INVIGORATING CORPORATE DEMOCRACY: RETHINKING "CONTROL" UNDER THE WILLIAMS ACT

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In the summer of 2021, a small, previously unknown hedge fund named Engine No. 1 did the unthinkable. Despite owning less than 0.0016% of the company's stock, Engine No. 1 elected three independent directors to the board of ExxonMobil on a platform of lowering Exxon's greenhouse gas emissions and investing in renewable energy. Engine No. 1's successful proxy battle at the country's largest oil and gas company came after years of efforts by some of its largest shareholders to push the company in this direction, and it succeeded only because of the support of these large institutional shareholders. This case study highlights the powerful role that activist campaigns play in corporate democracy: Motivated by the prospect of outsized returns, hedge funds like Engine No. 1 are among the few players capable of mounting effective challenges to incumbent management at publicly traded companies. Although commentators have written about this dynamic, no scholarship has yet focused on the significant second-order effects that hedge fund activism can have on issues like climate change.

In October 2023, the Securities and Exchange Commission (SEC) adopted a new rule to shorten the Schedule 13D filing window under the Williams Act from ten days to five. Although justified as necessary given the technological advances that have occurred since the Act's passage in 1968, shortening the filing window makes it more difficult for activists to engage in campaigns at publicly traded companies, thereby diminishing the power of the only actors within the world of corporate democracy capable of pushing management to respond to shareholder preferences and tipping the balance of power towards management. Thankfully, the Commission is not without options to address this difficulty. This Note proposes that the SEC create a new filing—Schedule 13I—which would permit activists who are not seeking control, but merely influence over corporate policy, the full ten-day filing window. Doing so is well within the Commission's statutory authority. Indeed, given the dramatic shifts in the corporate governance landscape that have occurred since the passage of the Williams Act, and the fact that the Act was explicitly envisioned as favoring neither management nor activists, creating this new filing Schedule would help regain the balance which Congress so carefully set when it passed the Act, thus achieving a regulatory structure more in line with its purpose. At a time when the functioning of corporate democracy implicates both value-creation and the satisfaction of shareholder preferences on the defining issues of our era, the Commission must consider changes to invigorate corporate democracy.

* Copyright © 2023 by Jack C. Hipkins, J.D. 2023, New York University School of Law; B.A., 2016, University of California, Santa Barbara. This Note reflects my personal views and opinions, not those of my colleagues or employer. Every student owes an immeasurable debt to their teachers. I'm indebted to Marsi Kobayashi for teaching me how to read, Dr. Gideon Rappaport for teaching me how to write, and Professor Chris Preble for teaching me to question my biases—this piece is as much theirs as it is mine. A special thanks to Charlie Penner and Professors Robert J. Jackson and John C. Coffee for their helpful comments. A big thanks also to Sanjay Dureseti, Jonathan Goldberg, Eliza Hopkins, Jon Spilletti, and all my other friends on the *New York University Law Review* for their assistance. This note is dedicated to my first, and most important teacher, my mother Anastasia. Thanks for cultivating my love of learning and for teaching me how to smile at the world. Everything I am is because of you.

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Introduction

On November 6, 2022, delegates from 190 countries arrived in Sharm El Sheikh, Egypt for the twenty-seventh United Nations Climate Change Conference (COP27),[1] a thirteen-day climate talk intended to elicit pledges from participating states to limit global warming to below 2°C above preindustrial levels by the end of this century, and ideally to 1.5°C.[2] The stakes were high. Projections indicate warming of 2°C will more than double the percentage of the global population

[1] Claire McGuire, *The 2022 UN Climate Change Conference (COP27): Outcomes and Opportunities for Libraries*, Int'l Fed'n of Library Ass'ns & Insts. (Dec. 1, 2022), https://www.ifla.org/news/the-2022-un-climate-change-conference-cop27-outcomes-and-opportunities-for-libraries [https://perma.cc/4DS2-EHF2].

[2] Nina Chestney, *Every Fraction of a Degree Counts, UN Says, as 2.8C Warming Looms*, Reuters (Oct. 27, 2022, 9:13 AM), https://www.reuters.com/business/environment/cop27-world-faces-28c-rise-after-woefully-inadequate-climate-pledges-un-says-2022-10-27 [https://perma.cc/TEE7-MEF6].

exposed to risk of extreme heat waves,[3] cause hundreds of millions more people worldwide to suffer from climate-related poverty,[4] and virtually eradicate the world's coral reefs.[5] The United Nations issued a report a week prior to COP27 that assessed the latest climate pledges by countries and indicated the planet was on track for an average rise in temperatures of 2.8°C.[6] In response to the report, United Nations Secretary-General António Guterres stated, "[w]e are headed for a global catastrophe."[7]

While some tangible successes emerged from COP27, including a historic decision to create a loss and damage fund,[8] only twenty-nine countries present ratified improved pledges to cut back on emissions,[9] and many commentators expressed disappointment at the lack of concrete outcomes.[10] The underwhelming results spurred calls from academics and policymakers for new approaches to fighting climate change, including proposals to bring the private sector to the negotiating table at future conferences.[11] Likewise,

[3] Bruce Lieberman, *1.5 or 2 Degrees Celsius of Additional Global Warming: Does It Make a Difference?*, Yale Climate Connections (Aug. 4, 2021), https://yaleclimateconnections.org/2021/08/1-5-or-2-degrees-celsius-of-additional-global-warming-does-it-make-a-difference [https://perma.cc/LPN2-DQ37].

[4] Kate Abnett, *Explainer: What's the Difference Between 1.5°C and 2°C of Global Warming?*, Reuters (Nov. 9, 2021, 2:46 PM), https://www.reuters.com/business/cop/whats-difference-between-15c-2c-global-warming-2021-11-07 [https://perma.cc/3HJU-7P8H].

[5] With a 1.5°C increase, coral reefs are expected to decline by 70% to 90%; at 2°C, they are projected to decline by more than 99%. Lieberman*, supra* note 3.

[6] Chestney, *supra* note 2.

[7] *Id.*

[8] The loss and damage fund is meant to compensate developing countries facing the brunt of climate change's negative consequences. *See What You Need to Know About the COP27 Loss and Damage Fund*, UN Env't Programme (Nov. 29, 2022), https://www.unep.org/news-and-stories/story/what-you-need-know-about-cop27-loss-and-damage-fund [https://perma.cc/TMQ7-S2GZ].

[9] *COP27: A Flawed Though Still Consequential Climate Summit*, Covington (Nov. 23, 2022), https://www.cov.com/en/news-and-insights/insights/2022/11/cop27-a-flawed-though-still-consequential-climate-summit [https://perma.cc/W5HS-NRGK].

[10] *See, e.g.*, Alice C. Hill, *COP27 Didn't Make Enough Progress to Prevent Climate Catastrophe*, Council on Foreign Rels. (Nov. 21, 2022, 3:15 PM), https://www.cfr.org/in-brief/cop27-didnt-make-enough-progress-prevent-climate-catastrophe [https://perma.cc/VBD5-HBG3] ("COP27, like many prior climate convenings, was long on discussion and short on progress."); Covington, *supra* note 9 ("[T]he broader picture that emerged from COP27 was one of lost opportunities to adopt more ambitious and accelerated climate mitigation commitments.").

[11] After the disappointing conclusion of COP27, Christiana Figueres, former Executive Secretary of The United Nations Framework Convention on Climate Change, argued for including the private-sector in future climate gatherings. "They have the capacity to implement, much more than governments do. . . . I think if we were able to bring down the wall between the [governments and private sector] we'd be able to move further and faster." Terry Slavin, *After 'Disappointing' COP27, Calls Grow for New Approach to Fighting Climate Change*, Reuters (Nov. 28, 2022, 10:17 AM), https://www.reuters.com/business/

private ordering[12]—most prominently Environmental Sustainability and Governance (ESG) investing[13]—has increasingly become an important component of any solution. In recent years, ESG investing has enjoyed explosive growth; in 2021, over $18 trillion of assets under management worldwide were invested in ESG-oriented funds.[14] Institutional investors have embraced ESG as it has grown in popularity, integrating it into their investment strategies and advocating for the companies they invest in to do more good.[15] Index fund providers in particular have elevated ESG in their hierarchy of concerns, exerting pressure on portfolio companies to embrace enhanced ESG practices.[16] However, in the face of resistance by

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sustainable-business/after-disappointing-cop27-calls-grow-new-approach-fighting-climate-change-2022-11-28 [perma.cc/8JPM-SF6P]; *cf.* Arunabha Ghosh, Artur Runge-Metzger, David G. Victor & Ji Zou, *The New Way to Fight Climate Change: Small-Scale Cooperation Can Succeed Where Global Diplomacy Has Failed*, Foreign Affs. (Nov. 4, 2022), https://www.foreignaffairs.com/world/new-way-fight-climate-change?check_logged_in=1 [https://perma.cc/9E5T-2UCN] (arguing that smaller scale, industry-by-industry efforts at cooperation has yielded real success and, alongside public policy and consensus-building diplomacy, must be part of the path forward).

12 *See generally* Steven L. Schwarcz, *Private Ordering*, 97 Nw. U. L. Rev. 319 (2002) (exploring the concept of private ordering, the historical precedent behind it, and its growing significance in contemporary commercial, financial, and business sectors).

13 ESG investing is a catchall term that refers to making investment decisions based on an analysis of a company's score on environmental, social, and governance metrics created by independent, third-party entities. *See* E. Napoletano, *Environmental, Social and Governance: What Is ESG Investing?*, Forbes (June 22, 2023), https://www.forbes.com/advisor/investing/esg-investing [https://perma.cc/SF6G-MUH9]. The focus of this Note is on the environmental component of ESG.

14 PwC, Asset and Wealth Management Revolution 2022: Exponential Expectations for ESG 4 (2022), https://www.pwc.com/gx/en/financial-services/assets/pdf/pwc-awm-revolution-2022.pdf [perma.cc/FK6V-QRM5] (detailing findings from PwC's global survey of the asset management industry).

15 *See, e.g.*, Ryan Stanton, *ESG-Focused Institutional Investment Seen Soaring 84% to US$33.9 Trillion in 2026, Making Up 21.5% of Assets Under Management*, PwC (Oct. 10, 2022), https://www.pwc.com/gx/en/news-room/press-releases/2022/awm-revolution-2022-report.html [https://perma.cc/KJW5-XGXG] ("Nearly nine in ten, 88%, of institutional investors surveyed believe asset managers should be more proactive in developing new ESG products."); PwC, *supra* note 14, at 4 ("[I]n our base-case scenario, the share of ESG assets over total AuM [assets under management] would increase from 14.4% in 2021 to 21.5% in 2026, comprising more than one-fifth of all assets . . . .").

16 *See, e.g.*, Larry Fink, *Larry Fink's 2022 Letter to CEOs: The Power of Capitalism*, BlackRock, https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter [https://perma.cc/W2XW-S8K4] ("Every company and every industry will be transformed by the transition to a net zero world. The question is, will you lead, or will you be led?"). ESG has not, however, been without its detractors. *See, e.g.*, Terrence Keeley, *Vanguard's CEO Bucks the ESG Orthodoxy*, Wall St. J. (Feb. 26, 2023, 1:08 PM), https://www.wsj.com/articles/vanguards-ceo-bucks-the-esg-orthodoxy-tim-buckley-net-zero-emissions-united-nations-initiative-nzam-f6ae910d [https://perma.cc/4Y56-5EJG] (noting that Vanguard CEO Tim Buckley withdrew his firm from the Net Zero Asset Managers initiative, an alliance restricting investments to companies in compliance with the Paris Climate Agreement,

management or boards of directors, the structural constraints faced by these institutional investors preclude them from pressing the issue too firmly.[17] Instead, they must rely on activists.

Against this backdrop unfurls the remarkable story of Engine No. 1, a small, previously unknown hedge fund that, in 2021, did the unthinkable. Despite owning less than 0.016% of the company's stock, Engine No. 1 elected three independent directors to the board of ExxonMobil on a platform of lowering the company's greenhouse gas emissions and investing in renewable energy. Engine No. 1's successful proxy battle at the country's largest oil and gas company came after unsuccessful efforts by Exxon's largest shareholders to push the company in this direction. And the hedge fund's campaign succeeded only because of the support of these large institutional shareholders.

Engine No. 1's campaign at ExxonMobil illustrates two dynamics. First, corporate governance battles today can be understood as "contest[s] between incumbents (the board and managers) and activist hedge funds for the hearts and minds of the institutional investors that constitute the stable core of the shareholder base."[18] The incumbent board and activist can be thought of as "representing two political parties that offer competing slates of candidates and competing plans for how to maximize value,"[19] between which the electorate—the company's shareholders—must choose. Without activists, the incumbent party runs unopposed and need not acede to shareholder preferences. Second, Engine No. 1's proxy battle success demonstrates that activist interventions at publicly held companies can viably effectuate ESG policies. Although hedge fund activism has not traditionally been associated with positive environmental outcomes, Engine No. 1's efforts at ExxonMobil represent an example of a nongovernmental actor influencing a major shift in policy at an oil and gas company. These dynamics should caution policymakers against implementing regulations that disincentivize activism.

And yet, a recently enacted regulatory change by the SEC does just that. On October 10, 2023, the SEC announced it had shortened the

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because Vanguard's research "indicates that ESG investing does not have any advantage over broad-based investing."); Ross Kerber, Isla Binnie & Simon Jessup, *U.S. Finance Faces ESG Backlash, More to Come in 2023*, Reuters (Dec. 27, 2022, 7:08 AM), https://www.reuters.com/business/sustainable-business/us-finance-faces-esg-backlash-more-come-2023-2022-12-27 [https://perma.cc/KLM7-QDLD] ("A movement by financial firms and activists to challenge companies over their efforts on climate change and social inequality faced organised and growing push-back in 2022, led by Republican U.S. politicians.").

[17] *See infra* notes 44–49 and accompanying text.

[18] Marcel Kahan & Edward B. Rock, *Anti-Activist Poison Pills*, 99 B.U. L. Rev. 915, 940 (2019).

[19] *Id.*

filing window under the Williams Act.[20] For various reasons discussed in Section II.C, activist campaigns are typically kicked off by the activist's accumulation of a substantial percentage of the target company's shares. The Williams Act, a 1968 amendment to the Securities Exchange Act of 1934, governs accumulations of these large blocks of shares. The Act imposes mandatory disclosure obligations on any person acquiring more than 5% of the outstanding shares of any class of a publicly traded corporation.[21] Previously, any person or entity who crossed the 5% threshold had to file a disclosure with the SEC within ten days explaining why they were doing so. The SEC's new rule shortens this timeframe to five days.

A five-day disclosure window makes it more difficult for activists to run campaigns at publicly traded companies, particularly small- and medium-cap companies.[22] Although commentators have explained the deterrent effect this change will have on would-be activists,[23] and the corresponding costs imposed on public company shareholders,[24] none have systematically considered the second-order, societal impact this change could have on pressing ESG concerns such as climate change.[25] By shortening the filing window for Schedule 13D, the SEC risks precluding activist investors from running some Engine

[20] *See* Andrew Freedman & Elizabeth R. Gonzalez-Sussman, *SEC Adopts Updates to Schedule 13D and 13G Reporting*, Harv. L. Sch. F. on Corp. Gov. (Oct. 24, 2023) [hereinafter SEC Updates 13D], https://corpgov.law.harvard.edu/2023/10/24/sec-adopts-updates-to-schedule-13d-and-13g-reporting [https://perma.cc/V56E-7LD9].

[21] *See* 17 C.F.R. § 240.13d-1(a).

[22] *See infra* Section II.A.

[23] *See, e.g.*, Lucian A. Bebchuk, Alon Brav, Robert J. Jackson Jr. & Wei Jiang, *Pre-Disclosure Accumulations by Activist Investors: Evidence and Policy*, 39 J. Corp. L. 1, 17–19 (2013) ("[R]equiring activist investors to disclose their ownership in public companies more quickly will reduce these investors' returns—thereby reducing the incidence and magnitude of outside blockholdings in large public companies."); Ronald J. Gilson & Jeffrey N. Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights*, 113 Colum. L. Rev. 863, 906–12 (2013) ("Shortening the disclosure period would go far toward capping the activist's ownership stake, not because of a legal prohibition against acquiring more, but because the economics would militate against it."). *But 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, 594–96 (2016) (claiming that the concerns motivating the arguments against the shortening of the Williams Act ten-day window are "overstated").

[24] *E.g.*, Lucian A. Bebchuk & Robert J. Jackson, Jr., *The Law and Economics of Blockholder Disclosure*, 2 Harv. Bus. L. Rev. 39, 50 (2012) ("Given the importance and beneficial role of outside blocks, disincentives to the creation of such blocks can be expected to impose costs on investors, increasing agency costs and managerial slack.").

[25] In their comment letter addressing the SEC's proposed changes, Engine No. 1 leaders Penner and Eccles gesture at the impact the rule change will have "on the growing ESG activist movement," but do not elaborate. Charlie Penner & Bob Eccles, Comment Letter on Proposed Rule to Modernize Beneficial Ownership Reporting at 2 (Apr. 11, 2022), https://www.sec.gov/comments/s7-06-22/s70622-20123320-279613.pdf [https://perma.cc/FLZ6-YVBZ].

No. 1-style campaigns by eliminating their potential to generate a sufficient return on their investment.[26] Thus, a shorter filing window for Schedule 13D may impose additional societal costs by limiting opportunities for activists to force public companies to embrace ESG practices. Thankfully, however, the SEC can mitigate this impact. To preserve a robust market for corporate influence in which activists of all stripes (ESG or otherwise) can force management to respond to shareholder preferences, this Note proposes that the SEC issue a new filing Schedule that provides a 10-day window for investors merely seeking *influence* rather than control—what this Note calls the Schedule 13I. Doing so is well within the SEC's statutory authority under the Williams Act.[27]

This Note proceeds as follows: Part I explains the theory of corporate governance and its relation to corporate democracy, the role of hedge fund activism, and the positive role such activism can play in the fight against climate change. Part II explains why the SEC's shortening of the Schedule 13D filing window may well deter ESG activism and proposes the creation of a new filing schedule to resolve this issue. Finally, Part III addresses a definitional puzzle: By creating different filing Schedules for investors who seek either "control" or "influence," the SEC must formulate some means of distinguishing between the two. Part III proposes two potential approaches, identifies several factors to be considered by the SEC in seeking a justiciable definition, and makes a normative case for using a clear-cut definition of control.

I
Background on Corporate Governance

A. *Agency Costs and Institutional Investors*

Corporate governance is "the system of rules, practices, and processes by which a firm is directed and controlled."[28] A corporation's governance model borrows from agency law and representative democracy. As principals, shareholders of a corporation delegate authority to a board of directors who serve as their economic agents.[29]

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[26] *See infra* Section II.A.

[27] *See infra* Section II.C.

[28] James Chen, *Corporate Governance Definition: How It Works, Principles, and Examples*, Investopedia (Mar. 22, 2023), https://www.investopedia.com/terms/c/corporategovernance.asp [https://perma.cc/SU24-M6CT].

[29] *See* John C. Coates, IV, *The Future of Corporate Governance Part I: The Problem of Twelve* 4 (Harv. John M. Olin Ctr. for L., Econ. & Bus., Discussion Paper No. 1001, 2019), https://www.law.harvard.edu/programs/olin_center/papers/pdf/Coates_1001.pdf [https://perma.cc/Z59E-QXD6].

These directors are elected by the shareholders and serve designated terms. The board has ultimate authority over strategic decisions about corporate policy and, in turn, delegates authority over the day-to-day implementation of that policy to corporate management. Although the board is ultimately answerable to the corporation's shareholders, shareholders can only force the board to respond to their preferences by either removing them or voting them out.[30] Otherwise, the board wields the undisputed authority to manage the business and affairs of the corporation, and shareholders cannot direct the board to take particular actions.[31]

While this structure allows the board and management to make decisions with fewer transaction costs, it also creates the risk of agency costs. Agency costs are those costs imposed on a principal that arise from their delegation of decisionmaking power to an agent.[32] When an agent has the authority to make decisions from which it benefits, the cost of which it does not internalize (or only partially internalizes), this creates the risk that the agent will act in their own interest rather than in the best interest of their principal.[33] Within the corporate context, these costs may include excessively luxurious board meetings at exotic destinations, the use of corporate resources for personal purposes, or capital expenditure strategies focused on empire-building rather than value-creation.

When shareholders disagree with directors' actions, there is a limited range of mechanisms by which they can hold them accountable. On the one hand, directors owe their shareholders fiduciary duties of care and loyalty, deviations from which are grounds for shareholders to bring suit. However, the duty of loyalty only applies to a small subset of director

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30 *See* Del. Code Ann. tit. 8, § 141(k) (2023) (establishing that directors can be removed with or without cause unless the board is staggered or there is cumulative voting, in which case they may only be removed for cause). Because of Delaware's preeminent role in U.S. corporate law, this Note's discussion of corporate governance law is grounded in Delaware law.

31 *See* tit. 8, § 141(a) ("The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors, except as may be otherwise provided in this chapter or in its certification of incorporation."); Arnold v. Soc'y for Sav. Bancorp, Inc., 678 A.2d 533, 539–40 (Del. 1996) ("The board of directors of a corporation is charged with the ultimate responsibility to manage or direct the management of the business and affairs of the corporation." (citing Del. Code Ann. tit. 8, § 141(a))).

32 *See* John Armour, Henry Hansmann & Reinier Kraakman, *Agency Problems, Legal Strategies, and Enforcement* 2–3 (Harv. John M. Olin Ctr. for L., Econ., & Bus., Discussion Paper No. 644, 2009), https://www.law.harvard.edu/programs/olin_center/papers/pdf/Kraakman_644.pdf [https://perma.cc/HX7E-9YFA] (explaining the costly monitoring principals must undertake to ensure the agent adheres to the principal's interests).

33 *See id.* at 2.

decisions,[34] while the business judgment rule,[35] waivers of personal liability for damages,[36] and the prevalence of director insurance covering such liability largely vitiate the deterrence effect of the duty of care for all but gross negligence. In other words, while shareholders can bring suit against directors and officers for structuring a bad merger or being grossly negligent, their fiduciary duties are not violated merely by performing poorly or ignoring shareholder preferences. In addition, because shareholders cannot tell the board what to do, they can only punish board members by voting them out. Thus, the specter of defeat at the ballot box is the primary mechanism that pressures directors and management to respond to shareholder preferences and disincentivizes them from imposing unnecessary agency costs on shareholders.[37] Shareholder rational apathy, however, means that the average shareholder will not monitor the company to a sufficient degree to detect agency costs,[38]

34 *See, e.g.*, *Duty of Loyalty*, Cornell L. Sch.: Legal Info. Inst., https://www.law.cornell.edu/wex/duty_of_loyalty#:~:text=The%20duty%20of%20loyalty%20requires,violate%20their%20duty%20of%20loyalty [https://perma.cc/Q4A4-99VE] (last updated July 2022) (listing examples such as diverting corporate assets and usurping a corporate chance for personal gain).

35 For an explanation of the rule's coverage, see generally Gerard V. Mantese & Emily S. Fields, *The Business Judgment Rule*, Mich. Bar J., Jan. 2020, at 30–33.

36 Corporations can waive or limit a director's personal liability for breaches of their fiduciary duty of care under Del. Code Ann. tit. 8, § 102(b)(7). *Exculpation of Officers of Delaware Corporations from Liability for Breach of Fiduciary Duties Now Permitted*, Baker Botts (Aug. 18, 2022), https://www.bakerbotts.com/thought-leadership/publications/2022/august/exculpation-of-officers-of-delaware-corporations [https://perma.cc/YT2F-45HL].

37 This was not always the case. For many years, the "market for corporate control" was widely viewed as the most significant corrective mechanism for addressing agency costs. *See* Bernard S. Sharfman, *The Illusion of Success: A Critique of Engine No. 1's Proxy Fight at ExxonMobil*, 12 Harv. Bus. L. Rev. Online, art. 3, 2021 at 5–6 (explaining how hostile takeover actors, motivated by profits, are incentivized to correct managerial inefficiencies). However, as discussed below, the rise of the poison pill and state antitakeover statutes reduced the prevalence of hostile takeovers and subdued the deterrent effect of the market for corporate control. *See* Bernard S. Sharfman & Marc T. Moore, *Liberating the Market for Corporate Control*, 18 Berkeley Bus. L.J. 1, 11–14, 27 (2021) (citing empirical evidence showing the relative infrequency of successful hostile takeovers in the U.S., as compared to the U.K.).

38 Given the size of many corporations, the cost of wasteful managerial decisions may have only a marginal impact per share. Under traditional corporate governance theory, the typical shareholder of a broadly held company only owns a small portion of the firm, and they internalize a small amount of any benefit or loss from managerial decisions. Further compounding this dynamic, the typical shareholder does not have a large absolute stake in the firm. Accordingly, the monetary benefit they will accrue from superior management is too small to justify the time and attention required to appropriately monitor the company. For a discussion of these issues, see Lisa M. Fairfax, *From Apathy to Activism: The Emergence, Impact, and Future of Shareholder Activism as the New Corporate Governance Norm*, 99 B.U. L. Rev. 1301, 1307–10 (2019).

and collective action problems[39] make it unlikely that shareholders will even participate in board elections should a candidate run against an incumbent board member.

Concern that rational apathy and collective action problems would preclude shareholders from sufficiently monitoring corporate boards and management has been a persistent focus of academic literature since the advent of the modern corporate form.[40] However, the rise of institutional investment funds—initially comprised of pension, insurance, and mutual funds in the 1980s and, more recently, index funds—have helped mitigate some of these concerns.[41] Unlike a typical investor, funds usually make significant investments in a firm and are positioned as the largest and most powerful shareholders.[42] Their holdings represent a large enough voting bloc to wield influence in board composition and provide incentive to monitor the company's performance. Thus, the rise of institutional investors has been identified as a market dynamic that reduces agency costs.[43]

However, though institutional investors have the incentive to monitor and engage with the officers and directors of the companies they own, structural factors make them disinclined to be too aggressive. Mutual funds suffer from regulatory constraints,[44] inadequate

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39 Even if a shareholder was motivated to overcome their rational apathy, their votes (frequently a fraction of 1% of the overall vote count) won't make a difference. *See* Bernard S. Black, *Agents Watching Agents: The Promise of Institutional Investor Voice*, 39 UCLA L. Rev. 811, 821–22 (1992) (summarizing the collective action problems facing shareholder action).

40 *See, e.g.*, Adolf A. Berle, Jr. & Gardiner C. Means, The Modern Corporation and Private Property (1933).

41 For an argument that pension, insurance, and mutual funds are able to overcome some of the rational apathy and collective action problems facing shareholders, see Black, *supra* note 39, at 850–52. For an overview of index funds and their ability to overcome the same issues, see Coates, *supra* note 29, at 7–17.

42 *See* Lucian A. Bebchuk, Alma Cohen & Scott Hirst, *The Agency Problems of Institutional Investors*, 31 J. Econ. Persps., Summer 2017, at 92–93 (noting institutional investors "hold sufficiently sizable positions in each large corporation to have a non-negligible effect on the outcomes of share-holder votes.").

43 *See id.* at 93 ("Institutional investors therefore provide constraints on agency problems in their portfolio companies that dispersed shareholders . . . were unable to accomplish."); Black, *supra* note 39, at 851 ("Institutional voice will not merely recreate our current agency problems at a different level. Investors weakly watching money managers who watch corporate managers is more promising than today's world, where most of the time no one watches corporate managers."); *cf.* Coates, *supra* note 29, at 15, 18 (noting that although index providers have weak incentives to exert control over firms they own, they are incentivized "to focus hard on the selection of their delegates, their demonstrated loyalty and ability, and their responsiveness to direction in specific instances").

44 Under the Investment Company Act of 1940, mutual funds are required to stand ready to redeem shares at their shareholders' request on short notice, thereby making them ill-suited to commit funds for the length of time necessary to run an activist campaign. *See* Investment Company Act of 1940 § 5(a)(1), 15 U.S.C. § 80a-5(a)(1). In addition, in order to be considered a diversified fund (a preferred classification for mutual funds due to tax and

incentives,[45] and conflicts of interest[46] that hamper their ability to monitor portfolio companies, essentially precluding them from running proxy battles to force out management. Similarly, while index funds frequently pursue private engagements with their portfolio companies, issue proxy voting guidelines, and actively participate in voting on shareholder proposals and director elections, their business model lacks the incentive structure for them to accept the costs of proxy battles.[47] Finally, while public pension funds do not face the regulatory, incentive, and commercial conflict of interest issues presented by mutual and index funds, their status as political entities subjects them to their own bevy of constraints and conflicts that make them unlikely to run proxy battles.[48] In sum, although institutional investors engage in less aggressive forms of activism, structural limitations ultimately prevent them from running successful proxy battles.

Thus, in the face of a board's refusal to accede to shareholder preferences for corporate change, neither individual nor institutional shareholders of a public company are likely to challenge them. Only one player within the sphere of corporate democracy can be so relied on: the activist hedge fund.

B. Hedge Funds: The Engines of Activism

Hedge funds are a form of lightly regulated limited partnerships that seek to use aggressive and frequently unorthodox investment

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advertising benefits) mutual funds must comply with diversification requirements which limit their ability to accumulate large stakes in particular companies. Marcel Kahan & Edward B. Rock, *Hedge Funds in Corporate Governance and Corporate Control*, 155 U. Pa. L. Rev. 1021, 1049 (2007). As will be discussed *infra* Section I.B, the accumulation of a large stake is a key mechanism that makes activism financially viable.

45 As will be discussed *infra* Section I.B, a performance-based fee arrangement is necessary to make activism worthwhile. Most mutual funds are constrained from charging performance-based fees. Even those funds with such fees have flat fee structures that provide insufficient incentives to wage proxy battles. *See* Kahan & Rock, *supra* note 44, at 1050–52.

46 Many mutual fund management companies are associated with financial institutions such as insurance companies or investment banks. *Id.* at 1054. As such, "[m]anagers of such funds may be reluctant to antagonize present or future clients of their parent company with their governance activities." *Id.*

47 Index funds are structured to replicate the performance of whatever index they track. As such, they compete with other funds replicating the same index on the basis of expenses. Insofar as activism increases the fund's costs—and, in the event that their activism is successful, benefits their competitors who are able to free ride on their efforts—this makes them less competitive. *See id.* at 1051.

48 For an explication of these political constraints and conflicts of interest, see *id.* at 1057–62. It is exceedingly rare for pension funds to do anything more than low-visibility activity such as voting on shareholder proposals and withholding votes from director candidates. Stephen J. Choi & Jill E. Fisch, *On Beyond CalPERS: Survey Evidence on the Developing Role of Public Pension Funds in Corporate Governance*, 61 Vand. L. Rev. 315, 317–18 (2008).

strategies to achieve above-average returns.[49] Activist hedge funds are those that invest in a company and then act as a company shareholder to boost the company's share price before selling their stock at a profit.[50] Crucially, the differences in their incentive structure, as compared to retail and institutional investors, make them willing and able to pursue even the most aggressive forms of shareholder engagement. Hedge funds typically use a "two and twenty" fee structure. The fund charges a fixed annual management fee of 2% of assets under management with a variable 20% performance fee based on annual returns.[51] In addition, hedge funds typically impose mandatory lockup periods of two years or longer, precluding investors from redeeming their shares.[52] The two and twenty fee structure properly incentivizes hedge funds to pursue activist interventions that create value, while the lockup periods provide them with a stable pool of capital to fund such activism.[53]

Many commentators view hedge fund activism as a corrective mechanism that can improve shareholder value by replacing inefficient management teams.[54] While there is a clear consensus that hedge fund activist campaigns generate short-term shareholder gains,[55] there is a

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[49] For an overview of regulatory constraints, legal and business structure, and common investment strategies, see Alexander T. Kraik, *Environmental, Social, and Governance Issues: An Altered Shareholder Activist Paradigm*, 44 Vt. L. Rev. 493, 503–09 (2020).

[50] Mark R. DesJardine & Rodolphe Durand, *Activist Hedge Funds: Good for Some, Bad for Others?*, HEC Paris (Mar. 26, 2021), https://www.hec.edu/en/knowledge/articles/activist-hedge-funds-good-some-bad-others [https://perma.cc/E9WM-XXMV].

[51] Kraik, *supra* note 49, at 507.

[52] Sec. and Exch. Comm'n, Off. of Inv. Educ. and Advoc., Investor Bulletin: Hedge Funds 2 (2012), https://www.sec.gov/files/ib_hedgefunds.pdf [https://perma.cc/63DQ-EUNC].

[53] *See, e.g.*, Garrett C. C. Smith & Gaurav Gupta, *Compensation and Incentives in Hedge Funds*, *in* Hedge Funds: Structure, Strategies, and Performance (H. Kent Baker & Greg Filbeck eds., 2017); Mark R. DesJardine & Rodolphe Durand, *Disentangling the Effects of Hedge Fund Activism on Firm Financial and Social Performance*, 41 Strat. Mgmt. J. 1054, 1058 (2020) (discussing a 1.5% fixed annual management fee as an incentive for activism); Julia Kagan, *What Is a Lock-Up Period? How They Work, Main Uses, and Example*, Investopedia (Apr. 25, 2021), https://www.investopedia.com/terms/l/lockup-period.asp [https://perma.cc/Y3XE-2J96].

[54] *See, e.g.*, Bernard S. Sharfman, *A Theory of Shareholder Activism and Its Place in Corporate Law*, 82 Tenn. L. Rev. 791, 804 (2015) ("In the context of public companies, shareholder activism may constitute a valuable asset in and of itself if the goal of such activism is to enhance managerial efficiency."); Andreas Jansson, *No Exit!: The Logic of Defensive Shareholder Activism*, 10 Corp. Bd.: Role, Duties & Composition 16, 16 (2014) ("It is widely believed that shareholder activism is a means by which outside shareholders discipline inefficient management teams.").

[55] *See, e.g.*, Alon Brav, Wei Jiang, Frank Partnoy & Randall Thomas, *Hedge Fund Activism, Corporate Governance, and Firm Performance*, 63 J. Fin. 1729, 1730 (2008) (finding an average of 7–8% abnormal returns over the period before and after the filing of the Schedule 13D). For a review of the empirical evidence, see Coffee & Palia, *supra* note 23, at 551 n.14.

lively debate about whether they generate long-term value at target companies.[56]

In the traditional activist model, activist hedge funds scour the public markets looking for companies underperforming their peers.[57] Once they find an appropriate target, they will accumulate a large block of the target company's shares, typically between 5–10% of the outstanding shares.[58] Accumulating a large block is important for two reasons. First, it ensures the fund can sufficiently profit from the expected appreciation in the target's stock price caused by its activism.[59] Second, it provides the hedge fund with sizable voting power, thereby giving it greater leverage in negotiations with management and a greater chance of success should it launch a proxy battle.[60]

At this stage, the provisions of the Williams Act become relevant. The Williams Act requires any person acquiring more than 5% of the outstanding shares of any class of a publicly traded company to file a

56 *See* Kraik, *supra* note 49, at 541 n.394 (providing an overview of academic literature on long-term value of hedge fund activism). For an argument that interventions by activist hedge funds do not have a detrimental effect on the long-term interests of companies, see generally Lucian A. Bebchuk, Alon Brav & Wei Jiang, *The Long-Term Effects of Hedge Fund Activism*, 115 Colum. L. Rev. 1085 (2015). The publication of this article led Martin Lipton and his firm Wachtell Lipton to attack the validity of the paper's conclusions. *See* Martin Lipton, *Current Thoughts About Activism*, Harv. L. Sch. F. on Corp. Gov. (Aug. 9, 2013), https://corpgov.law.harvard.edu/2013/08/09/current-thoughts-about-activism [https://perma.cc/QF8M-GN38] (criticizing hedge fund activists' short-term focus as exacerbating structural pressures on directors and management to focus on short-term performance at the expense of long-term value creation); Martin Lipton, *The Bebchuk Syllogism*, Harv. L. Sch. F. on Corp. Gov. (Aug. 26, 2013), https://corpgov.law.harvard.edu/2013/08/26/the-bebchuk-syllogism [https://perma.cc/E6DZ-EVSB] (same). In turn, this led to a colloquy between the two sides. Lucian Bebchuk, Alon Brav & Wei Jiang, *Don't Run Away from the Evidence: A Reply to Wachtell Lipton*, Harv. L. Sch. F. on Corp. Gov. (Sept. 17, 2013), https://corpgov.law.harvard.edu/2013/09/17/dont-run-away-from-the-evidence-a-reply-to-wachtell-lipton [https://perma.cc/4H8C-STHJ]; Martin Lipton, *Empiricism and Experience; Activism and Short-Termism; The Real World of Business*, Harv. L. Sch. F. on Corp. Gov. (Oct. 28, 2013), https://corpgov.law.harvard.edu/2013/10/28/empiricism-and-experience-activism-and-short-termism-the-real-world-of-business [https://perma.cc/VZ6H-RFY8]; Lucian Bebchuk, Alon Brav & Wei Jiang, *Still Running Away from the Evidence: A Reply to Wachtell Lipton's Review of Empirical Work*, Harv. L. Sch. F. on Corp. Gov. (Mar. 5, 2014), https://corpgov.law.harvard.edu/2014/03/05/still-running-away-from-the-evidence-a-reply-to-wachtell-liptons-review-of-empirical-work [https://perma.cc/DS6G-B7FR].

57 Bernard S. Sharfman, *The Tension Between Hedge Fund Activism and Corporate Law*, 12 J. L. Econ. & Pol'y, 251, 258 (2016). Under this model, the hedge fund identifies a company whose inefficient management is reflected in a share price lower than its potential value. By purchasing a stake and then successfully advocating for improved corporate governance, the activist will make substantial capital gains as the company's share price responds to the implementation of efficient policies. *Id.* at 260.

58 Sharfman, *supra* note 37, at 7.

59 *Id.*

60 *Id.*

public disclosure with the SEC.[61] If the person is acquiring the shares in the ordinary course of their business and with no intention of influencing *or* changing control of the company, they may file a Schedule 13G; otherwise, they must file a Schedule 13D.[62] Because hedge fund activists explicitly seek to influence corporate policy, they must file a Schedule 13D. Upon filing their Schedule 13D, the entire market learns of their acquisition of this stake and any plans for activism at the target. Under the prior regulatory regime, any person who acquired more than 5% of the company's shares was required to file a Schedule 13D within ten days of crossing the 5% threshold.[63]

Having revealed their stake to the market, activists typically instigate a series of private engagements with the target's management to begin implementation of changes the activist believes will increase shareholder value.[64] If these efforts are rebuffed, they may dial up the pressure by publicly airing their criticisms or threatening a lawsuit against the directors.[65] If all this extracts no concessions, the activist will launch a proxy battle.[66]

A proxy battle begins when the activist submits a proposal for consideration at the company's annual shareholder meeting to elect an alternate director.[67] After submitting their proposal, an activist solicits other shareholders to support their nominated director by providing them with their proxy.[68] As part of proxy solicitation, the activist must file a proxy statement with the SEC and include this statement with all communications sent to investors.[69] The solicitation, legal, and service provider costs for these campaigns can be quite high, with one study estimating that a campaign ending in a proxy contest has a total average cost to the activist of approximately $10 million.[70]

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61 Securities Exchange Act of 1934 §§ 13(d)(1)(A)–(E), 15 U.S.C. § 78m.

62 For a fuller explanation of these Schedules and their requirements, see *infra* Section III.B.

63 Press Release, SEC, SEC Proposes Rule Amendments to Modernize Beneficial Ownership Reporting (Feb. 10, 2022), https://www.sec.gov/news/press-release/2022-22 [https://perma.cc/4CVC-92VY].

64 Brian R. Cheffins & John Armour, *The Past, Present, and Future of Shareholder Activism by Hedge Funds*, 37 J. Corp. L. 51, 60 (2011).

65 *Id.*

66 *Id.* at 61.

67 Shareholder proposals are made pursuant to Rule 14a-8. 17 C.F.R. § 240.14a-8 (2022).

68 Proxy solicitations are governed by rules 14a-1 to 14b-2. 17 C.F.R. §§ 240.14a-1 to -2 (2022).

69 Will Kenton, *SEC Form DEF 14A: Definition and Information for Shareholder Use*, Investopedia (Feb. 22, 2021), https://www.investopedia.com/terms/s/sec-form-def-14a.asp#:~:text=SEC%20Form%20DEF%2014A%2C%20which,that%20shareholders'%20rights%20are%20upheld [https://perma.cc/3CWM-QQJS].

70 Nickolay Gantchev, *The Costs of Shareholder Activism: Evidence from a Sequential Decision Model*, 107 J. Fin. Econ. 610, 624 (2013).

Proxy battles can be analogized to political elections in which an upstart activist challenges an incumbent director on a platform of changing corporate policy.[71] Large institutional investors often hold sufficiently large ownership stakes for it to be worth their while to inform themselves about this platform and are sophisticated enough to evaluate its prospects.[72] Institutional investors serve as the paramount corporate constituents—the voters in the election who cast the decisive votes. Within this paradigm, the incumbent board remains in control of the corporation's business and affairs unless and until a corporate governance conflict, such as an activist intervention, forces the gears of corporate democracy to turn.

C. Engine No. 1's Activist Campaign at ExxonMobil

Engine No. 1 faced an uphill battle when it launched an activist campaign at ExxonMobil on December 7, 2020. The brand-new hedge fund controlled just 0.0016% of Exxon's shares.[73] With this minuscule ownership, it proposed to push the country's largest oil and gas company[74] to embrace an environmentally conscious corporate policy in the face of opposition by Exxon's management team.[75]

There were, however, inklings that Engine No. 1's campaign might succeed. Before the launch of Engine No. 1's campaign, ExxonMobil

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71 *See supra* notes 19–20 and accompanying text.

72 Kahan & Rock, *supra* note 18, at 942.

73 Robert P. Bartlett & Ryan Bubb, *Corporate Social Responsibility Through Shareholder Governance* 54 (Eur. Corp. Governance Inst. L., Working Paper No. 682/2023, 2023), https://www.ecgi.global/sites/default/files/working_papers/documents/corporatesocialresponsibilitythroughshareholdergovernance_0.pdf [https://perma.cc/GKY8-J74L] ("With a stake amounting to a mere 0.0016% of Exxon's shares outstanding, Engine No. 1 had to win the votes of other institutional investors in order to succeed.").

74 At the time, Exxon's market capitalization was over $180 billion. *Market Capitalization of ExxonMobil*, Cos. Market Cap, https://companiesmarketcap.com/exxon-mobil/marketcap [https://perma.cc/K67D-QPAW]. Hedge funds tend to avoid targeting companies with market capitalizations over $10 billion. Brav et al., *supra* note 55, at 1752. Though this trend has generally continued in the years since, activists have grown somewhat more comfortable targeting larger companies. Kostin et al., *Shareholder Activism: What Investors Seek, Which Companies are Targeted, and How Stocks Perform*, Goldman Sachs (Apr. 20, 2023), https://www.gspublishing.com/content/research/en/reports/2023/04/20/84239476-1a40-48e6-9dc7-f38b30f8a23c.html [https://perma.cc/DRB3-WE6J]. This hesitancy is understandable, as "the likelihood of [an activist's] success is slightly negatively correlated with target size, and positively correlated with the hedge funds' ownership stake." Brav et al., *supra* note 55, at 1745.

75 In 2020, Darren Woods, the chief executive officer of ExxonMobil, characterized other companies' efforts to set net-zero emission targets as "a beauty competition." Kevin Crowley, *Exxon CEO Darren Woods Calls Rivals' Climate Goals a 'Beauty Competition,'* Hous. Chron. (Mar. 6, 2020), https://www.chron.com/business/energy/article/Exxon-CEO-Calls-Rivals-Climate-Targets-a-15110580.php [https://perma.cc/VUC4-XRKR].

had lost nearly half of its market capitalization[76] and had been underperforming relative to its market peers for years.[77] Furthermore, Engine No. 1's campaign was centered around a powerful message—that shifting ExxonMobil's business model to prepare the company for a decarbonizing world would create value for shareholders.[78] Engine No. 1's thesis was persuasive: Given the energy transition's pressure on long-term oil and gas demand, management's focus on debt-financed investment in production growth rather than high net present value projects,[79] along with its refusal to prepare for the shift towards carbon neutrality,[80] was hampering the company's long-term prospects.[81]

This message was not falling on deaf ears. Many of ExxonMobil's shareholders had already tried and failed to persuade the company to prepare for impending shifts in the fossil fuel industry.[82] Although only BlackRock had taken decisive action against Exxon's management on climate-related issues, Exxon's two other largest institutional shareholders, State Street and Vanguard, had both made their focus on mitigating climate risk clear in other contexts.[83] Vanguard expressed

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[76] Exxon went from being worth $440 billion in 2014 to just over $180 billion when Engine No. 1 launched its campaign. *Market Capitalization of ExxonMobil*, *supra* note 74.

[77] *See The Case for Change*, Reenergize Exxon, https://reenergizexom.com/the-case-for-change [https://perma.cc/BPN6-ZQ9K] (noting that ExxonMobil had underperformed its peers by 9% in the year and 57% in the 10 years prior to Engine No. 1 launching its campaign).

[78] *Id.*

[79] *See* ExxonMobil Corp., Proxy Statement 38–45 (Schedule 14A) (Apr. 26, 2021) [hereinafter Engine No. 1 Proxy Statement], https://www.sec.gov/Archives/edgar/data/1835549/000093041321000874/c101627_dfan14a.htm [https://perma.cc/2SUV-2A4F] (criticizing ExxonMobil for taking on large amounts of debt to fund short-term oil production without adequately planning for the energy transition).

[80] *See generally id.* at 14–18.

[81] *Id.* at 21–28. Engine No. 1 also focused on issues such as the lack of relevant expertise among incumbent Board members, *id.* at 19, and poor compensation structures for management, *id.* at 58, as other value-destroying corporate policies.

[82] After efforts to engage with management over the company's failure to make progress on its climate change targets failed, BlackRock voted against the reelection of two of Exxon's directors, and, along with around a third of voting shareholders, voted to split the roles of chairman and chief executive. Cecelia Keating, *ExxonMobil Holds Out Against Shareholder Rebellion Over 'Insufficient' Climate Action*, Greenbiz (June 2, 2020), https://www.greenbiz.com/article/exxonmobil-holds-out-against-shareholder-rebellion-over-insufficient-climate-action [https://perma.cc/9RYT-B3XL].

[83] Just days prior to Engine No. 1's proxy announcement, State Street joined Climate Action 100+, "[a] global initiative led by investors to foster the clean energy transition by engaging [with] the companies and sectors with the highest greenhouse gas emissions." *Why We Are Joining Climate Action 100+*, State Street Global Advisors (Nov. 30, 2020), https://www.ssga.com/us/en/institutional/cash/insights/why-were-joining-climate-action-100 [https://perma.cc/2TQZ-3L62]. For its part, Vanguard's 2020 annual report emphasized its support for the Paris Agreement and encouraged companies to align their reporting with the Task Force for Climate Related Financial Disclosures, an industry group that developed consistent frameworks to measure and respond to climate change risks. *Vanguard, Investment*

additional concerns about board independence at Exxon.[84] When Engine No. 1 came in with its plan to shake up the board and move the company in a new direction, it met institutional shareholders receptive to its message.[85]

Thus, when the results of the proxy contest rolled out on May 26, 2021, Engine No. 1 elected three of their proposed candidates to the board.[86] The impact of Engine No. 1's activism has been palpable. During the campaign, Exxon's management announced it would abandon its strategic approach of investing capital expenditures into efforts to grow market share, in favor of a more disciplined capital-spending approach, which it has maintained to this day.[87] Over the next year, the company announced a bevy of subsequent initiatives to reduce its emissions footprint and develop a low-carbon business strategy. Relevant changes include: (1) a commitment to invest $15 billion over the next six years on initiatives to lower greenhouse gas emissions;[88] (2) the creation of a new "Low Carbon Solutions" business unit;[89] (3) an announcement that the

Stewardship: 2020 Annual Report 7 (2020), https://corporate.vanguard.com/content/dam/corp/advocate/investment-stewardship/pdf/policies-and-reports/2021_investment_stewardship_annual_report.pdf [https://perma.cc/GWQ7-AXED].

84 *Voting Insights: A Proxy Contest and Shareholder Proposals Related to Material Risk Oversight at ExxonMobil*, The Vanguard Group, Inc. (May 26, 2021), https://corporate.vanguard.com/content/dam/corp/advocate/investment-stewardship/pdf/perspectives-and-commentary/Exxon_1663547_052021.pdf [https://perma.cc/ZW9A-FGGH].

85 *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/53PU-2R72] ("[Engine No. 1] wouldn't have had a chance were it not for an unusual twist: the support of some of Exxon's biggest institutional investors. BlackRock, Vanguard and State Street voted against Exxon's leadership and gave Engine No. 1 powerful support.").

86 Katherine Dunn & Sophie Mellor, *ExxonMobil Faces Historic Loss in Proxy Shareholder Battle Over Future of Its Board*, Fortune (May 26, 2021), https://fortune.com/2021/05/26/exxonmobil-agm-landmark-vote-shareholders [https://perma.cc/MG6C-5Q7U].

87 *See* Press Release, ExxonMobil, ExxonMobil Outlines Plans to Grow Long-Term Shareholder Value in Lower Carbon Future (Mar. 3, 2021), https://corporate.exxonmobil.com/News/Newsroom/News-releases/2021/0303_ExxonMobil-outlines-plans-to-grow-long-term-shareholder-value-in-lower-carbon-future [https://perma.cc/RFQ4-A4JP] (announcing decrease in annual capex budget); ExxonMobil, 2021 ExxonMobil Investor Day Presentation 38 (Mar. 3, 2021), https://d1io3yog0oux5.cloudfront.net/_161f0ad0ee737b82a3ec771e72c07da2/exxonmobil/db/2406/21727/presentation/2021-ExxonMobil-Investor-Day.pdf [https://perma.cc/2BKE-WKHS] (illustrating abandonment of prior goal of 25% production growth by 2025 in favor of relatively flat production).

88 Darren W. Woods, *Why We're Investing $15 Billion in a Lower-Carbon Future*, ExxonMobil (Nov. 9, 2021), https://corporate.exxonmobil.com/News/Newsroom/News-releases/2021/1109_Why-we-are-investing-15-billion-in-a-lower-carbon-future [https://perma.cc/4DR6-AEEA].

89 Press Release, ExxonMobil, ExxonMobil Streamlines Structure To Enhance Effectiveness, Grow Value, Reduce Costs (Jan. 31, 2022), https://corporate.exxonmobil.com/News/Newsroom/News-releases/2022/0131_ExxonMobil-streamlines-structure-to-enhance-effectiveness-grow-value-reduce-costs [https://perma.cc/Z24Z-GVBG].

company had achieved its 2025 Scope 1 and 2 greenhouse gas (GHG) emission reduction targets three years early and new, more ambitious Scope 1 and 2 GHG emission reduction targets for 2030;[90] and (4) an aspiration to reach net-zero Scope 1 and 2 GHG emissions by 2050.[91]

D. The Prospects for Future ESG Campaigns

In many ways, Engine No. 1's campaign at ExxonMobil tracks the value-creation-focused approach of typical hedge fund activism.[92] Having identified a company underperforming its peers, Engine No. 1 challenged the incumbents with its own slate of directors on a platform of shifting corporate policy in a way that would generate long-term value creation.[93] Although improving Exxon's carbon emission profile did play a role in Engine No. 1's pitch to shareholders, the central premise of its campaign was, as Bartlett and Bubb have aptly described, "that management's overinvestment in fossil fuels constituted a failure to maximize the long-term value of the company."[94] In this way, the implementation of better environmental practices at the firm was appurtenant to the overarching goal of creating shareholder value.[95]

That said, some commentators have questioned whether Engine No. 1's campaign served as a value-creating corrective mechanism.[96]

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[90] Press Release, ExxonMobil, ExxonMobil Announces Corporate Plans to 2027 – Supports Approximately Doubling Earnings and Cash Flow Potential, Reducing Emissions (Dec. 1, 2021), https://corporate.exxonmobil.com/News/Newsroom/News-releases/2021/1201_ExxonMobil-announces-plans-to-2027-doubling-earnings-and-cash-flow-potential-reducing-emissions [https://perma.cc/4JWN-5M4F].

[91] Press Release, ExxonMobil, ExxonMobil Announces Ambition for Net Zero Greenhouse Gas Emissions by 2050 (Jan. 18, 2022), https://corporate.exxonmobil.com/news/news-releases/2022/0118_exxonmobil-announces-ambition-for-net-zero-greenhouse-gas-emissions-by-2050 [https://perma.cc/VWU9-XNVV].

[92] For a brief explanation of this approach, see *supra* note 56 and accompanying text.

[93] *See supra* note 78.

[94] Robert P. Bartlett & Ryan Bubb, *supra* note 73, at 55.

[95] One theoretical goal of some ESG proponents is to increase the cost of capital for companies with poor ESG track records. Jacquelyn Press, *Getting Dirty Firms to Clean Up Their Act: Should You Divest or Invest?*, Kenan Inst. of Priv. Enter. (Nov. 7, 2022) https://kenaninstitute.unc.edu/kenan-insight/getting-dirty-firms-to-clean-up-their-act-should-you-divest-or-invest [https://perma.cc/ZK9U-MHX6]. By diverting capital flows away from firms with poor ESG scores towards those with better track records, higher-polluting firms will suffer higher costs and lower profits than their cleaner peers. To the extent this dynamic plays out in practice, a higher capital cost for companies with poor ESG standards creates a structural factor in favor of ESG activism. Put simply, if implementing better ESG standards would allow the company to access cheaper capital, an activist can always point to an incumbent's reluctance to implement these standards as a missed opportunity for value creation.

[96] *See, e.g.*, Sharfman, *supra* note 37; John C. Coffee, Jr., *The Coming Shift in Shareholder Activism: From "Firm-Specific" to "Systematic Risk" Proxy Campaigns (and How to Enable Them)*, 16 Brook. J. Corp. Fin. & Com. L. 45 (Dec. 1, 2021).

Relying on an empirical assessment by Desai et al., Sharfman argues that the market did not view the success of Engine No. 1's campaign as such a corrective mechanism.[97] However, the empirical analysis[98] only "arguably" established that Exxon's share price appreciation was solely a reflection of oil price increases at the time.[99] A more granular event study incorporating a comparison to Exxon's peers would do much to pinpoint the causal factors leading to Exxon's share price appreciation throughout Engine No. 1's campaign.

In a similar vein, Coffee cites the lackluster appreciation in Exxon's stock after the announcement of Engine No. 1's successful proxy election when concluding that small activist firms like Engine No. 1 will lack the ex ante incentive to run similar campaigns.[100] Coffee argues that because Exxon's stock price did not significantly appreciate after the announcement of Engine No. 1's victory, the market did not perceive any value creation potential in the platform on which Engine No. 1 ran its campaign.[101] Without a large price bump, hedge fund activists will lack the incentive to run such campaigns because they will not make a satisfactory return.

However, this narrow focus on stock price appreciation directly after the announcement of the election results may miss part of the picture. Because ExxonMobil implemented policies in line with Engine No. 1's demands as part of its defensive efforts in the runup to the election, at least part of the value from the campaign may have been

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97 Sharfman, *supra* note 37, at 15 (citing Hemang Desai, Shiv Rajagopal & Sorabh Tomar, *Opinion: Is an Activist Hedge Fund's Climate-Linked Coup of Exxon's Board Simply a Case of 'Greenwashing'?*, MARKETWATCH (June 8, 2021, 1:54 PM), https://www.marketwatch.com/story/is-an-activist-hedge-funds-climate-linked-coup-of-exxons-board-simply-a-case-of-greenwashing-11623103432 [https://perma.cc/78QE-HYG9]).

98 Their analysis simply compared Exxon's stock price appreciation between the time Engine No. 1 began accumulating shares in ExxonMobil and the announcement of the proxy voting results to the performance of the S&P 500, oil prices, and a broad-based ETF tracking a range of small-, mid-, and large-cap oil and gas companies over the same time period. *See* Desai, *supra* note 97.

99 *See id.* (considering rise in oil prices alongside the appreciation in Exxon's stock to suggest the former contributed to the latter).

100 For his analysis of Exxon's stock price movement, see Coffee, *supra* note 96, at 55–56. Coffee's pessimism about activist's ex ante incentives to run campaigns like Engine No. 1's was partially predicated on the premise that Engine No. 1's campaign cost "as much as $30 million." *Id.* at 56. In fact, Engine No. 1 only spent around $12.5 million on its campaign—less than half of its original budget. Svea Herbst-Bayliss, *Little Engine No. 1 Beat Exxon with Just $12.5 Mln*, REUTERS (June 29, 2021), https://www.reuters.com/business/little-engine-no-1-beat-exxon-with-just-125-mln-sources-2021-06-29 [https://perma.cc/8WAX-S8MQ]; Telephone Interview with Charlie Penner, Former Partner, Engine No. 1 (Apr. 14, 2022) (confirming the $12.5 million figure). This expenditure shows the cost side of the incentive equation is not as grim as Coffee believed.

101 *See* Coffee, *supra* note 96, at 54–57.

baked into Exxon's stock price by the time the election results were released. When Engine No. 1 announced its investment on December 7, 2020, ExxonMobil's stock closed at $40.90.[102] By March 2, 2021, its price rose to $56.07.[103] During its investor day presentation on March 3, Exxon announced it would abandon its pursuit of 25% oil production growth by 2025[104]—a fundamental corporate policy shift that aligned precisely with Engine No. 1's platform.[105] The next day, Exxon's share price closed at $58.71.[106] One week later, it was at $61.31—an increase of $5.24.[107] Without a detailed event study, one cannot directly attribute this dramatic increase to this policy shift. Still, it appears the market perceived some value in those changes for which Engine No. 1 advocated.

Thus, there is reason to believe that there may indeed be sufficient ex ante incentives for activists to run similar campaigns in the future.[108] Further, the decision of institutional investors like BlackRock to support Engine No. 1's campaign is evidence that some of the largest and most sophisticated investment firms (whose business model is structured on the long-term success of portfolio companies) believe that Engine No. 1's brand of activism promotes long-term value creation.[109]

The causal link between Engine No. 1's campaign and Exxon's stock price appreciation is important—if activists do not believe their

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102 *Historical Stock Price Information for ExxonMobil Corporation*, Yahoo Fin. [hereinafter *Exxon Historical Stock Price*], https://finance.yahoo.com/quote/XOM/history?period1=1606780800&period2=1640995200&interval=1d&filter=history&frequency=1d&includeAdjustedClose=true [https://perma.cc/WDD7-TMDC].

103 *Id.*

104 *See ExxonMobil: One Year Later*, Engine No. 1 (May 25, 2022), https://engine1.com/transforming/articles/exxon-mobil-one-year-later [https://perma.cc/FK7N-D7VU].

105 *See* Engine No. 1 Proxy Statement, *supra* note 79, at 37–47 (criticizing Exxon's focus on growing production with little regard to return on investments).

106 *See Exxon Historical Stock Price*, *supra* note 102.

107 *Id.*

108 Telephone Interview with Charlie Penner, Former Partner, Engine No. 1 (Apr. 14, 2022) ("I'm proud of what we did at ExxonMobil, and I hope more people will find ways to connect smarter long-term approaches to environmental and social issues with long-term value creation.").

109 BlackRock has made it very clear that it is opposed to short-term activist interventions, but that it believes that ESG is good for long-term value creation at its portfolio companies. *See* Larry Fink, *BlackRock CEO Larry Fink Tells the World's Biggest Business Leaders to Stop Worrying About Short-Term Results*, Bus. Insider (Apr. 14, 2015, 11:18 AM), https://www.businessinsider.com/larry-fink-letter-to-ceos-2015-4 [https://perma.cc/TL5P-NANJ] (recounting a letter in which Larry Fink urged the CEOs of large companies not to take short-term actions that would satisfy activists but impair long-term value); Larry Fink, *Larry Fink's 2021 Letter to CEOs*, BlackRock, https://www.blackrock.com/us/individual/2021-larry-fink-ceo-letter [https://perma.cc/2Z9H-PWC5] (explaining BlackRock's view that ESG is good for long-term value creation). Alternatively, BlackRock's support for Engine No. 1's campaign may reflect an early example of a diversified institutional investor embracing Gordon's systematic stewardship model. *See infra*, note 112.

campaigns will generate returns, then shortening the Schedule 13D filing window will have no impact on ESG activism because traditional activists will lack any incentive to engage in such activism regardless of its length. However, even in such a world, this does not necessarily mean no ESG activism. Indeed, recent academic literature—partly inspired by Engine No. 1's success at ExxonMobil—has explored the possibility of a new form of activism: systematic risk activism.[110]

In his article, Coffee contrasts the traditional, "firm-specific" model of activism focused on correcting managerial inefficiencies with what he terms "systematic risk activism."[111] In systematic risk activism, an activist's focus is not on increasing the stock price of the target of its activism but on improving the value across the activist's portfolio.[112] The utility of this form of activism is predicated on changes at one company affecting the value of other firms in the activist's portfolio.[113] An activist with a large, broadly diversified portfolio has a strong incentive to effectuate changes at one firm within its portfolio, even if the benefit is felt not at the target firm but across the portfolio.[114] Commentators have even gone so far as to boldly posit that systematic risk campaigns which destroy value at the target firm may be normatively desirable because of the net benefit to a diversified investor's overall holdings.[115]

An obvious example here would be activism which reduces the negative externalities the target firm imposes on others within its portfolio.[116] Coffee, however, adroitly identifies a key problem in systematic risk activism. Because this form of activism seeks to reduce negative externalities and not to create value at the target firm, hedge fund activists (the standard engines of activism) will likely lack a profit incentive to engage in systematic risk campaigns.[117] At the same time, broadly diversified institutional investors like BlackRock have a strong incentive to embrace Gordon's systematic stewardship model and support systematic risk campaigns. But they remain unlikely to launch

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110 *See generally* Coffee, *supra* note 96.

111 *Id.* at 45–46.

112 *See id.* at 46; *see also* Jeffrey N. Gordon, *Systematic Stewardship*, 47 J. Corp. L. 627, 628–29 (2022) (noting that the insights of modern portfolio theory—which posits that in their effort to maximize risk-adjusted expected returns, investors ought to be focused on both risk and expected returns—suggest that investment managers of broadly diversified funds ought to concern themselves with reducing systematic risks within their portfolio under what he terms the "systematic stewardship" model).

113 *See* Coffee, *supra* note 96, at 46.

114 *See id.* at 46.

115 *See id.* at 47–48; Gordon, *supra* note 112, at 635.

116 *See, e.g.*, Gordon, *supra* note 112, at 629 (identifying climate risk as a salient systematic risk).

117 *See* Coffee, *supra* note 96, at 48 (discussing the characteristics of typical hedge funds that make them ill-suited for systematic risk campaigns).

such campaigns themselves due to their incentive structure[118] and the political risks that could accompany forceful positions on climate change.[119] Coffee identifies several potential means of private ordering to remedy these misaligned incentives,[120] but public policy solutions such as tax credits could also help resolve this issue. Coffee categorizes Engine No. 1's campaign at ExxonMobil as an instance of systematic risk activism.[121] As discussed above, this Note offers reasons the campaign could be an instance of traditional "firm-specific" activism.

In sum, Engine No. 1's campaign at ExxonMobil might provide a replicable template for a new form of hedge fund activism that can effectuate positive corporate environmental policy shifts through strategic changes that create shareholder value. This activism is threatened by the SEC's rule change and provides another reason for creating the Schedule 13I.

II
The SEC's Change and Schedule 13I

A. *Shortening the Schedule 13D Filing Window Will Deter Activism*

On October 10, 2023, the SEC announced it had shortened the filing window under the Williams Act from ten days to five.[122] As grounds for this change, the SEC argued that improvements in communications and information technology since the Williams Act's passage in 1968 justify a shortened filing window.[123] Although the Commission acknowledged that the shortening of the filing window could have a "chilling effect" on "change of control efforts . . . [which could] effect changes at companies that may benefit all shareholders," it asserted that it did not believe that the shortening would "unduly disrupt" these efforts.[124] In fact, the Commission argued that shortening the window would benefit "investors and market participants by providing more timely information relating to significant stockholders as well as potential

118 *See supra* notes 46–47 and accompanying text.

119 *See* Gordon, *supra* note 112, at 636–37 (warning investment managers of the risk of political blowback from engaging in systematic stewardship).

120 *See generally* Coffee, *supra* note 96, at 59–63.

121 *See id.* at 56.

122 SEC Updates 13D, *supra* note 20. The original proposal for this change was met with heavy criticism from the academic community. *See infra* note 130.

123 *See* Modernization of Beneficial Ownership Reporting, 87 Fed. Reg. 13846, 13849–50 (proposed Mar. 10, 2022) [hereinafter SEC Rulemaking] (to be codified at 17 C.F.R. pts. 232, 240), https://www.sec.gov/rules/proposed/2022/33-11030.pdf [https://perma.cc/38X5-K59A] (arguing that technological advancements warrant the shortening of disclosure deadlines).

124 *Id.* at 13851.

changes in corporate control, facilitating investor decision-making and reducing information asymmetry in the market."[125] Though one can challenge the Commission's reasoning, including the implication that activists ought not benefit from information asymmetries as part of their activism,[126] this Note offers the broader critique that this change unfairly tips the balance of power within corporate democracy. The new rule disincentivizes activist campaigns, further insulating management from accountability to shareholders.[127]

Activists will only engage in activism if they can acquire a sufficiently large bloc of shares in their target such that the returns from their campaign cover their costs and generate profit in line with the expectations of their investors. A core mechanism that enables them to achieve such returns is their ability to acquire shares at a price that does not yet reflect the expected value of their activism.[128] However, once an activist's plans are disclosed to the marketplace, the stock price of their target typically increases.[129] Thus, a shortening of the time activists have to acquire shares at pre-disclosure price levels reduces their expected returns, diminishing their incentives to engage in activist campaigns.[130]

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125 *Id.* at 13877.

126 *E.g.*, Jeffrey N. Gordon, Comment Letter on Proposed Rule to Modernize Beneficial Ownership Reporting at 4 (June 20, 2022) [hereinafter Gordon Comment Letter] (arguing that activists ought to be able to benefit from information they have generated because such information asymmetries are "bound up with an economic reward to activism, without which activism will cease").

127 *See, e.g.*, Penner and Eccles, *supra* note 25, at 1–2 (criticizing the rule for disincentivizing campaigns and shielding management from accountability).

128 *See* Bebchuk & Jackson, *supra* note 24, at 50 (describing this ability as an "important source of incentives" for activists).

129 *See* Alon Brav, Wei Jiang, Frank Partnoy & Randall Thomas, *Hedge Fund Activism, Corporate Governance,and Firm Performance*, 63 J. Fin. 1729, 1730 (2008) (finding a "filing of a Schedule 13D revealing an activist fund's investment in a target firm results in large positive average abnormal returns, in the range of 7% to 8%") [https://perma.cc/9P5Y-LKYW]; April Klein & Emanuel Zur, *Entrepreneurial Shareholder Activism: Hedge Funds and Other Private Investors*, 64 J. Fin. 187, 207 (2009) (noting that hedge fund targets earn statistically significant returns in the days immediately following the filing of their Schedule 13D).

130 Bebchuk & Jackson, *supra* note 24, at 50; *see also* Bebchuk et al., *supra* note 24, at 17–19 ("[R]equiring activist investors to disclose their ownership in public companies more quickly will reduce these investors' returns—thereby reducing the incidence and magnitude of outside blockholdings in large public companies."); Ronald J. Gilson & Jeffrey N. Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights*, 113 Colum. L. Rev. 863, 906–12 (2013) ("Shortening the disclosure period would go far toward capping the activist's ownership stake, not because of a legal prohibition against acquiring more, but because the economics would militate against it."); Gordon Comment Letter, *supra* note 126, at 2 (June 20, 2022) ("[S]hortening the window will in many cases significantly reduce the activist's potential economic return and thus in expectation will reduce the number of engagements."); Alan Schwartz & Steven Shavell, Comment Letter on Proposed Rule to Modernize Beneficial Ownership Reporting at 1–2

Professor Gordon has noted that this problem is most acute for small- and mid-cap targets.[131] Activists targeting large-cap firms may not seek to acquire more than a 5% stake in the firm,[132] but activists targeting mid- and small-cap firms often seek larger ownership percentages.[133] Because liquidity[134] is limited for all but the largest firms, an activist seeking "to accumulate a meaningful block without significantly affecting the market price needs a longer trading period."[135] As such, the difference between a ten- and five-day window can make the difference between an activist intervention penciling out or not.[136]

(Apr. 12, 2022) (arguing that not only will the change reduce activist potential economic returns and thereby reduce the rate of activism, but will also disincentivize activists from even monitoring the public markets for underperforming companies); *but 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, 595 (2016) (claiming the concerns motivating the arguments against the shortening of the Williams Act 10-day window are "overstated").

[131] A small-cap firm is one with a market value between $250 million and $2 billion, while a mid-cap firm is one with a market value between $2 billion and $10 billion. *Market Cap Explained*, FINRA (Sep. 30, 2022), https://www.finra.org/investors/insights/market-cap [https://perma.cc/6X84-FTNG].

[132] A 5% stake may be untenable because of the large amount of capital required or a desire to avoid inordinate amounts of idiosyncratic risk. *See* Alon Brav, Wei Jiang & Hyunseob Kim, *Hedge Fund Activism: A Review*, 4 Founds. and Trends in Fin. 186, 207 (2010).

[133] *See* Gordon Comment Letter, *supra* note 126, at 3 (noting that a 5% ownership stake in a large-cap firm is likely to generate a sufficient return to cover the activist's costs, but that "for a mid-cap or small-cap firm, a larger percent ownership position is required to cover those costs as part of the activist's economic return").

[134] Liquidity is a reference to the ease and speed with which the securities of a firm can be bought and sold on the secondary market. *Glossary: Liquidity (or Marketability)*, SEC, https://www.investor.gov/introduction-investing/investing-basics/glossary/liquidity-or-marketability [https://perma.cc/XP3S-UL72].

[135] Gordon Comment Letter, *supra* note 122, at 3.

[136] An example can help illustrate this point. Say a hedge fund activist targeting a company with a $100 million market capitalization knows it must amass a $15 million position (15% of the company's outstanding stock) in the target at its prevailing price in order for its return ($750,000) to cover its costs and provide it with a satisfactory risk-adjusted return. Say the secondary market for this company is illiquid, such that the fund can only purchase $1 million worth of shares per day without impacting the share price. The fund will proceed to purchase ~$4.9 million worth of shares. The next day it will purchase $1 million worth of shares, crossing the 5% threshold and entering the disclosure window under the Williams Act. At the end of five days, the fund will have purchased $9.9 million worth of shares, at which point, under the SEC's new rule, it will have to file its Schedule 13D, thereby disclosing its plans and causing the target's share price to increase. In order to amass the $15 million position required for its campaign to pencil, the fund must continue to make purchases of $1 million per day for ~five additional days to reach its 15% stake. But the market price of the target's shares will reflect some of the expected benefit of the fund's activism as it is purchasing these additional shares. Thus, the fund's expected return will proportionally decrease, rendering the campaign economically infeasible. By contrast, under the preexisting ten-day window, the fund would have been able to amass its 15% stake within the ten days after it crosses the 5% threshold at the target's prevailing price.

By shortening the Schedule 13D filing window, the SEC has disincentivized ESG activists, such as Engine No. 1, from running these kinds of campaigns. Though this change would not have specifically precluded Engine No. 1 from running its campaign at ExxonMobil, this was only because the fund made the anomalous decision to target one of the world's largest companies and thus did not cross the 5% beneficial ownership threshold that triggers the Schedule 13D filing requirement.[137] The vast majority of funds engaging in activist campaigns *do* cross this threshold.[138] Shortening the window minimizes returns for activists, and can be expected to reduce the overall number of campaigns. Not only is this a loss to shareholders, insofar as it will raise the barriers to removing ineffectual or unresponsive management, but it is also a societal loss, as it will disincentivize ESG-focused campaigns.

B. Schedule 13I: A Mechanism to Promote Activism

This Note proposes that the Commission issue a new filing Schedule—the Schedule 13I—to mitigate the chilling impact the shortened window will have on activism.[139] The Schedule 13I could be a mirror image of the current Schedule 13D,[140] except for two crucial differences: First, acquirors could only file a Schedule 13I if they were merely seeking to *influence* corporate policy. If they were seeking control, they would have to file a Schedule 13D. As discussed below

[137] *See* Andrew E. Nagel, Andrew N. Vollmer & Paul R.Q. Wolfson, *The Williams Act: A Truly "Modern" Assessment*, Harv. L. Sch. F. on Corp. Governance 16 (October 22, 2011) (noting that between April 1, 2006, and May 12, 2011, just 15.2% of 13D filings were made at large-cap companies, while 36% were at mid-cap and 48.8% were at small-cap).

[138] John Barry, Alon Brav & Wei Jiang, Hedge Fund Activism: Updated Tables and Figures 5 (2020) (finding that out of a sample of Schedule 13D filings over the period between 1994–2016, more than 75% of activists crossed the 5% threshold before filing, with the median activist acquiring a 6.5% stake); *see also* Nathan Reif, *13F Instead of 13D: Activists Make Smaller Purchases*, Investopedia (Aug. 21, 2016), https://www.investopedia.com/news/13f-instead-13d-activists-make-smaller-purchases [https://perma.cc/LY4L-XBSQ] (finding that just 26% of activist fund campaigns in 2015 did not cross the 5% threshold).

[139] An argument could be made that the Commission should create the Schedule 13I even if it does not end up shortening the Schedule 13D filing window. In such an instance, the Schedule 13I could provide activists seeking influence but not control a longer window beyond ten days.

[140] Presently, investors filing a Schedule 13D are required to disclose their background and identity, the source of the funds used for the purchase, the purpose of their purchase, the number of shares beneficially owned, and any contractual agreements or understandings they had with other persons with respect to any securities of the issuer. *See* 15 U.S.C. §§ 78m(d)(1)(A)–(E). The Commission is also empowered to require additional information be provided. *Id.* at § 78m(d)(1). As such, the Commission could also decide to require the disclosure of different information on each of the forms. For more information about the mechanics of both the current regulatory structure, and the structure which would be created by the addition of Schedule 13I, see *infra* Section III.A.

in Section III.A, the present disclosure regime does not distinguish between efforts to control or influence a company. So, in implementing the Schedule 13I, the Commission will have to articulate a way to distinguish between these two concepts. Second, the filing window for the Schedule 13I would be ten days, rather than the shortened five-day window.

Creating the Schedule 13I is the best way to balance the competing interests of corporate democracy. Given the substantial environmental benefits that activism of the Engine No. 1 variety can produce, some might advocate for the Commission to create an ESG-specific filing Schedule, which only provides ESG activists the full ten-day window while subjecting garden-variety activism to the shortened window. Though this would be a step in the right direction, the general importance of influence-seeking activism justifies a broader approach. In addition, an ESG-specific approach risks political blowback[141] and would be exposed to claims that the issuance of such a schedule is beyond the SEC's mandate.[142]

Alternatively, one could argue that the best solution to resolve the issues created by the SEC's change is to reverse it so as to reinstitute the pre-existing ten-day filing window. However, such an approach fails to address some of the merits of the SEC's proposal. As discussed below in Section II.C, the Williams Act—the statutory progenitor of the Schedule 13D—requires timely disclosures by acquirors to protect shareholders from losing their control premium. The Commission asserts that a shortened Schedule 13D is necessary because technological advances make accumulating large beneficial ownership positions easier.[143] Because purchasers seeking control can accumulate significant ownership blocks more rapidly, the Commission worries that the ten-day window deprives security holders of "a fair opportunity to adjust their evaluation of the securities of a company with respect to

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141 Republican lawmakers and pro-business groups may rally against such a rule, in line with their opposition to the SEC's climate-related disclosure regulations. *See* Emma Ricketts, *Republicans Eye the SEC's Climate-Related Disclosure Regulations, Should They Take Control of Congress*, Inside Climate News (Nov. 7, 2022), https://insideclimatenews.org/news/07112022/republicans-sec-climate-disclosures [https://perma.cc/TXS7-U5TY] (reporting on Republican efforts to block and scale back climate disclosure regulations).

142 The SEC's climate-related disclosure regulations have been assailed as being outside the SEC's mission to "protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation." Letter from Republican Senators to Gary Gensler, Chairman, SEC (Apr. 5, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20122544-278541.pdf [https://perma.cc/SH3B-BJVP].

143 *See* SEC Rulemaking, *supra* note 123, at 13852 (expressing concern with the current delays in reporting given how recent technological advancements allow for quicker acquisitions).

[a] potential change in control."[144] Thus, in the Commission's opinion, the costs of shortening the window are outweighed by the benefits accruing to existing shareholders from earlier disclosure to the marketplace and the concomitant improvement in the efficiency of U.S. capital markets.[145]

Though one can criticize this line of reasoning as discounting the costs and inflating the benefits of the shortened window,[146] the Commission's argument at least aligns with the purposes of the Williams Act insofar as it is intended to protect shareholder's control premium. A shortened window for acquirors seeking *control* fits with Congress's intent in passing the Williams Act. However, when an activist merely seeks *influence* over corporate policy, protecting existing shareholders' control premium drops away as a concern, as the activist is not seeking to consummate a control transaction. Therefore, shortening the window for activists seeking influence does not neatly align with Congress's intent to protect shareholders in takeover bid situations. Because the current Schedule 13D covers acquirors seeking *both* control and influence, shortening the window without creating Schedule 13I upsets the balance of power between incumbents and activists established by Congress under the Williams Act.[147]

C. Issuing Schedule 13I Fulfills the Purpose of the Williams Act

Today, contests for corporate control are usually resolved through proxy battles.[148] Such proxy battles typically follow the activist's accumulation of a substantial percentage of the target's shares. As discussed above, the Williams Act governs these accumulations, imposing mandatory disclosure obligations on any person acquiring more than 5% of the outstanding shares of any equity class of a publicly traded corporation.[149]

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144 *Id.* at 13852 n.37 (quoting SEC Report of the Securities and Exchange Commission on Beneficial Ownership Reporting Requirements Pursuant to Section 13(h) of the Securities Exchange Act of 1934 (June 27, 1980)).

145 *See id.* (promoting a shorter deadline to protect shareholders despite the benefits to activism offered by the current deadline).

146 *E.g.*, Schwartz & Shavell, *supra* note 130, at 2 (arguing that because the change will deter activists from seeking information about mismanaged companies, the efficiency benefits are overstated since activists will not be incentivized to acquire this valuable information which the rule seeks to disclose more quickly).

147 More on this *infra* Section II.C.

148 Martin C. Glass & Oleksandr Polonyk, *Market Trends 2019/20: Hostile Takeovers and Proxy Contests*, Jenner & Block (2020), https://www.jenner.com/a/web/jgm3Bkc42N2BnjQeToZvgk/4HRMZQ/Market%2520Trends%25202019_20%2520Hostile%2520Takeovers%2520and%2520Proxy%2520Contests%2520(All%2520Authors).pdf?1603468808 [https://perma.cc/ME6P-E7JT] ("Hostile takeovers in the United States usually involve a proxy contest that seeks to replace the board of a target company.").

149 *See* Nagel et al., *supra* note 137, at 1.

The Williams Act was passed in response to the hostile takeover attempts that began in the early 1960s.[150] These attempts largely took the form of coercive tender offers. Corporate raiders made exploding purchase offers to existing shareholders structured to pressure these investors to quickly tender their shares for prices widely believed to be below their true value.[151] At the time, federal and state law policed the acquisition of companies through share-for-share exchanges or proxy battles, but the lack of any regulatory structure governing tender offers led lawmakers to believe that the practice was being abused to the detriment of existing shareholders.[152] The Williams Act was designed to plug this gap and protect investors by providing them with information about the would-be acquiror's intentions such that they could make an informed decision about how to respond to the tender offer.[153]

Yet the Act's legislative history illustrates that it was not intended to serve as a shield to protect management from activist incursions. As explained by Nagel et al., the *original* draft of the bill *was* intended to serve as a shield against hostile acquirors.[154] Facing heavy opposition

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150 *See* Jonathan R. Macey & Jeffry M. Netter, *Regulation 13D and the Regulatory Process*, 65 Wash. U. L.Q. 131, 133 (1987). As Senator Williams, the eponymous lead sponsor of the Act, noted when introducing the bill for a floor vote in the Senate, the cash tender offer had become "an increasingly favored method of acquiring corporate control" growing in number from eight in 1960 to 107 tender offers in 1966. 113 Cong. Rec. 24662, 24664 (1967).

151 *See* Nagel et al., *supra* note 137, at 1; *id.* at 5 (explaining how these "Saturday night specials" typically functioned).

152 *See* Ronald J. Colombo, *Effectuating Disclosure Under the Williams Act*, 60 Cath. U. L. Rev. 311, 315–16, 318 (2011) (quoting H.R. Rep. No. 90-1711, at 2 (1968), *as reprinted in* 1968 U.S.C.C.A.N. 2811, 2811) (noting how the cash tender offer had "become an increasingly favored method of acquiring control of publicly held companies").

153 *See* Piper v. Chris-Craft Indus. Inc., 430 U.S. 1, 35 (1977) ("The legislative history thus shows that the *sole* purpose of the Williams Act was the protection of investors who are confronted with a tender offer." (emphasis added)); *see also Full Disclosure of Corporate Equity Ownership and in Corporate Takeover Bids: Hearing on S. 510 Before the Subcomm. on Secs. of the S. Comm. on Banking and Currency*, 90th Cong. 57 (1967) [hereinafter *Senate Hearings*] ("The two major protagonists—the bidder and the defending management—do not need any additional protection . . . . Rather, the investor—who is the subject of these entreaties of both major protagonists—is the one who needs a more effective champion . . . ."); *id.* at 15 ("[T]he general approach . . . of this bill is to provide the investor, the person who is required to make a decision, an opportunity to examine and to assess the relevant facts . . . ."); Colombo, *supra* note 152, at 317–18 n.43 (quoting H.R. Rep. No. 90-1711, at 4 (1968), *as reprinted in* 1968 U.S.C.C.A.N. 2811, 2814, and S. Rep. No. 90-550, at 4 (1967), *as reprinted in* 1968 U.S.C.C.A.N. 2811, 2814) (discussing Congress's intent to "correct the current gap in our securities laws" regarding disclosure in connection with cash tender offers).

154 Nagel et al., *supra* note 137. Senator Williams's initial rhetoric castigated those engaging in tender offers as a bane to society. 111 Cong. Rec. 28257 (1965) ("In recent years we have seen proud old companies reduced to corporate shells after white-collar pirates have seized control with funds from sources which are unknown in many cases, then sold or traded away the best assets, later to split up most of the loot among themselves."). He even went so far as to explicitly state that the bill would "obviously work to the disadvantage of any corporate takeover specialists" and would "penalize the raider[s]." *Id.* at 28258.

from the SEC over the Act's onerous provisions, Senator Williams and his staff substantially revised the original draft to "avoid tipping the balance of regulatory burden in favor of management or in favor of the offeror."[155] However, even this revised version encountered criticism that its antitakeover measures would excessively chill the market for corporate control, thereby weakening the ability of shareholders to hold inefficient management accountable.[156] During a hearing before the Senate Subcommittee on Securities, all four academics invited to comment on the revised bill emphasized the market for corporate control's importance in reducing agency costs.[157] In light of this continued criticism, Senator Williams once more revised the bill to create the disclosure regime that largely exists today.[158]

When introducing the completed bill on the floor of the Senate, Senator Williams acknowledged that the Act's final structure was informed by stakeholders' assertions "that takeover bids should not be discouraged, since they often serve a useful purpose by providing a check on entrenched but inefficient management."[159] He went on to emphasize Congress's policy of neutrality in contests for control:

> We have taken extreme care to avoid tipping the scales either in favor of management or in favor of the person making the takeover bids. S.B. 510 is designed solely to require full and fair disclosure for the benefit of investors. The bill will at the same time provide the offeror and management equal opportunity to present their case.[160]

The balanced approach embodied in Senator Williams's statement has long been recognized as a defining feature of the Act.[161]

This legislative history demonstrates that the Williams Act, though intended to establish well-regulated contests for control that would protect investors, was not meant to insulate management from activist

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155 113 Cong. Rec. 854 (1967).

156 *See* Nagel et al., *supra* note 137, at 7.

157 Commentary was offered by a panel of professors including Arthur Fleischer, Jr., Stanley A. Kaplan, Robert H. Mundheim, and William H. Painter. *See Senate Hearings*, *supra* note 153, at 128–29 (statement of Fleischer); *id.* at 120 (testimony of Kaplan); *id.* at 115–16, 137 (testimony and statement of Mundheim); *id.* at 139–40 (statement of Painter). A fifth professor, Samuel L. Hayes, offered a similar appraisal of the utility of takeovers. *See id.* at 62 (statement of Hayes).

158 The original Act triggered disclosure obligations only upon a person acquiring more than 10% of the company's equity—this threshold was subsequently lowered to 5% by amendment. *See* Nagel et al., *supra* note 137, at 7.

159 113 Cong. Rec. 24664 (1967).

160 *Id.*

161 *See, e.g.*, Piper v. Chris-Craft Indus., Inc. 430 U.S. 1, 29–30 (1977) ("Congress was indeed committed to a policy of neutrality in contests for control . . . .").

campaigns and the consequences of corporate democracy. Instead, as explicitly stated by Senator Williams, its purpose was to provide both the takeover bidder and management "equal opportunity to present their case."[162] This alone warrants close scrutiny of any regulatory change that would tip this delicate balance of power one way or the other.

To make matters worse, the landscape of corporate governance has changed since the passage of the Act in 1968 in ways which amplify the impact of the SEC's change. First, the creation of the poison pill and the emergence of state antitakeover statutes have largely made hostile tender offers an artifact of the past. As a result, incumbents already have a huge advantage in battles for corporate control as compared to when the Act was passed.[163] Second, the shareholder base of publicly traded companies has shifted from largely individual ownership in the 1960s to institutional ownership today.[164] As these sophisticated institutional investors have the incentives to monitor their portfolio companies and engage in corporate governance matters, the Act's concern that a hostile acquiror could rob uninformed shareholders of their control premium has been mitigated.[165] Thus, the Commision's rule change will impede activist campaigns in an era when management has grown more powerful in the name of protecting investors, who are themselves less vulnerable than when the Act was passed. Third, the impact of the Act has shifted. Though it was designed to protect shareholders against coercive tactics used by corporate raiders to rob shareholders of their control premium, the Williams Act now largely impacts activists merely seeking to influence corporate policy rather than to gain control of the corporation.[166] Because of this shift, the shortened window will further

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162 *Id.*

163 Nagel et al., *supra* note 137, at 8–12. A poison pill is the colloquial name for a defensive tactic used by boards to prevent acquirers from taking control of a company. Poison pills effectively block the acquisition of shares by any individual or group above a set amount by providing other shareholders with an option to acquire heavily discounted shares in the event an individual or group purchases more than the set amount. For more details, see Adam Hayes, *Poison Pill: A Defense Strategy and Shareholder Rights Plan*, Investopedia (May 9, 2023), https://www.investopedia.com/terms/p/poisonpill.asp [https://perma.cc/S7E7-D9MF].

164 In 1968, the year the Williams Act was passed, individuals owned more than 80% of shares in U.S. corporations. Nagel et al., *supra* note 137, at 13. As of 2017, they account for just over 33% of equity holdings in U.S. corporations, while institutional investors own more than 65%. *Id.*; Marianne Bertrand, Matilde Bombardini, Raymond Fisman, Francesco Trebbi & Eyub Yegen, *Investing in Influence: Investors, Portfolio Firms, and Political Giving*, 2 (Nat'l Bureau of Econ. Rsch., Working Paper No. 30876, 2023), https://www.nber.org/papers/w30876 [https://perma.cc/2ZUD-E87V].

165 Nagel et al., *supra* note 137, at 14.

166 *See id.* at 16–18 (overviewing the shift in activist investing from the 1980s—where corporate raiders sought control—to today where activist investors aim to "facilitate value-enhancing changes as minority shareholders").

insulate management by shielding them from this new mechanism of accountability.

Given the market's current operation, the SEC's shortening of the Schedule 13D filing window tips the the scales in favor of management in a way that runs counter to the balanced approach embedded in the Act. In recognition of these shifts in the corporate governance landscape, the SEC should issue this Note's proposed Schedule 13I in order to ensure that activists and incumbents have "equal opportunity to present their case."[167]

III
Implementing Schedule 13I

The new disclosure regime inaugurated by the issuance of Schedule 13I will require differentiating between efforts to influence corporate policy and efforts to change control of the company. Until now, this distinction has not been relevant since the existing filing structure presents a simple binary: An acquiror must file a Schedule 13D if they are making any effort to influence *or* change control of the company—if they make no effort to do either, they may file a 13G. In this new regime, the three filing Schedules—13G, 13I, 13D—can be conceived as laying on a spectrum from passive investing to more active investing. Purchasers who cross the 5% threshold in the ordinary course of business without the purpose or effect of influencing or changing control of the issuer will be permitted, as they are now, to file a Schedule 13G. Purchasers seeking only to *influence* the issuer must file a Schedule 13I within ten days of crossing the 5% threshold, occupying the middle of the spectrum. Finally, purchasers seeking *control* of the issuer will be required to file a Schedule 13D within five days of crossing the 5% threshold. By treating acquirors with influence intentions differently from those with control intentions, the disclosure regime inaugurated by the creation of the Schedule 13I will make the boundary between influence and control a determinative inquiry, as it will determine whether the filer has five or ten days after crossing the 5% threshold to make their filing. Thus, in issuing Schedule 13I, the SEC must accompany it with a definition of either influence or control to guide investors and the courts.

This Note proffers two possible approaches to distinguishing between influence and control. First, the SEC could adopt a new standard for defining control, such as the "actual control" standard used by the Delaware Court of Chancery in determining when fiduciary

[167] 113 Cong. Rec. 24664 (1967).

duties apply to a controlling shareholder. Second, the Commission could retain the existing definition of control but carve out a definition of activism as an effort to influence, not control. For example, the SEC could issue a "short slate" rule stating that any activist who is making their purchase with the narrow intention to run a short slate of independent directors[168] who are not officers, and is challenging 33% or less of the seats on the board, will be deemed to be seeking influence, not control.[169] As between these two approaches, this Note considers the short slate rule normatively preferable.

This Part seeks to contextualize the need to distinguish between influence and control and the origin of these proposed definitions. Section A explains several considerations the Commission should keep in mind in crafting a new definition to distinguish between influence and control. Section B outlines the significance of influence and control within the existing disclosure regime, while Section C details definitions for "control" provided by different legal doctrines. Finally, Section D concludes by addressing the counterargument that distinguishing between influence and control is too difficult to attempt.

A. Considerations for an Appropriate Definition

The Commission should keep in mind two salient considerations in defining control. First, the definition of influence and control will be inversely related. The broader the definition of control, the narrower the space within which activists can operate and still enjoy the luxury of the ten-day window, with the inverse being true as well. Thus, the Commission's choice about the legal breadth of these terms is inherently a policy choice—a broader definition of control will minimize activist activity, and a narrower definition will expand it.

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168 The short slate rule, formerly Rule 14a-4(d)(4), was a mechanism that allowed dissident shareholders seeking to elect a minority slate of directors to round out its slate by soliciting proxies to vote for a few select company nominees. Kai Liekefett, Derek Zaba & Beth Berg, *SEC Dramatically Changes the Rules for Proxy Contests*, Harv. L. Sch. F. on Corp. Governance (Nov. 19, 2021), https://corpgov.law.harvard.edu/2021/11/19/sec-dramatically-changes-the-rules-for-proxy-contests [https://perma.cc/4JBS-QMAR]. The rule was eliminated with the adoption of the Universal Proxy Rules by the Commission, which became applicable to all board elections held after August 31, 2022, but the rule's logic of rewarding dissidents who choose to run candidates for just a minority of seats applies to this context. *Id.*; *Fact Sheet: Universal Proxy Rules for Director Elections*, SEC, https://www.sec.gov/files/34-93596-fact-sheet.pdf [https://perma.cc/8XCL-FQ4R].

169 As discussed below, the requirement that the directors be both independent and not an officer reflects the presumption against control that inheres in the control person doctrine for nonofficers. The 33% proportion reflects the fact that typical boards have nine members, and that three of the nine voices in the room provides an activist significant influence but not control.

Second, this Note argues that a bright-line rule is preferable to a multifactor standard. Adopting squishy, multifactor standards, rather than a bright-line rule, carries inherent costs in terms of ex ante incentives and expectations.[170] A rule, such as the "short slate" rule described above,[171] would provide clarity to the marketplace about what activists can and can't do to benefit from the ten-day window. By contrast, a mushy standard could both deter activists with intentions to influence corporate policy from engaging in activism which treads close to the line of control and lead activists with control intentions to try and game the disclosure regime by presenting themselves as merely seeking influence, thereby taking advantage of the extra five days to accumulate shares.

Of course, in this context, activists with influence intentions are unlikely to be deterred since the standard remedy for violating the Williams Act is merely an injunction that orders issuance of the correct disclosure.[172] However, the relative impotence of this remedy exacerbates the risk of activists with control intentions seeking to game the regime. Thus, using a standard would present difficult enforcement issues against potential malefactors.

On the other hand, issuing broader definitions of influence and control in the form of a standard would allow courts to develop a range of factual circumstances that fall into either definition.[173] Judicial development of a standard may provide an optimal distinction between influence and control. However, the beneficial incentive effects derived from the clarity of a bright-line rule and the tricky enforcement issues presented under a standard are grounds for opting for a rule.

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170 For example, because the legal requirement of rules is more clear-cut, the cost of learning the law is reduced, thereby improving the rate of legal compliance. For a detailed theoretical explication of the advantages and disadvantages of rules versus standards, see generally Louis Kaplow, *Rules Versus Standards: An Economic Analysis*, 42 DUKE L.J. 557, 564 (1992).

171 *See supra* note 168 and accompanying text.

172 *See* Steven Bainbridge, *How to Deal with Alleged Williams Act Section 13(d) Disclosure Violations*, PROFESSORBAINBRIDGE (Aug. 7, 2014), https://www.professorbainbridge.com/professorbainbridgecom/2014/08/how-to-deal-with-alleged-williams-act-section-13d-disclosure-violations.html [https://perma.cc/6LXN-XBRM] (explaining that since the Court's decision in *Rondeau v. Mosinee Paper Corp.*, 422 U.S. 49 (1975), the typical response to a § 13(d) violation has been the issuance of "an order directing that the violation be cured, either by amending the filing or by filing a Schedule 13D not previously filed").

173 *See* Kaplow, *supra* note 170, at 616–17 (explaining the utility of standards).

B. Control & Influence in the Existing Disclosure Regime

Today's disclosure regime, without Schedule 13I, bifurcates according to a filer's control intentions: If a filer has control intentions, they file a Schedule 13D; if they do not, they file a Schedule 13G.[174] These filing Schedules are regulatory inventions, created by the SEC to implement the purposes of the Williams Act. The statutory authority for Schedule 13D is rooted in § 13(d)(1)(C) of the Securities Exchange Act of 1934, which requires any person who acquires more than 5% of a public company's equity to file a statement with the SEC providing a variety of information,[175] including information about their plans for the company "if the purpose of the purchases or prospective purchases is *to acquire control* of the business of the issuer . . . ."[176] However, the statute does not contain any language limiting the SEC from creating multiple Schedules which can satisfy these requirements.[177]

In turn, Schedule 13G is grounded in § 13(d)(5), which empowers the Commission to create new filing Schedules which require less information from the filer in circumstances where "such securities were acquired by such person in the ordinary course of his business and were not acquired for the purpose of and do not have the effect *of changing or influencing the control* of the issuer . . . ."[178] What emerges from the statutory text is that anyone who purchases more than 5% of the company *must* file a statement with the information contained within § 13(d)(1)(A)–(E), unless they have acquired such shares "in the ordinary course of [their] business" without the purpose or effect of "changing or influencing the control" of the company, in which case they *may* file a Schedule 13G instead.

From the statutory text, then, the concept of "control" is relevant for two purposes—first, in determining whether a filer may use Schedule 13G; and second, in dictating what kind of information must be included by filers who must file a statement containing the information within § 13(d)(1)(A)–(E) (today Schedule 13D).

However, the Securities Exchange Act does not define what precisely constitutes control. To operationalize these statutory

[174] *See* Kristin Giglia, Note, *A Little Letter, A Big Difference: An Empirical Inquiry into the Possible Misuse of Schedule 13G/13D Filings*, 116 Colum. L. Rev. 105, 112–13 (2016) (discussing the regulatory framework of Schedules 13D and 13G).

[175] Securities Exchange Act of 1934 §§ 13(d)(1)(A)–(E), 15 U.S.C § 78m.

[176] *Id.* § 13(d)(1)(C) (emphasis added).

[177] Thus, the Commission could ground its new Schedule 13I in the statutory grant of authority contained within § 13(d)(1).

[178] *Id.* § 13(d)(5) (emphasis added). This section, in combination with § 13(g)(1) constitute the statutory authority for Schedule 13G. Giglia, *supra* note 174, at 110 n.36.

commands, the SEC issued Rule 12b-2,[179] which defines control as "the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise." The question of what satisfies this definition is fact-specific, and in the absence of a clear rule, the task of defining the contours of control for purposes of the securities laws has fallen to the courts.

Without a clear definition, courts assessing the question of control for purposes of Schedule 13D collect pertinent facts and glance through them to determine whether a purchaser evinces control intent through what the Eighth Circuit aptly described as a "combination of numbers and influence."[180] Although such an "I know it when I see it" approach works in the current regime, greater delineation is required between this and influence in a new regime that includes Schedule 13I.

There are two additional areas of law from which to draw when distinguishing between influence and control: (1) federal doctrine regarding control person liability under § 20(a) of the Securities Exchange Act, and (2) the imposition of fiduciary duties on controlling shareholders under Delaware law.

C. Varying Definitions of Control

1. Control Person Liability

In addition to defining control under the Williams Act, Rule 12b-2 has also been interpreted to define "control" for the purposes of control person liability under § 20(a) of the Securities Exchange Act of 1934.[181] Section 20(a) establishes vicarious liability for controlling persons under Rule 10b-5,[182] so the focus of cases in this domain is on the degree of involvement an individual must have in the violating company to be considered to control it. A threshold determination involves the defendant's authority within the violating corporation: For control person liability to attach, the individual must have "the power to direct or cause the direction of the management and policies [of the primary violator]."[183] This requirement largely narrows the range of possible defendants to officers and directors.

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[179] 17 C.F.R. § 240.12b-2 (2022).

[180] For an example of what I call the "I know it when I see it" approach, see generally Chromalloy Am. Corp. v. Sun Chem. Corp., 611 F.2d 240, 246 (8th Cir. 1979).

[181] *See* Steven J. Choi & A.C. Pritchard, Securities Regulation Cases and Analysis 375–76 (5th ed. 2019) (discussing how Rule 12-b-2 influences circuit court approaches to defining control for § 20(a) liability).

[182] Securities Exchange Act of 1934 § 20(a), 15 U.S.C. § 78t(a).

[183] 17 C.F.R. § 240.12b-2 (2022).

A survey of control person liability cases reveals a broad inquiry with several consistent sub-rules used to mete out liability between officers and directors. At the highest level of generality, courts seek to determine whether the defendant at issue either exerted control or influence or was capable of exerting control or influence over the company's day-to-day operations.[184] The guiding question is: What is the defendant's degree of involvement in the day-to-day operations of the business? In answering this question, status as an officer creates a presumption that the individual has control, whereas simply being a director is insufficient.[185] The Ninth Circuit in *Howard v. Everex Systems, Inc.* explains that officers are treated this way because their position gives them day-to-day oversight of the company's operations.[186] However, if the individual is a director, then the inquiry focuses on a fact-specific inquiry into the degree of the director's involvement in the business's day-to-day operations.[187]

Of course, because of Rule 12b-2's capacious definition, and the remedial nature of § 20(a),[188] courts conducting these analyses do not draw a line between influence and control. Nevertheless, the fact that the doctrine distinguishes between officers and directors—presuming a sufficient degree of involvement in day-to-day operations on the part of the former and presuming a *lack* of such involvement for the

184 There is a circuit split as to whether or not the defendant must have actually exercised this control for liability to attach, or whether the mere ability to exercise control is sufficient. *Compare* Metge v. Baehler, 762 F.2d 621, 631 (8th Cir. 1985) (holding the defendant must have actually exercised control), *with* SEC v. First Jersey Secs., Inc., 101 F.3d 1450, 1472–73 (2d Cir. 1996) (holding the defendant must merely have the ability to exercise control).

185 *See, e.g.*, Adams v. Kinder-Morgan, Inc., 340 F.3d 1083, 1108 (10th Cir. 2003) ("The assertion that a person was a member of a corporation's board of directors . . . does not suffice to support an allegation that the person is a control person within the meaning of the Exchange Act."); Food & Allied Serv. Trades Dep't, AFL-CIO v. Millfeld Trading Co., 841 F. Supp. 1386, 1391 (S.D.N.Y. 1994) ("[T]he defendants' positions as [officers] . . . strongly suggest[s] that each of them possessed the power to direct the management and policies of Millfeld during this period . . . .").

186 *See* Howard v. Everex Sys., Inc., 228 F.3d 1057, 1065 (9th Cir. 2000) (discussing that "day-to-day oversight of company operations and involvement in the financial statements at issue were sufficient to presume control" for Everex's CEO).

187 *Compare* Wool v. Tandem Computs., Inc., 818 F.2d 1433, 1441–42 (9th Cir. 1987) (finding a presumption of control person liability where a group of directors had a high degree of day-to-day oversight of company operations and were heavily involved in drafting the financial statements at issue), *with* Burgess v. Premier Corp., 727 F.2d 826, 832–33 (9th Cir. 1984) (holding that two outside directors were not control persons because they did not participate in the fraudulent behavior and had only minimal involvement in the day-to-day business of the company).

188 As the Tenth Circuit put it in *Lustgraaf v. Behrens*, because the statute "is 'remedial and is to be construed liberally,'" it has been interpreted "as requiring only some indirect means of discipline or influence short of actual direction to hold a 'controlling person' liable." 619 F.3d 867, 873 (8th Cir. 2010) (citing Myzel v. Fields, 386 F.2d 718, 738 (8th Cir. 1967)).

latter—presents at least one justiciable factor with which to concretize the distinction between influence and control.

2. *Fiduciary Duties of a Controlling Shareholder*

Perhaps the clearest definition of what constitutes control is to be found in the doctrine used by Delaware courts for determining whether the fiduciary duties accompanying status as a controlling shareholder apply. In this context, the Chancery Court subscribes to the principle that a non-majority shareholder is not a controlling shareholder unless they can exercise actual control over the company.[189] Actual control is "actual domination and control in directing the corporation's business affairs."[190] In short, the relevant inquiry becomes the simple question: Can you dictate terms to management?[191] In the Chancery Court's conception, even significant leverage (i.e., influence) is not actual domination and control.[192]

There is much to commend in this definition of control. Unlike control person liability doctrine, which conflates influence and control, the actual domination and control conception provides an operational means of distinguishing between efforts to control or influence. And, as compared to the "combination of numbers and influence" approach under the Williams Act,[193] asking whether a shareholder can dictate terms to management lends itself to firm answers and is less likely to generate significant variance between different courts. That said, it is still a definition that admits to some uncertainty. After all, courts will still be required to determine where the line is between a shareholder's ability to significantly influence corporate policy and an ability to dictate terms, which on the margins will require a fact-specific inquiry.

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[189] *E.g.*, Gilbert v. El Paso, 490 A.2d 1050, 1055 (Del. Ch. 1984) ("For controlling stock ownership to exist in the absence of a numerical majority there must be domination by a minority shareholder through actual exercise of direction over corporate conduct."); In re Sea-Land Corp. S'holders Litig., CIV. A. No. 8453, 1988 WL 49126, at *3 (Del. Ch. 1988) (citation omitted) ("A stockholder is not deemed controlling unless it owns a majority of the stock, or has exercised actual domination and control in directing the corporation's business affairs.").

[190] In re Sea-Land Corp., 1988 WL 49126, at *3.

[191] *See* El Paso, 490 A.2d at 1056 (finding a lack of control when there is an ability to "bargain" with but not "dictate terms" to management).

[192] In re Sea-Land Corp., 1988 WL 49126, at *3 (citing with approval the notion that even significant leverage does not constitute domination and control so long as the defendant remained "an outsider, free to bargain but not to dictate terms" (quoting El Paso, 490 A.2d at 1055–56)); *cf.* In re Lehman Bros. Mortg.-Backed Secs. Litig., 650 F.3d 167, 188 (2d Cir. 2011) (holding that the provision of advice, feedback, and guidance which defendant could choose not to follow does not suggest control).

[193] Chromalloy Am. Corp. v. Sun Chem. Corp., 611 F.2d 240, 246 (8th Cir. 1979).

D. The SEC Already Distinguishes Between Influence and Control in Other Contexts

Some might argue that drawing a line between influence and control in the form of a definition is too difficult an endeavor given the myriad factual circumstances that can impact such an assessment. However, the SEC is already making this distinction in other contexts.

To provide market participants with some clarity about their obligations under the securities laws, the SEC's Division of Corporation Finance periodically issues Compliance and Disclosure Interpretations (C&DIs) that provide the Division's interpretations of statutory regimes. C&DIs take the form of answers to pointed questions, which help clarify the application of various provisions.

In its list of C&DIs regarding §§ 13(d) and 13(g) of the Securities Exchange Act, the Division's answer to Question 103.11 illustrates the Commission's implicit acknowledgment that there is indeed a relevant distinction between efforts to influence management and seeking control for purposes of Schedule 13D:

> The Hart-Scott-Rodino ("HSR") Act provides an exemption from the HSR Act's notification and waiting period provisions if, among other things, the acquisition of securities was made "solely for the purpose of investment," with the acquiror having "no intention of participating in the formulation, determination, or direction of the basic business decisions of the issuer." 15 U.S.C. 18a(c)(9); 16 C.F.R. 801.1(i)(1). Does the fact that a shareholder is disqualified from relying on this HSR Act exemption due to its efforts to influence management of the issuer on a particular topic, by itself, disqualify the shareholder from initially reporting, or continuing to report, beneficial ownership on Schedule 13G?[194]

The SEC's response to this question is no, the inability to rely on this HSR Act exemption "would not preclude a shareholder from filing on Schedule 13G."[195]

The SEC's position that a shareholder that *has* an intention of participating in the formulation, determination, or direction of the basic business decisions of the issuer on a particular topic—thereby falling outside the HSR Act exemption—does not preclude that shareholder from filing on Schedule 13G illustrates the SEC's belief that efforts to influence the business decisions of the issuer are not synonymous with

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[194] *Exchange Act Sections 13(d) and 13(g) and Regulation 13D-G Beneficial Ownership Reporting*, SEC (Oct. 7, 2022), https://www.sec.gov/corpfin/divisionscorpfinguidancereg13d-interphtm [https://perma.cc/TN29-LWZ3].

[195] *Id.*

control intentions. The Commission's choice to draw such a distinction as between the requirements of the HSR Act and the Williams Act highlights its implicit acknowledgment that the benefits of such line drawing outweigh its difficulties in certain contexts.

Conclusion

The rise of ESG investing has engendered a new era of investing, in which the consideration of corporate policies on environmental, social, and governance issues has become central to the investment philosophy of the world's most sophisticated investors. In line with this development, Engine No. 1's successful proxy campaign at ExxonMobil has revealed new models of ESG activism that can spur change on climate-related issues. However, the SEC's decision to shorten the Schedule 13D filing window undermines the ability of activists to give voice to shareholders' preferences, thereby tipping the scales of corporate democracy in management's favor. By issuing the new Schedule 13I, the SEC can regain the appropriate balance envisioned by Congress when it passed the Williams Act, invigorate corporate democracy, and preserve the possibility for this fledgling form of private ordering to become another viable tool in confronting the climate crisis.