia shocked the oil market and sent stock prices plummeting."[231] By mid-March 2020, the company's stock price "had fallen to approximately $11, which was close to a 55% decline since January 2020."[232] On March 19, 2020, fearing that an activist might take advantage of this market turmoil, the Williams board adopted a poison pill specifically designed to defend against activists.[233] The pill had a 5% ownership threshold and certain activist-specific features, including a definition of "acquiring person" that captures certain derivative interests, a broad "acting in concert" provision designed to capture wolf-pack behavior, and a limited "passive investor" exemption for certain passive investors like Schedule 13G filers.[234] On August 27, 2020, Williams stockholders sued the company and its board, seeking declaratory and injunctive relief regarding the pill's validity.[235]

Following trial, the Court of Chancery held that the pill was invalid under *Unocal*.[236] Reviewing the trial record, the court found that the board had identified three threats: (1) "the desire to prevent stockholder activism during a time of market uncertainty and a low stock price"; (2) "apprehension that hypothetical activists might pursue 'short-term' agendas or distract management from guiding Williams through uncertain times"; and (3) "the concern that activists might stealthily and rapidly accumulate over 5% of Williams stock."[237] The court held that the first two of these threats were illegitimate because they "run contrary [to] the tenet of Delaware law that directors cannot justify their actions by arguing that, without board intervention, the stockholders would vote erroneously out of ignorance or mistaken belief."[238] As to the third, the court assumed for the sake of argument that the threat was legitimate but held that the board's response was not proportional in light of the 5% ownership threshold and broad

231. *Id.*

232. *Id.*

233. *Id.* at *8-9.

234. *Id.* at *9-12. An investor who acquires beneficial ownership of more than 5% of a company's stock must file a "Schedule 13D" statement of beneficial ownership with the Securities and Exchange Commission (SEC) within ten days of the acquisition. 17 C.F.R. §§ 240.13d-1(a), 240.13d-101 (2022). Certain passive investors who do not seek to "chang[e] or influenc[e] the control of the issuer" are entitled to instead file an abbreviated "Schedule 13G" statement. §§ 240.13d-1(b)-(c), 240.13d-102. These passive investors are referred to as Schedule 13G filers.

235. *Williams*, 2021 WL 754593, at *16.

236. *Id.* at *2; *see id.* at *22-37.

237. *Id.* at *1-2.

238. *Id.* at *2.

acting in concert provision, which the court found were more restrictive than similar provisions adopted by other companies at the time.[239]

In addressing the precedents that the plaintiffs cited regarding the first two threats, the Court of Chancery was careful to distinguish each as involving a takeover attempt rather than pure activism.[240] In the court's telling, one case from the heyday of corporate raiders involved "well-known takeover artists," and the Delaware Supreme Court credited that those individuals "presented a takeover threat."[241] Another "involved a concrete takeover attempt."[242] A third similarly "involved a specific takeover attempt."[243] The last "involved a specific takeover attempt that started as an effort to obtain creeping control."[244] In rejecting the legitimacy of the "stockholder activism" threat, the court summarized: "None of these decisions support the notion that generalized concern about stockholder activism constitutes a cognizable threat under *Unocal*. Rather, these cases demonstrate that a board has authority to respond to a specific takeover attempt, even when the attempt does not involve a traditional tender offer."[245] Likewise, in holding that "short-termism and distraction" is not a legitimate threat, the court emphasized that "[e]ach of Defendants' cases, unlike this case, involved takeover threats."[246] Although the court arguably left the door open for a sufficiently "concrete" threat of activism to constitute a legitimate threat,[247] the thrust of the opinion suggests that activism is a legitimate threat only to the extent that there is an accompanying takeover threat.

Indeed, the very nature of activism suggests that by the time the "concreteness" of an activist campaign is apparent, it will be too late for the pill to do anything other than prevent a takeover. In the takeover context, the raider first

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239. *Id.*; *see also id.* at *35 (describing key features of the pill as "extreme"). In particular, the court took issue with the breadth of the acting in concert provision and the narrowness of the passive-investor exemption. *Id.* at *34-37. We take no position on this aspect of the court's opinion.

240. *See id.* at *29-33 (first citing Polk v. Good, 507 A.2d 531 (Del. 1986); then citing Cheff v. Mathes, 199 A.2d 548 (Del. 1964); then citing Yucaipa Am. All. Fund II, L.P. v. Riggio, 1 A.3d 310 (Del. Ch. 2010), *aff'd*, 15 A.3d 218 (Del. 2011) (unpublished table decision); and then citing Third Point LLC v. Ruprecht, C.A. No. 9469, 2014 WL 1922029 (Del. Ch. May 2, 2014)).

241. *Id.* at *30-31 (discussing *Polk*, 507 A.2d at 533-37).

242. *Id.* at *31 (discussing *Cheff*, 199 A.2d at 551-53).

243. *Id.* (discussing *Yucaipa*, 1 A.3d 310 at 320-25).

244. *Id.* at *32 (discussing *Third Point*, 2014 WL 1922029, at *22).

245. *Id.*

246. *Id.*

247. *See id.* at *32-33 ("Read broadly, the cases support the proposition that a Board can adopt defensive measures in response to *concrete* action by a stockholder activist." (emphasis added)).

buys a toehold—say, 10%—of the shares and then *attempts* to buy 100% of the shares. The federal securities laws ensure that a raider must disclose buying the toehold stake before making a tender offer to the rest of the shareholders.[248] This gives the board ample opportunity to adopt a pill to address any perceived threat that the takeover attempt poses. Indeed, because the board is interested in stopping the tender offer (the second stage) and not the buying of the toehold (the first stage), clear-day poison pills do not add much.[249] As a safeguard against activism, however, clear-day pills are essential. Unlike raiders, activists and their wolf-pack allies generally buy their shares in one fell swoop and move directly to their campaign. Once the purchased stake is disclosed in compliance with federal securities laws, the activist typically does not plan on buying more shares. Because a pill can stop the *buying* of shares rather than the activist campaign itself, inserting the pill after the disclosure of the purchased stake is useless. This means that the activist and its allies will have accumulated a large position and started their campaign before the board can respond with a pill. To be effective against an activist campaign, then, the pill *must* be in place before a "concrete" activist campaign is discernible.

While Jeffrey N. Gordon has praised the *Williams* court's decision,[250] our analysis of the differences between activists and raiders suggests that the Delaware Court of Chancery's instinct to support the use of poison pills against takeovers, while limiting their use against activism unaccompanied by a takeover threat, has it backward. Activists pose the greatest threat to companies when they urge operational or financial changes to the target company, not when they push for a sale. As we have argued, it is in the former situation that the risks and consequences of mistargeting are greatest, that activists are best positioned to shift their costs onto other shareholders, and that the ability of other shareholders to screen the contestant's proposals is weakest.[251] Moreover, when shareholders mistakenly tender their shares to an acquirer at a low price, the result is merely a wealth transfer, not a loss in social wealth.[252] Unlike the activist who, armed only with public information, causes the target company to make irreversible

248. *See* discussion *infra* Section IV.B.

249. A clear-day pill is included in the corporate bylaws before there is any concrete threat. *See, e.g.*, Emiliano M. Catan, *The Insignificance of Clear-Day Poison Pills*, 48 J. LEGAL STUD. 1, 2 n.1 (2019) ("Clear-day poison pills are pills that are adopted in a purely preemptive way (and not in response to any particular threat like a hostile tender offer or the disclosure by an investor that the investor has acquired a significant block of the firm's shares).").

250. *See generally* Gordon, *supra* note 62 (arguing that the *Williams* court "was surely right that The Williams Company pill fails under *Unocal* as a disproportionate response").

251. *See* discussion *supra* Section III.A.

252. *See* discussion *supra* Section III.A.3.

changes, the acquirer has the freedom to stick with the current plan after consulting with management and looking under the hood. If the acquirer likes what she sees, then there is no need to depart from the existing strategy and thereby destroy social wealth.[253] For these reasons, courts should (if anything) afford boards greater deference in adopting pills when the pills are designed to defend against activist campaigns for operational and financial changes rather than against takeovers. At the very least, courts should not give boards less leeway in responding to activists than in responding to raiders.

By contrast, our analysis supports the Court of Chancery's validation of the use of a pill against an activist hedge fund in *Third Point LLC v. Ruprecht*.[254] There, "[i]n response to an apparent threat posed by increasing hedge fund activity in its stock," the target corporation had adopted a poison pill with a 10% ownership threshold for stockholders who seek to influence control of the company.[255] After the board rejected a request by an activist-hedge-fund stockholder to provide it with a waiver from the pill's terms, the hedge fund and other stockholder plaintiffs sued for breach of fiduciary duties.[256] The Court of Chancery upheld the pill, finding at the preliminary-injunction stage that the board could likely show at trial that (1) the initial adoption of the pill was "a reasonable and proportionate response" to the legitimate threat of "creeping control";[257] and (2) the board's subsequent refusal to provide a waiver was a reasonable response to the legitimate threat of "negative control," meaning the threat that certain persons may "exercise disproportionate control and influence over major corporate decisions."[258] Our analysis provides a third justification for the *Third Point* court's decision based on the mistargeting hazard.

The fact that activists accomplish their goals by threatening proxy contests rather than tender offers is beside the point. In minimizing the threats posed by activists, the Court of Chancery and some legal scholars have argued that many fears about activists are rooted in a "concern that shareholders will cast votes in a mistaken assessment of their own best interests," which they contend is not a valid concern under Delaware law.[259] There are several problems with this argu-

253. *See* discussion *supra* Section III.A.3.

254. C.A. No. 9469, 2014 WL 1922029 (Del. Ch. May 2, 2014).

255. *Id.* at *1, 10.

256. *Id.* at *1.

257. *Id.* at *17, 20-21.

258. *Id.* at *21-22.

259. *In re* Williams Cos. S'holder Litig., C.A. No. 2020-0707, 2021 WL 754593, at *33 (Del. Ch. Feb. 26, 2021) (quoting Kahan & Rock, *supra* note 62, at 931); *see also id.* at *1 (holding that

ment. First, this argument rests on an oversimplification of Delaware law. Although boards generally cannot preclude stockholders from choosing a new set of directors on the ground that the board knows better,[260] they can take more modest actions designed to ensure an orderly and informed stockholder vote, especially in the absence of an imminent proxy contest.[261] There is no a priori reason why temporary measures designed to defend against activism while the informational environment is poor – such as during periods of extreme market volatility, which limit the utility of stock prices as informational signals – should not be consistent with that principle. For example, the market turmoil around the onset of the COVID-19 pandemic led prominent law firms to recommend that clients consider proactively adopting a poison pill even absent a specific activist or takeover threat, which numerous companies did.[262] Tellingly, the two major proxy advisers – who normally oppose the adoption of poison pills absent a specific threat – issued policy guidance following the onset of the pandemic

the stockholder activism and short-termism threats "run contrary [to] the tenet of Delaware law that directors cannot justify their actions by arguing that, without board intervention, the stockholders would vote erroneously out of ignorance or mistaken belief"); Kahan & Rock, *supra* note 62, at 927-28, 930-33, 936-39 (arguing that anti-activist pills cannot be justified based on concerns about mistaken beliefs, short-termism, or disproportionate influence).

260. *See* Leo E. Strine, Jr., *The Story of* Blasius Industries v. Atlas Corp.*: Keeping the Electoral Path to Takeovers Clear*, *in* CORPORATE LAW STORIES, *supra* note 87, at 243, 269; Mercier v. Inter-Tel (Del.), Inc., 929 A.2d 786, 811 (Del. Ch. 2007).

261. *See, e.g.*, AB Value Partners, LP v. Kreisler Mfg. Corp., C.A. No. 10434, 2014 WL 7150465, at *3, 8 (Del. Ch. Dec. 16, 2014) (upholding an advance notice bylaw against a challenge by an activist hedge fund and commenting that the clearest rationale for such challenges exists "where a board, aware of an imminent proxy contest, imposes or applies an advance notice bylaw so as to make compliance impossible or extremely difficult, thereby thwarting the challenger entirely"); *cf. Third Point*, 2014 WL 1922029, at *21-22 (holding that the board "may have had legitimate real-world concerns that enabling individuals or entities, such as [an activist hedge fund and its principal], to obtain 20% as opposed to 10% ownership interests in the Company could effectively allow those persons to exercise disproportionate control and influence over major corporate decisions").

262. *See, e.g.*, Mark D. Gerstein, Tiffany F. Campion & Joshua C. Reisman, *Proactively Adopting a Poison Pill in Response to the COVID-19 Crisis*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Apr. 8, 2020), https://corpgov.law.harvard.edu/2020/04/08/proactively-adopting-a-poison-pill-in-response-to-the-covid-19-crisis [https://perma.cc/3PV9-MDFF] (observing that pills can be supportable "even absent an overt takeover bid or identified activist stock accumulation" and recommending "that companies impacted by significant stock price declines proactively prepare rights plan materials, review the rights plan with the board, and either adopt or put the rights plan on the shelf"); Paul Shim, James Langston & Charles Allen, *Rewriting the Poison Pill Prescription: Consider Active Defenses During COVID-19*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Apr. 5, 2020), https://corpgov.law.harvard.edu/2020/04/05/rewriting-the-poison-pill-prescription-consider-active-defenses-during-covid-19 [https://perma.cc/4NWU-J2DB] (recommending that companies "revisit" adopting poison pills "[i]n light of the unique threat posed by the current market"); Klein et al., *supra* note 225 (observing that 2020 "saw about three times as many rights plans adopted compared to historical numbers").

stating that the pandemic and a resulting stock price decline could constitute a valid justification for adopting a pill,[263] and a recent academic study found that stock prices increased in response to these crisis pills.[264] And ultimately, an appropriately designed anti-activist pill does not prevent shareholders from exercising their independent judgment. It only prevents an activist hedge fund (and its wolf-pack allies) from acquiring more than whatever threshold the pill uses (e.g., 5% or 10%). The activist remains free to try to persuade other shareholders to support its agenda, and the other shareholders are free to vote as they like.

Moreover, in rejecting the threats of "mistaken beliefs" and "short-termism," the Court of Chancery relied on an excellent article by Marcel Kahan and Edward B. Rock, *Anti-Activist Poison Pills*.[265] But a closer look suggests a different reading, given that the authors accept that preserving a "fair election process" is a cognizable threat.[266] If preventing a biased vote is a cognizable threat, it is so because it can distort the vote and lead to "mistaken beliefs" and "short-termism." Faulting the board for stating as a threat the *outcomes* ("mistaken beliefs" and "short-termism") instead of the *cause* ("biased vote") is unjustifiable. The distinction is a pure technicality.

Second, although the Court of Chancery correctly ruled in *Williams* that the *Unocal* standard of review should apply to determine the validity of the ownership threshold and the acting in concert provision, in practice, it applied a far more restrictive test. In casting the activism and short-termism threats as rooted in an invalid concern that stockholders will mistakenly vote the wrong way, the court effectively adopted the heightened standard of review established by *Blasius Industries, Inc. v. Atlas Corp.*,[267] which provides for closer scrutiny of

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263. *See Impacts of the COVID-19 Pandemic: ISS Policy Guidance*, INSTITUTIONAL S'HOLDER SERVS. 6 (2020), https://www.issgovernance.com/file/policy/active/americas/ISS-Policy-Guidance-for-Impacts-of-the-Coronavirus-Pandemic.pdf [https://perma.cc/99XJ-PZMM] (stating that Institutional Shareholder Service's policies "account for the adoption of poison pills in the face of genuine, short-term potential threat situations such as during the current pandemic," and "[a] severe stock price decline as a result of the COVID-19 pandemic is likely to be considered valid justification in most cases for adopting a pill of less than one year in duration"); Aaron Bertinetti, *Poison Pills and the Coronavirus: Understanding Glass Lewis' Contextual Policy Approach*, GLASS LEWIS (Apr. 8, 2020), https://www.glasslewis.com/poison-pills-and-coronavirus-understanding-glass-lewis-contextual-policy-approach [https://perma.cc/AGG5-YD9X] (stating that the "coronavirus and the related economic crisis" may serve "as reasonable context for adopting a poison pill").

264. Eldar & Wittry, *supra* note 121, at 209-10.

265. *See supra* note 259 and accompanying text.

266. *See* Kahan & Rock, *supra* note 62, at 939.

267. 564 A.2d 651 (Del. Ch. 1988).

board efforts to impede stockholder voting in contested elections.[268] Indeed, Gordon has gone further and expressly called for *Blasius* to apply to anti-activist pills.[269] Under *Blasius*, courts uphold board actions taken with "the primary purpose of interfering with or impeding the effectiveness of the stockholder vote in a contested election for directors" only if the board can "prove a 'compelling justification' for its actions."[270] In reality, a decision to apply *Blasius* usually indicates that the court will invalidate the challenged action, making it resemble a per se rule.[271] Traditionally, however, courts have invoked *Blasius* only in rare circumstances, such as when the board tries to *dictate* the outcome of a vote or dilute an

268. The Delaware Supreme Court adopted *Blasius* in *MM Cos. v. Liquid Audio, Inc.*, 813 A.2d 1118, 1132 (Del. 2003). Although the *Williams* court did not directly cite *Blasius*, the court used language indirectly taken from *Blasius* and drew heavily from decisions and scholarship that directly cited the case. *Compare Blasius*, 564 A.2d at 663 ("The only justification that can, in such a situation, be offered for the action taken is that the board knows better than do the shareholders what is in the corporation's best interest. While that premise is no doubt true for any number of matters, it is irrelevant (except insofar as the shareholders wish to be guided by the board's recommendation) when the question is who should comprise the board of directors. The theory of our corporation law confers power upon directors as the agents of the shareholders; it does not create Platonic masters."), *with In re* Williams Cos. S'holder Litig., C.A. No. 2020-0707, 2021 WL 754593, at *30 (Del. Ch. Feb. 26, 2021) ("Viewing all stockholder activism as a threat is an extreme manifestation of the proscribed we-know-better justification for interfering with the franchise."), *and Williams*, 2021 WL 754593, at *33 ("[T]he 'short-termism' argument just particularizes the concern that shareholders will cast votes in a mistaken assessment of their own best interests." (quoting Kahan & Rock, *supra* note 62, at 931)).

Several other sources cited by the *Williams* court build on the reasoning in *Blasius*. *See Williams*, 2021 WL 754593, at *30 n.308 (citing Pell v. Kill, 135 A.3d 764, 788 (Del. Ch. 2016)); Pell v. Kill, 135 A.3d 764, 788-90 (Del. Ch. 2016) (citing *Blasius* for the proposition that "the belief that directors know better than stockholders is not a legitimate justification when the question involves who should serve on the board of a Delaware corporation"); Kahan & Rock, *supra* note 62, at 928 ("The logical consequence of the reasoning in *Blasius* is that . . . [with limited exceptions] a board's determination that shareholders are likely to vote 'the wrong way' is not a legitimate basis for taking defensive measures.").

269. Gordon, *supra* note 62 ("*Blasius* is the right standard for a pill, like the anti-activist pill in this case, that 'represent[s] action taken for the primary purpose of interfering with the exercise of the shareholders' right to elect directors.'" (quoting Stahl v. Apple Bancorp, Inc., C.A. No. 11510, 1990 WL 114222, at *7 (Del. Ch. Aug. 9, 1990))).

270. Coster v. UIP Cos., 255 A.3d 952, 962 (Del. 2021) (quoting *Liquid Audio*, 813 A.2d at 1132).

271. Chesapeake Corp. v. Shore, 771 A.2d 293, 323 (Del. Ch. 2000) ("In reality, invocation of the *Blasius* standard of review usually signals that the court will invalidate the board action under examination. Failure to invoke *Blasius*, conversely, typically indicates that the board action survived (or will survive) review under *Unocal*.").

existing stockholder purely to reduce its voting power.[272] The underlying concern is that directors may "unfairly taint the election process" to entrench themselves.[273] As explained below, these concerns do not call for application of *Blasius* to anti-activist pills.

Starting with the inappropriate application of *Blasius* based on the pill's 5% ownership threshold—such a threshold does not raise the concerns animating *Blasius*. To the contrary, when employed against an activist, a poison pill with a 5% threshold can actually *improve* the quality of the vote. Unlike a dilutive stock issuance, an anti-activist poison pill simply stops the activist and its wolf-pack allies from acquiring *more* stock. Rather than "unfairly taint[ing] the election process," this can help to ensure a level playing field. Typically, the lead activist tips off potential allies about the imminent campaign before going public, thereby allowing these potential allies to profit off this nonpublic information and ensuring their loyalty in any upcoming vote.[274] As a result, without a poison pill to stop them, an activist and its wolf-pack allies can potentially acquire a large enough position to swing the election simply by convincing a small number of large institutional investors to support them,[275] even if the majority of unaffiliated stockholders oppose the activist's proposal. This creates the potential for

272. *See, e.g.*, Mercier v. Inter-Tel (Del.), Inc., 929 A.2d 786, 806, 808 (Del. Ch. 2007) (observing, in an opinion by then-Vice Chancellor Strine, that "*Blasius* is so strict a test that it is 'applied rarely'" and that "decisions following *Blasius* have often focused on whether the director action challenged was preclusive or coercive of stockholder choice" (quoting Williams v. Geier, 671 A.2d 1368, 1376 (Del. 1996))); *Coster*, 255 A.3d at 961 & n.56 (observing that actions designed "to frustrate or completely disenfranchise a shareholder vote" are impermissible and collecting cases involving dilutive stock issuances (quoting Stroud v. Grace, 606 A.2d 75, 91 (Del. 1992))).

273. *Mercier*, 929 A.2d at 806.

274. *See* Coffee & Palia, *supra* note 29, at 565-66 ("[T]ipping and informed trading appears to characterize . . . the formation of the 'wolf pack' . . . . [I]t is in the interest of the wolf pack leader to tip such allies, as the larger the percentage of shares held by loosely affiliated hedge funds, the greater the likelihood of victory in any proxy contest brought by the lead hedge fund.").

275. *See* John C. Coates, *The Future of Corporate Governance Part I: The Problem of Twelve* (Harv. Pub. L. Working Paper No. 19-07, 2018), https://ssrn.com/abstract=3247337 [https://perma.cc/QHQ6-9TRM]. John C. Coates observes that the so-called "Big Three" indexed fund providers—Vanguard, State Street, and BlackRock—"controlled approximately 15% of the S&P 500 in 2017," and from the portfolio company perspective, about a third of S&P 500 companies "have four or fewer stockholders holding an aggregate of 20+% of their stock." *Id.* at 13.

This problem is likely to grow worse, and it has started to attract a great deal of attention from academics and policymakers. *See, e.g.*, Leo E. Strine, Jr., *Toward Fair and Sustainable Capitalism*, ROOSEVELT INST. (Aug. 2020), https://rooseveltinstitute.org/publications/toward-fair-both disloyalty on the part of the institutional-investor agents who control those votes—a second layer of agent costs related to the "separation of ownership from ownership"[276]—and mistakes by those agents, whose decisions reflect the judgments of a small number of individuals instead of the collective wisdom of the many.[277] With a poison pill, the board can ensure that the activist must instead convince something approaching a majority of unaffiliated stockholders. This is far from an impossible task, as reflected by the recent success of the activist fund Engine One, which had a less than 1% stake in the target company, in its proxy fight with Exxon Mobil.[278] In short, a poison pill can help to ensure that an activist must persuade *unbiased* stockholders, thereby safeguarding the integrity of the electoral process.[279]

Nor does a broad acting in concert provision call for the application of *Blasius* to an anti-activist pill. While *Blasius* aims to prevent boards from intervening in

and-sustainable-capitalism [https://perma.cc/WQP6-LNXC] (proposing an ambitious policy agenda based in part on this problem); Robert J. Jackson, Jr., *Common Ownership: The Investor Protection Challenge of the 21st Century*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Dec. 14, 2018), https://corpgov.law.harvard.edu/2018/12/14/common-ownership-the-investor-protection-challenge-of-the-21st-century [https://perma.cc/8ZYJ-B6DB] (commenting on problems related to the increasing concentration of voting power in corporate elections and urging policymakers to view this issue as an investor-protection problem).

276. Leo E. Strine, Jr., *One Fundamental Corporate Governance Question We Face: Can Corporations Be Managed for the Long Term Unless Their Powerful Electorates Also Act and Think Long Term?*, 66 BUS. LAW. 1, 9 (2010). Nearly a century ago, Adolph Berle and Gardiner Means coined the term "separation of ownership and control" to describe the problems that arise when the owners of capital do not control its use (i.e., agent costs). ADOLPH BERLE & GARDINER MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 117 (1932). More recently, Leo E. Strine, Jr., the former Chief Justice of the Delaware Supreme Court and Chancellor of the Delaware Court of Chancery, coined the term "separation of ownership from ownership" to describe similar agent costs that arise when institutional investors make voting decisions on behalf of their ultimate beneficiaries. Strine, *supra*, at 9 & n.27; *see also* Strine, *supra* note 114, at 474-77 (developing this idea to propose policy interventions in support of "a more sensible system of corporate accountability" in response to an essay by Lucian A. Bebchuk, *The Myth that Insulating Boards Serves Long-Term Value*, 113 COLUM. L. REV. 1637 (2013)).

277. *See* Timothy Feddersen & Wolfgang Pesendorfer, *Voting Behavior and Information Aggregation in Elections with Private Information*, 65 ECONOMETRICA 1029, 1029 (1997) ("Elections provide a mechanism for aggregating private information, ensuring a better collective decision."); *see also* H. P. Young, *Condorcet's Theory of Voting*, 82 AM. POL. SCI. REV. 1231, 1231-32 (1988) (explaining the origin of this theory in the work of the French mathematician and social philosopher Jean Antoine Nicolas Caritat, Marquis de Condorcet).

278. Matt Phillips, *Exxon's Board Defeat Signals the Rise of Social-Good Activists*, N.Y. TIMES (June 9, 2021), https://www.nytimes.com/2021/06/09/business/exxon-mobil-engine-no1-activist.html [https://perma.cc/WF4B-B5XC].

279. Although skeptical of many of the justifications offered for anti-activist pills, Marcel Kahan and Edward B. Rock have endorsed a similar "fair process" rationale. *See* Kahan & Rock, *supra* note 62, at 939-46.

the voting itself—guarding shareholders' freedom to vote and approve a decision preferred by the majority—any legal rule that reflexively invalidates acting in concert provisions would effectively expand *Blasius*'s reach to the process by which a proxy fight is organized. It is true that a broad acting in concert provision aimed primarily at stopping wolf packs might also frustrate the ability of the activist to engage in confidential private negotiations and reach a preliminary understanding with institutional investors before the proxy fight. But while this result might increase the hedge fund's risk—forcing it to start the campaign without its pack or preliminary understandings with institutional investors and engage only in public persuasions—it would not frustrate the voting itself or necessarily impose an undue burden on the activist's ability to engage in a proxy fight. The incidental effects on the activist's ability to wage a proxy fight might be justified in some cases and not in others.

Ultimately, courts must balance the burden imposed on stockholders' ability to challenge the incumbent board—including both the effects on activists' incentives to mount a challenge created by the ownership threshold and the impediments to effective shareholder communication created by the acting in concert provision—against the benefits that the pill produces, such as a less-biased electorate that is less likely to acquiesce in mistargeting. This calls for a fact-specific analysis that depends on the specific features of the pill and the circumstances under which the board adopted the pill. In such cases, flexible standards are generally preferable to bright-line rules.[280] Thus, it is inappropriate to apply *Blasius*'s per se prohibition instead of the balancing test of *Unocal*.

The third problem with the framing of the threats posed by activists in terms of how stockholders will vote is that it rests on an incomplete characterization of the threats that activists pose. An activist may pose a threat not only because she might convince other stockholders to support her value-destructive plans but also because she might convince a self-interested board to capitulate to those demands without a stockholder vote. Directors may settle with an activist to avoid the risk of losing their seats (or otherwise suffering embarrassment) through a proxy contest, even though they believe that the activist's plan is bad for the company and its stockholders. Sometimes, it is easier just to give up. Indeed, activist campaigns settle much more often than they go to a vote.[281] When that happens, the concern is not that other stockholders will make a mistake but rather that the directors will be disloyal.

280. *See* FREDERICK SCHAUER, PLAYING BY THE RULES: A PHILOSOPHICAL EXAMINATION OF RULE-BASED DECISIONMAKING IN LAW AND IN LIFE 152 (1992) (arguing that standards are a better fit than rules when the relevant facts vary from case to case); Louis Kaplow, *Rules Versus Standards: An Economic Analysis*, 42 DUKE L.J. 557, 599-600 (1992) (similar).

281. *See supra* note 56 and accompanying text.

So how should courts evaluate poison pills designed to address threats posed by activist hedge funds? In our view, courts should simply apply the *Unocal* framework straightforwardly to determine whether a valid threat to corporate policy exists and, if so, whether the board's response is proportional. Contrary to the Court of Chancery's reasoning in *Williams*, we would hold that activism may constitute a valid threat to corporate policy based on the mistargeting hazard, *especially* when the activism is unconnected to a concrete takeover attempt, though courts should root out pretext[282] and weigh whether the particular pill under consideration is a proportionate response.[283] Conceivably, testimony or documents produced in discovery could reveal that the board adopted the pill merely to entrench itself, failing at the first prong of *Unocal*, or a pill could contain sufficiently draconian features to fail at the second prong. But courts should certainly not rule out the possibility that a poison pill is warranted as a defense against mistargeting by activist hedge funds.

Those concerned about the welfare of stakeholders beyond shareholders should note that our proposal would not discourage environmental or social activists (e.g., activists trying to reduce carbon emissions or increase gender diversity). Such environmental and social activists generally do not acquire big enough stakes to trigger poison pills.[284] Thus, an anti-activist pill would usually not impede this type of activism unless the court gives an extremely broad interpretation to the pill's acting in concert provision. A more modestly interpreted acting in concert provision—one that picks up true wolf-pack behavior by multiple investors who have only recently become shareholders but does not capture parallel behavior by activists and existing, long-term investors—would pose little danger to environmental or social activism.

One potential way for the corporate lawyers who draft rights plans to ensure that courts adopt this modest interpretation would be to expressly exempt long-term shareholders from the acting in concert provisions, such that index funds and other investors who have owned their shares for a sufficiently long period

282. *See, e.g.*, Kallick v. Sandridge Energy, Inc., 68 A.3d 242, 259 (Del. Ch. 2013) ("[T]he directors must comply with their *Unocal* duties by identifying a circumstantially proper and non-pretextual basis for their actions . . . .").

283. *See, e.g.*, *In re* Gaylord Container Corp. S'holders Litig., 753 A.2d 462, 474 (Del. Ch. 2000) ("[*Unocal*] enables the court to do something that it ordinarily cannot do under Delaware corporate law: examine the substantive reasonableness of the decisions of a board of directors.").

284. *See supra* note 278 and accompanying text.

are not inadvertently swept in.[285] This would ensure that long-term shareholders who want to push for environmental or social change are still able to do so.

The Delaware Supreme Court's affirmance of the Court of Chancery in *Williams* does not preclude this approach. Although we believe that the Court of Chancery's rejection of stockholder activism and short-termism as valid threats wrongly overlooks the mistargeting hazard, our proposed approach would be consistent with a narrower reading of the court's decision. In light of its finding that the challenged pill was a disproportionate response to the "rapid accumulation of stock" threat,[286] the Court of Chancery's statements that shareholder activism and short-termism are not valid threats as a matter of law were dicta,[287] and the Supreme Court's summary affirmance should not be construed as endorsing them.

Instead, we would focus on the specific features of the challenged pill that supported the *Williams* court's proportionality holding: the combination of a 5% ownership threshold and a particularly broad acting in concert provision. Together, these two features were out of step with standard market practices and interacted in a way that created a greater burden on potential acquirers than either provision would standing alone; the burden imposed by the acting in concert provision was amplified by the lower ownership threshold. Indeed, in finding the pill disproportionate, the Court of Chancery called these features "extreme" compared to other pills.[288] The company's financial adviser apparently advised the board that "only 2% of all plans . . . had a trigger lower than 10%," and Williams "was one of only two" Delaware corporations that had adopted a 5% trigger for non-tax-related reasons.[289] Meanwhile, the acting in concert provision contained "broad language [that] sweeps up potentially benign stockholder communications 'relating to changing *or influencing* the control of the Company.'"[290] Citing testimony of the company's directors, the court found that

285. There may also be other ways to tailor these provisions; we do not seek to constrain the creativity of corporate lawyers in designing a pill that effectively addresses mistargeting while permitting environmental and social activism.

286. *In re* Williams Cos. S'holder Litig., C.A. No. 2020-0707, 2021 WL 754593, at *33, *37 (Del. Ch. Feb. 26, 2021).

287. *See id.* at *33 ("When used in the hypothetical sense untethered to any concrete event, the phrases 'short-termism' and 'disruption' amount to mere euphemisms for stereotypes of stockholder activism generally and thus are not cognizable threats.").

288. *Id.* at *35.

289. *Id.* The court observed that other 5% pills came from the "NOL context," referring to pills designed to preserve net operating losses for tax purposes. *Id.*

290. *Id.* at *37 (citing a company press release which "publicly disclosed the Board's adoption" of the poison pill at issue, *id.* at *9).

"[t]his language encompasses routine activities such as attending investor conferences and advocating for the same corporate action."[291] That same reasoning would have applied to the stockholder activism and short-termism threats as well.

Going forward, we would respectfully urge Delaware courts to read *Williams* narrowly based on its facts—as a case about an extreme pill with a low ownership threshold and a broad acting in concert provision that does more than is necessary to safeguard against mistargeting by activists. In future cases, the Court of Chancery would be free to uphold an anti-activist pill that contains more modest features, considering the combined effect of the pill's various features. For example, courts could uphold a pill with a 5% ownership threshold but a narrower acting in concert provision (e.g., with language that more clearly exempts passive or long-term investors). Meanwhile, a higher ownership threshold (e.g., 10% or 15%) could potentially justify upholding a pill with a relatively broad acting in concert provision. It is ultimately the interaction of the two provisions that should be evaluated. Courts must therefore balance the combined effect of these features against the pill's utility in safeguarding against the threat that the board has identified.

B. Federal Law

Aside from state law, the other major source of relevant law for corporate control contests is federal securities law. Here too, the law has discouraged raiders while doing less to keep out activists. Again, our analysis suggests that this asymmetry has it backward.

The Williams Act and its implementing regulations make hostile takeovers of public companies more difficult by imposing waiting periods, substantial disclosure requirements, antiwarehousing prohibitions, and other restrictions on tender offers. First, with certain exceptions, any person who acquires beneficial ownership of more than 5% of a company's stock must file a disclosure statement with the Securities and Exchange Commission (SEC) within ten days of reaching 5% ownership,[292] which prevents a would-be corporate raider from acquiring creeping control without paying a control premium. This rule also applies to any "group" of persons, thereby stopping bidders from evading the requirement by forming coalitions in which each member owns less than the threshold amount.[293] Second, if a person who is about to commence a tender offer tips off

291. *Id.*

292. 15 U.S.C. § 78m(d) (2018); 17 C.F.R. § 240.13d-1(a) (2022).

293. 15 U.S.C. § 78m(d)(3) (2018).

other investors about the tender offer before it is made public, those other investors cannot freely trade on the information.[294] This rule helps stop bidders from placing the target's stock in friendly hands before the tender offer is public, a practice known as "warehousing" that makes the takeover easier to accomplish.[295] Third, upon launching a tender offer, the raider must file a detailed disclosure document with the SEC and keep open the offer for at least twenty business days, giving stockholders information and time to decide whether to accept the offer.[296] On the whole, these restrictions give boards breathing room to implement antitakeover defenses, protect stockholders against being driven to accept a low-priced tender offer on little notice, and ensure an unbiased "electorate."

Although these rules also constrain activists in certain ways, they have less bite in the activism context. First, even though activists are also obligated to file a disclosure statement on Form 13D within ten days of crossing the 5% ownership threshold, the lengthy window allows activists to acquire much more than 5% before disclosing their stake, with activists often acquiring up to 10%.[297] Although this loophole is nominally available to raiders to acquire a bigger toehold, raiders are unlikely to find it very useful because they do not need a substantial toehold to succeed—and, in fact, frequently succeed with no toehold whatsoever.[298] Second, activists are not required to disclose in their 13D filings their ownership of derivative interests such as options, which activists may use instead of or alongside outright stock ownership.[299] In theory, it might be possible for an activist to either "morph" those derivative interests into voting securities or convince its counterparty to vote the shares bought as a hedge, thereby imbuing the activist with voting power,[300] though some scholars have doubted that this is likely.[301] At the very least, the omission might leave investors with an incomplete picture of the activist's financial interest in the target company. Third, the

294. *Id.* § 78n(e); 17 C.F.R. § 240.14e-3 (2022).

295. *See* Michael J. Voves, Comment, United States v. O'Hagan*: Improperly Incorporating Common Law Fiduciary Obligations into § 14(e) of the Securities Exchange Act*, 81 MINN. L. REV. 1015, 1043-45 (1997) (describing warehousing practices).

296. 15 U.S.C. § 78o(d)(1) (2018); 17 C.F.R. §§ 240.14d-3(a), 240.14e-1(a) (2022).

297. *See* Brav et al., *supra* note 14, at 29.

298. *See* Goldman & Qian, *supra* note 42, at 322-27.

299. *See generally* Jie (Michael) Guo, Jianhua Gang, Nan Hu & Vinay Utham, *The Role of Derivatives in Hedge Fund Activism*, 18 QUANTITATIVE FIN. 1531 (2018) (providing an empirical analysis of the abnormal returns of targets of hedge-fund activists who do or do not employ derivatives).

300. *See* Henry T.C. Hu & Bernard Black, *The New Vote Buying: Empty Voting and Hidden (Morphable) Ownership*, 79 S. CAL. L. REV. 811, 836-40 (2006).

301. *See, e.g.*, Gilson & Gordon, *supra* note 62, at 915.

narrowly interpreted definition of "group" that triggers the 13D filing requirement when multiple funds act together fails to capture a good deal of the "wolf pack" behavior that activist hedge funds engage in, and even where it does apply, the current case law does not provide the target company with an effective remedy for violations by activists.[302] Fourth, unlike in the tender offer context, there is no equivalent prohibition on one activist hedge fund tipping off others about the imminent campaign—a common practice among activist hedge funds.[303]

There is a particularly large disconnect in the restrictions on the use of nonpublic information in these two contexts. While the SEC's antiwarehousing rules effectively prohibit raiders from tipping off potential allies about an imminent tender offer,[304] there are no equivalent rules prohibiting activists from doing the same as to an imminent activist campaign. This discrepancy matters because tipping can help the control contestant to gain support for its campaign—that is, a tippee is likely to support the contestant as an implicit (or explicit) quid pro quo for the tip. In other words, tipping biases the electorate. Ultimately, by forming a big-enough wolf pack, the lead activist may be able to win the election even if most unaffiliated stockholders oppose the activist's proposal. Indeed, one of the strongest justifications for anti-activist poison pills is to close this loophole and force the activist to persuade unbiased shareholders.[305]

This Article's recognition that activists are more dangerous than raiders supports calls to modernize the federal securities regime to account for the modern reality of control contests. Over the past decade and a half, lawmakers and commentators have made numerous proposals to modify the federal securities laws to address modern practices by activist hedge funds.[306] These proposals raise

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302. Coffee & Palia, *supra* note 29, at 562-70 (explaining that courts have recently interpreted the term "group" narrowly and noting "the absence of any meaningful remedy if a 'group' is formed but not reported").

303. *Id.* at 566 ("Such tipping by the wolf pack leader to its allies of its intent to launch an activist campaign may seem to resemble insider trading, but legally it is not equivalent. Although the information may be material and non-public, there is no breach of a fiduciary or other duty.").

304. *See supra* notes 294-295 and accompanying text.

305. *See supra* notes 274-279 and accompanying text (arguing that anti-activist pills can be justified on this basis).

306. *See, e.g.*, Coffee & Palia, *supra* note 29, at 592-603; *Petition for Rulemaking Under Section 13 of the Securities Exchange Act of 1934*, WACHTELL, LIPTON, ROSEN & KATZ (Mar. 7, 2011), https://www.sec.gov/rules/petitions/2011/petn4-624.pdf [https://perma.cc/GDH4-6HEV] (petitioning the SEC to initiate a rulemaking to reform section 13(d) reporting requirements); Brokaw Act, S. 1744, 115th Cong. (2017) (proposing legislative amendments to section 13(d) reporting requirements); Strine, *supra* note 276, at 16-18 (proposing similar amendments).

numerous complex issues and have generated fierce debate.[307] Though we do not seek to evaluate the details of each of these proposals, our analysis suggests that modernization of the federal securities laws to account for the threats posed by activists is warranted. In particular, we support extending the SEC's antiwarehousing rules to address tipping by activist hedge funds in advance of an activist campaign, thereby aligning the SEC's regulation of the use of nonpublic information by raiders and activists. This would help safeguard against the mistargeting hazard by ensuring an unbiased electorate that evaluates each activist proposal on its merits. Notably, this proposal would not discourage environmental or social activists, who do not form wolf packs.[308]

The SEC recently proposed amendments to Regulation 13D-G that would move in this direction.[309] Specifically, the SEC's proposed amendments would (1) shorten the 13D filing window from ten days to five; (2) expand the definition of beneficial ownership to cover certain derivative securities; and (3) provide that purposeful tipping in advance of a 13D filing by an activist will create a "group" that aggregates the tipper and tippee's holdings for purposes of the filing requirement.[310] The third change would function as a partial (but only partial)

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307. *Compare* Lucian A. Bebchuk, Robert J. Jackson, Jr. & Wei Jiang, *Pre-Disclosure Accumulations by Activist Investors: Evidence and Policy*, 39 J. CORP. L. 1, 7-14 (2013) (providing empirical evidence questioning the basis for these proposals), Lucian A. Bebchuk & Robert J. Jackson, Jr., *The Law and Economics of Blockholder Disclosure*, 2 HARV. BUS. L. REV. 39, 41 (2012) (arguing that tightening existing disclosure requirements would not "protect investors from the risk that outside blockholders will capture a control premium at shareholders' expense"), *and* Gilson & Gordon, *supra* note 62, at 902-16 (arguing that the proposed SEC rule change would be equivalent to adopting a "regulatory pill directed at activist shareholders at precisely the moment that boards, increasingly, would not adopt one"), *with* Adam O. Emmerich, Theodore N. Mirvis, Eric S. Robinson & William Savitt, *Fair Markets and Fair Disclosure: Some Thoughts on the Law and Economics of Blockholder Disclosure, and the Use and Abuse of Shareholder Power*, 3 HARV. BUS. L. REV. 135, 139-40 (2013) (responding to Bebchuk and Jackson and arguing that tightening disclosure requirements would better fulfill the stated purpose of the underlying statute), Strine, *supra* note 39, at 1895-97, 1959-62 (arguing that the current reach of disclosure requirements is "incomplete, outdated, and has not kept pace with financial evolutions" and proposing that the SEC "require all-in disclosure of financial instruments of any kind—long or short, natural or synthetic—tied to the value of the company's stock so market participants can understand a fund's ability to gain from increases or decreases in a target's stock price"), *and* Joshua Mitts, *A Private Ordering Solution to Blockholder Disclosure*, 35 N.C. CENT. L. REV. 203, 205-07 (2013) (intervening in the debate to propose a "balanced" approach, based on private ordering, which "consider[s] the cost *and* benefits of hedge fund activism").

308. We are not aware of any instance in which environmental or social activists have formed a wolf pack.

309. Modernization of Beneficial Ownership Reporting, 87 Fed. Reg. 13846 (proposed Mar. 10, 2022) (to be codified at 17 C.F.R. pts. 232 & 240).

310. *Id.* at 13847-49.

substitute for our proposal to extend the SEC's antiwarehousing rules to activism.

Unfortunately, although the SEC's proposed amendments would help to equalize the regulation of raiders and activists, we are skeptical that they will do enough in practice. First, it will likely be hard to detect and prove violations. This is particularly true about tipping, which in our analysis would be the most important change. The SEC's proposed rule would aggregate ownership based on tipping only if the lead activist shares information about its upcoming filing "with the purpose of causing" the tippee to buy stock in the target company.[311] Any savvy activist will avoid leaving evidence that it has tipped anyone at all, let alone that it had such a "purpose" in doing so. Second, there is a well-known lack of effective remedies for 13D disclosure violations, leading one scholar to call the statute "toothless."[312] For private plaintiffs, it is exceedingly difficult to get a meaningful injunction,[313] and federal appellate courts have uniformly held that there is no private right of action for money damages under Section 13(d).[314] For the SEC, it is unclear whether the available remedies will be sufficient to deter wolf-pack activism, especially if the SEC fails to take an active role in enforcement. On the one hand, the SEC does have broad authority to investigate potential violations, seek injunctive relief, and impose civil money penalties.[315] However, the SEC has traditionally not made expansive use of that authority in

311. *Id.* at 13869.

312. Ronald J. Colombo, *Effectuating Disclosure Under the Williams Act*, 60 CATH. U. L. REV. 311, 311 (2011); *see also* Coffee & Palia, *supra* note 29, at 569 (noting "the absence of any meaningful remedy if a 'group' is formed but not reported").

313. *See* Colombo, *supra* note 312, at 335-38 (surveying the case law and concluding that the most common response to requests for injunctions "is the denial of relief on the ground of mootness").

314. *See* Motient Corp. v. Dondero, 529 F.3d 532, 536 (5th Cir. 2008) (collecting cases). Although investors have a private right of action for money damages based on certain 13D violations under a separate statutory provision, *id.* (citing 15 U.S.C. § 78r(a) (2018)), the statutory standard applies only to false or misleading "statement[s]" made in SEC filings, 15 U.S.C. § 78r(a) (2018), and would therefore likely not apply simply because a filing was late. *Cf.* Vladimir v. Bioenvision Inc., 606 F. Supp. 2d 473, 491 (S.D.N.Y. 2009) (finding a duty to *amend* a 13D filing based on the duty to disclose a change in the purpose of a beneficial owner's stock ownership). In any event, a plaintiff would likely encounter obstacles in pleading sufficient facts to satisfy the "purpose" requirement in the SEC's proposed rule in light of the Private Securities Litigation Reform Act's heightened pleading requirements. *See Vladimir*, 606 F. Supp. 2d at 491-95 (dismissing a complaint based on pleading deficiencies).

315. *See* 15 U.S.C. § 78u (2018).

policing 13D violations,[316] and it is unclear whether the risk of civil money penalties (capped at around $1,000,000 per violation for egregious cases and, in practice, usually much lower)[317] would be sufficient to deter activists given the low probability of getting caught. For those activists who acquire stakes in the hundreds of millions (or even billions) of dollars in large companies,[318] a six-figure penalty will seem like pocket change.

Ideally, Congress would amend the Williams Act to extend the antiwarehousing rules to cover tipping in all contests for corporate control, not just those involving a tender offer, or else make the remedies for 13D disclosure violations more meaningful. Because the statutory authority for the SEC's antiwarehousing rules is limited to tender offers,[319] the SEC would likely need additional statutory authority to replicate its antiwarehousing rules in a manner that effectively targets activists. In the absence of such congressional action, however, we support the SEC's proposed clarification that tipping can create a "group" for purposes of 13D filing requirements. But, to give meaning to the amended rule, the SEC must actively enforce it and seek expansive remedies, including referral to the Department of Justice for criminal prosecutions in appropriate cases.

CONCLUSION

The conventional wisdom on raiders and activists—lambasting corporate raiders while praising shareholder activists—is wrong. Because they acquire relatively small stakes rather than entire companies, activists are more likely to destroy social wealth through mistargeting—trying to fix something that only appears to be broken—and thereby inflict harms on both their fellow stockholders

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316. *See, e.g.*, Eberwein, Exchange Act Release No. 80038, 2017 WL 605040, at *10-11 (Feb. 14, 2017) (ordering the activist hedge-fund defendants to cease and desist from further 13D violations and pay civil money penalties but imposing no further sanctions).

317. *See* 15 U.S.C. § 78u(d)(3)(B) (2018) (establishing tiered levels of civil monetary penalties based on the severity of the misconduct); *Inflation Adjustments to the Civil Monetary Penalties Administered by the Securities and Exchange Commission*, SEC. & EXCH. COMM'N (Jan. 15, 2022), https://www.sec.gov/files/civil-penalties-inflation-adjustments_0.pdf [https://perma.cc/FF92-EAJW] (documenting the adjustments to civil monetary penalties over time and noting that the current penalty for the most severe misconduct under section 78u(d)(3)(B) is $1,035,909); *Eberwein*, 2017 WL 605040, at *10-11 (imposing penalties on several defendants ranging from $30,000 to $180,000).

318. *See, e.g.*, Juliet Chung & Ben Lefebvre, *Activist Investor Buys $1.3 Billion Stake in DuPont*, WALL ST. J. (Aug. 14, 2013, 5:50 PM ET), https://www.wsj.com/articles/activist-investor-buys-13-billion-stake-in-dupont-1376517017 [https://perma.cc/ZC59-64EX].

319. *See* 15 U.S.C. § 78n(e) (2018) (rendering unlawful false and misleading statements made "in connection with any tender offer or request or invitation for tenders, or any solicitation of security holders in opposition to or in favor of any such offer, request, or invitation").

and the entire economy. To the extent activists do provide value, it is primarily by opening the door to raiders. This insight has profound implications for corporate law and policy. The decades-long trend in the law discouraging raiders but encouraging activists should end. Lawmakers and courts should equalize the regulation of raiders and activists.